



2008 Management Discussion & Analysis

TSX.V: AMA





Management Discussion & Analysis

This management discussion and analysis (“MD&A”) should be read in conjunction with the audited annual consolidated financial statements of AeroMechanical Services Ltd. (“AMA” or the “Company”) as at and for the years ended December 31, 2008 and 2007. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP). Additional information with respect to AMA can be found on SEDAR at www.sedar.com.

This MD&A is dated April 8, 2009.

Non-GAAP Financial Measures

The Company reports its financial results in accordance with generally accepted accounting principles (GAAP). It also occasionally uses certain non-GAAP financial measures, such as working capital and cash revenue. AMA defines working capital as current assets less current liabilities. AMA defines cash revenue as financial statement revenue plus arrangement consideration received during the period that has not yet been recognized as revenue in the period. These non-GAAP financial measures are always clearly indicated. The Company believes that these non-GAAP financial measures provide investors and analysts with useful information so they can better understand the financial results and perform a better analysis of the Company’s growth and profitability potential. Since non-GAAP financial measures do not have a standardized definition, they may differ from the non-GAAP financial measures used by other companies. The Company strongly encourages investors to review its financial statements and other publicly filed reports in their entirety and not rely on a single non-GAAP measure.

Forward-Looking Statements

This discussion includes certain statements that may be deemed “forward-looking statements”. All statements in this discussion other than statements of historical fact, that address future acquisitions and events or developments that the Company expects are forward-looking statements. Although the Company believes the expectations expressed in such forward-looking statements are based on reasonable assumptions, such statements are not guarantees of future performance and actual results or developments may differ materially from those in the forward-looking statements. Factors that could cause actual results to differ materially from those in the forward-looking statements include market prices, foreign exchange rates, continued availability of capital and financing and general economic, market or business conditions in the aviation industry or any effect those may have on our customer base. Investors are cautioned that any such statements are not guarantees of future performance and that actual results or developments may differ materially from those projected in the forward-looking statements.



MI solutions provide airlines with the data to save fuel costs and to improve operational efficiency a valuable tool in managing aircraft operations. AMA customers are showing significant return on investment over the costs of afirs and UpTime.

In 2008 the Company witnessed extreme decline across a variety of financial markets, resulting in substantial volatility and uncertainty on a global basis together with recessionary conditions in many economies. The Company was not immune from the impact of these economic conditions. In particular, the aviation industry has been impacted by a slow down in the demand for air travel, both business and vacation. The offset to the industry was a major reduction in fuel costs, which has reduced operating costs and removed some of the pressure from the industry. The Company remains optimistic about its business outlook for 2009 as the aviation industry continues to adopt technology that will help it monitor flight operations and reduce costs. The high fuel prices of early 2008 and the economic turmoil in the later part of the year a further incentive to the industry to adopt leading edge technology such as afirs, UpTime, FIRST and Fuel MI. The Company has seen an upsurge in interest from legacy airlines for its technology as they strive to improve operational efficiency and reduce costs.

The weakening of the Canadian dollar relative to the US dollar since early 2008 has positively impacted the Company's revenues and income. As a result of these movements, the Company's Canadian dollar revenues, which are substantially all denominated in US dollars, were higher than would have been had the foreign exchange not changed. While a significant amount of the Company's costs are denominated in Canadian dollars, a significant portion of marketing costs are non-Canadian denominated, and therefore create some natural hedge against the fluctuations of the Canadian dollar.

