ANNUAL REPORT

2012

FLYHT AEROSPACE SOLUTIONS LTD.
FINANCIAL STATEMENTS

INDEPENDENT AUDITORS' REPORT

To the Shareholders of FLYHT Aerospace Solutions Ltd.

We have audited the accompanying consolidated financial statements of FLYHT Aerospace Solutions Ltd., which comprise the consolidated statements of financial position as at December 31, 2012 and December 31, 2011, the consolidated statements of comprehensive income (loss), changes in equity (deficiency) and cash flows for the years then ended, 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 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 FLYHT Aerospace Solutions Ltd. as at December 31, 2012 and December 31, 2011, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

Emphasis of Matter

Without modifying our opinion, we draw attention to Note 2 (e) in the consolidated financial statements, which indicates that FLYHT Aerospace Solutions Ltd. has a net loss and negative cash flows from operating activities for the year ended December 31, 2012 and, as at that date, its current liabilities exceeded its current assets. These conditions, along with other matters as set forth in Note 2 (e) in the consolidated financial statements, indicate the existence of a material uncertainty that may cast significant doubt about FLYHT Aerospace Solutions Ltd's ability to continue as a going concern.

Chartered Accountants
April 9, 2013
Calgary, Canada

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

	December 31, 2012 $	December 31, 2011 $
Assets		
Current assets		
Cash and cash equivalents (note 6)	676,246	1,928,065
Restricted cash (note 13)	250,000	250,000
Trade and other receivables (note 7)	1,209,497	680,886
Deposits and prepaid expenses	99,464	199,076
Inventory (note 8)	1,663,918	975,298
Total current assets	3,899,125	4,033,325
Non-current assets		
Property and equipment (note 9)	240,725	336,660
Rental assets	38,726	127,867
Intangible assets (note 10)	62,623	201,217
Inventory (note 8)	727,773	810,640
Total non-current assets	1,069,847	1,476,384
Total assets	4,968,972	5,509,709
Liabilities		
Current liabilities		
Trade payables and accrued liabilities (note 11)	3,658,254	4,903,537
Unearned revenue (note 12)	2,717,245	1,639,684
Loans and borrowings (note 13)	271,832	384,815
Finance lease obligations	19,963	48,715
Current tax liabilities (note 25)	4,078	4,437
Total current liabilities	6,671,372	6,981,188
Non-current liabilities		
Unearned revenue (note 12)	-	257,520
Loans and borrowings (note 13)	3,104,967	2,486,199
Finance lease obligations	13,175	33,138
Provisions (note 15)	46,452	47,027
Total non-current liabilities	3,164,594	2,823,884
Total liabilities	9,835,966	9,805,072
Equity (deficiency)		
Share capital (note 16)	39,877,966	36,741,492
Convertible debenture – equity feature (note 13)	231,318	231,318
Warrants (note 16)	3,340,222	2,499,778
Contributed surplus	6,957,809	6,622,606
Accumulated other comprehensive income (loss)	-	-
Deficit	(55,274,309)	(50,390,557)
Total equity (deficiency)	(4,866,994)	(4,295,363)
Total liabilities and equity (deficiency)	4,968,972	5,509,709

See accompanying notes to consolidated financial statements. Going concern (note 2e), Contingencies (note 27)

On behalf of the board   Director – Douglas Marlin   Director – Paul Takalo

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (LOSS)

	For the year ended December 31, 2012 $	For the year ended December 31, 2011 $
Revenue (note 18)	6,469,806	5,467,199
Cost of sales	2,769,996	2,514,122
Gross profit	3,699,810	2,953,077
Other (income) (note 19)	(257,520)	(257,520)
Distribution expenses (note 21)	3,361,205	3,494,929
Administration expenses (note 22)	2,496,769	2,517,511
Research and development expenses (note 23)	2,407,737	3,326,493
Results from operating activities	(4,308,381)	(6,128,336)
Finance (income) (note 24)	(12,788)	(88,818)
Finance costs (note 24)	584,350	493,312
Net finance costs	(571,562)	(404,494)
Loss for the period before income tax	(4,879,943)	(6,532,830)
Income tax expense (note 25)	3,809	10,219
Total comprehensive loss for the year	(4,883,752)	(6,543,049)
Earnings (loss) per share		
Basic and diluted loss per share (note 17)	(0.04)	(0.06)

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (DEFICIENCY)

For the years ended December 31, 2012 and 2011

	Share Capital $	Convertible Debenture $	Warrants $	Contributed Surplus $	Foreign Currency Translation Reserve* $	Deficit $	Total Equity (Deficit) $
Balance at January 1, 2011	36,730,844	231,318	5,134,018	3,750,114	-	(43,847,508)	1,998,786
Loss for the year	-	-	-	-	-	(6,543,049)	(6,543,049)
Foreign currency translation differences	-	-	-	-	-	-	-
Total comprehensive loss for the year	-	-	-	-	-	(6,543,049)	(6,543,049)
Contributions by and distributions to owners							
Share issue cost recovery	3,913	-	-	-	-	-	3,913
Share-based payment transactions	-	-	-	240,937	-	-	240,937
Share options exercised	6,735	-	-	(2,685)	-	-	4,050
Warrants expired	-	-	(2,634,240)	2,634,240	-	-	-
Total contributions by and distributions to owners	10,648	-	(2,634,240)	2,872,492	-	-	248,900
Balance at December 31, 2011	36,741,492	231,318	2,499,778	6,622,606	-	(50,390,557)	(4,295,363)
Balance at January 1, 2012	36,741,492	231,318	2,499,778	6,622,606	-	(50,390,557)	(4,295,363)
Loss for the year	-	-	-	-	-	(4,883,752)	(4,883,752)
Foreign currency translation differences	-	-	-	-	-	-	-
Total comprehensive loss for the year	-	-	-	-	-	(4,883,752)	(4,883,752)
Contributions by and distributions to owners							
Issue of common shares	4,349,940	-	-	-	-	-	4,349,940
Share issue cost	(492,227)	-	-	-	-	-	(492,227)
Bifurcation of warrants issued	(723,417)	-	-	-	-	-	(723,417)
Issues of warrants	-	-	840,444	-	-	-	840,444
Share-based payment transactions	-	-	-	335,881	-	-	335,881
Share options exercised	2,178	-	-	(678)	-	-	1,500
Warrants expired	-	-	-	-	-	-	-
Total contributions by and distributions to owners	3,136,474	-	840,444	335,203	-	-	4,312,121
Balance at December 31, 2012	39,877,966	231,318	3,340,222	6,957,809	-	(55,274,309)	(4,866,994)

*Accumulated other comprehensive income (loss) - See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

