Pacific Safety Products Inc.

REPORT TO SHAREHOLDERS

MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE YEARS ENDED June 30, 2012 and 2011

This Management's Discussion and Analysis ("MD&A") of the financial position and financial performance of Pacific Safety Products Inc. (the "Company" or "PSP") has been prepared as of October 18, 2012 and should be read together with the audited annual consolidated financial statements and the notes thereto for the year ended June 30, 2012, and the Joint Management Information Circular issued on November 17, 2011. Management is responsible for the preparation and integrity of the consolidated financial statements, including maintenance of appropriate information systems, procedures and internal controls, and to ensure that information used internally or disclosed externally, including the consolidated financial statements and management's discussion and analysis, is complete and reliable. All figures are in **Canadian dollars except as otherwise noted.**

The financial data has been prepared in accordance with International Financial Reporting Standards ("IFRS") and the Company's reporting currency is the Canadian dollar. Pacific Safety Products Inc. is a reporting issuer in Canada in the provinces of British Columbia, Alberta and Ontario. The Company trades on the TSX Venture Exchange under the symbol "PSP". Additional regulatory information relating to Pacific Safety Products Inc. can be found at the System for Electronic Document Analysis and Retrieval ("SEDAR") website at www.sedar.com.

FORWARD-LOOKING INFORMATION

A number of the matters discussed in the MD&A deal with potential future circumstances and developments and may constitute "forward-looking" information within the meaning of applicable securities laws. These forward-looking statements relate to anticipated or assumed events or results including, without limitation, projected costs and capital expenditures, future tax losses, plans with respect to internal controls and the Company's outlook, business and capital management strategy, direction, plans, growth opportunities and objectives. Generally, forward-looking information can be identified as such because of the context of the statements and often include words or phrases such as "will", "believes", "anticipates", "predicts", "plans", "intends", "estimates", "expects", "continues", "is pursuing", "improving", "projects", "indicates", or words or phrases of a similar nature.

The forward-looking information is based on current expectations and assumptions regarding expected growth, results of operations, financial performance and business prospects and opportunities. Forward-looking information is subject to known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company, or general industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. These factors include, but are not limited to, the possible failure to successfully plan and execute business improvement strategies, restrictions and covenants contained in the Company's credit agreements, the potential impact of the current economic downturn on the Company's business, the unpredictability of purchasing patterns by governmental agencies, the possibility of a deterioration in the Company's working capital position, the impact that changes in supplier payment terms or slow payment of accounts receivable could have on the Company's liquidity, the unavailability of or increase in price of external capital to finance the Company's research, development and growth initiatives, changes in the laws, regulations, policies and economic conditions, including inflation, interest and foreign currency exchange rate fluctuations of countries in which the Company does business, competition in the Company's markets, successful integration of structural changes or downsizing initiatives, including resizing plans, acquisitions, divestitures and alliances, cost of raw material, the uncertainty associated with the outcome of research and development of new products, including regulatory approval and market acceptance, and seasonality of sales in some products, as well as other factors described below under "Part VIII: Risks and Uncertainties" and the Company's other filings with applicable securities regulatory authorities which are available at www.sedar.com. The impact of any one risk factor on a particular forward-looking statement is not determinable with certainty as such factors are interdependent upon other factors, and management's course of action would depend upon its assessment of the future, considering all information then available.

Although the Company believes that the expectations and assumptions conveyed by the forward-looking information are reasonable based on information available to it as of October 18, 2012, no assurances can be given as to future results, levels of activity and achievements. All subsequent forward-looking information, whether written or oral, attributable to the Company or persons acting on its behalf, are expressly qualified in their entirety by these cautionary statements and readers are cautioned not to place undue reliance or importance on this information. The Company assumes no obligation to update forward-looking statements should circumstances or management's estimates or opinions change, except as required by applicable law.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Mission

...we bring everyday heroes home safely. ™

This MD&A is organized into the following parts:

I. Business Overview and Recent Events
II. Results
III. Cash Flow
IV. Liquidity and Capital Resources
V. Summary of Annual Information
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VII. Significant Accounting Policies and Estimates
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IX. Other Information

Part I: BUSINESS OVERVIEW AND RECENT EVENTS

Business Overview

PSP is an established industry leader in the defence and security market. The Company is engaged in the design, production, and sale of protective and duty products for law enforcement, security and defence. PSP's products are worn or included in equipment used by officers, agents, guards and military personnel. The Company has a significant market position in Canada, where it is one of the largest soft body armour manufacturers. The Company, through its wholly-owned subsidiary, Sentry Armor Systems Inc. ("Sentry"), provides body armour products to U.S. based law enforcement and private security firms. The Company's business strategy is to be a preferred supplier of body armour and other personal protection solutions throughout North America.

PSP has a significant recurring revenue stream from its Canadian customers in the form of long standing contracts with terms of up to five years. These contracts are with federal, provincial and municipal organizations and agencies. The Company also pursues long-term defence contracts. PSP has been successful in supplying the Canadian military with fragmentation protection products and chemical and biological protection suits. The Company's U.S. business is primarily supplying state, county and municipal law enforcement agencies with soft body armour. These products are sold primarily through a network of third party distributors.

PSP has a research and development program that works cooperatively with customers on new product design. The Company also conducts independent research in future technologies and products that will enhance user effectiveness, increase value and survivability. PSP's current research and development programs are focused on the certification of certain product lines as required by the U.S. Department of Justice.

PSP has manufacturing operations in Arnprior, Ontario and Dover, Tennessee and its head office is located in Arnprior, Ontario. Its design and production facilities are all ISO9001:2008 registered and compliant to BA9000 (National Institute of Justice Body Armor Quality Management Requirements). Founded in 1984, PSP has grown to currently include more than 120 employees at its Canadian and U.S. facilities.

Recent Events

On August 17, 2010, the Company issued a $1 million unsecured convertible debenture in favour of a group of investors.

On October 20, 2010, the Company signed a letter of intent to complete a business combination by way of a court approved plan of arrangement (the "Plan of Arrangement") with Zuni Holdings Inc. ("Zuni"), an NEX listed company. On November 18, 2010, PSP and Zuni signed a definitive arrangement agreement (the "Arrangement Agreement") specifying the terms on which the Plan of Arrangement would be completed.

On December 31, 2010 pursuant to the Plan of Arrangement, PSP acquired all of the outstanding common shares of Zuni in exchange for PSP common shares at an agreed exchange ratio of one PSP common share for each Zuni common share. Zuni was amalgamated with a wholly-owned subsidiary of PSP incorporated for the purpose of carrying out the Plan of Arrangement. The amalgamated entity was continued as Zuni Holdings Inc., a subsidiary of PSP. The transaction has been accounted for as the acquisition of the assets and liabilities of Zuni in exchange for PSP common shares valued at the effective date of the acquisition.

This transaction strengthened the capital position of PSP and restricted cash of $2.5 million was released on June 11, 2011. The working capital ratio at June 30, 2012 is 1.89 compared to 1.73 at June 30, 2011 and 1.06 at June 30, 2010. The debt to tangible net worth ratio at June 30, 2012 is 1.46 compared to 1.87 at June 30, 2011 and 25.89 at June 30, 2010. The debt to tangible net worth ratio does not have a standardized meaning as prescribed by IFRS. The Company defines debt as total liabilities less convertible debentures, and tangible net worth as the sum of shareholders' equity and convertible debentures less intangible assets and product development costs.

On May 5, 2011, the Company completed the sale of certain assets of APS Distributors, a division of PSP located in Bedford, Nova Scotia for a purchase price of $500,000 before transaction costs. Proceeds of the sale, net of an $18,000 holdback, have been used to reduce debt obligations.

On August 31, 2011, PSP signed an agreement ("Agreement") with a major Canadian bank for a credit facility in the amount of $1.0 million. The facility is secured by cash collateral of $1.0 million and a general security agreement over all personal property of PSP and its subsidiaries. The Agreement has no financial covenants and is subject to certain general covenants as outlined in the Agreement.

On January 23, 2012, the Company announced that it had entered into a letter of intent to sell substantially all of its assets on a cash free, debt-free basis for cash payable at closing. The letter of intent was terminated on March 5, 2012.

On April 18, 2012, the Company announced that it had entered into a letter of intent to acquire all of the issued and outstanding shares of a Canadian company in a reverse take-over transaction (the "Transaction"). On May 14, 2012, the Company announced that the letter of intent has been terminated.

Throughout the last 2 years the Company has successfully implemented many significant steps in its business transformation process including: setting a clear strategic direction built around personal protection solutions, building out its NIJ.06-certified body armour product portfolio, sub-letting its former head office space in Kanata, upgrading its quality assurance processes, implementation of continuous improvement programs throughout the Company, and working closely with its customers and suppliers among other achievements. Notably, effective January 16, 2012, the Company was awarded a new contract by the Ontario Ministry of Community Safety and Correctional Services for the delivery and disposal of ballistic personal soft body armour systems ("Contract"). This omnibus contract allows Municipal and Provincial agencies to acquire PSP's products through pre-negotiated arrangements. This Contract has an initial period of performance of three years with an option for an additional two years. Based on historical data the Company estimates the potential revenue value of this Contract to be between $12.5 million to $15 million, including the option years. The Company was the incumbent.

At this stage in the transformation, the Company continues to focus on adding value for its customers in conjunction with revenue stability and growth. In order to further strengthen the Company's financial position and address its liquidity requirements, the Company continues to consider and evaluate on an ongoing basis, all alternatives available to it. These alternatives include, without limitation, taking the necessary steps to align and size its operations to current North American business opportunities, seeking additional sources of financing, identifying and pursuing strategic partnerships, and other value enhancing opportunities. However, there can be no assurance that such efforts will result in the Company pursuing any such alternative or, if pursued, there can be no assurance any such alternative will be successfully completed and implemented.

The Company's ability to continue as a going concern and to realize the carrying value of its assets and discharge its liabilities when due is dependent upon the Company's ability to restore profitable operations and/or raise additional capital.

Part II: RESULTS

SUMMARY OF OPERATIONS	***YEAR ENDED JUNE 30, 2012*** [1]	*YEAR ENDED JUNE 30, 2011* [1]	*YEAR ENDED JUNE 30, 2010* [2]
REVENUES	**$ 16,733,663**	$ 22,663,696	$ 29,989,255
COST OF SALES	**11,910,121**	17,675,300	24,079,235
GROSS MARGIN	**4,823,542**	4,988,396	5,910,020
EXPENSES	**4,902,510**	6,362,515	7,370,074
LOSS BEFORE OTHER ITEMS	**(78,968)**	(1,374,179)	(1,460,054)
OTHER ITEMS	**1,181,821**	2,691,701	1,656,783
LOSS BEFORE INCOME TAXES	**(1,260,789)**	(4,065,880)	(3,116,837)
INCOME TAX RECOVERY	**(24,918)**	-	(67,655)
NET LOSS FOR THE YEAR	**(1,235,871)**	(4,065,880)	(3,049,182)
OTHER COMPREHENSIVE INCOME (LOSS)	**186,022**	(367,813)	-
TOTAL COMPREHENSIVE LOSS FOR THE YEAR	**$ (1,049,849)**	$ (4,433,693)	$ (3,049,182)
BASIC AND DILUTED LOSS PER SHARE	**$ (0.02)**	$ (0.10)	$ (0.12)
WEIGHTED AVERAGE BASIC COMMON SHARES ISSUED AND OUTSTANDING - BASIC AND DILUTED	**57,307,808**	40,976,048	25,690,173

FINANCIAL POSITION	***JUNE 30, 2012*** [1]	*JUNE 30, 2011* [1]	*JUNE 30, 2010* [1]
TOTAL ASSETS	**$ 7,159,496**	$ 8,676,113	$ 11,584,119
TOTAL LONG-TERM FINANCIAL LIABILITIES	**$ 1,607,298**	$ 1,656,897	$ 999,936

[1] Presented in accordance with IFRS
[2] Presented in accordance with previous Canadian GAAP

Revenues

Revenues for the year ended June 30, 2012 were $16.7 million, a decrease of $5.9 million or 26.2% as compared to the prior year. The decrease is attributed to a decline in the distribution business pursuant to its sale in May, 2011 and non-recurring contract revenues in both Canada and the United States. Revenues from Canadian customers for the year ended June 30, 2012 were $10.2 million, a decline of $3.3 million or 24.3% compared to the prior year. The decrease is primarily attributed to the decline in the distribution business pursuant to its sale in May 2011 and a decrease in contract sales to the Canadian Department of National Defence (“DND”). Revenues from U.S. and International customers for the year ended June 30, 2012 were $6.6 million, a decrease of $2.7 million or 28.8% compared to the prior year. The decrease is primarily due to a significant GSA contract during the same period in the prior year.

Gross Margin

For the year ended June 30, 2012, gross margin as a percentage of revenues was 28.8%, which was an increase over gross margin of 22.0% during the prior year. The increase is primarily related to product mix, production efficiency improvements and sale of the distribution business in May 2011.

Expenses

For the year ended June 30, 2012, expenses were $4.9 million, a decrease of $1.5 million or 22.9% as compared to the prior year. The decrease in expenses is primarily related to cost reduction initiatives implemented over the last 12 months, lower commissions in connection with lower revenue volumes, and lower amortization expense partially offset by expenses related to the entities acquired pursuant to the Plan of Arrangement.

For the year ended June 30, 2012, sales and marketing expenses were $1.6 million as compared to $2.3 million during the prior year. The decrease is primarily related to lower commissions, other cost reduction initiatives, and a reduction in amortization expense as a result of disposal and impairment of intangible assets compared to the same period in the prior year.

For the year ended June 30, 2012, research and development expenses were $0.5 million as compared to $0.6 million during the prior year. The development cost expense is primarily related to the development and certification of certain product lines in accordance with U.S. Department of Justice standards. The reduction in expense is due to lower amortization expense as a result of impairment of product development costs capitalized.

For the year ended June 30, 2012, general and administration expenses were $2.8 million as compared to $3.4 million during the prior year. The decrease is primarily due to management cost reduction initiatives.

Other Items

Foreign exchange losses (gains)

For the year ended June 30, 2012, foreign exchange losses were $0.08 million as compared to gains of $0.20 million during the same period in the prior year. The decrease in gains is primarily related to the impact of devaluation of the Canadian dollar against the U.S. dollar with respect to purchases of materials in U.S. funds.

Finance costs

For the year ended June 30, 2012, interest expense on bank indebtedness was $0.04 million, a decrease from $0.10 million during the prior year due to lower utilization of banking facilities and certain one-time charges incurred in the prior year. For the year ended June 30, 2012, interest expense on the long-term debt was $0.06 million, consistent with the prior year.

For the year ended June 30, 2012, accrued interest on convertible debentures issued on August 17, 2010 was $0.10 million and the Company recorded an interest expense for accretion of the convertible debentures of $0.10 million.

Onerous contract charges (settlement)

For the year ended June 30, 2012, the net recovery related to onerous contracts was $0.3 million with no comparable amount during the same period in the prior year.

On August 16, 2011 the Company signed a sublease for the remaining lease term for its former head office premises in Kanata, Ontario. The Company recognized a provision for the discounted future lease payments to which the Company is committed less expected future sublease income in the amount of $0.1 million. Pursuant to the Plan of Arrangement the Company assumed a provision for discounted future lease payments related to the vacated manufacturing facility of a Zuni subsidiary that no longer had any operating business activities. A settlement was reached with the landlord and the lease was terminated on September 30, 2011 resulting in a release of the provision in the amount of $0.5 million.

Long-lived asset impairment

At December 31, 2011, it was determined that the remaining intangible assets of both the Canada CGU and the US CGU were fully impaired. A draft letter of intent ("LOI") to sell substantially all of the assets of the Company was received prior to December 31, 2011 and was signed on January 20, 2012. The value of the estimated net proceeds indicated that there was a potential impairment. As a result management reviewed the recoverable value of each CGU and determined that the fair value less costs to sell for each CGU represented the recoverable value. Fair value was determined based on the signed LOI. The carrying value of net assets expected to be included in the sale, excluding intangible assets, exceeded the estimated net proceeds of sale. Therefore an impairment loss of $1.2 million was recognized at December 31, 2011. The letter of intent was terminated on March 5, 2012.

On May 5, 2011, the Company recorded a loss of $1.5 million from the sale of certain assets of APS Distributors, a division of PSP located in Bedford, Nova Scotia.

On June 15, 2010, the Company announced its intent to sell its headborne system assets. During the year ended June 30, 2010, the Company recorded a loss of approximately $0.6 million to write down these assets to their fair value less costs to sell and a further loss related to the sale of these assets of $0.04 million during the year ended June 30, 2011.

Income taxes

Income tax expense varies from the amount that would be computed by applying the combined federal and provincial tax rate as a result of the tax effect of items not deductible for tax purposes, the tax benefit of losses not recognized and other items.

Net loss for the year

For the year ended June 30, 2012, the Company recorded a net loss for the year of $1.2 million as compared to a net loss for the year of $4.4 million during the prior year. The decrease in loss is primarily due to the long-lived asset impairment charge in the prior year partially offset by improvements in gross margin, a reduction in operating expenses and settlement of certain property lease obligations.