System Approvals

AMA has received STC approvals for afirs on the following aircraft:

- ✓ Airbus A319, A320, A321
- ✓ Boeing B737-200, 300, 400, 500
- ✓ Boeing B737-500, 600, 700, 800
- ✓ Boeing B757-200
- ✓ Boeing B767-200, 300
- ✓ Bombardier DHC-8-100, 200, 300
- ✓ Bombardier CRJ100, 200, 400
- ✓ Fokker F100
- ✓ Hawker Beech 850XP, 900XP, 950XP
- ✓ DC-10
- ✓ Viking Air DHC-7 (LSTC)

AMA has a pending STC approval for afirs, expected in 2009, on the following aircraft:

- Airbus A330
- Hawker Beech 750

AMA has STC applications in process for afirs, expected to be submitted in 2009, on the following aircraft:

- Boeing B747-100, 200
- Boeing B747-300, 400
- Boeing B747-8
- MD-81/82/83/87/88

Results of Operations – Year Ended December 31, 2008

Revenues

The following table shows, afirs and UpTime revenue as well as other revenue which consists of consulting services and interest revenue. The Company's long-term investment in marketing, research and development and building relationships has resulted in a strong pipeline of prospective customers around the world. The ongoing revenue streams from our existing customer base will continue to expand throughout future years.

In 2008 the Company commenced using a new service agreement, which passes title of equipment to the purchaser. This results in two types of revenue streams: (1) leases and (2) sales depending on the type of service agreement. In accordance with the Company's revenue recognition policy for lease type agreements, the arrangement consideration are deferred as unearned revenue and revenue is recognized over the initial term of the contracts. In the early stages of the Company's growth this will result in less recognized revenue than cash received. For sales type agreements, afirs fees are deferred as unearned revenue and corresponding expenses are recorded as work in progress. When the system is fully functional and the customer has accepted, the system, the deferred amount is fully recognized in revenue along with the work in progress as cost of sales. Under both forms of agreement, the UpTime usage fees are recognized as the service is provided based on actual customer usage that month. The effect in the year is that AMA received \$5,252,618 (2007 - \$2,638,111) in cash revenue which is calculated as \$3,176,995 (2007 - \$1,989,404) reported as financial statement revenue plus \$2,186,541 (2007 - \$693,463) being cash received for arrangement consideration less the portion of cash received during the year that is recognized in financial statement revenue of \$110,918 (2007 - \$44,756).

In 2008, revenue for the Company continued to reflect the benefits of the research and development efforts that have been invested over the past 8 years. AMA has products tested, certified, and installed on aircraft to generate revenue, as well as inventory to continue the roll out to our new and existing customers.



Total revenues were \$3,176,996 and \$1,989,404 for fiscal 2008 and 2007, respectively.

	2008			2007			2006		
	afirs UpTime	Other	Total	afirs UpTime	Other	Total	afirs UpTime	Other	Total
Q1	\$ 349,893	\$ 48,175	\$ 398,068	\$ 171,778	\$ 666,140	\$ 837,918	\$ 93,901	\$ 124,427	\$ 218,328
Q2	475,675	120,588	596,263	191,278	281,844	473,122	140,304	158,548	298,852
Q3	502,966	287,027	789,993	256,710	55,974	312,684	134,397	124,416	258,813
Q4	1,027,491	365,180	1,392,671	282,629	83,051	365,680	239,262	79,211	318,473
Total	\$ 2,356,025	\$ 820,970	3,176,995	\$ 902,395	\$ 1,087,009	\$ 1,989,404	\$ 607,864	\$ 486,602	\$1,094,466

Other revenue is derived from the sale of underfloor stowage units, the sale of consulting services, licensing fees, and interest. During 2008, underfloor stowage units revenue was \$254,946 (2007 – \$193,159) where the increase from the previous year was due to increased interest in the product. Consulting revenue increased to \$484,408 (2007 - \$nil) due to the increased emphasis on providing consulting services to airlines. Licensing fees were \$Nil (2007 – \$797,989) and interest revenue was \$81,616 (2007 - \$95,861).

Gross Margin and Cost of Sales

Gross margins before general and administrative expenses was \$1,017,149 for 2008 (2007 - \$638,009). This increase was the result of the continued increase in afirs, UpTime revenue, increased consulting services revenue, and the move to sales type agreements from lease type agreements.