	For the year ended December 31	
Cash flows from operating activities	**2012 $**	**2011 $**
Loss for the year	(4,883,752)	(6,543,049)
Adjustments for:		
Depreciation	104,215	144,137
Depreciation of rental assets	24,131	43,811
Amortization of intangible assets	138,594	138,593
Convertible debenture accretion	402,275	379,479
Payment of debenture interest	(252,720)	(258,259)
Amortization of debenture issue costs	78,546	78,331
Government grant accretion	70,508	5,512
Government grant (note 3g, 23)	(585,705)	(631,652)
Loss on disposal of property and equipment and rental assets	61,116	9,930
Equity-settled share-based payment transactions	335,881	240,937
Change in inventories	(605,753)	449,246
Change in trade and other receivable	(541,660)	166,959
Change in deposits and prepaid expenses	99,612	(58,772)
Change in trade payables and accrued liabilities	(1,202,968)	1,323,136
Change in provisions	(934)	(14,212)
Change in unearned revenue	820,041	(934,674)
Unrealized foreign exchange	(191)	(70,446)
Interest expense	12,300	8,662
Interest paid	(12,300)	(8,662)
Income tax expense	3,809	10,219
Income tax paid	(4,168)	(5,782)
Net cash used in operating activities	(5,939,123)	(5,526,556)
Cash flows from investing activities		
Acquisitions of property and equipment	(8,280)	(88,192)
Disposal (acquisitions) of rental assets	3,894	(16,577)
Interest income	(1,958)	(22,412)
Interest received	1,958	22,412
Net cash used in investing activities	(4,386)	(104,769)
Cash flows from financing activities		
Share issue (cost) recovery	(375,200)	3,913
Proceeds from issue of shares and warrants	4,349,940	-
Proceeds from exercise of share options and warrants	1,500	4,050
Proceeds from government grant	879,854	890,902
Repayment of loans and borrowings	(86,973)	(61,827)
Payment of finance lease liabilities	(48,715)	(36,294)
Net cash from financing activities	4,720,406	800,744
Net decrease in cash and cash equivalents	(1,223,103)	(4,830,581)
Cash and cash equivalents at January 1	1,928,065	6,617,852
Effect of exchange rate fluctuations on cash held	(28,716)	140,794
Cash and cash equivalents	676,246	1,928,065

See accompanying notes to consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. REPORTING ENTITY

FLYHT Aerospace Solutions Ltd. (the "Company" or "FLYHT") was founded in 1998 under the name AeroMechanical Services Ltd. FLYHT is a public company incorporated under the Canada Business Corporations Act, and is domiciled in Canada. The Company has been listed on the TSX Venture Exchange since March 2003, first as TSX.V: AMA. On May 10, 2012, the Company announced that shareholders approved a name change from AeroMechanical Services Ltd. to FLYHT Aerospace Solutions Ltd. On May 17, 2012, FLYHT received approval from the Toronto Stock Exchange to trade under the new symbol FLY. The Company's head office is 200W, 1144 – 29th Avenue NE, Calgary, Alberta T2E 7P1.

The consolidated financial statements of the Company as at and for the years ended December 31, 2012 and 2011 consist of the Company and its subsidiaries.

FLYHT is a designer, developer, and service provider to the global aerospace industry. The Company supports aviation customers in different sectors including commercial, business, leasing and military operators. Clients are using FLYHT's products on every continent and the Company proudly serves more than 35 aircraft operators globally. FLYHT's headquarters are located in Calgary, Canada with representation in China, the Middle East, South America, the United States and Europe.

2. BASIS OF PREPARATION

(a) Statement of compliance

These consolidated annual financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). These consolidated financial statements were approved by the Board of Directors on April 9, 2013.

(b) Basis of measurement

The consolidated financial statements have been prepared on a historical cost basis except for financial instruments at fair value through profit or loss, which are measured at fair value in the statement of financial position ("SFP").

(c) Functional and presentation currency

These consolidated financial statements are presented in Canadian dollars, which is the Company's functional currency.

(d) Use of estimates and judgments

The preparation of the consolidated financial statements 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.

Critical judgments in applying accounting policies and key estimates having the most significant effect on the amounts recognized in the consolidated financial statements include:

- Inventories: judgement is required in determining amounts to be classified as non-current, and in determining potential impairment. Regular analysis is performed on inventory items, including a review of the age of outstanding inventory, historical movement patterns, contracted sales requirements, physical obsolescence, and technological advances (notes 3c, 3j, 8)
- Trade and other receivables: estimates regarding collectability, and potential impairment are made taking into account the age of outstanding receivables, customer payment history, and specific indicators (notes 3j, 7)
- Revenue recognition: recognition of AFIRS UpTime revenue relies on a determination of the point when a system is fully functional, and when customer acceptance has been received. Services revenue is recognized in proportion to the stage of completion of the transaction at the reporting date, which requires an estimate of the services performed to date as a portion of the total services to be performed. (notes 3k, 12, 18)

2. BASIS OF PREPARATION (CONTINUED)

(e) Going concern

These consolidated financial statements have been prepared on the basis that the Company will continue to realize its assets and meet its obligations in the ordinary course of business. As at December 31, 2012, the Company had negative working capital of $2,772,247, a deficit of $55,274,309, a net loss of $4,883,752 and negative cash flow from operations of $5,939,123.

The Company has incurred significant operating losses and negative cash flows from operations over the past years. The Company's ability to continue as a going concern is dependent upon attaining profitable operations and/or obtaining additional financing to fund its ongoing operations. The Company's ability to attain profitable operations and positive cash flow in the future is dependent upon various factors including its ability to acquire new customer contracts, the success of management's continued cost containment strategy, the completion of research and development ("R&D") projects, and general economic conditions. It is the Company's intention to continue to fund operations by adding revenue and its resulting cash flow as well as continue to manage outgoing cash flows. If the need arises due to market opportunities the Company may meet those needs via the capital markets. These material uncertainties may cast significant doubt upon the Company's ability to continue as a going concern.

There is no assurance that the Company will be successful in attaining and sustaining profitable operations and cash flow or raising additional capital to meet its working capital requirements. If the Company is unable to satisfy its working capital requirements from these sources, the Company's ability to continue as a going concern and to achieve its intended business objectives will be adversely affected. These consolidated financial statements do not reflect adjustments that would otherwise be necessary if the going concern assumption was not valid, such as revaluation to liquidation values and reclassification of statement of financial position items.

3. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in these consolidated annual financial statements.

These accounting policies have been applied consistently by FLYHT's subsidiaries.

(a) Basis of consolidation

(i) Business combinations

For acquisitions on or after January 1, 2010, the Company measures goodwill as the fair value of the consideration transferred including the recognized amount of any non-controlling interest in the acquiree, less the net recognized amount (fair value) of the identifiable assets acquired and liabilities assumed, all measured as of the acquisition date. When the excess is negative, a bargain purchase gain is recognized immediately in profit or loss.

The Company will elect on a transaction-by-transaction basis whether to measure non-controlling interest at its fair value, or at its proportionate share of the recognized amount of the identifiable net assets, at the acquisition date.

Transaction costs, other than those associated with the issue of debt or equity securities, that the Company incurs in connection with a business combination will be expensed as incurred.

(ii) Subsidiaries

Subsidiaries are entities controlled by FLYHT. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. The accounting policies of subsidiaries have been changed when necessary to align them with the policies adopted by the Company.

These consolidated financial statements consolidate the accounts of FLYHT and its wholly owned subsidiaries, FLYHT Inc., AeroMechanical Services USA Inc., FLYHT Corp., FLYHT India Corp. and TFM Inc. The latter four subsidiaries are inactive.

(iii) Transactions eliminated on consolidation

Intra-group balances, transactions, and any unrealized income and expenses arising from intra-group transactions are eliminated in preparing the consolidated financial statements.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(b) Financial instruments

(i) Non-derivative financial assets

The Company initially recognizes loans, receivables and deposits on the date they are originated. All other financial assets (including assets designated at fair value through profit or loss) are recognized initially on the trade date at which the Company becomes a party to the contractual provisions of the instrument.

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.

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Company has a legal right to offset the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, loans and receivables are measured at amortized cost using the effective interest method, less any impairment losses.

Loans and receivables comprise trade and other receivables.

(ii) Non-derivative financial liabilities

The Company initially recognizes debt securities issued and subordinated liabilities on the date that they are originated. All other financial liabilities (including liabilities designated at fair value through profit or loss) are recognized initially on the trade date at which the Company becomes a party to the contractual provisions of the instrument.

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

The Company has the following non-derivative financial liabilities: debentures, trade payables and accrued liabilities, loans and borrowings, and finance lease obligations.