Other comprehensive income (loss)

For the year ended June 30, 2012, the Company recorded other comprehensive income of $.2 million compared to other comprehensive loss of $0.4 million during the prior year. The increase in other comprehensive income is due to foreign currency translation differences relating to foreign operations.

Adjusted Earnings Before Interest, Taxes, Depreciation and Amortization ("Adjusted EBITDA")

Adjusted EBITDA is not a recognized performance measure under IFRS and does not have a standardized meaning prescribed by IFRS. The term Adjusted EBITDA consists of net loss and excludes interest, income tax expense (recovery), depreciation and amortization. Adjusted EBITDA excludes stock-based compensation, foreign exchange and one-time charges and gains. Adjusted EBITDA is included as a supplemental disclosure because management believes that such a measurement provides a better assessment of the Company's operations on a continuing basis by eliminating certain non-cash charges and charges that are nonrecurring. The most directly comparable measure to Adjusted EBITDA calculated in accordance with IFRS is Net loss for the year.

For the year ended June 30, 2012 Adjusted EBITDA was a gain of $0.2 million compared to an Adjusted EBITDA loss of $0.4 million during the prior year.

The following is a reconciliation of Net Loss to Adjusted EBITDA:

	YEAR ENDED JUNE 30, 2012[1]	YEAR ENDED JUNE 30, 2011[1]	YEAR ENDED JUNE 30, 2010[2]
Net loss for the year	**$ (1,235,871)**	$ (4,065,880)	$ (3,049,182)
Foreign exchange losses (gains)	**75,483**	(234,364)	80,923
Finance costs, net	**277,371**	340,399	268,890
Income taxes (recovery)	**(24,918)**	-	(67,655)
Stock-based compensation	**41,874**	113,226	17,185
Depreciation and Amortization	**272,291**	867,852	971,132
Restructuring/relocation costs	**-**	-	188,545
Onerous contract charges (settlement)	**(331,958)**	-	-
Loss on assets held for sale	**1,020**	1,489,666	609,422
Write-down of investment tax credits recoverable	**-**	-	589,926
Long-lived asset impairment	**1,159,905**	1,096,000	-
Adjusted EBITDA	**$ 235,197**	$ (393,101)	$ (390,814)

[1] Presented in accordance with IFRS
[2] Presented in accordance with previous Canadian GAAP

Part III: CASH FLOW

CASH FLOW FROM (USED IN)	***YEAR ENDED JUNE 30, 2012***	*YEAR ENDED JUNE 30, 2011*	*YEAR ENDED JUNE 30, 2010*
Operating activities	**$ (733,642)**	$ (1,181,033)	$ 1,431,446
Investing activities	**(198,036)**	467,711	(896,554)
Financing activities	**(287,002)**	3,406,463	(754,874)
	$ (1,218,680)	$ 2,693,141	$ (219,982)

Cash flow used in operating activities for the year ended June 30, 2012 was $0.7 million as compared to cash flows used in operating activities of $1.1 million during the prior year. The increase in cash flow from operating activities is primarily due to the reduced investment of working capital relative to revenues.

Cash flow used investing activities for the year ended June, 2012 was $0.2 million as compared to cash flow from investing activities of $0.5 million during the prior year. Cash used in investing activities in the prior year was offset by the receipt of proceeds from the sale of assets.

Cash flow used in financing activities for the year ended June 30, 2012 was $0.3 million as compared to cash flow from financing activities of $3.4 million during the prior year. During the year ended June 30, 2011, proceeds from the issuance of convertible debentures were used to reduce bank indebtedness, cash acquired pursuant to the plan of arrangement was $1.9 million and share issue costs were $0.3 million.

Part IV: LIQUIDITY AND CAPITAL RESOURCES

AS AT	***JUNE 30, 2012***	*JUNE 30, 2011*
Cash and cash equivalents	**$ 1,707,563**	$ 2,897,735
Bank indebtedness	**(620,344)**	(693,026)
Working capital	**3,134,104**	2,943,855
Long-term debt (long-term portion only)	**(625,100)**	(839,420)
Convertible debentures	**(855,068)**	(742,496)
Shareholders' equity (deficiency)	**(2,049,969)**	(2,964,144)

The Company's objective when managing liquidity and capital resources is to ensure that it has sufficient liquidity to support its financial obligations and fund its operating and strategic objectives.

In order to further strengthen the Company's financial position and address its liquidity requirements, the Company continues to consider and evaluate on an ongoing basis, all alternatives available to it. These alternatives include, without limitation, seeking additional sources of financing, identifying and pursuing strategic partnerships, raising additional equity, working closely with our financial institution to obtain favourable borrowing terms and other value enhancing opportunities. The Company receives continued support from its bank and lender. There has been a decrease of $1.5 million in expenses in fiscal year 2012 compared to fiscal year 2011. The Company expects this trend to continue as it puts in place new cost reduction initiatives. However, there can be no assurance that such efforts will result in the Company pursuing any such alternative or, if pursued, there can be no assurance any such alternative will be successfully completed and implemented (note 16).

The Company's ability to continue as a going concern and to realize the carrying value of its assets and discharge its liabilities when due is dependent upon the Company's ability to restore profitable operations, internally generate cash flow from operations and raise additional capital. These consolidated financial statements do not include any adjustments to the carrying value and classification of assets and liabilities that would be necessary should the Company be unable to continue as a going concern, and such adjustments could be material.

Working Capital

At June 30, 2012, PSP's working capital was $3.1 million compared to $2.9 million as at June 30, 2011. The increase in working capital is primarily related to a reduction in cash and cash equivalents of $1.2 million offset by an increase in receivables of $.9 million and a decrease in short term provisions of $0.6 million.

Accounts receivable as at June 30, 2012 were $3.4 million compared to $2.5 million as at June 30, 2011. The increase in accounts receivable reflects the increase in revenues in the latter part of the three months ended June 30, 2012 compared to the three months ended June 30, 2011.

Inventory as at June 30, 2012 decreased by $0.1 million to $1.3 million as compared to $1.4 million as at June 30, 2011. This decrease is primarily related to reduced revenue volume.

Accounts payable and accrued liabilities as at June 30, 2012 were $2.6 million compared to $2.3 million as at June 30, 2011. The decrease reflects the reduction in inventory, expenses, and days payables outstanding.

Provisions as at June 30, 2012, were $0.1 million compared to $0.6 million as at June 30, 2011. The decrease reflects the recovery on settlement of a lease obligation in the year ended June 30, 2012.

Bank Indebtedness

PSP signed an Agreement with a Canadian bank on August 31, 2011 for a credit facility in the amount of $1.0 million. The facility is a revolving demand facility available by way of overdraft with interest payable monthly calculated at the bank prime lending rate plus 1.95% per annum. The facility is secured by cash collateral of $1.0 million and a general security agreement over all personal property of PSP and its subsidiaries. The Agreement has no financial covenants and is subject to certain general covenants as outlined in the Agreement. At June 30, 2012, the amount drawn on the overdraft facility of $0.6 million is included in bank indebtedness, and cash collateral held in a GIC with the Bank in the amount of $1.0 million is included in cash and cash equivalents.

Sentry had an agreement with a United States bank to provide advances repayable on demand with interest payable monthly calculated at the bank prime lending rate plus 2.00% per annum. The loan was secured by a first priority general security agreement over U.S. accounts receivable, inventory and an assignment of insurance. The maximum operating line was $1.4 million USD subject to margin requirements and covenants set by the lenders. On January 27, 2012 the United States bank was closed and a receiver was appointed. As a result funding was suspended. The loan facility was not being utilized, and the account has been closed and the security has been released. Sentry operates with a deposit account with a United States bank.

Long-term Debt

The Company has a $1.4 million secured term loan with the Business Development Bank of Canada ("BDC" or the "Lender"). At June 30, 2012, the principal outstanding on the loan was $0.8 million.

Convertible Debentures

On August 17, 2010, the Company completed a private placement of $1,000,000 aggregate principal amount, consisting of 40 units (the "Units") at a purchase price of $25,000 per Unit. Each Unit consists of $25,000 in principal amount of unsecured convertible debentures (the "Debentures") and 62,500 detachable common share purchase warrants (the "Warrants").

The Debentures mature three years from the date of issuance and bear interest at a rate of 10% per annum, payable annually in cash or common shares at the option of the Company. The Company elected to settle interest payable on convertible debentures as of August 17, 2011 in the amount of $100,000 with the issuance of 1,145,408 common shares. On August 17, 2012, the Company elected to settle the interest payable of $100,000 with the payment of $60,000 dollars to certain debenture holders on September 4, 2012. The remaining $40,000 in interest will be paid with the issuance of 800,000 common shares. The holder has the right to convert all (but not less than all) principal and accrued interest at any time to common shares at a rate of one common share per $0.10 of indebtedness (the "Conversion Option").

The Warrants have a one-year term with an exercise price of $0.10 per common share during the first six-months and an exercise price of $0.12 per common share during the second six-months of the term. The Warrants expired unexercised on August 17, 2011.

On the date of issuance, the gross proceeds in the amount of $1,000,000 were allocated based on the fair values of the Debentures ($700,049) and Warrants ($45,500) with the residual being allocated to the Conversion Option ($254,451). On the date of issuance, the fair value of the Debentures was classified as a liability, while the fair values of the Conversion Option and Warrants were classified as separate components of shareholders' equity.

Over the three-year term, the Debentures are accreted to their principal amount through a periodic charge to accretion expense with a corresponding credit to the liability component. The accretion expense is based on the effective interest method. For the year ended June 30, 2012, the Company recorded accretion expense of $97,745 (year ended June 30, 2011 - $76,365) related to the Debentures.

The Company incurred transaction costs of $65,000 in connection with the issuance of the Debentures. These costs were allocated to Debenture issuance costs ($45,503) and to equity issuance costs ($19,497) based on the relative fair values of the debt and equity components.

The fair value of the Debentures was estimated using the present value of future cash flows using a discount rate of 18%. The fair value of the Warrants was estimated using the Black-Scholes option pricing model assuming no expected dividends, a volatility of the Company's share price of 101%, a risk-free interest rate of 1.4%, and an expected life of one year.

Certain directors and a former director of the Company beneficially own or control, directly or indirectly, $750,000 aggregate principal amount of the Debentures.

The Debentures contain certain default provisions that would provide the holders the right to demand repayment. The Company was in compliance with these conditions at June 30, 2012.

Deferred Income Taxes

At June 30, 2012, the Company had approximately $3.1 million in Canadian tax non-capital loss carryforwards and approximately $4.3 million in U.S. tax loss carryforwards available, excluding loss carryforwards of Zuni and its subsidiaries which have no operating business activities.

Equity Instruments and Other Paid-in Capital

At June 30, 2012, the Company's issued and outstanding shares were 57,454,895. At June 30, 2011, the Company's issued and outstanding shares were 56,309,487. On August 17, 2011 the Company issued 1,145,408 common shares in settlement of interest payable on convertible debentures in the amount of $100,001.

The Company's contributed surplus balance was $1.8 million at June 30, 2012 and June 30, 2011. Stock-based compensation expense for the nine months ending June 30, 2012 was $0.04 million.

Other paid-in capital of $0.2 million at June 30, 2012 reflects the allocation of the equity component of convertible debentures, net of issue costs.

Contractual Obligations

The Company is committed to operating leases in respect of its premises and equipment as follows:

	June 30, 2012	June 30, 2011	July 1, 2010
Less than 1 year	**$ 519,029**	$ 545,037	$ 748,778
Between 1 and 5 years	**1,570,854**	2,044,559	2,644,543
More than 5 years	**–**	426,168	1,254,596
	$ 2,089,883	$ 3,015,764	$ 4,647,917

On August 16, 2011, the Company signed a sublease for the remaining lease term for its former head office premises in Kanata, Ontario. As a result of entering in this sublease, future operating lease commitments as at June 30, 2011 were reduced by $438,000. The lease and sublease expire in 2017. The Company recognized a provision of $122,308 in respect of this lease, the balance of the provision at June 30, 2012 was $104,470 (note 15).

Capital Management

The Company's capital management strategy is designed to maintain financial strength and flexibility to support profitable growth. The Company's capital consists of accumulated debt, which is comprised of long-term debt, convertible debentures, bank indebtedness and shareholders' equity, excluding other comprehensive income (loss). The Company manages its capital structure and makes adjustments to it, based on the level of funds available to the Company to manage its operations. See "Bank Indebtedness", "Long-term Debt" and "Convertible Debentures".

The Company has not established a quantitative return on capital criteria; but rather promotes year-over-year sustainable growth.

The Company must adhere to certain financial covenants related to debt. See "Bank Indebtedness", "Long-term Debt" and "Convertible Debentures".

There have been no changes in the Company's approach to capital management during the period.

Part V: SUMMARY OF ANNUAL INFORMATION

(In Canadian dollars, except per share amounts)	**Year ended June 30, 2012[1]**	Year ended June 30, 2011[1]	Year ended June 30, 2010
Revenues	**$ 16,733,663**	$ 22,663,696	$ 29,989,255[2]
Net and comprehensive loss for the year	**(1,049,849)**	(4,433,693)	(3,049,182)[2]
Basic and diluted loss per share	**(0.02)**	(0.10)	(0.12)[2]
Total assets	**7,159,496**	8,676,113	11,584,119[1]
Total long-term financial liabilities	**1,607,298**	1,656,897	999,936[1]

[1] Presented in accordance with IFRS
[2] Presented in accordance with previous Canadian GAAP

Part VI: QUARTERLY RESULTS

Fiscal 2012

	June 30, 2012[1]	March 31, 2012[1]	December 31, 2011[1]	September 30, 2011[1]
Revenues	**$ 4,456,155**	**$ 5,153,175**	**$ 3,638,271**	**$ 3,486,062**
Net income (loss) for the period	**320,894**	**138,001**	**(1,397,389)**	**(297,377)**
Basic and diluted earnings (loss) per share	**0.006**	**0.002**	**(0.024)**	**(0.005)**

Fiscal 2011

	June 30, 2011[1]	March 31, 2011[1]	December 31, 2010[1]	September 30, 2010[1]
Revenues	$ 4,943,820	$ 8,286,012	$ 5,094,773	$ 4,339,091
Net loss for the period	(3,114,818)	(64,664)	(259,580)	(626,818)
Basic and diluted loss per share	(0.055)	(0.001)	(0.010)	(0.024)

Fiscal 2010

	June 30, 2010[2]	March 31, 2010[2]	December 31, 2009[2]	September 30, 2009[2]
Revenues	$ 7,125,500	$ 7,731,869	$ 7,472,312	$ 7,659,574
Net loss for the period	(2,439,037)	(87,378)	(158,984)	(363,783)
Basic and diluted loss per share	(0.095)	(0.003)	(0.006)	(0.014)

[1] Presented in accordance with IFRS
[2] Presented in accordance with previous Canadian GAAP

Fourth Quarter 2012

Revenues

Revenues for the three months ended June 30, 2012 were $4.5 million, a decrease of $0.5 million or 9.9% compared to the same period in the prior year. The decrease is primarily attributed to the decline in core law enforcement revenues in Canada and the U.S.

Gross Margin

For the three months ended June 30, 2012, gross margin as a percentage of revenues was 32.5%, a significant increase over the gross margin of 24.1% during the same period in the prior year. The increase is primarily related to product mix and production efficiency improvements.

Expenses

Total expenses were $1.0 million for the three months ended June 30, 2012 compared to $1.7 million for the same period in the prior year. The decrease is primarily attributable to cost reduction initiatives and a decrease in consulting and professional fees.

Other Items

Total other items were $0.1 million for the three months ended June 30, 2012 compared to $2.6 million for the same period in the prior year. The Company recorded a loss on sale of certain assets of the APS Distributors division of $1.5 million and an impairment loss of $1.1 million during the three months ended June 30, 2011.

Significant Fluctuations in Quarterly Results

As identified in the table above not all comparative quarterly information has been restated in accordance with IFRS. For this reason the value of the information for comparative purposes may be limited.

For the three months ended June 30, 2012, the Company recorded net income from operations of $0.3 million or $0.006 per share. The increase in income compared to the prior quarter is primarily due to increased gross margin for the three months ended June 30, 2012 and a decrease of $0.3 million of operating expenses.

For the three months ended March 31, 2012, the Company recorded net income from operations of $0.1 million or $0.002 per share. The increase in income compared to the prior quarter is primarily due to increased revenues and gross margin for the three months ended March 31, 2012 and the long-lived asset impairment charge of $1.2 million at December 31, 2011.

For the three months ended December 31, 2011, the Company recorded a net loss from operations of $1.4 million or $0.024 per share. The increase in the loss compared to the prior quarter is primarily due to the long-lived asset impairment charge of $1.2 million.

For the three months ended September 30, 2011, the Company recorded a net loss from operations of $0.3 million or $0.005 per share. The decrease in the loss compared to the prior quarter is due to the loss on sale of APS assets and disposal of certain intangible assets of $1.5 million recorded in the prior quarter and settlement of an onerous contract obligation in the three months ended September 30, 2011.

Part VII: CRITICAL ACCOUNTING ESTIMATES, CHANGES TO ACCOUNTING POLICIES

Transition to IFRS

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). The effective date of transition for the Company was July 1, 2010 and comparative information in the financial statements has been restated in accordance with IFRS.