Cost of sales for afirs, UpTime was \$1,978,679 on revenues of \$2,356,025 representing a gross margin of \$377,346 in 2008. This compares to 2007's \$1,206,506 cost of sales on revenues of \$902,395 or a gross loss of \$304,111 on afirs, UpTime revenue. The increase in the 2008 gross margin over 2007 on afirs UpTime is primarily due to an increased number of installed afirs units under the sales type agreement versus the lease type agreements. The sales type agreements revenue recognition policy does not require the deferral of revenue, which improves the margin.

Cost of sales on other revenue was \$181,167 on revenues of \$820,970 for a gross margin of \$639,803. In 2007 other revenue cost of sales was \$144,889 on revenues of \$1,087,009 or a gross margin of \$942,120. While this appears to be a reduction in the gross margin for other revenue in 2007 there was a one-time license fee of \$727,989 with no corresponding cost of sales. The increase in other revenue in 2008 is the result of an increase in consulting services provided to customers.

2008			
	Revenue	Cost of Sales	Gross Margin
afirs UpTime	\$ 2,356,025	\$ 1,978,679	\$ 377,346
Other	820,970	181,167	639,803
Total	\$ 3,176,995	\$ 2,159,846	\$ 1,017,149

2007			
	Revenue	Cost of Sales	Gross Margin
afirs UpTime	\$ 902,395	\$ 1,206,506	\$ (304,111)
Other	1,087,009	144,889	942,120
Total	\$ 1,989,404	\$ 1,351,395	\$ 638,009

2006			
	Revenue	Cost of Sales	Gross Margin
afirs UpTime	\$ 607,864	\$ 535,046	\$ 72,818
Other	486,602	326,101	160,501
Total	\$ 1,094,466	\$ 861,147	\$ 233,319

Net Loss, General and Administrative and Marketing Expenses

In 2008 the key driver of our performance continued to be the timely closing of contracts with potential customers, the airline installation schedules of afirs on contracted aircraft due to their maintenance schedules, and the timely receipt of STC approvals from multiple regulators. The key challenge continues to be the speed with which potential customers execute contracts and the difficulty in predicting the accuracy of aircraft maintenance schedules that are supplied by customers. As a result, the net loss for the year ended December 31, 2008 was \$8,523,228 compared with \$6,868,314 loss for 2007.

Our expense categories are not broken into departments for this year as the entire company was and is focused on getting our main products, afirs, UpTime, FIRST and Fuel MI, out to our customers. For the year ended December 31, 2008, expenses were \$9,504,377 compared with \$7,506,323 for 2007.



Major Expense Categories	2008	2007	Variance	Explanation
Salaries and benefits, third party consulting, and share compensation	5,865,426	4,624,138	1,241,688	Staff levels increased marginally in 2008 because of the addition of key individuals to meet specific needs and a settlement of an action brought by the former President, resulting in increased salaries of \$610,331 over 2007, and related statutory payments and benefits increased \$36,835. Third party consultants were engaged in 2008 to deal with sales and customer support of international customers resulting in an increase in consulting costs of \$476,634. Share based compensation increased by \$179,607 over 2007. With the goal of retaining leading edge staff, the need for training was addressed in 2007 with less of a requirement in the current year, thus reducing that cost by \$61,719 during 2008.
Research and development costs	745,308	253,236	492,072	The increase in research and development is the result of increased direct research and development activities to meet the ongoing needs of the aviation industry. This included \$255,925 for a new operating system for afirs which was required to conform to emerging aviation rules. As well, the introduction of additional service offerings such as FIRST and Fuel MI had created an increase in the requirement for research and development.
Office, computer services, insurance, depreciation stock exchange fees and bad debts	787,360	572,455	214,905	Office costs increased \$214,905 primarily due to an increase in equipment amortization of \$85,655, which was the result of equipment added in late 2007 and software added early in 2008. Bad debt expenses during 2008 were \$175,333 versus none in 2007 due to the bankruptcy of three customers during the year. Foreign exchange loss decreased \$20,793 from 2007 as the result of the weakening of the Canadian dollar. Other office related expenses tracked either at the same level or lower than 2007.
Interest and bank charges	41,963	24,094	17,869	Bank charges increased in 2008 due to an increase of \$8,386 in service charges related to increased banking activity and increased interest expense of \$9,483 related to capital leases.
Rent	240,589	194,448	46,141	Rent expense increased in 2008 as the result of the operating expense adjustment in the year being 17,194 lower than in 2007.