These financial liabilities are recognized initially at fair value less any directly attributable transaction costs. Subsequent to initial recognition, these financial liabilities are measured at amortized cost using the effective interest rate method.

(iii) Share capital

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 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.

(iv) Compound financial instruments

Compound financial instruments issued by the Company comprise convertible secured subordinate debentures that can be converted to common shares 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.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(b) Financial instruments (Continued)

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 relating to the financial liability is recognized in profit or loss. On conversion, the financial liability is reclassified to equity and no gain or loss is recognized.

(c) Inventories

Inventories are measured at the lower of cost and net realizable value. The cost of inventories includes expenditures incurred in acquiring the inventories, production or conversion costs, and other costs incurred in bringing them to their existing location and condition. The amount of inventory that is expected to be recovered more than 12 months after the reporting date is presented as a non-current asset.

Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses. Any writedown to net realizable value is recognized as an expense. Reversals of previous writedowns are recognized in profit or loss in the period when the reversal occurs.

AFIRS raw material inventories include general parts, which are held pending installation and sales to customers. The weighted average cost method is used.

The carrying cost of AFIRS finished goods includes AFIRS raw material component costs plus a standard labour allocation. AFIRS finished goods consists of AFIRS units that have been assembled and are held pending sale to customers. The weighted average cost method is used for components, while the labour component allocated to each unit is valued using a standard cost.

Installations-in-progress includes product costs, and other direct project costs. When the system is fully functional, the installations-in-progress balance is recognized as cost of sales to correspond with the full unearned revenue amount then recognized as revenue.

The production of Underfloor Stowage Units is outsourced and the weighted average cost method is used.

(d) Property and equipment

(i) Recognition and measurement

Items of property and equipment are measured at cost less accumulated depreciation and accumulated impairment losses.

Cost includes expenditures that are directly attributable to the acquisition of the asset including those that are directly attributable to bringing the asset to the location and working condition for its intended use.

Software that is integral to the functionality of the related equipment is recognized as property and equipment, otherwise it is considered an intangible asset.

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. Net gains (losses) are recognized in profit or loss.

(ii) Subsequent costs

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

(iii) Depreciation

Depreciation is calculated using the depreciable amount, which is the cost of an asset less its residual value. Depreciation is recognized in profit or loss at rates calculated to write-off assets over their estimated useful lives since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the assets.

Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Company will obtain ownership by the end of the lease term.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(d) Property and equipment (Continued)

The depreciation rates are as follows:

Asset	Depreciation
Computers	30% declining balance
Software	12 months straight line
Equipment	20% declining balance
Leasehold improvements	Term of lease (5 years)

Estimates of depreciation methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate. Any changes in these estimates are accounted for prospectively.

(iv) Research and development ("R&D")

Expenditure on research activities is expensed as incurred.

R&D costs consist primarily of consulting expenses and parts related to the design, testing, and manufacture of Automated Flight Information Reporting System ("AFIRS™") and the design and testing of UpTime, FIRST, FLYHTStream, and FLYHT Fuel Management System. Other R&D costs include testing and certification.

Development activities involve a plan or design for the production of new or substantially improved products and processes. Development expenditure is capitalized only if development costs can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable, and the Company intends to and has sufficient resources to complete development and to use 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, and borrowing costs on qualifying assets for which the commencement date for capitalization is on or after January 1, 2010. Other development expenditure is recognized in profit or loss as incurred.

Capitalized development expenditure is measured at cost less accumulated amortization and accumulated impairment losses.

(v) Subsequent expenditure

Subsequent expenditure is capitalized only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditures are recognized in profit or loss as incurred.

(vi) Amortization

Amortization is calculated based on the asset's cost less its residual value.

Estimates of amortization methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate. Any changes in these estimates are accounted for prospectively.

(e) Leased assets

Leases where the Company assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition, the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for according to the accounting policy applicable to that asset. Other leases are operating leases and the Company does not recognize the leased assets in its statement of financial position. Initial direct costs for operating leases are expensed immediately.

As a lessee, FLYHT has several finance leases for computer hardware.

As a lessee, FLYHT has only one operating lease, for its premises.

As a lessor, rental assets are recorded at cost in FLYHT's statement of financial position and consist of AFIRS units that are leased and in use in customer aircraft under lease type agreements. Depreciation is provided for active leased units on a straight-line basis over nine years. Spare units at customer sites are not depreciated until swapped into service.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(f) Intangible assets

Intangible assets that are acquired by the Company and have finite useful lives are measured at cost less accumulated amortization and accumulated impairment losses.

Customer contracts and relationships are amortized over the remaining life of the contracts that were assumed on acquisition of Wingspeed Corporation's assets (residual value is zero). This method most closely reflects the expected pattern of consumption of the future economic benefits embodied in the assets. The useful initial lives range from two to four years as per the terms of the contracts.

Acquired intangible assets with indefinite useful lives are stated at cost and are not amortized.

The license with Bombardier that allows FLYHT access to technical documents has an indefinite life and is not amortized. The Company presently has dealings with Bombardier and sees no end to that relationship.

An intangible asset is derecognized on disposal or when no future economic benefits are expected from its use or disposal.

(g) Government assistance

(i) Government grants

Low-interest or interest-free government loans are measured initially at their fair value and interest is imputed on the loan in subsequent periods. The benefit of the below-market interest rate is measured as the difference between the fair value of the loan on initial recognition and the amount received. This benefit is accounted for according to the type of grant.

(h) Lease payments

(i) Operating lease payments

Payments made under operating leases are recognized in profit or loss on an accrual basis over the term of the lease. Initial direct costs for operating leases are immediately expensed.

(ii) Finance lease payments

Minimum lease payments made under finance leases are apportioned between finance costs and a reduction of the outstanding liability. The finance cost is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

(i) Provisions

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

(i) Warranties

The Company warrants that the AFIRS products shall be free of defects during the term of each agreement and any renewals. Also, FLYHT warrants that it will deliver all data services required by the customer accurately and on-time. A provision for warranties is recognized when the underlying products or services are sold. The provision is based on historical warranty data.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(j) Impairment

(i) Financial assets (including receivables)

A financial asset not carried at fair value through profit or loss is assessed at each reporting date to determine whether there is objective evidence that it is impaired. A financial asset is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably.

Objective evidence that financial assets are impaired can include default or delinquency by a debtor, restructuring of an amount due to the Company on terms that the Company would not consider otherwise, or indications that a debtor will enter bankruptcy.

The Company assesses impairment of each customer's receivable balance by analyzing historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgment as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical trends.

An impairment loss regarding a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Losses are recognized in profit or loss and reflected in an allowance account against receivables. Interest on the impaired asset continues to be recognized through the unwinding of the discount. 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 carrying amounts of the Company's non-financial assets, other than inventories, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. For intangible assets that have indefinite useful lives, the recoverable amount is estimated at year end. The Company's non-financial assets that are subject to impairment include: property and equipment, rental assets, and intangible assets.

The recoverable amount of an asset is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit", or "CGU"). The Company's corporate assets do not generate separate cash inflows. If there is an indication that a corporate asset may be impaired, then the recoverable amount is determined for the CGU to which the corporate asset belongs.

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

Impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, had no impairment loss been recognized.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(k) Revenue

(i) AFIRS UpTime sales

(a) Sales type agreements

AFIRS fees from sales type service agreements are deferred as unearned revenue and corresponding expenses are recorded as an asset (installations in progress). Once the system (including the AFIRS unit and installation kit) is fully functional and accepted by the customer, the full deferred amount is recognized in revenue along with the installations in progress as cost of sales.