The Company's IFRS accounting policies are provided in note 3 to the consolidated financial statements for the year ended June 30, 2012.

An explanation of how the transition to IFRS has affected the consolidated financial statements of the Company is provided in note 26 to the consolidated financial statements. Reconciliations from previous Canadian Generally Accepted Accounting Principles ("GAAP") to IFRS are provided in the note.

No material changes in internal control over financial reporting or disclosure controls and procedures resulted from the adoption and implementation of IFRS.

Use of estimates and judgments

The preparation of the consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

In the process of applying the Company's accounting policies, management has made the following estimates and judgments, which have the most significant effect on the amounts recognized in the condensed consolidated interim financial statements:

Impairment of non-financial assets
Impairment exists when the carrying value of a non-financial asset or cash-generating unit exceeds its recoverable amount, which is the higher of its fair value less costs to sell and its value in use. The value in use calculation is based on a discounted cash flow model. The recoverable amount is most sensitive to the discount rate used for the discounted cash flow model as well as the expected future cash flows and the growth rates used.

Depreciation and amortization rates
In calculating the depreciation and amortization expense, management is required to make estimates of the expected useful lives of property and equipment and intangible assets.

Taxes
Deferred tax assets, if any, are recognized for all unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilized. Significant management judgment is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and the level of future taxable profits together with future tax planning strategies.

Trade and other receivables

Allowance for doubtful accounts

The Company uses historical trends and performs specific account assessments when determining the allowance for doubtful accounts. These accounting estimates are in respect to the trade and other receivables line on the Company's consolidated statement of financial position. At June 30, 2012, the trade and other receivables line represented 48% of total assets.

The estimate of the Company's allowance for doubtful accounts could change from period to period due to the allowance being a function of the balance and composition of accounts receivable. If the future were to adversely differ from management's expectations of allowance for doubtful accounts, the Company could experience an additional bad debt charge in the future.

Inventories

Allowance for inventory obsolescence

The Company determines its allowance for inventory obsolescence based upon expected inventory turnover, inventory aging and current and future expectations with respect to product offerings. The Company reviews future revenue trends and forecasts, expected inventory requirements and inventory composition necessary to support future revenues. These accounting estimates are with respect to inventory on the Company's consolidated statement of financial position. At June 30, 2012, the inventory line represented 18% of total assets.

The estimate for the Company's allowance for inventory obsolescence could change from period to period due to changes in product offerings and consumer acceptance of those products. If the inventory obsolescence was inadequate it would result in a charge to operations expense in the future.

Provisions

The Company estimates provisions for warranties and onerous contracts. A provision will be recognized if the Company has a legal or constructive obligation due to a prior event. Warranties are based on historical trends. Onerous contracts are based on an unavoidable cost in excess of any future benefit. The onerous contract provision is calculated at the present value of the lower of the expected cost of terminating the contract and the expected net cost of continuing the contract. Details for these provisions can be found in note 15 of the consolidated financial statements.

The estimate for the Company's provisions could change from period to period due to changes in historical trends, revenue or the business environment.

Share-based compensation

The Company uses the Black-Scholes option-pricing model to determine the grant date fair value of share-based compensation. The following assumptions are used in the model: dividend yield; expected volatility; risk-free interest rate; expected option life; and fair value.

Changes to assumptions used to determine the grant date fair value of share-based compensation awards can affect the amounts recognized in the consolidated financial statements.

Canadian GAAP to IFRS adjustments

The following is a summary of the significant changes resulting from the adoption of IFRS. For a full explanation of all changes refer to note 26 of the consolidated financial statements for the year ended June 30, 2012.

- The Company elected under IFRS 1 *First-time adoption of IFRS*, to measure certain items of property and equipment at fair value and to deem the fair value as the new carrying cost as of July 1, 2010. Fair value was determined by a third party certified asset appraiser and resulted in a $0.3 million decrease in the value of property and equipment.

- The Company assessed the recoverable amount of its cash generating units at July 1, 2010 on transition to IFRS. The recoverable amount was based on a value in use calculation. Under Canadian GAAP, the recoverable amount was calculated on an undiscounted basis, using higher long-term growth assumptions than are permissible under IFRS, and no impairment was recognized. Under IFRS an impairment loss of $0.2 million was recorded at July 1, 2010. A further impairment loss of $1.1 million was recorded in the year ended June 30, 2011 and an impairment loss of $1.2 million was recorded in the year ended June 30, 2012.

- Under IFRS the Company determined that the functional currency of the U.S. operating subsidiary, Sentry Armor Systems Inc., is the U.S. dollar. Sales prices, labour and material costs of the U.S. operating subsidiary are determined in U.S. dollars which are primary indicators of the functional currency in accordance with IFRS. Under Canadian GAAP, the U.S. operating subsidiary was accounted for as an integrated foreign operation. The U.S operating subsidiary is generating positive cash flows in U.S. dollars and is no longer dependent on funding from the Canadian parent company.

- The Company elected, under IFRS 1 *First-time adoption of IFRS*, to deem all foreign currency translation differences that arose prior to the date of transition to be nil at the date of transition. Foreign currency translation differences with respect to the U.S. operating subsidiary were $0.4 million at June 30, 2011, resulting in a reduction to foreign exchange losses recorded under Canadian GAAP. Under IFRS foreign currency translation differences are recorded in other comprehensive income.

Part VIII: RISKS AND UNCERTAINTIES

In the normal course of business, the Company's operations continue to be influenced by a number of internal and external factors, and are exposed to risks and uncertainties, that can affect its business, financial condition and operating results. The activities of the Company are subject to ongoing operational risks, including the performance of key suppliers, product performance, government and other industry regulations, and reliance on information systems, all of which may affect the ability of the Company to meet its obligations. The ongoing ability to meet the needs of the market place is dependent on the development and introduction of new products. While management believes its innovation and technology make it a leader in the industry, revenue and results may be affected if products are not accepted in the market place, are not approved by regulatory authorities, or if products are not brought to market in a timely manner.

PSP operates in markets subject to government purchasing patterns and large tenders that are at times unpredictable and create fluctuations in the production load throughout the year. Government purchasing is typically tender driven and subject to competitive bidding. These buying patterns create the necessity of being able to quickly increase and decrease production capacity. PSP has addressed this risk by using a casual pool of staff and cell-based manufacturing in which production staff is grouped into cells. Cells can quickly be added or reduced in order to mitigate the impact of large contracts on regular production of core products. In addition, large contracts often create a situation where a significant portion of the Company's revenue and accounts receivable may be from a small number of customers increasing the risks of economic dependence and concentration of credit.

The Company's working capital position is dependent on the timely collection of accounts receivable, inventory management and scheduled supplier payments. A change in supplier payment terms or slow collection of accounts receivable could adversely affect the Company's liquidity. Management has implemented controls to ensure accounts receivable are current and suppliers payments are largely within terms. However, based on the current estimates, the Company cannot conclude that existing cash resources, together with cash expected to be generated by operations will be sufficient to meet operating, capital and working capital requirements for at least the next twelve-month period.

Going Concern

These financial statements have been prepared assuming the Company will continue as a going concern. The going concern basis of presentation assumes the Company will continue in operation for the foreseeable future and be able to realize its assets and discharge its liabilities and commitments in the normal course of business. During the year ended June 30, 2012, the Company incurred a loss of $1,235,871 and negative cash flow from operations of $733,642. In addition, the Company has a deficit of $20,032,618.

The above factors raise significant doubt about the Company's ability to continue as a going concern. Management has taken actions to address these issues including seeking additional sources of financing, instituting a company-wide cost reduction program and identifying and pursuing strategic partnerships and value enhancing opportunities. The Company's ability to continue as a going concern is dependent on management's ability to successfully complete one or more of these actions, generate a profit from operations, or obtain additional financing, if required. Failure to achieve one or more of these plans could have a material adverse effect on the Company's financial condition and / or results of operations.

The Company cannot be certain that cash generated from its operations will be sufficient to satisfy its liquidity requirements, and it may need to continue to raise capital by selling additional equity and / or by securing credit facilities. The Company's future capital requirements will depend on many factors, including, but not limited to, the market acceptance of its products and services. No assurance can be given that any such additional funding will be available or that, if available, it can be obtained on terms favorable to the Company.

The financial statements do not reflect adjustments that would be necessary if the going concern assumption were not appropriate. If the going concern basis was not appropriate for these financial statements, then adjustments would be necessary to the carrying value of assets and liabilities, the reported revenues and expenses, and the statement of financial position classifications used.

No Record of Recent Profitability

The Company has incurred cumulative losses of $20.0 million in the last five fiscal years, including $1.0 million in 2012, $4.4 million in 2011, $3.0 million in 2010, $9.2 million in 2009, and $0.2 million in 2008 and there can be no assurance that the future business activities of the Company will restore profitability. The Company's ability to operate profitably and generate positive cash flow in the future will be affected by a variety of factors (including its ability to further develop and test its technology on schedule and on budget, the pace at which it secures additional customers, the time and expense required for the roll-out of its products, its success in marketing such product to its customers, the intensity of the competition experienced by the Company and the availability of additional capital to pursue its business plan, including development of new products). An inability to generate sufficient funds from operations will have a materially adverse effect on the Company's business, results of operations and financial condition.

Dependence on Key Personnel

The success of The Company's operations depends on its senior management team and other key employees, as well as their ability to retain and attract skilled and qualified management and employees. The loss of the services of key personnel could have a material adverse effect on the business, financial condition, results of operations or future prospects of the Company.

Defaults under Credit Agreements

The credit facility with the Canadian bank is a demand facility. In the event that the Company was in default under the terms of the agreement, the bank may thereafter demand repayment of all amounts owing under the bank indebtedness and by virtue of the inter-lender agreement, the Lender and the Debenture holder may also demand repayment.

For further discussion with respect to defaults under the Company's credit agreements, refer to the Bank Indebtedness, Long-term Debt and Convertible Debentures sections in Part IV of this MD&A.

Other Risks

Refer to the Company's June 30, 2012 consolidated financial statements note 23 for other risks including credit risk, liquidity risk, currency risk, interest rate risk, and fair value of financial instruments.

Part IX: OTHER INFORMATION

The authorized share capital of the Company consists of an unlimited number of common shares. As of October 18, 2012, there were 59,504,895 common shares outstanding. As of October 18, 2012, there were 4,875,000 options outstanding.

Consolidated Financial Statements of

PACIFIC SAFETY PRODUCTS INC.

Years ended June 30, 2012 and 2011

KPMG LLP
Chartered Accountants
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160 Elgin Street
Ottawa, ON K2P 2P8
Canada

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INDEPENDENT AUDITORS' REPORT

To the Shareholders of Pacific Safety Products Inc.

We have audited the accompanying consolidated financial statements of Pacific Safety Products Inc., which comprise the consolidated statements of financial position as at June 30, 2012, June 30, 2011 and July 1, 2010, the consolidated statements of comprehensive income, changes in equity and cash flows for the years ended June 30, 2012 and June 30, 2011, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Pacific Safety Products Inc. as at June 30, 2012, June 30, 2011 and July 1, 2010, and its consolidated financial performance and its consolidated cash flows for the years ended June 30, 2012 and June 30, 2011 in accordance with International Financial Reporting Standards.

Emphasis of Matter

Without qualifying our opinion, we draw attention to Note 2(a) to the consolidated financial statements which describes that for the year ended June 30, 2012 the Company incurred a net loss of $1,235,871, had negative cash flows from operations of $733,642 and as at June 30, 2012 has an accumulated deficit of $20,032,618. These conditions along with other matters described in Note 2(a), indicate the existence of a material uncertainty which may cast a significant doubt on the Company's ability to continue as a going concern.

KPMG LLP

Chartered Accountants, Licensed Public Accountants

October 18, 2012

Ottawa, Canada

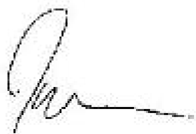
PACIFIC SAFETY PRODUCTS INC.
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

	June 30, 2012	June 30, 2011	July 1, 2010
ASSETS			
CURRENT ASSETS			
Cash and cash equivalents (note 8)	**$ 1,707,563**	$ 2,897,735	$ –
Trade and other receivables (note 9)	**3,431,439**	2,472,626	4,194,435
Inventories (note 10)	**1,319,709**	1,349,006	2,258,874
Prepaid expenses and deposits	**177,622**	279,560	204,677
Assets held for sale	**–**	–	250,215
Total current assets	**6,636,333**	6,998,927	6,908,201
NON-CURRENT ASSETS			
Property and equipment (note 11)	**523,163**	633,199	887,770
Intangible assets (note 12)	**–**	1,043,987	3,788,148
Total non-current assets	**523,163**	1,677,186	4,675,918
TOTAL ASSETS	**$ 7,159,496**	$ 8,676,113	$ 11,584,119
LIABILITIES AND EQUITY			
CURRENT LIABILITIES			
Bank indebtedness (notes 8 and 13)	**$ 620,344**	$ 693,026	$ 2,410,390
Trade and other payables (note 14)	**2,568,300**	2,323,137	3,692,787
Short-term provisions (note 15)	**48,801**	646,417	95,555
Deferred revenue	**50,464**	73,134	93,089
Income taxes payable	**–**	105,038	–
Current portion of long-term debt (note 16)	**214,320**	214,320	214,320
Total current liabilities	**3,502,229**	4,055,072	6,506,141
NON-CURRENT LIABILITIES			
Long-term debt (note 16)	**625,100**	839,420	946,580
Long-term provisions (note 15)	**127,130**	74,981	53,356
Convertible debentures (note 17)	**855,068**	742,496	–
Total non-current liabilities	**1,607,298**	1,656,897	999,936
TOTAL LIABILITIES	**5,109,527**	5,711,969	7,506,077
EQUITY			
Share capital (note 19(a))	**20,180,223**	20,080,222	17,614,731
Warrants (note 19(b))	**–**	45,500	–
Contributed surplus (note 19(c))	**1,849,202**	1,768,027	1,194,176
Other paid-in capital	**234,953**	234,953	–
Deficit	**(20,032,618)**	(18,796,745)	(14,730,865)
Accumulated other comprehensive loss	**(181,791)**	(367,813)	–
Total equity	**2,049,969**	2,964,144	4,078,042
TOTAL LIABILITIES AND EQUITY	**$ 7,159,496**	**$** 8,676,113	**$** 11,584,119

Going concern (note 2(a))
Commitments (note 23)
Subsequent events (note 17)

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

ON BEHALF OF THE BOARD OF DIRECTORS:



Terry Vaudry, Director

Fraser Campbell, Interim Chairman of the Board

PACIFIC SAFETY PRODUCTS INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

FOR THE YEARS ENDED JUNE 30,

	2012	2011
REVENUES (note 4)	**$ 16,733,663**	$ 22,663,696
COST OF SALES	**11,910,121**	17,675,300
GROSS MARGIN	**4,823,542**	4,988,396
EXPENSES		
Sales and marketing	**1,588,150**	2,346,219
Research and development	**465,949**	632,300
General and administration	**2,848,411**	3,384,056
Total expenses	**4,902,510**	6,362,575
LOSS BEFORE OTHER ITEMS	**(78,968)**	(1,374,179)
OTHER ITEMS		
Foreign exchange losses (gains)	**75,483**	(234,364)
Finance income (note 6)	**(12,493)**	(26,808)
Finance costs (note 6)	**289,864**	367,207
Onerous contract changes (settlement) (note 15)	**(331,958)**	–
Long-lived asset impairment (note 12)	**1,159,905**	1,096,000
Loss on sale of assets (note 12)	**1,020**	1,489,666
Total other items	**1,181,821**	2,691,701
LOSS BEFORE INCOME TAXES	**(1,260,789)**	(4,065,880)
INCOME TAXES		
Current income tax recovery (note 18)	**(24,918)**	–
NET LOSS FOR THE YEAR	**(1,235,871)**	(4,065,880)
OTHER COMPREHENSIVE INCOME (LOSS)		
Foreign currency translation differences – foreign operations	**186,022**	(367,813)
TOTAL COMPREHENSIVE LOSS FOR THE YEAR	**$ (1,049,849)**	$ (4,433,693)
LOSS PER SHARE (note 20)		
BASIC AND DILUTED	***$ (0.02)***	*$ (0.10)*
WEIGHTED AVERAGE COMMON SHARES ISSUED AND OUTSTANDING (note 20)		
BASIC AND DILUTED	***57,307,808***	*40,976,048*

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

PACIFIC SAFETY PRODUCTS INC.
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