Marketing	1,009,963	1,079,353	(69,390)	The decrease in marketing was related to the decreased requirement for general marketing material as significant investment was made in 2007. General marketing expenses such as trade show costs, advertising, and promotional material decreased \$108,827. The travel and entertainment portion of marketing increased \$39,437 over 2007. The Company expects that expenses in marketing will continue at these levels over the next year, as AMA continues to target global markets for its solutions. Marketing costs do not include salaries.
Investor relations	158,330	193,981	(35,651)	Investor relations costs decreased \$35,651 due to the decreased emphasis on the use of investor show attendance and video presentations and the termination of the relationship with Agoracom. The Company maintained a presence in the capital markets and by presenting the Company to institutional investors, retail brokers, and retail investors via one on one meetings. The Company believes that one on one meetings to be the most effective use of funds.
Professional fees	691,438	564,618	126,820	Accounting and audit fees were \$78,270 in 2008 compared to \$119,665 in 2007, a decrease of \$41,395. Legal fees were higher in 2008 by \$119,130 because of legal work related to the actions by a Toronto based company. These actions are related to an allegation of patent infringement, request for a review of the Company's patent, and an allegation of interference with an employment contract. Consulting fees were \$170,904 in 2008 compared to \$121,848 in 2007, an increase of \$49,056. This increase is primarily due to the use of a consulting group to assist with the introduction of FIRST and Fuel MI to the aviation industry.
Total	9,540,377	7,506,323	2,034,054	



2008				
	Q4	Q3	Q2	Q1
Revenue	\$1,392,671	\$789,994	\$596,263	\$398,067
Loss	1,912,469	1,814,010	2,709,237	2,087,512
Loss/Share	0.02	0.02	0.03	0.03

2007				
	Q4	Q3	Q2	Q1
Revenue	365,680	312,684	473,122	837,918
Loss	2,387,162	1,693,258	1,978,629	809,265
Loss/Share	0.04	0.03	0.03	0.01

2006				
	Q4	Q3	Q2	Q1
Revenue	318,473	258,813	298,852	218,328
Loss	1,231,842	1,176,113	965,349	1,166,402
Loss/Share	0.02	0.03	0.03	0.04

Comments on Quarterly Results

Quarterly revenue streams continue to shift to monthly repeating afirs, UpTime revenues from specific sales of goods and consulting revenue streams over 2008. The monthly and annual UpTime fees will increase over time as more aircraft are installed with afirs and customers contract for the FIRST and Fuel MI products that were introduced in 2008.

Research and Development

Research and development costs are being expensed as incurred. The majority of R&D costs are salaries and consulting expenses related to the design, testing, and manufacture of afirs, the design and testing of UpTime, and the design and testing of FIRST and Fuel MI. There are also expenses being incurred in the preliminary phases of AeroQ development.

Foreign Exchange

All international sales of the Company's products and services are denominated in U.S. dollars. Accordingly, the Company is susceptible to foreign exchange fluctuations. In 2008, over 97% of the Company's gross sales were made in U.S. dollars compared to nearly 96% in 2007. The Company expects this to increase with the aviation industry conducting a majority of its transactions in U.S. dollars, the opportunity for sales in Canadian dollars is limited.

Transactions with Related Parties

During the year the Company's transactions with a company owned by a director to supply consulting services totaled \$73,694. All of the transactions were at amounts that were agreed by the parties and approximated fair market value. The remaining transactions with related parties

were normal business transactions related to their positions with the Company. These transactions were expense reimbursements for business travel and other company expenses paid by the related party and were measured at exchange amounts that the related party paid to a third party and were substantiated with a third party receipt.