(b) Lease type agreements

The Company rents AFIRS units to some customers under operating leases. Under the terms of the lease agreements, the AFIRS units remain the property of FLYHT and title does not transfer to the customer nor is there an option for the customer to purchase the AFIRS unit at the end of the lease.

The upfront fee from leased AFIRS contracts is initially recorded as unearned revenue and recognized as revenue on a straight line basis over the first term of the lease agreement upon shipment of the AFIRS unit.

(ii) AFIRS UpTime usage

Revenue from UpTime usage fees is recognized at the end of each month and is based on actual usage during that month.

(iii) Parts sales

Revenue from the sale of goods is measured at the fair value of the consideration received or receivable. 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 buyer, recovery of the consideration is probable, there is no continuing management involvement with the goods, and the amount of revenue can be measured reliably.

Revenue from the sale of Underfloor Stowage Units is recognized when the unit is shipped, title is transferred, and collection is reasonably assured.

(iv) Services

Technical services are provided based on orders and contracts with customers that include fixed or determinable prices that are based on daily, hourly, or contracted rates. Revenue is recognized in proportion to the stage of completion of the transaction at the reporting date.

(v) Other income

License fees and royalties paid for the use of FLYHT's assets (i.e., trademarks, patents, and software) are recognized on an accrual basis.

(l) Employee benefits

(i) Short-term employee benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided.

The Company follows accrual accounting for wages, salaries, commissions and variable compensation payments. The commission policy outlines how commissions are calculated and when payment is made to employees.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(l) Employee benefits (Continued)

(ii) Share-based payment transactions

The grant date fair value of share-based payment awards granted to employees is recognized as an expense, with a corresponding increase in equity, over the period that the employees unconditionally become entitled to the awards.

Share-based payment transactions are equity-settled. Share options granted to directors and employees are measured using the fair value of the equity instruments granted at the grant date, which is determined using the Black-Scholes option pricing model.

If options are promised to an employee before the grant date, the Company recognizes the expense at the service commencement date based on fair value. Once the grant date is established, the earlier estimate is revised so that the expense is recognized based on the actual grant date fair value.

FLYHT estimates the expected forfeiture rate at the option grant date and updates the estimate over time as new information becomes available. Forfeitures may occur if employees terminate their employment before the options vest.

(m) Share-based payment transactions to non-employees

(i) Stock options granted to consultants

The Company grants stock options to consultants. These share-based payment transactions are equity-settled. Transactions with non-employees are measured based on the fair value of the goods or services received, at the receipt date. Fair value is measured at the date the Company obtains the goods or the counterparty renders service.

FLYHT estimates the expected forfeiture rate at the option grant date and updates the estimate over time as new information becomes available. Forfeitures may occur if consultants do not fulfill their obligations before the options vest.

(ii) Agent warrants

When the Company issues common shares, warrants, and debentures through brokered private placements, agent warrants are issued to the agents as consideration for their services.

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.

(n) Finance income and finance costs

Finance income comprises interest income which is recognized as it accrues in profit or loss, using the effective interest method. The Company earns income on its cash and cash equivalents (bank deposits) and its restricted cash (Guaranteed Investment Certificates). Interest is recognized as it accrues in profit or loss, using the effective interest method.

Finance costs comprise interest expense on borrowings, and unwinding of the discount on provisions and are recognized in profit or loss using the effective interest method.

Foreign currency gains and losses are reported on a net basis, as either finance income or finance costs.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(o) Foreign currency

(i) Foreign currency transactions

Foreign currency transactions are translated to Canadian dollars at the exchange rate in effect on the transaction date. Foreign currency denominated monetary assets and liabilities at each reporting date are retranslated to the functional currency at the exchange rate in effect on 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.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate in effect on the date of the transaction.

Foreign currency differences arising on retranslation are recognized in profit or loss.

(ii) 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 exchange rates in effect on the transaction dates.

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

Foreign exchange gains or losses arising 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.

(p) Income tax

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 a business combination, or 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 year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognized in respect to 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.

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.

When a taxable temporary difference arises from the initial recognition of the equity component separately from the liability component of a compound financial instrument, the resulting deferred tax liability is charged directly to the carrying amount of the equity component.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(q) Earnings per share

The Company presents basic and diluted earnings per share ("EPS") data for its common shares. Basic EPS 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. Diluted EPS is determined each period by adjusting the profit or loss attributable to common shareholders and the weighted average number of common shares outstanding, for the effects of all dilutive potential common shares, which comprise debentures, share options, and warrants.

4. NEW STANDARDS AND INTERPRETATIONS NOT YET ADOPTED

All accounting standards effective for periods beginning on or after January 1, 2012 have been adopted by FLYHT. The following new accounting pronouncements have been issued but are not effective and may have an impact on the Company. All of the following new or revised standards and amendments to existing standards permit early adoption with transitional arrangements depending upon the date of initial application:

IFRS 7 / IAS 32 – Offsetting Financial Assets and Liabilities clarifies that an entity currently has a legally enforceable right to set-off if it is not contingent on a future event, situations under which it is enforceable, and defines related disclosure requirements (January 1, 2013 / January 1, 2014).

IFRS 9 – Financial Instruments replaces the current multiple classification and measurement models for financial assets and liabilities with a single model that has only two classification categories: amortized cost and fair value. (January 1, 2015).

IFRS 10 – Consolidated Financial Statements builds on existing principles and standards and identifies the concept of control as the determining factor in whether an entity should be included within consolidated financial statements of the parent company (January 1, 2013).

IFRS 11 – Joint Arrangements establishes the principles for financial reporting by entities when they have an interest in arrangements that are jointly controlled (January 1, 2013).

IFRS 12 – Disclosure of Interest in Other Entities provides disclosure requirements for interests held in other entities including joint arrangements, associates, special purpose entities and other off balance sheet entities (January 1, 2013).

IFRS 13 – Fair Value Measurement defines fair value, requires disclosure of fair value measurements and provides a framework for measuring fair value when it is required or permitted within the IFRS standards (January 1, 2013).

IAS 1 – Presentation of Financial Statements requires that an entity present separately the items of OCI that may be reclassified to profit and loss in the future from those that would never be reclassified (annual periods beginning on or after July 1, 2012).

IAS 19 – Employee Benefits clarifies the distinction between short-term and other long-term employee benefits and removes policy choice for recognition of actuarial gains and losses. (January 1, 2013).

IAS 28 - Investments in Associate and Joint Ventures revised the existing standard and prescribes the accounting for investments and sets out requirements for application of the equity method when accounting for investments in associates and joint ventures (January 1, 2013).

The Company has not completed its evaluation of the effect of adopting these standards on its consolidated financial statements.

5. DETERMINATION OF FAIR VALUES

(a) Share based payment transactions: measured using the Black-Scholes option pricing model; and

(b) Loans and borrowings: fair value is calculated based on the present value of future principal and interest cash flows, discounted at the market rate of interest at the reporting date. In respect of the liability component of convertible debenture, the market rate of interest is determined by reference to similar liabilities that do not have a conversion feature.

6. CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of cash balances and bank deposits with an original maturity of three months or less.

7. TRADE AND OTHER RECEIVABLES

	December 31, 2012	December 31, 2011
	$	$
Trade receivables	882,990	586,855
Non-trade receivables and accrued receivables	326,507	94,031
Total	1,209,497	680,886

Non-trade receivables consist of earned interest income receivable, input tax credits, and government grants receivable. The Company's exposure to credit and currency risks is disclosed in note 26.