FOR THE YEARS ENDED JUNE 30, 2012 AND 2011

	Share capital	Warrants	Contributed surplus	Other paid-in capital	Deficit	Cumulative translation account	Total
Balance, July 1, 2010	$ 17,614,731	$ –	$ 1,194,176	$ –	$ (14,730,865)	$ –	$ 4,078,042
Net loss for the period	–	–	–	–	(4,065,880)	–	(4,065,880)
Other comprehensive income (loss):							
Foreign currency translation differences	–	–	–	–	–	(367,813)	(367,813)
Total comprehensive loss	17,614,731	–	1,194,176	–	(18,796,745)	(367,813)	(355,651)
Issuance of warrants	–	45,500	–	–	–	–	45,500
Issuance of convertible debentures	–	–	–	234,953	–	–	234,953
Issuance of shares under Plan of Arrangement	2,742,150	–	–	–	–	–	2,742,150
Share issuance costs	(283,659)	–	–	–	–	–	(283,659)
Fair value of options issued	–	–	106,400	–	–	–	106,400
Excess value of net assets acquired over consideration paid	–	–	361,225	–	–	–	361,225
Share-based compensation expense	–	–	113,226	–	–	–	113,226
Release to share capital on reclassification of restricted shares	7,000	–	(7,000)	–	–	–	–
Total amounts attributable to owners	2,465,491	45,500	573,851	234,953	–	–	3,319,795
Balance, June 30, 2011	$ 20,080,222	$ 45,500	$ 1,768,027	$ 234,953	$ (18,796,745)	$ (367,813)	$ 2,964,144
Balance, July 1, 2011	**$ 20,080,222**	**$ 45,500**	**$ 1,768,027**	**$ 234,953**	**$ (18,796,745)**	**$ (367,813)**	**$ 2,964,144**
Net loss for the period	**–**	**–**	**–**	**–**	**(1,235,871)**	**–**	**(1,235,871)**
Other comprehensive income (loss):							
Foreign currency translation differences	**–**	**–**	**–**	**–**	**(2)**	**186,022**	**186,020**
Total comprehensive income (loss)	**20,080,222**	**45,500**	**1,768,027**	**234,953**	**(20,032,618)**	**(181,791)**	**1,914,293**
Issuance of shares	**100,001**	**–**	**–**	**–**	**–**	**–**	**100,001**
Share-based compensation expense	**–**	**–**	**41,874**	**–**	**–**	**–**	**41,874**
Warrants expired	**–**	**(45,500)**	**39,301**	**–**	**–**	**–**	**(6,199)**
Total amounts attributable to owners	**100,001**	**(45,500)**	**81,175**	**–**	**–**	**–**	**135,676**
Balance, June 30, 2012	**$ 20,180,223**	**$ –**	**$ 1,849,202**	**$ 234,953**	**$ (20,032,618)**	**$ (181,791)**	**$ 2,049,969**

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

PACIFIC SAFETY PRODUCTS INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED JUNE 30,

	2012	2011
CASH FLOW FROM OPERATING ACTIVITIES		
Cash receipts from customers	**$ 15,813,155**	$ 24,592,408
Cash paid to suppliers and employees	**(16,370,981)**	(25,640,584)
Interest paid	**(92,119)**	(203,673)
Interest received	**12,493**	26,808
Investment tax credits recovered	**–**	38,864
Income taxes recovered	**6,319**	–
Income taxes paid	**(102,509)**	–
Other	**–**	5,144
CASH FLOW USED IN OPERATING ACTIVITIES	**(733,642)**	(1,181,033)
CASH FLOW FROM INVESTING ACTIVITIES		
Purchase of property and equipment	**(64,037)**	(25,065)
Investment in intangible assets	**(133,999)**	(293,439)
Proceeds from sale of assets, net of selling costs	**–**	786,215
CASH FLOW FROM (USED IN) INVESTING ACTIVITIES	**(198,036)**	467,711
CASH FLOW FROM FINANCING ACTIVITIES		
Proceeds from issue of convertible debentures, net of issue costs	**–**	935,000
Repayment of long-term debt	**(214,320)**	(107,160)
Decrease in bank indebtedness	**(72,682)**	(1,680,059)
Restricted cash acquired pursuant to plan of arrangement (note 7)	–	2,649,699
Cash acquired pursuant to plan of arrangement (note 7)	**–**	1,892,642
Share issue costs (note 7)	**–**	(283,659)
CASH FLOW FROM (USED IN) FINANCING ACTIVITIES	**(287,002)**	3,406,463
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**(1,218,680)**	2,693,141
CASH AND CASH EQUIVALENTS, BEGINNING	**2,897,735**	–
Effect of exchange rate fluctuations on cash held	**28,508**	204,594
CASH AND CASH EQUIVALENTS, ENDING (note 8)	**$ 1,707,563**	$ 2,897,735

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

1. REPORTING ENTITY

Pacific Safety Products Inc. ("PSP" or the "Company") is a company domiciled in Canada and incorporated under the Canada Business Corporation Act. The address of the Company's head office is 124 Fourth Avenue, Arnprior, Ontario K7S 0A9. The Company manufactures and sells a comprehensive line of protective products for the defence and security markets.

The consolidated financial statements of the Company as at and for the year ended June 30, 2012 comprise the Company and its subsidiaries. Nexus Armour Inc. ("Nexus") is a wholly-owned subsidiary of PSP and is the parent company of Sentry Armor Systems Inc. ("Sentry"). Sentry is incorporated in the State of Delaware, USA and commenced operations in Dover, Tennessee on July 5, 2006. In accordance with the terms of a Plan of Arrangement, Zuni Holdings Inc. ("Zuni") became a wholly-owned subsidiary of PSP effective December 31, 2010. Zuni is the parent company of MTI Leewood GmbH and MTI Specialty Silicones Inc. Zuni and its subsidiaries have no operating business activities. MTI Leewood GmbH was deregistered effective June 27, 2012.

2. BASIS OF PREPARATION

(a) Going concern:

These financial statements have been prepared assuming the Company will continue as a going concern. The going concern basis of presentation assumes the Company will continue in operation for the foreseeable future and be able to realize its assets and discharge its liabilities and commitments in the normal course of business. During the year ended June 30, 2012, the Company incurred a loss of $1,235,871 and negative cash flow from operations of $733,642. In addition, the Company has a deficit of $20,032,618.

The above factors raise significant doubt about the Company's ability to continue as a going concern. Management has taken actions to address these issues including seeking additional sources of financing, instituting a company-wide cost reduction program and identifying and pursuing strategic partnerships and value enhancing opportunities. The Company's ability to continue as a going concern is dependent on management's ability to successfully complete one or more of these actions, generate a profit from operations, or obtain additional financing, if required. Failure to achieve one or more of these plans could have a material adverse effect on the Company's financial condition and/or results of operations.

The Company cannot be certain that cash generated from its operations will be sufficient to satisfy its liquidity requirements, and it may need to continue to raise capital by selling additional equity and/or by securing credit facilities. The Company's future capital requirements will depend on many factors, including, but not limited to, the market acceptance of its products and services. No assurance can be given that any such additional funding will be available or that, if available, it can be obtained on terms favorable to the Company.

The financial statements do not reflect adjustments that would be necessary if the going concern assumption were not appropriate. If the going concern basis was not appropriate for these financial statements, then adjustments would be necessary to the carrying value of assets and liabilities, the reported revenues and expenses, and the statement of financial position classifications used.

(b) Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). These are the Company's first annual consolidated financial statements prepared in accordance with IFRS and IFRS 1 *First-time Adoption of International Financial Reporting Standards* has been applied.

An explanation of how the transition to IFRS has affected the reported financial position, financial performance and cash flows of the Company is provided in note 26. Reconciliations from previous Canadian Generally Accepted Accounting Principles ("Canadian GAAP") to IFRS are provided in the note.

2. BASIS OF PREPARATION (CONTINUED)

(b) Statement of compliance (continued)
The significant accounting policies applied in these consolidated financial statements are presented in note 3 and are based on the IFRS issued and effective as of October 18, 2012.

The consolidated financial statements were authorized for issue by the Board of Directors on October 18, 2012.

(c) Basis of measurement
These consolidated financial statements have been prepared on the historical cost basis except as permitted by IFRS and as otherwise indicated within these notes.

(d) Functional and presentation currency
These consolidated financial statements are presented in Canadian dollars, which is the Company's functional currency.

(e) Use of estimates and judgments
The preparation of the consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

In the process of applying the Company's accounting policies, management has made the following estimates and judgments, which have the most significant effect on the amounts recognized in the consolidated financial statements:

Impairment of non-financial assets
Impairment exists when the carrying value of a non-financial asset or cash-generating unit exceeds its recoverable amount, which is the higher of its fair value less costs to sell and its value in use. The value in use calculation is based on a discounted cash flow model. The recoverable amount is most sensitive to the discount rate used for the discounted cash flow model as well as the expected future cash flows and the growth rates used.

Depreciation and amortization rates
In calculating the depreciation and amortization expense, management is required to make estimates of the expected useful lives of property and equipment and intangible assets.

Taxes
Deferred tax assets, if any, are recognized for all unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilized. Significant management judgment is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and the level of future taxable profits together with future tax planning strategies.

Trade and other receivables

Allowance for doubtful accounts

The Company uses historical trends and performs specific account assessments when determining the allowance for doubtful accounts. These accounting estimates are in respect to the trade and other receivables line on the Company's consolidated statement of financial position. At June 30, 2012, the trade and other receivables line represented 48% of total assets.

The estimate of the Company's allowance for doubtful accounts could change from period to period due to the allowance being a function of the balance and composition of accounts receivable. If the future were to adversely differ from management's expectations of allowance for doubtful accounts, the Company could experience an additional bad debt charge in the future.

2. BASIS OF PREPARATION (CONTINUED)

(e) Use of estimates and judgments (continued)

Inventories

Allowance for inventory obsolescence

The Company determines its allowance for inventory obsolescence based upon expected inventory turnover, inventory aging and current and future expectations with respect to product offerings. The Company reviews future revenue trends and forecasts, expected inventory requirements and inventory composition necessary to support future revenues. These accounting estimates are with respect to inventory on the Company's consolidated statement of financial position. At June 30, 2012, the inventory line represented 18% of total assets.

The estimate for the Company's allowance for inventory obsolescence could change from period to period due to changes in product offerings and consumer acceptance of those products. If the inventory obsolescence was inadequate it would result in a charge to operations expense in the future.

Provisions

The Company estimates provisions for warranties and onerous contracts. A provision will be recognized if the Company has a legal or constructive obligation due to a prior event. Warranties are based on historical trends. Onerous contracts are based on an unavoidable cost in excess of any future benefit. The onerous contract provision is calculated at the present value of the lower of the expected cost of terminating the contract and the expected net cost of continuing the contract. Details for these provisions can be found in note 15.

The estimate for the Company's provisions could change from period to period due to changes in historical trends, revenue or the business environment.

Share-based compensation

The Company uses the Black-Scholes option-pricing model to determine the grant date fair value of share-based compensation. The following assumptions are used in the model: dividend yield; expected volatility; risk-free interest rate; expected option life; and fair value.

Changes to assumptions used to determine the grant date fair value of share-based compensation awards can affect the amounts recognized in the consolidated financial statements.

3. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements and in preparing the opening IFRS statement of financial position at July 1, 2010 for the purposes of the transition to IFRS, unless otherwise indicated.

(a) Basis of consolidation

The consolidated financial statements comprise the accounts of the Company and its wholly-owned subsidiaries.

Subsidiaries are consolidated from the date of acquisition, being the date on which the Company obtains control, and continue to be consolidated until the date that such control ceases. The financial statements of the subsidiaries are prepared for the same reporting period as the Company using consistent accounting policies. Intra-group balances and transactions, and any unrealized income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

(b) Foreign currency

Foreign currency transactions

Transactions in foreign currencies are translated to the respective functional currencies of PSP and its subsidiaries at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortized cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortized cost in foreign currency translated at the exchange rate at the end of the reporting period.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

(b) Foreign currency (continued)
Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value was determined.

Foreign currency differences are recognized in profit or loss.

Foreign operations
The assets and liabilities of foreign operations are translated to Canadian dollars at exchange rates in effect at the reporting date. The income and expenses of foreign operations are translated to Canadian dollars at the monthly average exchange rates as an approximation of the actual exchange rate at the date of the transaction.

Foreign currency differences are recognized in other comprehensive income in the cumulative translation account.

Foreign exchange gains or losses from a monetary item receivable from or payable to a foreign operation, the settlement of which is neither planned nor likely to occur in the foreseeable future and which in substance is considered to form part of the net investment in the foreign operation, are recognized in other comprehensive income in the cumulative amount of foreign currency translation differences.

(c) Revenue recognition
Revenue from the sale of goods in the course of ordinary activities is measured at the fair value of the consideration received or receivable, net of returns, trade discounts and volume rebates. Revenue is recognized when persuasive evidence exists, usually in the form of an executed sales agreement, that the significant risks and rewards of ownership have been transferred to the customer, recovery of the consideration is probable, the associated costs and possible return of goods can be estimated reliably, there is no continuing management involvement with the goods, and the amount of revenue can be measured reliably. If it is probable that discounts will be granted and the amount can be measured reliably, then the discount is recognized as a reduction of revenue as the revenues are recognized.

(d) Taxes
Income tax expense comprises current and deferred tax. Current tax and deferred tax are recognized in profit or loss except to the extent that it relates to items recognized directly in equity or in other comprehensive income.

Current tax is the expected tax payable or receivable on the taxable income or loss for the period, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous periods.

Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized for the following temporary differences: the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss, and differences relating to investments in subsidiaries to the extent that it is probable that they will not reverse in the foreseeable future. In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

(e) Government assistance
Government grants and assistance are recognized when there is reasonable assurance that the grant or assistance will be received and all attached conditions will be complied with. When the grant or assistance relates to an expense item, it is recognized as income over the period necessary to match the grant or assistance on a systematic basis to the costs that it is intended to compensate. Where the grant relates to an asset, it reduces the carrying amount of the asset. The grant is then recognized as income over the useful life of a depreciable asset by way of a reduced depreciation charge.

When government assistance is received which relates to expenses of future periods, the amount is deferred and amortized to income as the related expenditures are incurred.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

(f) Financial instruments

(i) Non-derivative financial assets

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

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

The Company's financial assets include cash and cash equivalents and accounts receivable.

Subsequent measurement
The subsequent measurement of financial assets depends on their classification.

Financial assets at fair value through profit or loss
Financial assets at fair value through profit or loss include financial assets held for trading and financial assets designated upon initial recognition at fair value through profit or loss. Financial assets are classified as held for trading if they are acquired for the purpose of selling or repurchasing in the near term. Financial assets at fair value through profit and loss are carried in the statement of financial position at fair value with changes in fair value recognized in finance income or finance cost in the statement of comprehensive income.

Loans and receivables and cash and cash equivalents
Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement, such financial assets are subsequently measured at amortized cost using the effective interest rate method, less any impairment losses.

Loans and receivables comprise cash and cash equivalents and accounts receivable.

Cash and cash equivalents consist of bank balances and short-term investments that are redeemable in three months or less. The Company uses the direct method of reporting cash flow from operating activities.

Derecognition
The Company derecognizes a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Company is recognized as a separate asset or liability.

(ii) Non-derivative financial liabilities

Initial recognition and measurement
Financial liabilities within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* are classified as financial liabilities at fair value through profit or loss or other financial liabilities. The Company determines the classification of its financial liabilities at initial recognition.

All financial liabilities are recognized initially at fair value plus any directly attributable transaction costs.

The Company's financial liabilities including accounts payable and accrued liabilities, bank indebtedness, convertible debentures and long-term debt, are classified as other financial liabilities.

Subsequent measurement
Subsequent to initial recognition, the Company's financial liabilities are measured at amortized cost using the effective interest method.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(f) Financial instruments (continued)

(ii) Non-derivative financial liabilities (continued)

Derecognition
The Company derecognizes a financial liability when its contractual obligations are discharged or cancelled or expire.

(iii) Offsetting of financial instruments
Financial assets and financial liabilities are offset and the net amount presented in the statement of financial position when, and only when, there is a currently enforceable legal right to offset the recognized amounts and the Company intends to settle on a net basis or to realize the asset and settle the liability simultaneously.

(iv) Share capital

Common shares
Common shares are classified as equity. Incremental costs directly attributable to the issue of common shares and share options are recognized as a deduction from equity, net of any tax effects.

Warrants
Warrants are classified as equity. Incremental costs directly attributable to the issue of warrants are recognized as a deduction from equity, net of any tax effects. The fair value of warrants is estimated using the Black-Scholes option pricing model.

(v) Compound financial instruments
Compound financial instruments issued by the Company comprise convertible debentures that can be converted to share capital at the option of the holder, and the number of shares to be issued does not vary with changes in their fair value.

The liability component of a compound financial instrument is recognized initially at the fair value of a similar liability that does not have an equity conversion option. The equity component is recognized initially at the difference between the fair value of the compound financial instrument as a whole and the fair value of the liability component. Any directly attributable transaction costs are allocated to the liability and equity components in proportion to their initial carrying amounts.

Subsequent to initial recognition, the liability component of a compound financial instrument is measured at amortized cost using the effective interest method. The equity component of a compound financial instrument is not remeasured subsequent to initial recognition.

Interest, losses and gains relating to the financial liability are recognized in profit or loss.

(g) Property and equipment
Property and equipment is measured at cost, net of accumulated depreciation and accumulated impairment losses, if any. Cost includes expenditure that is directly attributable to the acquisition of the asset.

On transition to IFRS from previous Canadian GAAP the Company elected, under IFRS 1 *First-time adoption of IFRS*, to measure certain items of property and equipment at fair value and to deem the fair value as the new carrying cost as of July 1, 2010, the date of transition to IFRS (note 26).

Gains and losses on disposal of an item of property and equipment are determined by comparing the proceeds from disposal with the carrying amount of property and equipment, and are recognized net within other income in profit or loss. The cost of replacing a part of an item of property and equipment is recognized in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Company, and its cost can be measured reliably. The carrying amount of the replaced part is derecognized. The costs of the day-to-day servicing of property and equipment are recognized in profit or loss as incurred.

