# Star Navigation Systems Group Ltd.
**(A development stage company)**

**Interim Consolidated Financial Statements**

**For the Periods Ended September 30, 2011 and 2010**

**Unaudited**

**(Expressed in Canadian dollars)**

## NOTICE TO READER

The accompanying unaudited interim consolidated financial statements have been prepared by the Company's management and the Company's independent auditors have not performed a review of these financial statements.

Toronto, Ontario
December 29, 2011

## Star Navigation Systems Group Ltd.
**(A development stage company)**
**Unaudited Interim Consolidated Statement of Financial Position**
**(Expressed in Canadian dollars)**

| | Sept 30, 2011 | June 30, 2011 | July 1, 2010 |
|---|---|---|---|
| | | (Note 19) | (Note 19) |
| **Assets** | | | |
| **Current** | | | |
| Cash and cash equivalents | **$ 733,152** | $ 1,721,524 | $ 2,022,926 |
| Accounts receivable | **78,289** | 69,921 | 150,189 |
| Prepaid expenses and sundry receivables | **555,967** | 404,356 | 88,681 |
| | **1,367,408** | 2,195,801 | 2,261,796 |
| **Property and equipment** (Note 5) | **519,138** | 530,660 | 247,093 |
| **Licenses** (Note 6) | **7,613** | 7,863 | 8,863 |
| | **$ 1,894,159** | $ 2,734,324 | $ 2,517,752 |
| **Liabilities** | | | |
| **Current** | | | |
| Accounts payable and accrued liabilities | **$ 456,830** | $ 538,221 | $ 365,721 |
| Current portion of finance lease obligation (Note 7) | **853** | 1,555 | 2,534 |
| Due to related parties (Note 8) | 1,**522,867** | 1,635,957 | 1,709,782 |
| Other payables (Note 9) | **196,000** | 196,000 | 196,000 |
| Deferred revenue | **10,000** | 10,000 | - |
| | **2,186,550** | 2,381,733 | 2,274,037 |
| **Due to related parties** (Note 8) | **-** | - | - |
| **Long term portion of accounts payable and accrued liabilities** (Note 12) | **-** | - | 13,423 |
| **Finance lease obligation** (Note 7) | **-** | - | 1,555 |
| | **2,186,550** | 2,381,733 | 2,289,015 |
| **Shareholders' Equity (Deficiency)** | | | |
| **Share capital** (Note 10) | **24,781,016** | 24,706,373 | 22,006,725 |
| **Contributed Surplus** (Note 11) | **10,292,963** | 10,207,960 | 6,437,202 |
| **Deficit** | **(35,366,370)** | (34,561,742) | (28,215,190) |
| | **(292,391)** | 352,591 | 228,737 |
| | **$ 1,894,159** | $ 2,734,324 | $ 2,517,752 |

***Nature of Operations (Note 1)***

***Commitments and Contingencies (Note 15)***

***Approved by the Board*** ***(signed) "Viraf S. Kapadia"*** ***(signed) "Dale F. Sparks"***

***Director*** ***Director***

See accompanying notes

**Star Navigation Systems Group Ltd.**
**(A development stage company)**
**Unaudited Interim Consolidated Statement of Loss, Comprehensive Loss and Deficit**
**For the three month periods ended September 30, 2011 and 2010**
**(Expressed in Canadian dollars)**

| | 2011 | 2010 (Note 19) |
|---|---|---|
| **Revenue** (Note 17) | **$ 18,269** | $ 31,804 |
| **Cost of sales** | **18,380** | 29,892 |
| **Gross Profit** | **(111)** | 1,912 |
| **Expenses** | | |
| General and administrative | **237,436** | 205,459 |
| Research and development | **246,573** | 135,544 |
| Marketing and promotion | **94,085** | 120,650 |
| Professional fees | **114,096** | 102,963 |
| Stock-based compensation (Note 11,19) | **103,926** | 723,857 |
| Amortization (Note 5) | **11,772** | 22,951 |
| | **807,888** | 1,311,424 |
| **Loss before the undernoted items and income taxes** | **(807,999)** | (1,309,512) |
| **Other income (expenses)** | | |
| Interest income | **3,309** | 2,044 |
| Foreign exchange gain (loss) | **62** | (35,136) |
| Income tax recovery | **-** | 7,762 |
| | **3,371** | 25,330 |
| **Net loss and comprehensive loss for the period** | **(804,628)** | (1,334,842) |
| **Deficit, beginning of period** | **(34,561,742)** | (28,215,190) |
| **Deficit, end of period** | **$(35,366,370)** | $(29,550,032) |
| **Loss per share** | | |
| Basic and diluted | **$ (0.02)** | $ (0.05) |
| **Weighted average number of common shares outstanding** | | |
| Basic and diluted | **179,578,192** | 171,746,993 |