8. INVENTORY

	December 31, 2012	December 31, 2011
	$	$
AFIRS raw materials	1,157,382	998,529
AFIRS finished goods	249,703	187,747
Installations in progress	984,606	599,662
Balance	2,391,691	1,785,938
Less current portion	(1,663,918)	(975,298)
Non-current portion	727,773	810,640

In 2012, AFIRS materials and changes in AFIRS units and installations in progress recognized as cost of sales amounted to $1,389,017 (2011: $1,199,011). Included in this amount was a recovery of previously written down inventories amounting to $13,899 in 2012 (2011: writedown of $409,887) resulting from a complete review of slow moving inventory parts. All inventories are pledged as security for the bank loan and debentures.

9. PROPERTY AND EQUIPMENT

2012	Computers and Software $	Equipment $	Leasehold improvements $	Total $
Cost				
Balance at January 1	886,080	230,297	132,851	1,249,228
Additions	8,280	-	-	8,280
Disposals	-	-	-	-
Balance at December 31	894,360	230,297	132,851	1,257,508
Accumulated Depreciation				
Balance at January 1	703,554	139,241	69,773	912,568
Depreciation for the year	56,557	18,211	29,447	104,215
Disposals	-	-	-	-
Balance at December 31	760,111	157,452	99,220	1,016,783
Carrying Amounts				
At January 1	182,526	91,056	63,078	336,660
At December 31	134,249	72,845	33,631	240,725

2011	Computers and Software $	Equipment $	Leasehold improvements $	Total $
Cost				
Balance at January 1	851,210	235,349	126,592	1,213,151
Additions	81,933	-	6,259	88,192
Disposals	(47,063)	(5,052)	-	(52,115)
Balance at December 31	886,080	230,297	132,851	1,249,228
Accumulated Depreciation				
Balance at January 1	648,092	120,495	42,029	810,616
Depreciation for the year	93,422	22,971	27,744	144,137
Disposals	(37,960)	(4,225)	-	(42,185)
Balance at December 31	703,554	139,241	69,773	912,568
Carrying Amounts				
At January 1	203,118	114,854	84,563	402,535
At December 31	182,526	91,056	63,078	336,660

The Company leases equipment under several finance lease agreements. Certain leases provide FLYHT with the option to purchase the equipment at the end of the lease term. At December 31, 2012, the net carrying amount of leased property and equipment was $59,456 (2011: $84,937).

As of December 31, 2012, all property and equipment are pledged as security for the bank loan and debentures (note 13).

There were no contractual commitments for the acquisition of property or equipment as of December 31, 2012.

10. INTANGIBLE ASSETS

2012	License	Customer contracts	Total
	$	$	$
Cost			
Balance at January 1	34,992	466,510	501,502
Balance at December 31	34,992	466,510	501,502
Amortization			
Balance at January 1	-	300,285	300,285
Amortization for the year	-	138,594	138,594
Balance at December 31	-	438,879	438,879
Carrying amounts			
At January 1	34,992	166,225	201,217
At December 31	34,992	27,631	62,623

2011	License	Customer contracts	Total
	$	$	$
Cost			
Balance at January 1	34,992	466,510	501,502
Balance at December 31	34,992	466,510	501,502
Amortization			
Balance at January 1	-	161,692	161,692
Amortization for the year	-	138,593	138,593
Balance at December 31	-	300,285	300,285
Carrying amounts			
At January 1	34,992	304,818	339,810
At December 31	34,992	166,225	201,217

The license with Bombardier allows FLYHT access to technical documents. It has an indefinite life and is not amortized. The Company presently has dealings with Bombardier and sees no end to that relationship.

FLYHT provides the contracted customers with UpTime data services. The fair value of the contracts acquired is being amortized over the remainder of the contract period.

Amortization of intangibles is included in the statement of comprehensive income as cost of sales. All intangible assets are pledged as security for the bank loan and debentures.

11. TRADE PAYABLES AND ACCRUED LIABILITIES

	December 31, 2012	December 31, 2011
	$	$
Trade payables	2,334,164	3,372,232
Non-refundable customer deposits	797,070	980,955
Compensation and statutory deductions	316,058	422,776
Accrued liabilities	210,962	127,574
Total	3,658,254	4,903,537

Compensation and statutory deductions include accrued vacation pay, variable compensation, and statutory payroll deductions.

12. UNEARNED REVENUE

Unearned revenue classified as current consists of sales type agreements revenue that will be recognized when the AFIRS system is fully functional, and rental type agreements revenue and license fees expected to be recognized as income in the next year.

Unearned revenue classified as non-current consists of the non-current portion of rental type agreements and license fees.

The license and manufacturing agreement with SNC gives SNC the right to manufacture the Company's AFIRS product and market the AFIRS UpTime technology and products to the global military market. This license fee is deferred as unearned revenue and revenue is recognized on a straight-line basis over the five year term of the agreement. See note 19.

All amounts recorded in unearned revenue are non-refundable.

	2012	2011
	$	$
Balance January 1	1,897,204	2,831,878
AFIRS UpTime sales: shipped, not accepted	3,445,930	1,139,288
AFIRS UpTime usage: prepaid	376,981	113,752
AFIRS UpTime sales: revenue recognized	(2,464,784)	(1,810,540)
AFIRS UpTime usage: revenue recognized	(280,566)	(119,654)
License fees: revenue recognized	(257,520)	(257,520)
Balance December 31	2,717,245	1,897,204
Less current portion	(2,717,245)	(1,639,684)
Non-current portion	-	257,520

13. LOANS AND BORROWINGS

Bank loan

The Company currently has no bank debt and has available to it an operating demand loan up to a maximum of $250,000 (2011: $250,000). The operating loan bears interest at Canadian chartered bank prime plus 1.5%. The operating demand loan is secured by an assignment of cash collateral in the amount of $250,000 and a general security agreement including a first ranking security interest in all personal property. The amount of the cash collateral has been disclosed as restricted cash. As at December 31, 2012 and 2011, the facility had not been drawn. All amounts recorded in unearned revenue are non-refundable.

13. LOANS AND BORROWINGS (CONTINUED)

Government loans

The IRAP loan is non-interest bearing and is repaid annually, based on 1.11% of gross revenues, commencing October 2005 and is unsecured. The current portion is calculated based on the actual gross revenues in the fourth quarter plus the Company's revenue projections for the next nine months.

The TPC loan is non-interest bearing and unsecured. The loan is repayable annually, based on 15% of the initial contribution when the Company has achieved more than 10% growth in gross revenues above the previous year's gross revenue and the gross revenue for the year is greater than the base amount. The base amount is defined as the Company's gross revenue in fiscal 2004, which was at $556,127.

On February 23, 2011, the Company signed a contribution agreement with Industry Canada under the SADI program for the development of the next generation product, AFIRS 228. Under the terms of the agreement, SADI will make a repayable unsecured contribution to the Company of the lesser of 30% of the eligible project costs to December 30, 2012 or $1,967,507. The amount is repayable over 15 years commencing April 30, 2014. The payments are on a stepped basis starting April 30, 2014. Payments comprise 3.5% of the contribution and increase 15% yearly until April 30, 2028, when the final payment is 24.5% of the contribution. The amount to be repaid is 165% of the original contribution. At December 31, 2012, the Company had received a cumulative total of $1,770,756 (December 31, 2011: $890,902) (note 23).

Convertible debentures

The debentures mature on December 23, 2014 and bear interest at a rate of 8% per annum, accrued and paid annually in arrears commencing December 31, 2011. The debentures are convertible into common shares at a conversion rate of $0.40 per share at any time prior to maturity. The debentures are secured against all personal property of the Company, with the exception of the Company's intellectual property, and are subordinated in right of payment to all existing and future bank and/or governmental indebtedness of the Company. The fair value of the conversion feature was determined at the time of issue as the difference between the principal value of the debentures and the discounted cash flows assuming a 15% rate. The conversion feature is classified as equity and amounts to $231,318 as at December 31, 2012 (2011: $231,318). If the debentures are converted to shares, a portion of the value of the conversion feature recognized in shareholders' equity will be classified to share capital along with the conversion price paid.