Depreciation is calculated over the depreciable amount, which is the cost of an asset, or other amount substituted for cost, less its residual value.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(g) Property and equipment (continued)
Depreciation of property and equipment is calculated using the following methods and annual rates:

Office equipment	20% to 30% diminishing balance
Manufacturing equipment	20% to 35% diminishing balance
Computer equipment	30% to 40% diminishing balance
Leasehold improvements	Shorter of useful lives or terms of the leases

The assets' residual values, useful lives, and methods of depreciation are reviewed at each financial year end and adjusted if appropriate. Any changes in these estimates are accounted for prospectively.

(h) Leased assets
Finance leases, which transfer to the Company substantially all the risks and benefits incidental to ownership of the leased item, are capitalized at the commencement of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are recognized in the statement of comprehensive income.

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

(i) Intangible assets
Research and development costs include out-of-pocket costs and direct overheads. Research costs are expensed as incurred and are reduced by related government assistance and tax incentives.

Product development costs are capitalized only if development costs can be measured reliably, the product is technically and commercially feasible, future economic benefits are probable, and the Company intends to and has sufficient resources to complete development and to use or sell the asset. The expenditure capitalized includes the cost of materials, direct labour and overhead costs that are directly attributable to preparing the asset for its intended use. Other development expenditure is recognized as an expense in the statement of comprehensive income as incurred.

Capitalized product development costs are measured at cost less accumulated amortization and accumulated impairment losses.

Other intangible assets acquired separately are measured on initial recognition at cost which represents the fair market value at the date of the acquisition. Following initial recognition, intangible assets are carried at cost less accumulated amortization and accumulated impairment losses.

Amortization of intangible assets is recognized in the statement of comprehensive income on a straight-line basis over the estimated useful lives of intangible assets from the date they are available for use. The estimated useful lives are as follows:

Product development costs	5 years
Patents and trademarks	5 years
Customer relationships	10 to 15 years
Trade names	15 years
Software	3 to 5 years

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(j) Inventories
Inventories are measured at the lower of weighted average cost and net realizable value.

Costs incurred in bringing inventories to their existing location and condition is accounted for as follows:

Raw materials - Purchase cost on a weighted average basis
Finished goods and work-in-progress - Cost of direct materials and labour and a proportion of manufacturing overheads based on normal operating capacity

Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

(k) Impairment

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

If there is objective evidence that an impairment loss has incurred, the amount of the loss is measured as the difference between the asset’s carrying amount and the present value of estimated future cash flows. The present value of the estimated future cash flows is discounted at the financial asset’s original effective interest rate.

Losses are recognized in profit or loss and reflected in an allowance account against the asset. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

(ii) Non-financial assets
The Company assesses at each reporting date whether there is an indication that a non-financial asset may be impaired. If any indication exists, or when annual impairment testing for an asset is required, the Company estimates the asset’s recoverable amount. An asset’s recoverable amount is the higher of its fair value less costs to sell and its value in use. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or cash-generating unit. In determining fair value less costs to sell, an appropriate valuation model is used.

An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss and are allocated to reduce the carrying amounts of the assets in the CGU on a pro rata basis.

An assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. A previously recognized impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. The reversal is limited such that the carrying amount of the asset does not exceed its recoverable amount, nor exceed the carrying amount that would have been determined, net of depreciation or amortization, had no impairment loss been recognized in prior periods.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(l) Share-based payment transactions

The grant-date fair value of share-based payment awards granted to employees is recognized as an employee expense, with a corresponding increase in equity, over the period that the employees become unconditionally entitled to the awards. The amount recognized as an expense is adjusted to reflect the number of awards for which the related service and non-market performance conditions are expected to be met, such that the amount ultimately recognized as an expense in based on the number of awards that meet the related service and non-market performance conditions at the vesting date. For share-based payment awards with non-vesting conditions, the grant-date fair value of the share-based payment is measured to reflect such conditions and there is no true-up for differences between expected and actual outcomes.

(m) Provisions

A provision is recognized if the Company has a present legal or constructive obligation, as a result of a past event, that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. The expense relating to any provision is presented in profit or loss net of any reimbursement. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as a finance cost.

Warranties

A provision for warranties is recognized when the underlying products are sold. The provision is based on historical warranty data.

Onerous contracts

A provision for onerous contracts is recognized when the expected benefits to be derived by the Company from a contract are lower than the unavoidable cost of meeting its obligations under the contract. The provision is measured at the present value of the lower of the expected cost of terminating the contract and the expected net cost of continuing with the contract. Before a provision is established, the Company recognizes any impairment loss on the assets associated with that contract.

(n) Loss per share

The Company presents basic and diluted loss per share data for its common shares. Basic loss per share is calculated by dividing the profit or loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period, adjusted for own shares held. Diluted loss per share is determined by adjusting the profit or loss attributable to common shareholders and the weighted average number of common shares outstanding, adjusted for own shares held, for the effects of all dilutive potential common shares, which comprise convertible debentures and stock options granted to employees.

(o) Segment reporting

An operating segment is a component of the Company that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Company's other components. All operating segments' operating results are reviewed regularly by the Company's Chief Executive Officer ("CEO") to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available.

Segment results that are reported to the CEO include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items comprise mainly corporate assets, public company and head office expenses, and income tax assets and liabilities.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(p) New standards and interpretations not yet adopted

A number of new standards, and amendments to standards and interpretations, are not yet effective for the year ended June 30, 2012, and have not been applied in preparing these consolidated financial statements. None of these are expected to have a significant effect on the consolidated financial statements of the Company.

(i) IFRS 7, Financial Instruments – Disclosures ("IFRS 7")

The IASB amended IFRS 7 in October 2010. IFRS 7 was amended to provide guidance relating to disclosures with respect to the transfer of financial assets that results in derecognition, and continuing involvement in financial assets. The amendments to this standard are effective for annual periods beginning on or after July 1, 2011 with earlier application permitted. The Company does not believe the changes resulting from these amendments will have a significant impact on its consolidated financial statements.

(ii) IFRS 9, Financial Instruments ("IFRS 9")

IFRS 9 replaces International Accounting Standard 39, Financial Instruments: Recognition and Measurement ("IAS 39"), and establishes principles for the financial reporting of financial assets and financial liabilities to permit users to assess the amounts, timing and uncertainty of an entity's future cash flows. The standard retains but simplifies the mixed measurement model and establishes two primary measurement categories for financial assets.

IFRS 9 is effective for annual periods beginning on or after January 1, 2015 with earlier application permitted. The Company has not yet adopted this standard and management is currently assessing the impact of this new standard on Its consolidated financial statements.

(iii) Consolidation standards

(a) IFRS 10, Consolidated Financial Statements ("IFRS 10'), and amended 1AS 27 (2011), Separate Financial Statements

IFRS 10 requires an entity to consolidate an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

(b) IFRS 11, Joint Arrangements ("IFRS 11'), and amended IAS 28 (2011), Associates and Joint Ventures

This new standard requires a venture to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting, whereas for a joint operation the venture will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. Under existing IFRS, entities have the choice to proportionately consolidate or equity account for interests in joint ventures.

(c) IFRS 12, Disclosure of Interests in Other Entities ('IFRS 12')

IFRS 12 establishes disclosure requirements for interests in other entities, such as joint arrangements, associates, special purpose vehicles and off-balance sheet vehicles. The standard carries forward existing disclosures and also introduces significant additional disclosure requirements that address the nature of, and risks associated with, an entity's interest in other entities.

The above suite of consolidation standards is effective for annual periods beginning on or after January 1, 2013. Early adoption is permitted; however, all of the standards must be adopted at the same time, with the exception of the disclosure requirements in IFRS 12.

The Company has not early-adopted these standards and amendments, and is currently assessing the impact the application of these standards and amendments will have on the consolidated financial statements of the Company.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

(iv) IFRS 13, Fair Value Measurement

This new standard provides guidance on the measurement of fair value, replacing fair value guidance contained in individual IFRSs. The standard provides a framework for determining fair value and clarifies the factors to be considered in estimating fair value in accordance with IFRS. The new standard establishes disclosures surrounding fair value measurement that are more extensive than current standards.

This new standard is effective for the Company's interim and annual consolidated financial statements commencing July 1, 2013. The Company is assessing the impact of this new standard on its consolidated financial statements.

(v) IAS 1, Presentation of Financial Statements ("IAS 1")

IAS 1 was amended to align the presentation of items in other comprehensive income with U.S. GAAP standards. Items in other comprehensive income will be required to be presented in two categories: items that might be reclassified into net earnings and those that will not be reclassified. The amendments to IAS 1 are effective for annual periods beginning on or after July 1, 2012. The Company is assessing the impact of this new standard on its consolidated financial statements.

4. REVENUES

	2012	2011
Sale of goods	**$ 16,638,606**	$ 22,581,579
Freight charges	**95,057**	82,117
Total revenue	**$ 16,733,663**	$ 22,663,696

5. NATURE OF EXPENSES

The table below is supplemental to the consolidated statement of comprehensive income; it presents the major functional expenses by their nature.

	2012	2011
Direct material	**$ 7,085,017**	$ 11,808,327
Compensation, employees and directors	**5,843,741**	6,841,685
Professional services	**1,078,761**	1,297,119
Amortization	**266,904**	683,038
Facility rent	**455,388**	591,488
Travel and living	**229,712**	393,236
Freight	**318,606**	393,104
Samples	**301,789**	275,238

6. *FINANCE INCOME AND FINANCE COSTS*

Recognized in profit or loss:

		2012		2011
Interest income on bank deposits	**$**	**12,493**	$	26,808
Finance income	**$**	**12,493**	$	26,808
Interest on bank indebtedness	**$**	**37,091**	$	143,760
Interest on long-term debt		**55,028**		59,913
Interest on convertible debentures		**100,000**		87,169
Accretion of convertible debentures		**97,745**		76,365
Finance costs	**$**	**289,864**	$	367,207

7. *PLAN OF ARRANGEMENT*

Pursuant to a Plan of Arrangement effective December 31, 2010, the Company acquired all of the outstanding common shares of Zuni in exchange for PSP common shares at an agreed exchange ratio of one PSP common share for each Zuni common share. Zuni was amalgamated with a wholly-owned subsidiary of PSP incorporated for the purpose of carrying out the Plan of Arrangement. The amalgamated entity was continued as Zuni Holdings Inc., a subsidiary of PSP.

This transaction has been accounted for as the acquisition of the assets and liabilities of Zuni in exchange for PSP common shares valued at the date of completion of the acquisition. The number of PSP common shares issued was 30,468,334 and the PSP share price was $0.09 resulting in purchase consideration of $2,742,150 related to the shares issued.

The Company also issued 2,000,000 replacement stock options and recorded the fair value of the options of $106,400 in purchase consideration. In accordance with the terms of the Plan of Arrangement, 2,000,000 Zuni stock options outstanding immediately prior to the transaction were exchanged for PSP replacement stock options at an exercise price of $0.10. The PSP replacement stock options were fair-valued using the Black-Scholes option pricing model at the effective date of the transaction using the following assumptions:

Remaining life	4.6 years
Volatility	77%
Dividends	–
Risk-free interest rate	2.4%

A summary of net assets acquired is as follows:

Assets acquired:		
Cash	**$**	**1,892,642**
Restricted cash		**2,649,699**
Accounts receivable and prepaid expenses		**372,446**
Asset held for sale		**184,124**
		5,098,911
Liabilities assumed:		
Accounts payable and accrued liabilities		**(1,789,243)**
Income taxes payable		**(99,893)**
		(1,889,136)
Excess value of net assets acquired over consideration paid (note 19(c))		**(361,225)**
Total purchase consideration	**$**	**2,848,550**

All costs incurred by the Company relating to the Plan of Arrangement have been recorded as share issue costs and presented as a reduction in share capital.

8. CASH AND CASH EQUIVALENTS

		June 30, 2012		June 30, 2011		July 1, 2010
Bank balances	**$**	**667,563**	$	2,897,735	$	–
Guaranteed investment certificates		**1,040,000**		–		–
Cash and cash equivalents		**1,707,563**		2,897,735		–
Bank overdraft used for cash management purposes		**(620,344)**		(693,026)		(2,410,390)
Cash and cash equivalents in the statement of cash flows	**$**	**1,087,219**	$	2,204,709	$	(2,410,390)

Cash held in guaranteed investment certificates includes $1,040,000 held by the Canadian Bank as cash collateral for the overdraft facility.

The Company's exposure to interest rate risks and a sensitivity analysis for financial assets and liabilities are included in note 23.

9. TRADE AND OTHER RECEIVABLES

		June 30, 2012		June 30, 2011		July 1, 2010
Trade receivables	**$**	**3,333,370**	$	2,147,888	$	4,035,839
Other receivables		**98,069**		324,738		158,596
	$	**3,431,439**	$	2,472,626	$	4,194,435

The Company had no trade receivables due from related parties as at June 30, 2012, June 30, 2011 or July 1, 2010. The Company's other receivables are mainly for commodity tax refunds, Scientific Research and Experimental Development tax credits recoverable and withholding tax refunds.

The Company's exposure to credit and currency risks and impairment losses related to trade and other receivables is disclosed in note 23.

10. INVENTORIES

		June 30, 2012		June 30, 2011		July 1, 2010
Raw materials and consumables	**$**	**2,018,955**	$	2,031,037	$	1,885,897
Work-in-process		**14,049**		101,553		13,507
Finished goods and samples		**31,533**		7,115		1,119,254
		2,064,537		2,139,705		3,018,658
Less provision		**(744,828)**		(790,699)		(759,784)
	$	**1,319,709**	$	1,349,006	$	2,258,874

Write-down of inventories recognized as an expense and recorded in cost of sales during the year ended June 30, 2012 was $22,429 (June 30, 2011 - $180,756).

11. PROPERTY AND EQUIPMENT

	Manufacturing equipment	Office equipment	Leasehold improvements	Computer equipment	Total
Cost or deemed cost					
As at July 1, 2010	$ 605,614	$ 109,162	$ 227,420	$ 48,653	$ 990,849
Additions	7,933	–	–	16,770	24,703
Disposals	(2,279)	(59,267)	(37,328)	(33,267)	(132,141)
Effect of movements in exchange rates	(28,997)	(781)	(2,032)	(529)	(32,339)
As at June 30, 2011	582,271	49,114	188,060	31,627	851,072
Additions	6,249	–	53,627	4,161	64,037
Disposals	(3,000)	–	(10,436)	–	(13,436)
Effect of movements in exchange rates	16,140	418	5,188	132	21,878
As at June 30, 2012	$ 601,660	$ 49,532	$ 236,439	$ 35,920	$ 923,551
Depreciation and impairment losses					
As at July 1, 2010	$ –	$ 45,711	$ 25,417	$ 31,951	$ 103,079
Depreciation	176,709	16,500	31,102	7,566	231,877
Disposals	–	(49,448)	(28,927)	(32,809)	(111,184)
Effect of movements in exchange rates	(5,336)	(144)	(260)	(159)	(5,899)
As at June 30, 2011	171,373	12,619	27,332	6,549	217,873
Depreciation	124,253	9,456	39,631	9,059	182,399
Disposals	(1,353)	–	(1,864)	–	(3,217)
Effect of movements in exchange rates	4,214	98	(1,089)	110	3,333
As at June 30, 2012	$ 298,487	$ 22,173	$ 64,010	$ 15,718	$ 400,388
Net book value					
As at July 1, 2010	$ 605,614	$ 63,451	$ 202,003	$ 16,702	$ 887,770
As at June 30, 2011	$ 410,898	$ 36,495	$ 160,728	$ 25,078	$ 633,199
As at June 30, 2012	**$ 303,173**	**$ 27,359**	**$ 172,429**	**$ 20,202**	**$ 523,163**

The Company elected under IFRS 1 *First-time Adoption of International Financial Reporting Standards* to measure certain items of property and equipment at fair value and to deem the fair value as the new carrying cost as at July 1, 2010 (note 27).