Liquidity and Capital Resources

During 2008, the Company issued Common Shares through a private placement, the exercise of warrants, and the exercise of stock options. This has improved the financial position of the Company, especially when coupled with the increased cash based revenue.

Pursuant to a private placement on March 13th, 2008 the Company issued 4,500,000 units at \$1.00 for gross proceeds of \$4,500,000. Each unit consisted of one common share and one-half of one purchase warrant where one full warrant is exercisable until March 13, 2010 at \$1.30. The net cash proceeds after issuance costs of these private placements totaled \$4,010,491. This private placement also included the issuing of an additional 472,500 relating to agent options. Of these warrants 315,000 are agent option units which consist of one common share and one-half warrant which are exercisable at \$1.00 until September 13, 2009. The remaining 157,500 warrants that are associated with the agent options entitle the holder to acquire one common share at \$1.30 until March 13, 2010. During 2008, AMA issued a total of 4,751,597 common shares on the exercise of various series of warrants at a weighted average price of \$0.39 per share. These exercised warrants provided net cash proceeds of \$1,853,411. A further 528,000 common shares were issued to directors, officers, employees, and consultants on the exercise of stock options. The weighted average issue price of these common shares was \$0.32, resulting in cash proceeds of \$169,230.

The successful equity offerings combined with increased cash based revenue throughout the year created sufficient capital to continue to operate and to provide capital for inventory to be deployed in order to expand our customer base.

Working capital at December 31, 2008 was \$1,335,314 compared to \$3,469,360 in 2007. The decrease in working capital is primarily attributed to the operating loss for the year of \$8,523,228 less the net funds generated from the raising of capital equity of \$6,522,641; the remaining decrease of \$133,459 is the result of various changes in working capital components as the result of business operations during the year. The Company currently has an available operating line of \$250,000 which had not been drawn at December 31, 2008. The operating line bears an interest rate of Canadian chartered bank prime plus 1.0% and is secured by assignment of cash collateral and a general security agreement.

The achievement of positive earnings before interest and amortization is necessary before the Company can improve liquidity. The Company has continued to expand its cash flow potential through its continued marketing drive to clients around the world. Management believes that the company's installation momentum, conversion of installations to recurring revenue, new revenue streams, and ongoing sales will be sufficient to meet standard liquidity requirements. If general



economic conditions or the financial condition of a major customer deteriorates then the Company may have to raise the necessary financing in the capital markets.

As at April 8, 2009, AMA's issued and outstanding shares was 82,500,219.

Contractual Obligations

The Company has entered into various leases for its operating premises and equipment. Future minimum annual payments under these operating leases are as follows:

Year	Premises	Equipment	Total
2009	\$ 392,335	\$ 34,263	\$ 426,598
2010	419,619	22,107	441,726
2011	432,652	16,630	449,282
2012	445,685		445,685
2013	458,718		458,718
2014	76,815		76,815
	\$ 2,225,824	\$ 73,000	\$ 2,298,824

In addition, the Company has repayment obligations related to two Government of Canada loan programs. Under the Industrial Research Assistance Program (IRAP), the outstanding balance is \$307,101 (2007 - \$330,966), which is to be repaid, as a percentage of gross revenues, over a five to ten year period commencing in October 2005. Under the Technology Partnerships Canada (TPC) program, the Company has an outstanding balance of \$85,410 (2007 - \$104,523) to be repaid over a ten-year period commencing in April 2006.

During 2008, AMA leased computer equipment totaling \$15,612 (2006 - \$15,612), which was accounted for as capital leases that expire in various years to 2011. The minimum lease payments are as follows:

Year	Total
2009	\$ 34,263
2010	22,107
2011	16,630
	\$ 73,000

The imputed interest is \$17,575 (2007 - \$7,847), leaving a total obligation of \$55,425 (2007 - \$41,832).