See accompanying notes

## Star Navigation Systems Group Ltd.
### (A development stage company)
### Unaudited Interim Consolidated Statement of Changes in Equity
### For the three month periods ended September 30, 2011 and 2010
### (Expressed in Canadian dollars)

| | Number of common shares | Number of preferred shares | Share capital | Contributed surplus | Deficit | **Total** |
|---|---|---|---|---|---|---|
| Balance at July1, 2010 | 169,520,906 | 615,000 | $22,006,725 | $6,437,202 | $(28,215,190) | **$228,737** |
| Issued for cash on private placement (net of issuance costs) | 10,875,000 | - | 1,182,325 | - | - | **1,182,325** |
| Stock options exercised | 400,000 | - | 55,000 | - | - | **55,000** |
| Fair Value of Options exercised | - | - | 18,500 | (18,500) | - | **-** |
| Stock-based compensation | - | - | - | 723,857 | - | **723,857** |
| Loss for the period | - | - | - | - | (1,334,842) | **(1,334,842)** |
| Balance at September 30, 2010 | 180,795,906 | 615,000 | 22,262,550 | 7,142,559 | (29,550,032) | **855,077** |
| Issued for cash on private placement (net of issuance costs) | 5,064,000 | - | 1,131,742 | - | - | **1,131,742** |
| Issued for finders fees on private placement | 506,400 | - | 126,600 | - | - | **126,600** |
| Stock options exercised | 2,628,672 | - | 366,225 | - | - | **366,225** |
| Fair value of Options exercised | - | - | 191,810 | (191,810) | - | - |
| Issued for cash on warrants exercised | 600,000 | - | 120,000 | - | - | **120,000** |
| Fair value on Issuance of warrants | - | - | (559,700) | 559,700 | - | - |
| Fair Value of warrants exercised | - | - | 67,146 | (67,146) | - | - |
| Stock-based compensation | - | - | - | 901,833 | - | **901,833** |
| Warrant Modification (Note 11) | - | - | - | 1,862,824 | (1,862,824) | |
| Loss for the period | - | - | - | - | (3,148,886) | **(3,148,886)** |
| Balance at June 30, 2011 | 189,594,978 | 615,000 | 24,706,373 | 10,207,960 | (34,561,742) | **352,591** |
| Fair Value of options exercised | - | - | 18,923 | (18,923) | - | - |
| Stock options exercised | 352,000 | - | 55,720 | - | - | **55,720** |
| Stock-based compensation | - | - | - | 103,926 | - | **103,926** |
| Loss for the period | - | - | - | - | (804,628) | **(804,628)** |
| Balance at September 30, 2011 | 189,946,978 | 615,000 | $24,781,016 | $10,292,963 | $(35,366,370) | **$(292,391)** |

## Star Navigation Systems Group Ltd.
### Unaudited Interim Consolidated Statement of Cash Flows
### For the three month periods ended September 30, 2011 and 2010
### (Expressed in Canadian dollars)

| | 2011 | 2010 (Note 19) |
|---|---|---|
| **Cash provided by (used in)** | | |
| **Operations** | | |
| Net loss | $ (804,628) | $ (1,334,842) |
| Items not affecting cash | | |
| Amortization | 11,772 | 22,951 |
| Stock-based compensation | 103,926 | 723,857 |
| | (688,930) | (588,034) |
| Net changes in non-cash working capital | | |
| Accounts receivable | (8,368) | (386) |
| Prepaid expenses and sundry receivables | (151,611) | (25,759) |
| Accounts payable and accrued liabilities | (81,391) | 135,681 |
| Due to related parties | (113,090) | (330,587) |
| | (1,043,390) | (809,085) |
| **Investing** | | |
| Property and Equipment additions | - | (102,500) |
| **Financing** | | |
| Finance lease obligation | (702) | (703) |
| Issuance of capital stock | 55,720 | 1,237,325 |
| Other long term payables | - | 25,090 |
| | 55,018 | 1,261,712 |
| **Net change in cash and cash equivalents** | (988,372) | 350,127 |
| **Cash and cash equivalents, beginning of period** | 1,721,524 | 2,022,926 |
| **Cash and cash equivalents, end of period** | $ 733,152 | $ 2,373,053 |