12. INTANGIBLE ASSETS

	Product development	Patents and trademarks	Tradenames	Software	Customer relationships	Total
Cost						
As at July 1, 2010	$ 1,668,232	$ 138,966	$ 525,233	$ 649,793	$ 2,947,796	$ 5,930,020
Additions	288,441	5,069	–	–	–	293,510
Disposals	–	–	–	–	(1,644,146)	(1,644,146)
Effect of movements in exchange rates	–	–	(49,385)	(5,910)	(122,577)	(177,872)
As at June 30, 2011	1,956,673	144,035	475,848	643,883	1,181,073	4,401,512
Additions	133,160	625	–	214	–	133,999
Effect of movements in exchange rates	–	–	25,902	3,099	64,289	93,290
As at June 30, 2012	$ 2,089,833	$ 144,660	$ 501,750	$ 647,196	$ 1,245,362	$ 4,628,801
Amortization and impairment losses						
As at July 1, 2010	$ 663,896	$ 99,237	$ 110,877	$ 497,341	$ 770,521	$ 2,141,872
Amortization	316,905	13,564	36,702	44,740	224,064	635,975
Impairment	975,872	31,234	–	88,894	–	1,096,000
Disposals	–	–	–	–	(437,790)	(437,790)
Effect of movements in exchange rates	–	–	(15,404)	(5,086)	(58,042)	(78,532)
As at June 30, 2011	1,956,673	144,035	132,175	625,889	498,753	3,357,525
Amortization	255	19	18,352	3,356	67,910	89,892
Impairment	132,905	606	347,963	16,438	661,993	1,159,905
Effect of movements in exchange rates	–	–	3,260	1,513	16,706	21,479
As at June 30, 2012	$ 2,089,833	$ 144,660	$ 501,750	$ 647,196	$ 1,245,362	$ 4,628,801
Net book value						
As at July 1, 2010	$ 1,004,336	$ 39,729	$ 414,356	$ 152,452	$ 2,177,275	$ 3,788,148
As at June 30, 2011	$ –	$ –	$ 343,673	$ 17,994	$ 682,320	$ 1,043,987
As at June 30, 2012	**$ –**	**$ –**	**$ –**	**$ –**	**$ –**	**$ –**

On August 18, 2010, the Company sold certain PSP headborne system assets, in particular, the helmet liner capability, for $275,000 and a 4% royalty on gross revenues over a five-year period. On September 14, 2010, the purchaser exercised an option to acquire the remainder of the headborne systems for an additional $100,000 and a 2.5% royalty on gross revenues over a five-year period. The Company recorded a loss of $609,422 related to this transaction in the year ended June 30, 2010 based on the fair value of the assets, less estimated costs to complete the sale. The Company recorded a further loss of $39,838 related to this transaction in the year ended June 30, 2011.

On May 5, 2011, the Company completed the sale of certain assets of APS Distributors, a former division of PSP located In Bedford, Nova Scotia, with a carrying value of $1,913,698, for a purchase price of $500,000 before transaction costs. The Company recorded a loss on the sale of $1,449,828 in the year ended June 30, 2011.

Amortization
For the year ended June 30, 2012, amortization expense was presented in sales and marketing $89,637 (2011 - $319,070) and research and development $255 (2011 - $316,905).

12. INTANGIBLE ASSETS (CONTINUED)

Impairment
At June 30, 2011, due to continuing losses, negative cash flow from operating activities, and the reduction in projected revenue in Canada following the sale of the distribution division, the Company assessed the recoverable amount of its cash generating units ("CGUs"). The recoverable amount of the CGUs was based on a value in use calculation.

Value in use was based on cash flows expected to be generated from each of the Company's two CGUs. The two CGUs are assets of the Canadian ("Canada") and U.S. operations ("USA"). Cash flows were projected up to the date that the assets within the CGUs are expected to be consumed by the entity. For Canada, the expected life of the CGU was 6 years and the life of the USA CGU was 6 years. The key assumptions used in the value in use calculations of the CGUs are:

- Expected life of the CGUs' assets
- Projection of cash inflows and outflows
- Discount rates

The value in use was determined using pre-tax discount rates of 25.15% and 25.55% for the Canada and USA CGUs, respectively. The discount rates applied reflect the Company's weighted average cost of capital adjusted for the risks specific to the CGU. Cash flows were projected based on past experience, actual operating results and the Company's operating plan extrapolated for a fiveyear period. A zero growth rate was assumed beyond year 5.

Based on the value in use assessment, the carrying amount of the Canada CGU at June 30, 2011 was determined to be $1,096,000 higher than its recoverable amount and an impairment loss was recognized. The impairment loss was allocated pro-rata to the intangible assets comprising the Canada CGU. The recoverable amount of the USA CGU based on the value in use calculation exceeded the carrying amount therefore no impairment loss was recognized.

At December 31, 2011, it was determined that the remaining intangible assets of both the Canada CGU ($134,125) and the US CGU ($1,025,780) were fully impaired. A draft letter of intent ("LOI") to sell substantially all of the assets of the Company was received prior to December 31, 2011 and was signed on January 20, 2012. The value of the estimated net proceeds indicated that there was a potential impairment. As a result, management reviewed the recoverable value of each CGU and determined that the fair value less costs to sell for each CGU represented the recoverable value. Fair value was determined based on the signed LOI. The carrying value of net assets expected to be included in the sale, excluding intangible assets, exceeded the estimated net proceeds of sale. Therefore an impairment loss of $1,159,905 was recognized at December 31, 2011. The letter of intent was terminated on March 5, 2012.

At June 30, 2012, management determined that there has not been any change to the assets' value in use, fair value less costs to sell, or resulting recoverable amount. Therefore, no change to the impairment loss is required.

13. BANK INDEBTEDNESS

PSP had an agreement with a Canadian bank to provide advances repayable on demand with interest payable monthly calculated at the bank prime lending rate plus 3.50% per annum. The loan was secured by a first priority general security agreement over Canadian accounts receivable and inventory. The maximum operating line was $3.0 million, reduced to $1.0 million following the sale of the APS Distributors division and the release of cash being held in escrow, and was subject to margin requirements and covenants set by the bank. At June 30, 2011, the amount drawn on the line of credit was $693,026. On August 31, 2011 the amount drawn on the line of credit was repaid in full and the facility was closed.

PSP signed an Agreement with another Canadian bank (the "Bank") on August 31, 2011 for a replacement credit facility in the amount of $1.0 million. The facility is a revolving demand facility available by way of overdraft with interest payable monthly calculated at the bank prime lending rate plus 1.95% per annum. The facility is secured by cash collateral of $1.0 million and a general security agreement over all personal property of PSP and its subsidiaries. The Agreement has no financial covenants and is subject to certain general covenants as outlined in the Agreement. At June 30, 2012, the amount drawn on the overdraft facility of $620,344 is included in bank indebtedness, and cash collateral held in a GIC with the Bank in the amount of $1,040,000 is included in cash and cash equivalents.

Sentry had an agreement with a United States bank to provide advances repayable on demand with interest payable monthly calculated at the bank prime lending rate plus 2.00% per annum. The loan was secured by a first priority general security agreement over U.S. accounts receivable, inventory and an assignment of insurance. The maximum operating line was $1.4 million USD, subject to margin requirements and covenants set by the lenders. On January 27, 2012, the United States Bank was closed and a receiver was appointed. The loan facility was not being utilized and the account has been closed and the security has been released.

14. TRADE AND OTHER PAYABLES

	June 30, 2012	June 30, 2011	July 1, 2010
Trade and other payables due to related parties	**$ –**	$ 11,379	$ –
Other trade payables	**805,515**	871,080	2,259,995
Non-trade payables and accrued expenses	**1,762,785**	1,440,678	1,432,792
	$ 2,568,300	$ 2,323,137	$ 3,692,787

The Company's exposure to currency and liquidity risk related to trade and other payables is disclosed in note 23.

15. PROVISIONS

	Warranties	Restructuring	Onerous contracts	Total
As at July 1, 2010	$ 46,221	$ 102,690	$ –	$ 148,911
Assumed pursuant to Plan of Arrangement	–	–	631,767	631,767
Provisions made during the year	27,838	–	–	27,838
Provisions used during the year	(8,533)	(86,311)	–	(94,844)
Effect of movements in exchange rates	7,726	–	–	7,726
As at June 30, 2011	73,252	16,379	631,767	721,398
Provisions made during the year	(18,897)	–	122,308	103,411
Provisions used during the year	(10,750)	–	(649,605)	(660,355)
Effect of movements in exchange rates	11,477	–	–	11,477
As at June 30, 2012	$ 55,082	$ 16,379	$ 104,470	$ 175,931

As at July 1, 2010	Warranties	Restructuring	Onerous contracts	Total
Short-term	$ 9,244	$ 86,311	$ –	$ 95,555
Long-term	36,977	16,379	–	53,356
Total	$ 46,221	$ 102,690	$ –	$ 148,911

As at June 30, 2011	Warranties	Restructuring	Onerous contracts	Total
Short-term	$ 14,650	$ –	$ 631,767	$ 646,417
Long-term	58,602	16,379	–	74,981
Total	$ 73,252	$ 16,379	$ 631,767	$ 721,398

As at June 30, 2012	Warranties	Restructuring	Onerous contracts	Total
Short-term	$ 11,017	$ 16,379	$ 21,405	$ 48,801
Long-term	44,065	–	83,065	127,130
Total	$ 55,082	$ 16,379	$ 104,470	$ 175,931

Warranties
The provision for warranties is based on estimates made from historical data associated with similar products.

15. PROVISIONS (CONTINUED)

Restructuring
During the year ended June 30, 2010, the Company implemented a restructuring plan directed at reducing costs. The balance in the restructuring provision relates to liabilities arising as a result of executing the plan.

Onerous contracts
On August 16, 2011 the Company signed a sublease for the remaining lease term for its former head office premises in Kanata, Ontario. The Company recognized a provision for the discounted future lease payments to which the Company is committed less expected future sublease income in the amount of $122,308.

Pursuant to the Plan of Arrangement (note 7) the Company assumed a provision for discounted future lease payments related to the vacated manufacturing facility of a Zuni subsidiary that no longer had any operating business activities. A settlement was reached with the landlord and the lease was terminated on September 30, 2011 resulting in a release of the provision in the amount of $462,838.

16. LONG-TERM DEBT

	June 30, 2012	June 30, 2011	July 1, 2010
Secured term loan with interest payable monthly calculated at the Lender's floating base rate of 5% at June 30, 2012 plus a variance of 0.75% per annum on the principal outstanding. The principal is repayable by one installment of $17,620 on December 23, 2008, 83 consecutive monthly payments of $17,860 commencing January 23, 2009 with the final payment on May 23, 2016. This loan is secured by a first security interest in all present and after-acquired personal property, subject only to a prior charge with respect to receivables and inventory in favour of the bank providing a Canadian credit facility. The Lender agreed to a six-month postponement of principal payments pursuant to a letter agreement dated August 4, 2010. All other terms and conditions of the debt facility remain unchanged. Principal payments resumed on February 23, 2011.	**$ 839,420**	$ 1,053,740	$ 1,160,900
Less current portion	**(214,320)**	(214,320)	(214,320)
	$ 625,100	$ 839,420	$ 946,580

The principal installments required to be paid over the next five years are as follows:

Years ending June 30,	
2013	$ 214,320
2014	214,320
2015	214,320
2016	196,460
2017	–
	$ 839,420

17. CONVERTIBLE DEBENTURES

On August 17, 2010, the Company completed a private placement of $1,000,000 aggregate principal amount, consisting of 40 units (the "Units") at a purchase price of $25,000 per Unit. Each Unit consists of $25,000 in principal amount of unsecured convertible debentures (the "Debentures") and 62,500 detachable common share purchase warrants (the "Warrants").

17. CONVERTIBLE DEBENTURES (CONTINUED)

The Debentures mature three years from the date of issuance and bear interest at a rate of 10% per annum, payable annually in cash or common shares at the option of the Company. The Company elected to settle interest payable on convertible debentures as of August 17, 2011 in the amount of $100,000 with the issuance of 1,145,408 common shares. On August 17, 2012, the Company elected to settle the interest payable of $100,000 with the payment of $60,000 dollars to certain debenture holders and the remaining $40,000 in interest will be paid with the issuance of 800,000 common shares. The holder has the right to convert all (but not less than all) principal and accrued interest at any time to common shares at a rate of one common share per $0.10 of indebtedness (the “Conversion Option”).

The Warrants have a one-year term with an exercise price of $0.10 per common share during the first six months and an exercise price of $0.12 per common share during the second six months of the term. The Warrants expired unexercised on August 17, 2011.

On the date of issuance, the gross proceeds in the amount of $1,000,000 were allocated based on the fair values of the Debentures ($700,049) and Warrants ($45,500) with the residual being allocated to the Conversion Option ($254,451). On the date of issuance, the fair value of the Debentures was classified as a liability, while the fair values of the Conversion Option and Warrants were classified as separate components of shareholders’ equity.

Over the three-year term, the Debentures are accreted to their principal amount through a periodic charge to accretion expense with a corresponding credit to the liability component. The accretion expense is based on the effective interest method. For the year ended June 30, 2012, the Company recorded accretion expense of $97,745 (year ended June 30, 2011 - $76,365) related to the Debentures.

The Company incurred transaction costs of $65,000 in connection with the issuance of the Debentures. These costs were allocated to Debenture issuance costs ($45,503) and to equity issuance costs ($19,497) based on the relative fair values of the debt and equity components.

The fair value of the Debentures was estimated using the present value of future cash flows using a discount rate of 18%. The fair value of the Warrants was estimated using the Black-Scholes option pricing model assuming no expected dividends, a volatility of the Company’s share price of 101%, a risk-free interest rate of 1.4%, and an expected life of one year.

Certain Directors of the Company beneficially own or control, directly or indirectly, $750,000 aggregate principal amount of the Debentures.

The Debentures contain certain default provisions that would provide the holders the right to demand repayment. The Company was in compliance with these conditions at June 30, 2012.

18. DEFERRED TAX ASSETS AND LIABILITIES

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

	June 30, 2012	June 30, 2011	July 1, 2010
Loss carryforwards	**$ 5,008,587**	$ 4,964,847	$ 1,956,970
Financing costs	**446,268**	435,751	6,352
Reserves	**221,748**	483,211	292,797
Harmonization tax credit	**11,041**	11,542	10,818
Scientific research and development	**281,463**	344,384	25,192
Intangible assets	**1,383,940**	955,332	869,312
Property and equipment	**–**	–	24,427
	$ 7,353,047	$ 7,195,067	$ 3,185,868

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

18. DEFERRED TAX ASSETS AND LIABILITIES (CONTINUED)

At June 30, 2012, the Company has approximately $3.1 million in Canadian non-capital loss carryforwards and $4.3 million of U.S. net operating loss carryforwards available, excluding loss carryforwards of Zuni and its subsidiaries which have no operating business activities. The unused losses will expire between 2026 and 2032.

		2012		2011
Current tax expense:				
Current period	**$**	**–**	$	–
Adjustment for prior periods		**(24,918)**		–
		(24,918)		–
Deferred tax expense (recovery):				
Origination and reversal of temporary differences		**(614,814)**		(1,199,435)
Reduction in tax rate		**44,414**		223,372
Current year losses for which no deferred tax asset was recognized		**413,632**		541,453
Change in unrecognized temporary differences		**57,183**		417,318
Other		**99,585**		17,292
		–		–
Total income tax expense (recovery)	**$**	**(24,918)**	$	–

Reconciliation of effective tax rate

		2012		2011
Net loss for the year	**$**	**1,235,871**	$	4,065,880
Total income tax expense (recovery)		**(24,918)**		–
Net loss, excluding income tax	$	**1,260,789**	$	4,065,880
Rate		**28.1%**		29.5%
Expected Canadian income tax expense (recovery)	**$**	**(354,282)**	$	(1,199,435)
Difference resulting from:				
Effect of tax rates in foreign jurisdictions		**(196,997)**		(10,580)
Reduction in tax rate		**44,414**		223,372
Non-deductible expenses		**20,470**		153,018
Recognition of previously unrecognized tax losses		**(260,532)**		–
Current year losses for which no deferred tax asset was recognized		**413,632**		541,453
Change in unrecognized temporary differences		**57,183**		417,318
Under (over) provided in prior periods		**251,194**		(125,146)
Total income tax expense (recovery)	$	**(24,918)**	$	

The expected income tax rate reflects the combined Federal and Provincial income tax rates for manufacturing and processing companies.

Recognized deferred tax assets and liabilities
Deferred tax assets and liabilities are attributable to the following:

	Assets		Liabilities		Net	
	2012	2011	2012	2011	2012	2011
Property and equipment	$ –	$ –	$ 65,211	$ 43,966	$ 65,211	$ 43,966
Investment tax credits	–	–	10,901	10,490	10,901	10,490
Convertible debentures	–	–	33,348	57,014	33,348	57,014
Tax loss carry-forwards	(109,460)	(111,470)	–	–	(109,460)	(111,470)
Tax (assets) liabilities	(109,460)	(111,470)	109,460	111,470	–	–
Set off of tax	109,460	111,470	(109,460)	(111,470)	–	–
Net tax (assets) liabilities	$ –	$ –	$ –	$ –	$ –	$ –

19. CAPITAL AND OTHER COMPONENTS OF EQUITY

(a) Share capital

The authorized share capital of the Company consists of unlimited voting common shares without par value.

	2012		2011	
	Number of Shares	**Amount**	Number of Shares	Amount
Beginning balance	**56,309,487**	**$ 20,080,022**	25,741,153	$ 17,614,731
Shares issued under the Plan of Arrangement (note 7)	–	–	30,468,334	2,742,150
Shares issued in lieu of interest, convertible debentures	**1,145,408**	**100,001**	–	–
Share issue costs (note 7)	–	–	–	(283,659)
Restricted shares	–	–	100,000	7,000
Balance, June 30	**57,454,895**	**$ 20,180,023**	56,309,487	$ 20,080,222

On August 17, 2011, the Company issued 1,145,408 common shares at a deemed price of $0.087305 per share in settlement of interest payable on the Debentures.