Results of Operations – Three Months Ended December 31, 2008

Revenues

The introduction of a new service agreement that passes title of the equipment to the purchasers has resulted in two types of revenue streams, leases and sales. The Company has adopted, for lease type agreements, a revenue recognition policy whereby the arrangement consideration is deferred as unearned revenue and revenue is recognized over the initial term of the contract. This will result in less revenue recognized than cash received. For sales type agreements, afirs fees are deferred as unearned revenue and corresponding expenses are recorded as work in progress. Upon acceptance by the customer the deferred revenue is fully recognized in revenue along with work in progress as cost of sales. The effect in the quarter of these two revenue streams is that \$1,934,462 (2007 - \$640,941) was received in cash revenue which is calculated as \$1,392,672 (2007 - \$365,680) reported as financial statement revenue plus \$624,805 (2007 - \$300,176) being cash received for arrangement consideration less the portion of cash recognized during the quarter that is included in financial statement revenue of \$83,015 (2007 - \$24,915).

Revenue increased \$1,026,992 in the fourth quarter compared to the fourth quarter of last year. afirs UpTime revenues increased by \$775,443 over the fourth quarter of 2007. Product sales revenue increased \$145,995 and services revenue and interest increased \$105,554 over the same quarter of the previous year. The increase in afirs UpTime revenue is the result of the increased number of installed and revenue generating afirs boxes as well as the installation of afirs from sales contracts where the entire revenue is recognized upon acceptance by the customer. These revenues are expected to grow at a significantly higher rate because of the sales type agreements and the additional revenue generating services that are being offered to customers. As well, the Company has the infrastructure, sales people, and support organization in place to support revenue growth.

Gross Margin and Cost of Sales

Cost of sales in the fourth quarter of 2008 is \$847,179 compared to \$610,190 in 2007, an increase of \$236,989. The gross margin for the fourth quarter of 2008 was 38.1% versus 15.7% for the same period of 2007. This is a result of an increase in the volume of installations and product mix variations. Included in cost of sales are costs of non-routable parts and travel expenses for our engineers on initial installations of aircraft. Also, the introduction of the sales type agreement will increase the gross margin as all cost of sales are recognized when the revenue is recognized instead of the revenue being recognized over the first term of the agreement. As part of our service agreement, we assist new customers with engineering support on their initial installations. Non-routable parts are parts involved in the installation process that are non-reusable (such as cables) and do not form part of the afirs unit. They would remain on the aircraft if the afirs unit was extracted. The travel and support costs form part of the non-routable parts and are expenses in the period. As we move forward with more clients the result will be less initial installations and increased recurring revenue streams. Accordingly, we will see cost of sales decline and margins increase.



Net Loss, General and Administrative and Marketing Expenses

The net loss for the quarter ended December 31, 2008 was \$1,912,469 (2007-\$2,387,162). Included in general and administrative expenses are decreased marketing costs. Marketing expenses decreased by \$53,398 to \$224,776 over the fourth quarter of 2008. The Company's focus is on generating new customers and will continue to engage resources in marketing; however, a marketing plan is in place that holds costs in line with the previous year but aims to improve effectiveness for the cost.

Office expenses decreased by \$149,474 in the fourth quarter over the same period of 2007, primarily due to a \$114,146 decrease in professional fees mainly related to legal fees, a \$19,403 decrease in equipment costs, and an overall \$15,655 decrease in general office expenses.

Salaries, the main cost of doing business, increased to \$1,504,493 for the quarter versus \$1,209,974 for the fourth quarter of 2007, a \$294,519 increase. This increase is the result of the settlement of an action brought by the former President and minor staffing changes during 2008. The Company continues to hire qualified personnel as our customer base grows to ensure the Company is prepared for the growth as the result of our strategic business alliances that continue to open opportunities.

Stock based compensation was \$34,757 in the fourth quarter of 2008 compared to \$Nil in the same period of 2007. The increase was due to an option grant to non executive employees in the quarter to recognize their service to the Company.