**Supplemental Disclosure**

| | | |
|---|---|---|
| Interest paid | $ 2,131 | $ 221 |

## 1. NATURE OF OPERATIONS

Star Navigation Systems Group Ltd. ("the Company") is in the development stage, devoting substantially all of its activity to the development, marketing and promotion of an In-flight Safety Monitoring System ("STAR-ISMS® "), whereby data from an aircraft can be transmitted to ground stations for the duration of a flight. Certain technology used for this system as well as patents granted have been licensed to the Company by a director and a former director of the Company who undertook the initial research and development (Note 6). For the period from inception to June 30, 2011, the Company has incurred research and development expenses relating to the STAR-ISMS® project of approximately $8,403,573 and earned revenues of approximately $930,269.

The Company's ability to continue operations, meet its obligations and realize its investment in development costs is dependent on the continued support from investors and related parties to finance sales to customers, continue the project development, obtain the necessary certifications from regulatory agencies as well as successfully marketing the STAR-ISMS® for gain.

The Company’s registered head office is located at 203-2970 Lakeshore Blvd W., Toronto, Ontario M8V 1J7.

## 2. BASIS OF PRESENTATION

### (a) Statement of Compliance

These interim consolidated financial statements are the Company’s first unaudited interim consolidated financial statements that have been prepared in accordance with International Financial Reporting Standards (“IFRS”) applicable to interim financial statements including International Accounting Standard 34 (“IAS 34”), Interim Financial Reporting and International Financial Reporting Standards 1 (“IFRS 1”), First-time adoption of IFRS, as issued by the International Accounting Standards Board (“IASB”) as of December 29, 2011. Any subsequent changes to IFRS that are given in the annual consolidated financial statements for the year ended June 30, 2012 could result in restatement if these interim consolidated financial statements, including the transition adjustments recognized on change over to IFRS. Previously, the Company prepared its annual consolidated and interim consolidated financial statements in accordance with Canadian Generally Accepted Accounting Principles (“GAAP’). These interim consolidated financial statements do not include all of the information required for the full annual consolidated financial statements and should be read in conjunction with the annual consolidated financial statements of the Company for the year ended June 30, 2011.

The Company has adopted IFRS on July 1, 2011 with a transition date of July 1, 2010. Under IFRS 1, IFRS standards are applied retrospectively at the transition date subject to certain exceptions and exemptions. The accounting policies set out below have been applied consistently to all periods presented in these interim consolidated financial statements. The 2010 financial statements include an opening consolidated statement of financial position as at July 1, 2010, the date at which the impact of the IFRS transition was recorded against equity, in accordance with the provisions of IFRS 1 and the 2010 comparative statements were prepared using the same basis of accounting. Detailed reconciliations of the consolidated financial statements prepared under GAAP are presented in Note 19.

## 2. BASIS OF PRESENTATION (Cont'd)

### (a) Statement of Compliance (Cont'd)

The Company's Board of Directors approved these interim consolidated financial statements for issue on December 29, 2011.

### (b) Basis of Measurement

The interim consolidated financial statements have been prepared under the historical cost convention, except for certain financial assets which are measured at FVTPL and financial liabilities that are recognized at fair value through the consolidated statement of comprehensive income.

### (c) Functional and presentation currency

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

## 3. SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

These consolidated financial statements include the accounts of the Company and its wholly-owned operating subsidiaries, Star Navigation Systems Inc. ("Star"), Star Navigation Systems (Quebec) Inc. and Star Navigation Systems (U.K) Ltd. All significant inter-company transactions and balances have been eliminated on consolidation. All references to the Company should be treated as references to the Company and its subsidiaries.

Cash and Cash Equivalents

Cash and cash equivalents include bank deposits such as guaranteed investment certificates, with maturities of less than three months.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Inventory

The Company's inventory consists of STAR-ISMS® units and parts inventory. Inventory is valued at the lower of cost or net realizable value. Cost is determined using the weighted average cost method and includes the cost of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. Net realizable value is determined as the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

Property and Equipment and Amortization

Property and Equipment are recorded at cost. Rates and bases of amortization applied to equipment over their estimated useful lives are as follows:

| | |
|---|---|
| Leasehold improvements | - 5 years, straight-line |
| Aircraft | - 25% per annum, declining balance |
| Furniture and equipment | - 20%, per annum, declining balance |
| Computer equipment and software | - 50% per annum, declining balance |
| Computer equipment under finance lease | - 50% per annum, declining balance |
| Vehicles | - 30% per annum, declining balance |
| Production equipment | - 3 years, straight-line |

Licenses

The Company owns the exclusive, worldwide license to the patented technology upon which its STAR-ISMS® product is based. Payment in full in respect of the purchase of the License has been made. Ongoing costs represent out-of-pocket costs for various patent applications and processing. Costs directly attributable to the License are amortized on a straight-line basis over the estimated useful life of 5 years. Costs of renewals of licenses in foreign jurisdictions are amortized over the period of renewal. As the first country patent was granted in 2005, the Company commenced the amortization of these costs to operations from the time of acquisition (Note 6).