Effective March 13, 2007, the Company entered into a Restricted Share Agreement with an Employee. Subject to the terms and conditions of this Agreement, the Company agreed to grant Restricted Shares to the Employee on each of November 26, 2007, 2008 and 2009. The Restricted Shares granted in any year vest one year after the grant date and will be issued to the Employee on the second anniversary of the vesting date. The Company granted 62,206 and 100,000 Restricted Shares on November 26, 2007 and November 26, 2008, respectively, and issued the shares on June 16, 2009. The Company granted 100,000 Restricted Shares on November 29, 2010 and issued the shares on January 27, 2011.

(b) Warrants

	2012		2011	
	Number of Warrants	**Amount**	Number of Warrants	Amount
Opening balance	2,500,000	$ 45,500	–	$ –
Issued	–	–	2,500,000	45,500
Expired	(2,500,000)	(45,500)	–	–
Ending balance	**–**	**$** –	2,500,000	**$** 45,500

The Warrants expired unexercised on August 17, 2011.

(c) Contributed surplus

	2012	2011
Balance, beginning of year	**$ 1,768,027**	$ 1,194,176
Stock-based compensation	**41,874**	113,226
Expired warrants	**39,301**	–
Fair value of options issued (note 7)	**–**	106,400
Excess value of net assets acquired over consideration paid (note 7)	**–**	361,225
Release to share capital on reclassification of restricted shares	**–**	(7,000)
Balance, end of year	$ **1,849,202**	$ 1,768,027

19. CAPITAL AND OTHER COMPONENTS OF EQUITY (CONTINUED)

(d) Accumulated other comprehensive income
Accumulated other comprehensive income (loss) includes the cumulative translation account which comprises all foreign differences arising from the translation of the financial statements of foreign operations.

20. LOSS PER SHARE

As the Company incurred a net loss during the years ended June 30, 2012 and 2011, the loss and diluted loss per common share are based on the weighted-average common shares outstanding during the period. The following outstanding instruments could have a dilutive effect in the future:

	2012	2011
Shares issuable on conversion of convertible debentures	**10,000,000**	10,000,000
Stock options	**4,875,000**	4,884,000
	14,875,000	14,884,000

21. SHARE-BASED PAYMENT

The Company had a stock option plan that provides options to purchase common shares of the Company for its management, executive officers and members of the Board of Directors. These options expire five years after the issue date or, in the event the employee's service ceases, at a date determined by the Board of Directors. Board members' options expire 90 days after termination or resignation, subject to certain exceptions whereby specific board members' options expire one year after resignation. The exercise price for these stock options is set at the average closing price over the previous 20-day trading period. Vesting periods are determined by the Board of Directors upon issuance.

On December 22, 2010, the Board approved the New PSP Stock Option Plan. Under the New PSP Stock Option Plan, the PSP Board determines the term of any options granted, which shall not exceed ten years from the date of grant. The exercise price and vesting periods will be determined by the Board of Directors upon issuance. The expiration of any PSP option will be accelerated if the participant’s employment or other relationship with PSP terminates. Vested options may be exercised until the earlier of the fixed expiry date or a period of up to one year following the date the optionee ceases to be a participant as determined by the PSP Board at the time of the option grant.

The aggregate number of PSP shares that may be reserved for issuance pursuant to PSP options shall not exceed 10% of the outstanding PSP shares at the time of granting of a PSP option, less the aggregate number of shares reserved for issuance under any other PSP share compensation arrangement.

Details of the outstanding options granted to management and directors as at July 1, 2010 and for the years ended June 30, 2011 and June 30, 2012 are as follows:

Grant date	Number of options	Contractual life of options	Vesting conditions
December 31, 2010	2,000,000	4.6 years	100% on grant
February 28, 2011	925,000	5 years	1/3 on grant, 1/3 in 6 months and 1/3 in 12 months
March 11, 2011	1,500,000	5 years	1/3 March 11, 2011, 1/3 March 31, 2011, 1/6 December 31, 2011, 1/6 June 30, 2010
April 21, 2011	125,000	5 years	1/3 on grant, 1/3 in 6 months and 1/3 in 12 months
May 2, 2011	100,000	5 years	1/3 on grant, 1/3 in 6 months and 1/3 in 12 months
June 24, 2011	75,000	5 years	1/3 on grant, 1/3 in 6 months and 1/3 in 12 months
June 27, 2011	150,000	5 years	1/3 on grant, 1/3 in 6 months and 1/3 in 12 months
	4,875,000		

21. SHARE-BASED PAYMENT (CONTINUED)

At June 30, 2012, the Company had 4,875,000 stock options outstanding with a weighted average exercise price of $0.10.

	Total	*Weighted Average Exercise Price*
Balance July 1, 2010	987,800	$ 0.59
Granted	2,875,000	0.10
Issued pursuant to Plan of Arrangement (note 7)	2,000,000	0.10
Expired	(978,800)	0.59
Balance, June 30, 2011	4,884,000	0.10
Expired	(9,000)	0.10
Balance, June 30, 2012	**4,875,000**	**$ 0.10**

Total Stock Option Pool Authorized	**5,745,489**
Total Stock Option Pool Remaining	**870,489**

The fair value of stock options issued during 2011 was estimated using the Black-Scholes option-pricing model with the following assumptions: dividend yield (nil), expected volatility ranging from 0.69 to 0.93, risk-free interest rate of 2%, and expected option life of two to five years with a resulting grant date fair value ranging from $0.05 to $0.06.

The following table summarizes information regarding the Company's outstanding stock options at June 30, 2012:

Options Outstanding				*Options Exercisable*	
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$0.10	4,875,000	3.48	$ 0.10	4,875,000	$ 0.10
	4,875,000		**$ 0.10**	**4,875,000**	**$ 0.10**

The share-based payment expense for the year ended June 30, 2012 was $41,874 (June 30, 2011 - $113,226).

22. FINANCIAL INSTRUMENTS

(a) Credit risk

(i) Exposure to credit risk

The carrying amount of financial assets represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date was:

	June 30, 2012	June 30, 2011	July 1, 2010
Cash and cash equivalents	**$ 1,707,563**	$ 2,897,735	$ –
Trade and other receivables	**3,431,439**	2,472,626	4,194,435
	$ 5,139,002	$ 5,370,361	$ 4,194,435

The carrying amount of the financial assets of the Company approximate their fair values due to the relatively short periods to maturity of the instruments.

The Company's credit risk is primarily attributable to its trade receivables. The amounts disclosed in the Consolidated Statements of Financial Position are net of allowances for impairment, estimated based on prior experience.

The maximum exposure to credit risk for trade and other receivables at the reporting date by geographic region was:

	June 30, 2012	June 30, 2011	July 1, 2010
Domestic	**$ 2,438,680**	$ 1,217,659	$ 2,980,501
United States	**983,958**	1,207,454	1,213,934
Other	**8,801**	47,513	–
	$ 3,431,439	$ 2,472,626	$ 4,194,435

A significant customer represented approximately 41% of the total trade and other receivables carrying amount as at June 30, 2012 (June 30, 2011 - 20% and July 1, 2010 – 31%).

(ii) Impairment losses

The aging of trade receivables at the reporting date was:

	June 30, 2012		June 30, 2011		July 1, 2010	
	Gross	**Impairment**	Gross	Impairment	Gross	Impairment
Not past due	**$ 1,982,423**	**$ –**	$ 1,556,686	$ –	$ 2,961,057	$ –
Past due 0 – 30 days	**894,219**	**–**	486,897	–	556,426	–
Past due 31 – 120 days	**458,496**	**(6,133)**	88,958	(6,720)	427,770	(2,980)
More than 120 days	**78,567**	**(74,202)**	33,133	(12,045)	119,784	(57,958)
Trade receivables	**3,413,705**	**(80,335)**	2,165,674	(18,765)	4,065,037	(60,938)
Other receivables	**98,069**	**–**	325,717	–	190,336	–
	$ 3,511,774	**$ (80,335)**	$ 2,491,391	$ (18,765)	$ 4,255,373	$ (60,938)

22. FINANCIAL INSTRUMENTS (CONTINUED)

(a) Credit risk (continued)

(ii) Impairment losses (continued)

The movement in the allowance for impairment in respect of trade receivables during the year was as follows:

		2012		2011
Balance, July 1	**$**	**(18,765)**	$	(60,938)
Impairment loss recognized		**(69,210)**		(2,505)
Recovery		**(1,519)**		–
Write-offs		**9,159**		44,678
Balance, June 30	**$**	**(80,335)**	$	(18,765)

Trade receivables due for more than 120 days are analyzed and an allowance for impairment is recognized with consideration of the customers' credit ratings and historic payment behaviour. The allowance account in respect of trade receivables is used to record impairment loss unless the Company is satisfied that no recovery of the amount owing is possible, at which point the amounts are considered irrevocable and are written off against the financial asset directly.

The Company believes that the unimpaired amounts past due by more than 30 days are collectible.

(b) Liquidity risk

As of June 30, 2012 and 2011, the Company did not have any derivative financial liabilities. The following are the contractual maturities of non-derivative financial liabilities including estimated interest payments:

June 30, 2012	**Carrying amount**	**Contractual cash flows**	**6 months or less**	**6 – 12 months**	**1 – 2 years**	**2 - 5 years**
Bank indebtedness	$ 620,344	$ 622,903	$ 622,903	$ –	$ –	$ –
Trade and other payables	2,568,300	2,568,300	2,568,300	–	–	–
Provisions	175,931	175,931	16,211	32,589	32,422	94,709
Long-term debt	839,420	935,953	130,010	126,929	244,615	434,400
Convertible debentures	855,068	1,200,000	100,000	–	1,100,000	–
	$ 5,059,063	**$** 5,503,087	$ 3,437,424	$ 159,518	$ 1,377,037	$ 529,109

June 30, 2011	Carrying amount	Contractual cash flows	6 months or less	6 – 12 months	1 – 2 years	2 - 5 years
Bank indebtedness	$ 693,026	$ 696,780	$ 696,780	$ –	$ –	$ –
Trade and other payables	2,323,137	2,323,137	2,323,137	–	–	–
Provisions	721,398	721,398	639,092	7,325	31,029	43,951
Long-term debt	1,053,740	1,205,215	136,245	133,017	256,938	679,015
Convertible debentures	742,496	1,300,000	100,000	–	100,000	1,100,000
	$ 5,533,797	**$** 6,246,530	$ 3,895,254	$ 140,342	$ 387,967	$ 1,822,966

22. FINANCIAL INSTRUMENTS (CONTINUED)

(b) Liquidity risk (continued)

July 1, 2010	Carrying amount	Contractual cash flows	6 months or less	6 – 12 months	1 – 2 years	2 - 5 years
Bank indebtedness	$ 2,410,390	$ 2,423,446	$ 2,423,446	$ –	$ –	$ –
Trade and other payables	3,692,787	3,692,787	3,692,787	–	–	–
Provisions	148,911	148,911	14,891	14,891	29,782	89,347
Long-term debt	1,160,900	922,503	50,466	121,135	269,262	481,640
Convertible debentures	–	–	–	–	–	–
	$ 7,412,988	$ 7,187,647	$ 6,181,590	$ 136,026	$ 299,044	$ 570,987

(c) Currency risk

(i) Exposure to currency risk
The Company's exposure to foreign currency risk was as follows:

June 30, 2012 (in CAD)	**Exposure to USD**
Cash and cash equivalents	$ 504,104
Short-term investments	–
Trade and other receivables	992,759
Bank indebtedness	–
Trade and other payables	(850,848)
Provisions	(29,887)
Gross Statement of Financial Position exposure	$ 616,128

June 30, 2011 (in CAD)	Exposure to USD
Cash and cash equivalents	$ 332,131
Short-term investments	–
Trade and other receivables	1,254,966
Bank indebtedness	(222,096)
Trade and other payables	(695,670)
Provisions	(643,019)
Gross Statement of Financial Position exposure	$ 26,312

July 1, 2010 (in CAD)	Exposure to USD
Cash and cash equivalents	$ –
Short-term investments	–
Trade and other receivables	1,213,665
Bank indebtedness	(622,236)
Trade and other payables	(1,142,812)
Provisions	(8,388)
Gross Statement of Financial Position exposure	$ (559,771)

22. FINANCIAL INSTRUMENTS (CONTINUED)

(c) Currency risk (continued)

(ii) Sensitivity analysis

Based on the net exposures at June 30, 2012 and 2011, and assuming all other variables remain constant, a 10% depreciation or appreciation of the Canadian dollar against the US dollar would result in an increase (decrease) in net profit and loss by the amounts shown.

June 30, 2012 (in CAD)		**USD**
Canadian dollar		
Depreciation 10%	$	61,613
Appreciation 10%		(61,613)

June 30, 2011 (in CAD)		USD
Canadian dollar		
Depreciation 10%	$	2,631
Appreciation 10%		(2,631)

(d) Interest rate risk

		June 30, 2012		June 30, 2011		July 1, 2010
Fixed rate instruments						
Financial assets	**$**	**1,040,000**	$	–	$	–
Financial liabilities		**(855,068)**		(742,496)		–
	$	**184,932**	$	(742,496)	$	–

Variable rate instruments						
Financial assets	**$**	–	$	–	$	–
Financial liabilities		(1,459,764)		(1,746,766)		(3,571,290)
	$	(1,459,764)	$	(1,746,766)	$	(3,571,290)

Guaranteed investments certificates comprise the Company's fixed rate financial assets for the years ended June 30, 2012 and 2011. The Company does not account for any fixed rate financial assets at fair value through profit or loss.

22. FINANCIAL INSTRUMENTS (CONTINUED)

(d) Interest rate risk (continued)

The Company is exposed to interest rate risk on variable rate financial liabilities comprised of short-term variable rate credit facilities and a long-term variable rate secured loan for the year ended June 30, 2012. If interest rates on the credit facilities and long-term debt were to fluctuate by 1%, and all other variables were held constant, there would be an impact on profit or loss amounting to $14,598.

(e) Fair values

The Company's financial instruments consist of cash and cash equivalents, trade and other receivables, bank indebtedness, trade and other payables, convertible debentures and long-term debt. The fair values of trade and other receivables, bank indebtedness, and trade and other payables, as recorded in the consolidated statement of financial position approximate their carrying amounts due to the short-term maturities of these instruments. The long-term debt reflects current market interest rates and therefore the carrying amount approximates fair value. Convertible debentures were measured initially at fair value and are carried at amortized cost. The fair value of the Debentures was estimated to be $1,009,979 at June 30, 2012 (June 30, 2011 - $953,373) using the present value of future cash flows and a discount rate of 18%.

Financial instruments recorded at fair value on the consolidated statement of financial position are classified using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

Level 1 – valuation based on quoted prices (unadjusted) in active markets for identical assets or liabilities;
Level 2 – valuation techniques based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices);
Level 3 – valuation techniques using inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The fair value hierarchy requires the use of observable market inputs whenever such inputs exist. A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value.

There are no financial instruments measured at fair value. During the years ended June 30, 2011 and June 30, 2012, there have been no transfers of amounts between any categories. There were no items classified as Level 2 or Level 3 as at June 30, 2012 and June 30, 2011.

23. OPERATING LEASES

The Company is committed to operating leases in respect of its premises and equipment as follows:

	June 30, 2012	June 30, 2011	July 1, 2010
Less than 1 year	**$ 519,029**	$ 545,037	$ 748,778
Between 1 and 5 years	**1,570,854**	2,044,559	2,644,543
More than 5 years	**–**	426,168	1,254,596
	$ 2,089,883	$ 3,015,764	$ 4,647,917

On August 16, 2011, the Company signed a sublease for the remaining lease term for its former head office premises in Kanata, Ontario. As a result of entering in this sublease, future operating lease commitments as at June 30, 2011 were reduced by $438,000. The lease and sublease expire in 2017. The Company recognized a provision of $122,308 in respect of this lease, the balance of the provision at June 30, 2012 was $104,470 (note 15).

24. OPERATING SEGMENTS

The Company's principal business activity is the manufacture and sale of a comprehensive line of protective products and accessories for the defence and security market. The Company operates in Canada through its PSP and formerly APS Distributors divisions with operations based in Arnprior, Ontario and formerly Bedford, Nova Scotia respectively, and in the U.S. through its Sentry subsidiary located in Dover, Tennessee. Head office expenses, including the office of the CEO and public company costs, are reported as Corporate.

24. OPERATING SEGMENTS (CONTINUED)

These segments represent the Company's reportable segments, which are used to manage the business. The Company analyzes the performance of its operating segments based on revenue growth and operating profitability. Assets acquired pursuant to the Plan of Arrangement (note 7) are reported as Corporate assets.