	2012 $	2011 $
IRAP	66,690	134,550
TPC	28,074	47,186
SADI	629,419	264,762
Debenture payable	2,652,616	2,424,516
Balance December 31	3,376,799	2,871,014
Less current portion	(271,832)	(384,815)
Non-current portion	3,104,967	2,486,199

14. OPERATING LEASES

The Company has entered into a lease for its operating premises. Operating lease rentals are payable as follows:

	Premises $
2013	487,651
2014	81,637
Total	569,288

Operating lease payments made in 2012 totaled $472,142 (2011: $449,370).

15. PROVISIONS

Product warranty - non-current provision	2012 $	2011 $
Balance January 1	47,027	61,239
Provision made during the period	39,801	12,624
Provision used during the period	(40,376)	(26,836)
Balance December 31	46,452	47,027

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

16. CAPITAL AND OTHER COMPONENTS OF EQUITY

Share capital

Authorized:

Unlimited numbers of common shares, and classes A, B and C preferred shares, issuable in series and have no par value.

The preferred shares may be issued in one or more series. The directors are authorized to fix the number of shares in each series and to determine the designation, rights, privileges, restrictions and conditions attached to the shares in each series.

Issued and outstanding:

Common shares:	Number of shares $	Value $
Balance January 1, 2011	118,615,466	36,730,844
Share issue cost recovery	-	3,913
Exercise of employee options	15,000	4,050
Contributed surplus from exercise of employee options	-	2,685
Balance December 31, 2011	118,630,466	36,741,492
Issued for cash	21,749,700	4,349,940
Share issue costs	-	(375,200)
Share issue costs – agent warrants	-	(117,027)
Bifurcation of warrants	-	(723,417)
Exercise of employee options	6,000	1,500
Contributed surplus from exercise of employee options	-	678
Balance December 31, 2012	140,386,166	39,877,966

In four tranches in June and July 2012 the Company issued 20,749,700 share units pursuant to a combination of brokered and non-brokered private placements at $0.20 per share unit resulting in gross proceeds of $4,149,940. Each share unit consists of one common share and one-half share purchase warrant. Each full share unit warrant entitles the holder to acquire one common share at a price of $0.30 until 24 months after the issue date of the share purchase warrant. As at December 31, 2012 share purchase warrants outstanding totaled 10,374,850 from the four tranches: 4,595,750 will expire June 22, 2014; 1,437,500, June 27, 2014; 1,889,100, June 29, 2014 and 2,452,000 July 4, 2014. The net cash proceeds after issuance costs of the brokered and non-brokered private placements totaled $3,784,367. A further 1,223,509 agent warrants were issued which entitle the holder to acquire one common share at a price of $0.20 until 24 months after the issue date of the agent warrant. The expiry details are: 606,935, June 22, 2014; 8,750, June 27, 2014; 264,474, June 29, 2014; and 343,350 July 4, 2014.

16. CAPITAL AND OTHER COMPONENTS OF EQUITY (CONTINUED)

On September 27, 2012 the Company issued 1,000,000 common shares at $0.20 per share in connection with a non brokered private placement resulting in gross proceeds of $200,000 The net cash proceeds after issuance costs was $198,115.

An additional 6,000 common shares were issued to directors, officers, employees and consultants on the exercise of options. The weighted average exercise price of these common shares was $0.25, resulting in cash proceeds of $1,500.

Stock option plan

The Company grants stock options to its directors, officers, employees and consultants. The Company has a policy of reserving up to 10% of the outstanding common shares for issuance to eligible participants. As at December 31, 2012, there were 14,038,617 (2011: 11,863,047) common shares reserved for this purpose. All outstanding options issued to date vest immediately at the grant date with the exception of 1,000,000 options granted to an employee effective January 1, 2012, 75,000 options granted to an employee effective January 9, 2013, and 400,000 options granted to a consultant effective September 20, 2012, of which 300,000 have not yet vested. The total unvested options are 1,375,000 (2011: 1,000,000). The options are granted at an exercise price not less than fair market value of the stock on the date of issuance. A summary of the Company's outstanding and exercisable stock options as at December 31, 2012 and 2011 and changes during these years is presented below.

	2012		2011	
	Number of options	Weighted average exercise price $	Number of options	Weighted average exercise price $
Outstanding, January 1	4,485,991	0.28	2,498,977	0.39
Options granted	2,607,500	0.25	3,099,000	0.23
Options exercised	(6,000)	0.25	(15,000)	0.27
Options expired	(816,991)	0.31	(1,096,986)	0.41
Outstanding, December 31	6,270,500	0.26	4,485,991	0.28
Exercisable, December 31	4,895,500	0.28	3,485,991	0.30

Weighted average life remaining for the options outstanding and exercisable is 2.3 years. The exercise prices for options outstanding at December 31, 2012 were as follows:

	All options		Exercisable options	
Exercise price:	Number	Weighted average remaining contractual life (years)	Number	Weighted average remaining contractual life (years)
$0.20	1,000,000	1.0	-	-
$0.25	1,923,500	2.0	1,923,500	2.0
$0.25	2,482,000	3.0	2,182,000	3.0
$0.25	75,000	4.0	-	-
$0.41	790,000	1.0	790,000	1.0
Total	6,270,500	2.1	4,895,500	2.3

The weighted average fair value of the options granted during the year was $0.14 (2011: $0.09). The fair value of the options granted was estimated using the Black-Scholes option pricing model with the following weighted average assumptions:

	2012	2011
Risk-free interest rate	1.38%	1.63%
Expected life (years)	3.60	2.58
Volatility in the price of the Company's common shares	99%	94%
Dividend yield rate	0.00%	0.00%

16. CAPITAL AND OTHER COMPONENTS OF EQUITY (CONTINUED)

Warrants

	Number of warrants	Weighted average exercise price	Value
		$	$
Outstanding January 1, 2011	29,655,609	0.73	5,134,018
Warrants expired	(9,119,999)	0.72	(2,634,240)
Outstanding December 31, 2011	20,535,610	0.47	2,499,778
Issued on private placement	10,374,850	0.30	723,417
Agent warrants granted	1,223,509	0.20	117,027
Outstanding December 31, 2012	32,133,969	0.40	3,340,222

17. EARNINGS PER SHARE

Basic earnings per share

The calculation of basic and diluted earnings per share for the year ended December 31, 2012 was based on a weighted average number of common shares outstanding of 129,567,629 (2011: 118,626,151).

18. REVENUE

	2012	2011
	$	$
AFIRS Uptime sales	2,464,784	1,724,342
AFIRS Uptime usage	3,091,626	2,951,762
Parts sales	202,420	201,208
Services	710,976	589,887
Total	6,469,806	5,467,199

AFIRS Uptime sales includes revenue for both lease and sales type contracts. AFIRS Uptime usage includes UpTime monthly voice and data usage fees. Parts sales includes spare AFIRS units, spare installation kit parts and Underfloor Stowage Units. Services include technical, repair, and installation support services.

19. OTHER INCOME

Other income consists of the recognition of the SNC license fee that was deferred as unearned revenue when received and is being recognized over the initial five year term of the agreement (note 12).

20. OPERATING SEGMENTS

The Company has one operating segment.

Geographical Information

The following revenue is based on the geographical location of customers.