Research and Development

Research and development costs are being expensed as incurred. The fourth quarter development costs for 2008 were \$258,158 as compared to \$102,408 in the same quarter of 2007. The majority of R&D costs are salaries, consulting expenses, testing and certification, and other expenses related to ongoing design, testing and certification of afirs UpTime, FIRST, and Fuel MI. The introduction of additional service offerings such as FIRST and Fuel MI created an increase in the requirement for research and development. There is also a minor amount of expense associated with the preliminary phases of AeroQ. Development continues on a next generation afirs product in collaboration with Sierra Nevada Corporation as noted in Subsequent Events.

Critical Accounting Policies and Estimates

The Company prepares its consolidated financial statements in accordance with accounting principles generally accepted in Canada. The preparation of these financial statements requires Management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. These estimates are based on management's historical experiences and various other assumptions that are believed by management to be reasonable under the circumstances. Such assumptions are evaluated on an ongoing basis and form the basis

for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results could differ from these estimates.

The following are the Company's critical accounting policies, significant estimates, and assumptions used in preparing our financial statements:

1. The Company maintains an allowance for doubtful accounts for estimated losses that may occur if customers are unable to pay trade balances owing to the Company. This allowance is determined based on a review of specific customers, historical experience and economic circumstances.
2. Inventories are carried at the lower of cost and net realizable value. Provisions for excess or obsolete inventory are recorded based on Management's assessment of the estimated market value of components and rental assets.
3. The Company evaluates its future tax assets and records a valuation allowance where the recovery of future taxes does not meet the required level of certainty. At December 31, 2008, valuation allowances are provided for the full amount of future tax assets.
4. The Company accrues reserves for estimated afirs warranty expenses for the repair or replacement of defective products leased or sold. The warranty reserve is based on an assessment of the historical experience of the Company. If the Company suffers a decrease in the quality of its products, an increase in warranty reserve may be required.
5. The Company recognizes revenue from lease type agreements as agreement consideration which is recorded as unearned revenue and recognized into revenue over the term of the lease agreement. Sales type agreement consideration is deferred as unearned revenue and corresponding expenses are recorded as work in progress until the system is fully functional and customer acceptance has been obtained when the full deferred amount is recognized in revenue along with the work in progress as cost of sales. For both types of agreement the revenue from UpTime usage fees is recognized at the end of each month and is based on actual usage during that month.

Under floor storage box revenue is recognized when the unit is shipped and consulting services revenue is recognized when the services are completed.



Financial Instruments

The Company is exposed to fluctuations in the exchange rates between the Canadian dollar and other currencies with respect to assets, sales and purchases. The Company monitors fluctuations and may take action, if deemed necessary to mitigate its risk.

The Company is exposed to changes in interest rates as a result of the operating loan, bearing interest based on the Company's lenders' prime rate.

There is a credit risk associated with accounts receivable where the customer fails to pay invoices. The Company extends credit generally to credit worthy or well established customers. In the case of network access fees or product sales the invoiced amount is generally payable before the afirs or other product is shipped to the customer. The Company assesses the financial risk of a customer and based on that analysis will require that a deposit payment be made before a service is provided. As well, for monthly recurring revenue the Company has the ability to disable afirs UpTime and/or supply data in cases where the customer has not fulfilled its financial obligations.

Subsequent Events

On March 3rd, 2009, the Company signed a License and Manufacturing Agreement with Sierra Nevada Corporation ("SNC") of Reno, Nevada. Under the agreement SNC will manufacture the Company's afirs product and market the afirs UpTime technology and products to the global military market. Under the terms of the agreement SNC will pay the Company a license fee and a royalty for all future sales to the military, contribute funds, personnel, and expertise to the design of next generation afirs technologies, and share other revenue opportunities from the sale of afirs UpTime technology by SNC to military organizations.