	Canadian operations	U.S. operations	Corporate	Consolidated total
For the year ended June 30, 2012				
Revenue	$ 10,230,254	$ 6,694,860	$ –	$ 16,925,114
Elimination of inter-segment revenue	(47,108)	(144,343)	–	(191,451)
Total revenue	10,183,146	6,550,517	–	16,733,663
Gross margin	3,290,125	1,533,417	–	4,823,542
Expenses	2,403,991	977,995	1,520,524	4,902,510
Other items	630,698	1,024,015	(472,892)	1,181,821
Income tax recovery	–	(9,871)	(15,047)	(24,918)
Net loss (earnings) after taxes	$ 255,436	$ (458,722)	$ (1,032,585)	$ (1,235,871)

	Canadian operations	U.S. operations	Corporate	Consolidated total
For the year ended June 30, 2011				
Revenue	$ 13,505,435	$ 9,258,220	$ –	$ 22,763,655
Elimination of inter-segment revenue	(45,473)	(54,486)	–	(99,959)
Total revenue	13,459,962	9,203,734	–	22,663,696
Gross margin	3,096,821	1,891,575	–	4,988,396
Expenses	2,834,533	1,968,978	1,559,064	6,362,575
Other items	2,542,618	175,891	(26,808)	2,691,701
Income tax expense (recovery)	–	–		
Net loss after taxes	$ (2,280,330)	$ (253,294)	$ (1,532,256)	$ (4,065,880)

	Canadian operations	U.S. operations	Corporate	Consolidated total
As at June 30, 2012				
Assets				
Current assets	$ 4,546,031	$ 1,879,151	$ 211,151	$ 6,636,333
Property and equipment	281,491	241,672	–	523,163
Intangible assets	–	–	–	–
	$ 4,827,522	$ 2,120,823	$ 211,151	$ 7,159,496

24. OPERATING SEGMENTS (CONTINUED)

	Canadian operations	U.S. operations	Corporate	Consolidated total
As at June 30, 2011				
Assets				
Current assets	$ 2,209,131	$ 1,780,366	$ 3,009,430	$ 6,998,927
Property and equipment	395,316	237,883	–	633,199
Intangible assets	–	1,043,987	–	1,043,987
	$ 2,604,447	$ 3,062,236	$ 3,009,430	$ 8,676,113

	Canadian operations	U.S. operations	Corporate	Consolidated total
As at July 1, 2010				
Assets				
Current assets	$ 5,309,408	$ 1,598,793	$ –	$ 6,908,201
Property and equipment	542,554	345,216	–	887,770
Intangible assets	2,461,917	1,326,231	–	3,788,148
	$ 8,313,879	$ 3,270,240	$ –	$ 11,584,119

Revenues for the year ended June 30	**2012**	2011
Canada	**$ 10,181,192**	$ 13,363,213
United States	**5,999,495**	8,976,083
International	**552,976**	324,400
	$ 16,733,663	$ 22,663,696

Included in Fiscal 2012 were revenues of $4.8 million to the Canadian Federal Government (Fiscal 2011 - $5.0 million) which represents 28.6% (Fiscal 2011 - 22.1%) of total revenues. There were no other significant sales (over 10% of total revenues) to any one customer. In Fiscal 2011, one US customer totaled $2.9 million in revenues representing 13% of total revenues.

The Company experiences revenues cycles that can be dependent on the award of contracts by major police agencies and federal government departments. These cycles are, at times, unpredictable and may cause variations in revenue and profitability.

25. RELATED PARTIES

Key management personnel of the Company includes the Chief Executive Officer, the Chief Financial Officer, the Executive Chairman and all members of the Board of Directors.

Key management personnel compensation comprised:

	2012	2011
Short-term employee benefits	**$ 351,802**	$ 307,500
Board of Directors fees	**80,000**	130,912
Share-based payments (note 21)	**17,933**	61,768
	$ 449,735	$ 500,180

25. RELATED PARTIES (CONTINUED)

Trade and other payables as of June 30, 2012 include $40,000 (June 30, 2011 - $20,000) of directors' fees payable.

Directors and a former director of the Company control 27% of the voting shares of the Company.

Certain directors and a former director of the Company beneficially own or control, directly or indirectly, $750,000 aggregate principal amount of the debentures (note 17). On August 17, 2012, the Company elected to settle the interest payable of $40,000 dollars to certain debenture holders, who are directors, with the issuance of 800,000 common shares. Interest payable of $35,000 was settled in cash to a debenture holder who is a former director. Trade and other payables as at June 30, 2012 includes interest payable to the directors and a former director of $62,500 (June 30, 2011 - $62,500).

Consulting expenses for services performed by a shareholder and former director of the Company during the year ended June 30, 2012 were $115,000 (year ended June 30, 2011 - $60,000). These expenses are included in general and administrative expenses.

26. EXPLANATION OF TRANSITION TO IFRS

As stated in note 2(a), these are the Company's first consolidated financial statements prepared in accordance with IFRS.

The accounting policies set out in note 3 have been applied in preparing the consolidated financial statements for the year ended June 30, 2012, the comparative information for the year ended June 30, 2011, and the opening IFRS statement of financial position at July 1, 2010.

In preparing its opening IFRS statement of financial position, the Company has adjusted certain amounts reported previously in its financial statements prepared in accordance with previous Canadian GAAP. An explanation of how the transition from previous Canadian GAAP to IFRS has affected the Company's financial position, financial performance and cash flows is set out in the following tables and the notes that accompany the tables.

26. EXPLANATION OF TRANSITION TO IFRS (CONTINUED)

Statement of Financial Position Reconciliation

July 1, 2010	Note	Canadian GAAP	Effect of transition to IFRS	IFRS
ASSETS				
CURRENT ASSETS				
Cash and cash equivalents		$ –	$ –	$ –
Accounts receivable		4,154,435	40,000	4,194,435
Inventories		2,258,874	–	2,258,874
Prepaid expenses and deposit		204,677	–	204,677
Investment tax credits		40,000	(40,000)	–
Assets held for sale		250,215	–	250,215
		6,908,201	–	6,908,201
NON-CURRENT ASSETS				
Property and equipment	a, b	1,426,667	(538,897)	887,770
Intangible assets	b, c, e	3,805,750	(17,602)	3,788,148
		5,232,417	(556,499)	4,675,918
TOTAL ASSETS		$ 12,140,618	$ (556,499)	$ 11,584,119
LIABILITIES AND EQUITY				
CURRENT LIABILITIES				
Bank indebtedness		$ 2,410,390	$ –	$ 2,410,390
Accounts payable and accrued liabilities	f	3,841,698	(148,911)	3,692,787
Provisions	f	–	148,911	148,911
Deferred revenue		93,089	–	93,089
Income taxes payable		–	–	–
Current portion of long-term debt		214,320	–	214,320
		6,559,497	–	6,559,497
NON-CURRENT LIABILITIES				
Long-term debt		946,580	–	946,580
Convertible debentures		–	–	–
		946,580	–	946,580
TOTAL LIABILITIES		7,506,077	–	7,506,077
EQUITY				
Share capital		17,614,731	–	17,614,731
Warrants		–	–	–
Contributed surplus		1,194,176	–	1,194,176
Other paid-in capital		–	–	–
Deficit	g	(14,174,366)	(556,499)	(14,730,865)
Accumulated other comprehensive income		–	–	–
		4,634,541	(556,499)	4,078,042
TOTAL LIABILITIES AND EQUITY		$ 12,140,618	$ (556,499)	$ 11,584,119

26. EXPLANATION OF TRANSITION TO IFRS (CONTINUED)

Statement of Financial Position Reconciliation (continued)

June 30, 2011	Note	Canadian GAAP	Effect of transition to IFRS	IFRS
ASSETS				
CURRENT ASSETS				
Cash and cash equivalents		$ 2,897,735	$ –	$ 2,897,735
Accounts receivable		2,431,490	41,136	2,472,626
Inventories		1,349,006	–	1,349,006
Prepaid expenses and deposit		279,560	–	279,560
Investment tax credits		41,136	(41,136)	–
Assets held for sale		–	–	–
		6,998,927	–	6,998,927
NON-CURRENT ASSETS				
Property and equipment	a, b, e	1,095,910	(462,711)	633,199
Intangible assets	b, c, e	2,231,661	(1,187,674)	1,043,987
		3,327,571	(1,650,385)	1,677,186
TOTAL ASSETS		$ 10,326,498	$ (1,650,385)	$ 8,676,113
LIABILITIES AND EQUITY				
CURRENT LIABILITIES				
Bank indebtedness		$ 693,026	$ –	$ 693,026
Accounts payable and accrued liabilities	f	3,044,535	(721,398)	2,323,137
Provisions	f	–	721,398	721,398
Deferred revenue		73,134	–	73,134
Income taxes payable		105,038	–	105,038
Current portion of long-term debt		214,320	–	214,320
		4,130,053	–	4,130,053
NON-CURRENT LIABILITIES				
Long-term debt		839,420	–	839,420
Convertible debentures		728,653	13,843	742,496
		1,568,073	13,843	1,581,916
TOTAL LIABILITIES		5,698,126	13,843	5,711,969
EQUITY				
Share capital		20,080,222	–	20,080,222
Warrants		45,500	–	45,500
Contributed surplus		1,768,027	–	1,768,027
Other paid-in capital	d	290,980	(56,027)	234,953
Deficit	g	(17,556,357)	(1,240,388)	(18,796,745)
Accumulated other comprehensive income	e	–	(367,813)	(367,813)
		4,628,372	(1,664,228)	2,964,144
TOTAL LIABILITIES AND EQUITY		$ 10,326,498	$ (1,650,385)	$ 8,676,113

26. EXPLANATION OF TRANSITION TO IFRS (CONTINUED)

Reconciliation of statement of comprehensive income

Year ended June 30, 2011	Note	Canadian GAAP	Effect of transition to IFRS	IFRS
REVENUES		$ 22,663,696	$ –	$ 22,663,696
COST OF SALES	a	17,670,900	4,400	17,675,300
GROSS MARGIN		4,992,796	(4,400)	4,988,396
OPERATING EXPENSES				
Sales and marketing	b	2,027,148	319,071	2,346,219
Research and development	b	315,396	316,904	632,300
General and administration	b, d	3,367,017	17,039	3,384,056
Depreciation of property and equipment	a, b	154,089	(154,089)	–
Amortization of intangible assets	b, c	607,085	(607,085)	–
Total operating expenses		6,470,735	(108,160)	6,362,575
LOSS BEFORE OTHER ITEMS		(1,477,939)	103,760	(1,374,179)
OTHER ITEMS				
Foreign exchange loss (gain)	e	7,671	(242,035)	(234,364)
Finance income	d	(26,808)	–	(26,808)
Finance costs	d	379,367	(12,160)	367,207
Long-lived asset impairment	c	–	1,096,000	1,096,000
Loss on sale of assets	c	1,543,822	(54,156)	1,489,666
Total other items		1,904,052	787,649	2,691,701
LOSS BEFORE INCOME TAXES		(3,381,991)	(683,889)	(4,065,880)
INCOME TAXES				
Current income tax expense		–	–	–
Deferred income tax expense		–	–	–
Total income tax expense		–	–	–
NET LOSS FOR THE YEAR		(3,381,991)	(683,889)	(4,065,880)
OTHER COMPREHENSIVE INCOME (LOSS)				
Foreign currency translation differences – foreign operations	e	–	(367,813)	(367,813)
TOTAL COMPREHENSIVE LOSS FOR THE PERIOD		$ (3,381,991)	$ (1,051,702)	$ (4,433,693)
LOSS PER SHARE (note 21)				
Basis and diluted		(0.08)	(0.02)	(0.10)
WEIGHTED AVERAGE COMMON SHARES ISSUED AMOUNT STANDING				
Basic and diluted		40,976,048	–	40,976,048

Reconciliation of cash flows

There are no material differences between the statement of cash flows presented under IFRS and the statement of cash flows presented under previous Canadian GAAP.

26. EXPLANATION OF TRANSITION TO IFRS (CONTINUED)

Notes to the reconciliations

(a) Property and equipment
The Company elected under IFRS 1 *First-time adoption of IFRS*, to measure certain items of property and equipment at fair value and to deem the fair value as the new carrying cost as of July 1, 2010. Fair value was determined by a third party certified asset appraiser.

The impact arising from changes to property and equipment are summarized as follows :

	July 1, 2010	June 30, 2011
Consolidated statement of financial position		
Reduction in property and equipment to fair value	$ (323,894)	$ (323,894)
Impairment (c)	(53,500)	(53,500)
Depreciation adjustments	–	102,626
Reclassification of software to intangible assets	(161,503)	(161,503)
Effect of movements in exchange rates (e)	–	(26,440)
	$ (538,897)	$ (462,711)

(b) Depreciation and amortization expenses
Under IFRS, the Company has adopted classification of expenses by function in the Statement of Comprehensive Income. Depreciation and amortization expenses have been reclassified to the appropriate functional classification.

(c) Intangible assets
The Company assessed the recoverable amount of its CGUs at July 1, 2010 on transition to IFRS. The recoverable amount was based on a value in use calculation. Under Canadian GAAP, the recoverable amount was calculated on an undiscounted basis, using higher long-term growth assumptions than are permissible under IFRS, and no impairment was recognized.

Impairment testing was performed as at July 1, 2010 in accordance with IFRS, based on a value in use calculation. Value in use was based on cash flows expected to be generated from each of the Company's two CGUs . Cash flows were projected up to the date that the assets within the CGUs are expected to be consumed by the entity. For the Canada CGU the expected life was 7 years and the life of the USA CGU was 7 years. The key assumptions used in the value in use calculations of the CGUs are:

- Expected life of the CGUs' assets
- Projection of cash inflows and outflows
- Discount rates

The value in use was determined using pre-tax discount rates of 31.98% and 25.04% for Canada and the USA CGUs, respectively. Cash flows were projected based on past experience, actual operating results and the Company's operating plan extrapolated for a 5 year period. A zero growth rate was assumed beyond year 5.

Based on the value in use assessment, the carrying amount of the Canada CGU was determined to be $164,020 higher than its recoverable amount and an impairment loss was recognized. The impairment loss was allocated to property and equipment ($53,500) and pro rata to the intangible assets ($110,520) comprising the Canada CGU.

As described in note 12, in accordance with IFRS, the Company recognized a further impairment loss with respect to the Canada CGU at June 30, 2011 in the amount of $1,096,000.

26. EXPLANATION OF TRANSITION TO IFRS (CONTINUED)

Notes to the reconciliations (continued)

(c) Intangible assets (continued)
The impact arising from changes to intangible assets is summarized as follows:

		July 1, 2010		June 30, 2011
Consolidated statement of financial position				
Reclassification of software from property and equipment to intangibles	$	161,503	$	161,503
Impairment loss		(110,520)		(1,206,520)
Change in amortization due to adjustments		–		(28,890)
Change in loss on sale of assets due to impairment at the date of transition (note 12)		–		54,156
Effect of movements in exchange rates (e)		(68,585)		(167,923)
	$	(17,602)	$	(1,187,674)

(d) Convertible debentures
In accordance with IFRS the Company has restated the allocation of the proceeds assigned to the debt and equity components on the issuance of convertible debentures on August 17, 2010. Under Canadian GAAP, the proceeds were allocated based on the relative fair values. Under IFRS, the proceeds assigned to the debt and conversion option are allocated based on the fair value of the Debentures with the residual being allocated to the Conversion Option.

Under IFRS, directly attributable transaction costs are allocated to the liability and equity components in proportion to their initial carrying amounts. Under Canadian GAAP the Company had elected a policy to expense Debenture transaction costs as incurred.

The impact arising from these changes is summarized below:

		Year ended June 30, 2011
Consolidated statement of comprehensive income		
Capitalization of debenture issue costs	$	(30,024)
Decrease in accretion of convertible debentures		(12,160)
	$	(42,184)

		June 30, 2011
Consolidated statement of financial position		
Decrease in other paid-in capital conversion option	$	56,027
Adjustment to allocation of proceeds	$	(56,027)
Transaction costs capitalized		30,024
Decrease in accretion expense		12,160
	$	(13,843)

26. EXPLANATION OF TRANSITION TO IFRS (CONTINUED)

Notes to the reconciliations (continued)

(e) Foreign currency translation – foreign operations
Under IFRS the Company has determined that the functional currency of the U.S. operating subsidiary, Sentry Armor Systems Inc., is the U.S. dollar. Sales prices, labour and material costs of the U.S. operating subsidiary are determined in U.S. dollars which are primary indicators of the functional currency in accordance with IFRS. Under Canadian GAAP, the U.S. operating subsidiary was accounted for as an integrated foreign operation. The U.S. operating subsidiary is generating positive cash flows in U.S. dollars and is no longer dependent on funding from the Canadian parent company.

The Company elected, under IFRS 1 First-time adoption of IFRS, to deem all foreign currency translation differences that arose prior to the date of transition to be nil at the date of transition. As a result, foreign currency translation differences in the amount of $68,585 were reclassified to Deficit on July 1, 2010.

Cumulative foreign currency translation differences with respect to the U.S. operating subsidiary were $(367,813) at June 30, 2011, resulting in a reduction to foreign exchange losses recorded under Canadian GAAP. Under IFRS foreign currency translation differences are recorded in other comprehensive income.

(f) Provisions
Provisions for warranties, restructuring costs and onerous contracts were reclassified to Provisions under IFRS. They were previously classified as trade and other payables under Canadian GAAP.

(g) Deficit
The above adjustments to Deficit for differences between IFRS and Canadian GAAP can be summarized as follows:

	July 1, 2010	June 30, 2011
Property and equipment, fair value adjustment (a)	$ 323,894	$ 323,894
Impairment (a) (c)	164,020	1,260,020
Depreciation and amortization (a) (c)	–	(73,736)
Loss on sale of assets (c)	–	(54,156)
Debenture transaction costs	–	(30,024)
Debenture accretion (d)	–	(12,160)
Foreign exchange losses (e)	–	(367,813)
Effect of movements in exchange rates (a) (c) (e)	68,585	194,363
	$ 556,499	$ 1,240,388