	For the year ended December 31	
	2012	2011
	$	$
North America	3,522,317	2,469,888
South / Central America	472,850	452,334
Africa / Middle East	1,729,862	1,787,817
Europe	150,247	133,246
Australasia	520,843	440,408
Asia	73,687	183,506
Total	6,469,806	5,467,199

All non-current assets (property and equipment and intangible assets) reside in Canada.

Major customers

Revenues from the three largest customers represent approximately 23.7% of the Company's total revenues for the year ended December 31, 2012 (2011: 26.1%).

21. DISTRIBUTION EXPENSES

	For the year ended December 31	
	2012	2011
	$	$
Salaries and benefits	1,829,053	1,790,460
Stock based compensation	95,458	84,815
Contract labour	559,096	770,297
Office	345,648	335,959
Travel	315,797	260,500
Equipment & maintenance	31,820	55,931
Depreciation	52,956	-
Marketing	61,773	102,104
Other	69,604	94,863
Total	3,361,205	3,494,929

22. ADMINISTRATION EXPENSES

	For the year ended December 31	
	2012 $	2011 $
Salaries and benefits	1,253,401	1,208,138
Stock based compensation	227,808	149,343
Contract labour	112,366	77,525
Office	324,465	312,217
Legal fees	142,378	173,895
Audit and accounting	104,855	129,086
Investor relations	93,709	135,443
Brokerage, stock exchange, and transfer agent fees	26,961	29,174
Travel	106,586	74,713
Equipment and maintenance	57,844	60,960
Depreciation	28,874	144,137
Other	17,522	22,880
Total	2,496,769	2,517,511

23. RESEARCH AND DEVELOPMENT EXPENSES

To date, all development costs have been expensed as incurred.

In 2012, FLYHT did not receive funding from the IRAP government grant through the National Research Council of Canada as the project was completed as of March 31, 2011. Under this project, funding of $90,031 was received in 2011 to develop the FLYHT Fuel Management System. The grant reimbursed a portion of FLYHT's salary and contractor costs. This grant was classified as related to income. FLYHT used the net presentation approach by reducing compensation expense relating to R&D.

In 2012, FLYHT also received payment for two claims totaling $879,854 (2011: $890,902) from SADI which is a repayable contribution. It was determined that the repayable contribution is at below market interest rates and therefore the payments were accounted for as a loan payable of $294,149 and a grant of $585,705. The grant portion was determined at the time of installment receipt as the difference between the principal value of the installment and the discounted cash flows assuming an 18% rate. The grant portion reimbursed a portion of FLYHT's costs related to the development of the AFIRS 228. This grant was classified as related to income. FLYHT used the net presentation approach by reducing R&D expenses.

	For the year ended December 31	
	2012 $	2011 $
Salaries and benefits	1,544,718	1,333,410
Stock based compensation	12,615	6,780
Contract labour	1,265,032	2,373,009
Office	303,740	101,826
Travel	60,419	78,940
Equipment and maintenance	48,704	147,314
Components	63,267	354,693
Government grants	(585,705)	(721,683)
SRED tax credit	(327,438)	(355,982)
Depreciation	22,385	-
Other	-	8,186
Total	2,407,737	3,326,493

24. FINANCE INCOME AND FINANCE COSTS

Recognized in profit or loss:

	For the year ended December 31	
	2012 $	2011 $
Interest income on bank deposits	1,958	22,412
Net foreign exchange gain	10,830	66,406
Finance income	12,788	88,818
Bank service charges	20,721	21,328
Interest expense	12,300	8,662
Government grant interest expense	70,508	5,512
Debenture interest expense	402,275	379,479
Debenture cost amortization	78,546	78,331
Finance costs	584,350	493,312

25. INCOME TAX EXPENSE

	2012 $	2011 $
Current income tax expense	3,809	10,219
	3,809	10,219

Unrecognized deferred tax assets

Deferred tax assets have not been recognized in respect to the following items:

	2012	2011
Capital assets	191,859	143,520
Intangibles	113,958	86,829
Inventory	4,327	7,676
Non-capital loss carry-forwards	9,122,110	8,400,861
Share issue costs	179,014	198,982
Scientific research and experimental development expenditures	6,286,853	5,525,055
	15,898,121	14,362,923

25. INCOME TAX EXPENSE (CONTINUED)

The Company has non-capital losses for income tax purposes of approximately $36,700,821 which are available to be applied against future year's taxable income. The benefit of these non-capital losses has not been recognized in the consolidated financial statements because it is not probable that future taxable profit will be available against which FLYHT can use the benefits. These losses will expire as follows:

Year	Amount $
2013	
2014	2,570,288
2015	2,461,959
2026	3,390,309
2027	5,596,948
2028	6,997,140
2029	2,791,748
2030	6,442,039
2031	3,627,617
2032	2,822,773
Total	36,700,821

Reconciliation of effective tax rate

	2012 $	2011 $
Loss for the period	(4,883,752)	(6,543,049)
Total income tax expense	3,809	10,219
Loss excluding income tax	(4,879,943)	(6,532,830)
Tax Rate	25.0%	26.5%
Expected income tax recovery	(1,219,986)	(1,731,200)
Change in tax rate and other	(374,542)	(586,097)
Non-deductible expenses	7,484	10,881
Stock based compensation	83,970	63,849
Change in unrecognized temporary differences	1,506,883	2,252,786
	3,809	10,219

26. FINANCIAL RISK MANAGEMENT

The Company's operating activities expose it to a variety of financial risks, including credit, liquidity and market risks associated with the Company's financial assets and liabilities. FLYHT has established procedures and policies to minimize its exposure to these risks, and continually monitors its exposure to all significant risks to assess the impact on its operating activities. The following details the Company's exposure to credit, liquidity, currency, and other market risks.

26. FINANCIAL RISK MANAGEMENT (CONTINUED)

Credit risk

The Company's exposure to credit risk is influenced mainly by the individual characteristics of each customer. Management considers the demographics of the Company's customer base, including the default risk of the industry and country in which customers operate. Approximately 9.0% (2011: 10.6%) of the Company's 2012 revenue is attributable to transactions with a single customer; however, geographically there is no concentration of credit risk.

Each new customer is analyzed individually for creditworthiness before the Company's standard payment and delivery terms and conditions are offered. Customers that fail to meet the Company's benchmark creditworthiness may transact with FLYHT only on a prepayment basis. The AFIRS solution is subject to a retention of title clause, so that in the event of non-payment the Company will have a secured claim. To further minimize credit exposure, the sale of most AFIRS solutions requires payment in advance of any product shipment. At each reporting date, the Company establishes an allowance for impairment that represents its estimate of incurred losses.

The aging of receivables at the reporting date was:

December 31, 2012	0-30 days $	31-60 days $	61-90 days $	91+ days $	Total $
Accounts receivable	757,953	385,839	48,448	30,251	1,222,491
Impairment	(5,073)	(7,572)	-	(349)	(12,994)
Net receivable	752,880	378,267	48,448	29,902	1,209,497

December 31, 2011	0-30 days $	31-60 days $	61-90 days $	91+ days $	Total $
Accounts receivable	335,723	174,268	132,855	140,119	782,965
Impairment	(54,577)	(33,547)	(13,355)	(600)	(102,079)
Net receivable	281,146	140,721	119,500	139,519	680,886

The Company believes that the unimpaired amounts that are past due by more than 30 days are still collectible, based on historic payment behavior.

The movement in the allowance for impairment in respect of trade and other receivables for the years ended December 31, 2012 and 2011 was:

	2012 $	2011 $
Balance, January 1	102,079	3,818
Provision	4,763	196,447
Amounts written off	(69,268)	(94,368)
Impairments recovered	(24,580)	(3,818)
Balance, December 31	12,994	102,079

Liquidity risk

The Company's approach to managing liquidity is to ensure that it will always have sufficient liquidity to meet its liabilities when due, without incurring unacceptable losses or risking damage to the Company's reputation. The Company manages its liquidity risks by having cash available, by maintaining a conservative capital structure, by prudently managing its credit risks, and by maintaining its relationship with the capital markets to meet any near-term liquidity requirements. The Company had a working capital deficiency at December 31, 2012, explained further in note 2(e).