Contingencies

The Company is defending itself in two actions instigated by the same plaintiff and the Company believes that, as the amount of any liability is undetermined at this time, no liability has been accrued for claims on these actions:

In September 2007, the Company, among others, was served with a counterclaim alleging that the Company induced a breach of contract and interfered with economic relationships. The Company maintains that the claims are without merit and no liability in respect to this action has been included in these consolidated financial statements, as management intends to vigorously defend the matter and believes the outcome will be in its favour. On November 7, 2007, the Company filed a statement of defense and a counterclaim against three parties for interference with legally binding contracts, disrupted business, attacks on the Company's reputation, and costs. Any amounts awarded as a result of these actions will be reflected in the year the amounts become reasonably estimable.

In September 2007, the Company was served with a claim of patent infringement seeking unspecified damages. The Company maintains that the claims are without merit and no liability in respect to this action has been included in these consolidated financial statements, as management intends to vigorously defend the matter and believes the outcome will be in its favour. On December 24, 2007 the Company filed a Motion to Dismiss, which was heard on April 8, 2008 and dismissed with the caveat that the plaintiff could file an amended complaint by April 30, 2008 in which both inventors are named as parties. On April 28, 2008 the plaintiff filed an amended complaint and the Company filed a motion to dismiss on May 12, 2008. On June 20, 2008 the court issued an order requiring the plaintiffs to submit supplemental information and rescheduled the hearing on the motion. On August 20, 2008 the court issued an order granting the motion to dismiss with the caveat that the plaintiff could file an amended complaint, which they did, and the Company filed a third motion to dismiss on September 17, 2008. On October 30, 2008 the court issued an order affording the plaintiffs leave to conduct jurisdictional discovery by February 7, 2009 and until February 27, 2009 to file supplemental opposition to the Company's motion to dismiss. The discovery was completed and the plaintiff submitted a supplemental response on February 27, 2009. On March 17, 2009 the plaintiff filed a voluntary dismissal without prejudice. Therefore, no amount will be awarded. The Company filed a motion for sanctions against the plaintiff and their attorneys. The motion requests that the court award sanctions in the form commensurate with the Company's legal fees. The motion is to be heard on May 15, 2009.

On October, 28, 2008, the Company was served with a Statement of claim by the former President alleging that on or about August 5, 2008, his employment was wrongfully terminated without cause and without notice. The action was settled on March 27, 2009 and the court action was discontinued. The amount of the settlement was included in the consolidated statements for 2008.

Adoption of New Accounting Standards

The Canadian Accounting Standards Board (AcSB) has confirmed a strategic plan to converge Canadian GAAP with International Financial Reporting Standards (IFRS) for fiscal years beginning on or after January 1, 2011. IFRS uses a conceptual framework similar to Canadian GAAP, but there are significant differences on recognition, measurement and disclosures. IFRS is likely to result in a change in certain of the Company's accounting policies and may require restatements for comparative purposes on amounts reported by the Company for the year ended December 31, 2010. In order to mitigate the impact of the adoption of IFRS, the AcSB will continue to issue accounting standards that are converged with IFRS. The Company is in the education and assessment phases of the conversion. This includes, among other things, educating staff on and identifying the differences between existing Canadian GAAP and IFRS as it relates to the Company and the analysis of the potential for exemptions under IFRS 1.

As of January 1, 2008, the Company adopted CICA Handbook Section 1535, "Capital Disclosures", Section 3862, "Financial Instruments – Disclosures", and Section 3863, "Financial Instruments –



Presentation”. The new standards have been adopted on a prospective basis with no restatement of prior periods. Section 1535 requires additional disclosures regarding the Company’s capital management (note 14), while section 3862 addresses financial instruments and the nature, extent and management of risks arising from financial instruments to which the Company may be exposed (note 13). The adoption of Section 3863 had no effect on the presentation of the Company’s financial instruments.

The CICA issued new accounting standard Section 3064 “Goodwill and Intangible Assets” which is applicable for fiscal years beginning on or after October 1, 2008. The Company does not expect any significant effect on its financial statements due to the application of this standard.

As of January 1, 2008, the company has adopted newly issued accounting standards for inventories, relating to the method of accounting for inventory and related disclosures. The adoption had no effect on the amounts recorded or presentation contained within the financial statements.