26. FINANCIAL RISK MANAGEMENT (CONTINUED)

The following table details the contractual maturities of financial liabilities, including estimated interest payments.

December 31, 2012	< 2 months $	2-12 months $	1-2 years $	2-5 years $	> 5 years $	Total $
Accounts payable	531,548	12,045		-	-	543,593
Accounts payable – SNC (note 27a)	1,790,571	-	-	-	-	1,790,571
Compensation and statutory deductions	136,007	180,051	-	-	-	316,058
Finance lease liabilities	4,058	20,291	14,029	-	-	38,378
Accrued liabilities	20,046	190,916	-	-	-	210,962
Loans and borrowings	24,785	313,736	3,482,088	245,218	1,464,132	5,529,959
Total	2,507,015	717,039	3,496,117	245,218	1,464,132	8,429,521

December 31, 2011	< 2 months $	2-12 months $	1-2 years $	2-5 years $	> 5 years $	Total $
Accounts payable	1,441,147	99,120	-	-	-	1,540,267
Accounts payable – SNC (note 27a)	1,831,965					1,831,965
Compensation and statutory deductions	54,226	368,550	-	-	-	422,776
Finance lease liabilities	14,082	42,587	24,350	14,029	-	95,048
Accrued liabilities	10,200	89,136	23,894	4,344	-	127,574
Loans and borrowings	-	384,815	293,400	3,527,963	783,620	4,989,798
Total	3,351,620	984,208	341,644	3,546,336	783,620	9,007,428

Currency risk

A significant portion of the Company's revenues and a portion of its expenses are denominated in U.S. dollars. Management estimates that a 1% weakening of the Canadian dollar relative to the U.S. dollar would increase net earnings by approximately $62,317 (2011: $51,938) and a strengthening of the Canadian dollar would decrease net earnings by approximately $62,317 (2011: $51,938).

The Company mitigates its cash flow exposures by the international nature of the business where a significant portion of its cost of goods sold are in currencies that naturally hedge a portion of U.S. dollar revenue. The Company has not engaged in activities to manage its cash flow foreign currency exposure through the use of financial instruments.

The Company has exposure to foreign exchange risk for working capital items denominated in U.S. dollars. At December 31, 2012, negative working capital denominated in U.S. dollars was approximately $1,367,243 (2011: negative $1,483,550). As a result a 1% weakening of the Canadian dollar would decrease net earnings by approximately $13,672 (2011: $14,836) and a strengthening of the Canadian dollar would increase net earnings by approximately $13,672 (2011: $14,836).

The Company mitigates its working capital exposure by managing its U.S. dollar denominated working capital items to limit the requirement to convert either to or from U.S. dollars to fulfill working capital payment requirements.

Although there are limited expenses under contracts denominated in EUR, GBP and CHF, fluctuations in these currencies would result in insignificant foreign exchange variances. In respect of other monetary assets and liabilities denominated in foreign currencies, the Company ensures that its net exposure is kept to an acceptable level by buying or selling foreign currencies at spot rates when necessary to address short-term imbalances.

26. FINANCIAL RISK MANAGEMENT (CONTINUED)

Interest rate risk

Borrowings issued at variable rates result in exposure to interest rate risk, which would affect future cash flows if interest rates were to rise. Fluctuations in the prime interest rate could result in exposure for the Company with regards to the bank credit facility, which bears interest at Canadian chartered bank prime plus 1.5%. The Company's exposure to interest rate risk as at December 31, 2012 and 2011 was minimal as the credit facility had not been drawn.

Market risk

Market risk is the risk that changes in market conditions, such as foreign exchange rates, interest rates and equity prices will affect the Company's income or the value of its financial instruments. The Company's objectives in managing market risk is to manage and control exposure, while optimizing return.

Fair values versus carrying amounts

The fair values of financial assets and liabilities approximate carrying values.

Capital management

FLYHT's objectives when managing capital are to safeguard the Company's ability to continue as a going concern. In order to maintain or adjust the capital structure, the Company may issue new debt, sell assets to reduce debt, or issue new shares. There were no changes in the Company's approach to capital management during the year.

27. CONTINGENCY

(a) The Company took action against SNC and is defending itself against an action by SNC related to the development of the AFIRS 228. The Company has accrued a liability of $1,790,571, which represents the total amount of invoices received from SNC. The Company maintains that the claims are without merit and that the services invoiced were not provided. Management intends to vigorously defend the matter and believes the outcome will be in its favour.

In November 2011, the Company formally notified SNC that they were in material breach of the License and Manufacturing Agreement that was entered into between the two parties on December 28, 2008. The Company demanded payment of $1,329,976 USD and $2,650,000 CDN and terminated the agreement. As well, the Company applied to the Alberta courts for arbitration under the provisions of the agreement. The courts granted the request for arbitration on November 29, 2011. Subsequent to the grant, SNC refused to recognize the jurisdiction of the court and has contested the cancellation of the agreement and the arbitration.

In November 2011, SNC filed an action in Utah alleging that FLYHT failed to pay $2,042,000 USD.

As all invoices presented to the Company by SNC have been accrued, management does not expect the outcome to have a material effect on the Company's financial position.

(b) In the second quarter of 2012, a full and final settlement was reached with a Toronto-based company for the outstanding claims and counterclaims that were commenced in September 2007 alleging the Company induced a breach of contract and interfered with economic relationships. The parties agreed to dismiss existing litigation on a without cost basis with no admissions of liability. Therefore there were no amounts to be recorded.

28. RELATED PARTIES

(a) Throughout 2012 the Company engaged in transactions with a company owned by a director to supply consulting services. The related party provided business development services such as trade show attendance and corporate introductions related to the business jet initiatives of the Company.

(b) Throughout 2012 the Company engaged in transactions with a company owned by a director to supply consulting services. The related party provided business development services such as market analysis and corporate introductions related to the commercial aviation initiatives of the Company.

	Included in contract labour:		Included in accounts payable and accrued liabilities:	
	For the year ended December 31		December 31	
	2012 $	2011 $	2012 $	2011 $
(a)	89,875	88,784	14,915	15,387
(b)	17,984	41,596	-	6,192
Total	107,859	130,380	14,915	21,579

All of the transactions with these related parties were amounts that were agreed upon by the parties and approximated fair value. All other transactions with related parties were normal business transactions related to their positions within the Company. These transactions included expense reimbursements for business travel and other 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.

Transactions with key management personnel

Key management personnel includes all persons with direct or indirect authority and responsibility for planning, directing and controlling the activities of the Company, and includes directors and the FLYHT's executive team.

In addition to salary and variable compensation, the Company also provides non-cash benefits to key management personnel. Certain executive officers are entitled to a mutual term of notice of six months.

Compensation for this group comprised:

	2012 $	2011 $
Salary	815,596	824,136
Director fees	84,023	34,952
Variable compensation	169,218	215,640
Share-based payments	195,393	91,482
Short-term employee benefits	89,935	67,134
Total	1,354,165	1,233,344

Subsidiaries

	Country of Incorporation	Ownership interest
FLYHT Inc.	United States	100%
AeroMechanical Services USA Inc.	United States	100%
FLYHT Corp.	Canada	100%
FLYHT India Corp.	Canada	100%
TFM Inc.	Canada	100%

CORPORATE INFORMATION

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