Impairments

When events or changes in the economic environment indicate a risk of impairment of property and equipment and licenses, an impairment test is performed to determine whether the carrying amount of the asset or group of assets under consideration exceeds its or their recoverable amount. Recoverable amount is defined as the higher of an asset's fair value (less costs to sell) and its value in use. Value in use is equal to the present value of future cash flows expected to be derived from the use and sale of the asset

## 3. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Provisions

A provision is recognized in the statement of financial position when the Company has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, 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, where appropriate, the risks specific to the liability.

Finance leases

Lease agreements that effectively transfer substantially all the risks and rewards of ownership of the leased assets to the Company are classified as finance leases. Assets held under finance leases are initially recognized at their fair value or, if lower, at amounts equal to the present value of the minimum lease payments, each determined at the inception of the lease. The corresponding liability is included in the statement of financial position as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly as an expense. Finance leased assets are reported under the relevant asset categories, with recognition of a corresponding financial liability. They are depreciated on a 50% declining balance basis over the shorter of their estimated useful life or the term of the agreement.

Operating leases

Lease agreements that do not meet the recognition criteria of a finance lease are classified and recognized as operating leases. Payments made under operating leases are expensed on a straight-line basis over the term of the related lease agreement.

Revenue Recognition

The Company recognizes revenue at the time persuasive evidence of an arrangement exists, price is fixed and determinable, the delivery has occurred and collectability is reasonably assured. Revenues from the sale of the Company's STAR-ISMS® are recognized when the installation of the system is complete, defined to be when the related equipment has been installed in a customer's aircraft or transportation vehicle, tested and accepted by the customer, and has received the necessary regulatory approvals. Installations are generally conducted by customers under the Company’s management and supervision. In the event, the customer chooses to manage the installation without the Company’s supervision, revenues are recognized when the product is delivered to the customer.

Revenues from airtime services are recognized as the services are performed based on air time used by the customer. The customer is billed at the end of each month.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Revenue Recognition (Cont'd)

In the event that the Company's STAR-ISMS® and airtime are sold as a bundled package, the Company enters into transactions that represent multiple-element arrangements. These multiple-element arrangements are assessed to determine whether they can be sold separately in order to determine if they can be treated as more than one unit of accounting or element for the purpose of revenue recognition. When there are multiple elements or units of accounting in an arrangement, the arrangement consideration is allocated to the separate units of accounting or elements on a relative fair value basis, as determined by reliable objective evidence of fair value. Objective evidence of fair value is based on the price charged when the elements are sold separately, which is in accordance with the Corporation's standard price list. If elements cannot be sold separately, revenue recognition is deferred until all elements have been delivered.

Research and Development Expenses

Research and development expenses represent costs incurred for development and certification of the Company's STAR-ISMS® and its peripherals. Research costs are expensed as incurred. Expenditures during the development phase are capitalized if the Company can demonstrate each of the following criteria: (i) the technical feasibility of completing the intangible asset so that it will be available for use or sale, (ii) its intention to complete the intangible asset and use or sell it, (iii) its ability to use or sell the intangible asset, (iv) how the intangible asset will generate probable future economic benefits, (v) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset, and (vi) its ability to measure reliably the expenditure attributable to the intangible asset during its development; otherwise, they are expensed as incurred.

Investment tax credits

The Company accrues investment tax credits for qualifying research and development costs when there is reasonable assurance that the amounts are recoverable. The Company accounts for the investment tax credits relating to research and development expenses as a deduction in the statement of loss and those relating to capital expenditures as a reduction of the cost of the assets acquired.

Foreign Exchange

Monetary assets and liabilities denominated in foreign currencies are translated at the period end exchange rate. Non-monetary assets and liabilities as well as revenue and expense transactions denominated in foreign currencies are translated at the rate prevailing at the time of the transaction. Translation gain or loss adjustments are recognized in the period in which they occur.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Loss Per Share

Basic loss per share is calculated by dividing the net loss available to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted earnings per share is determined by adjusting the net 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 share options and warrants issued by the Company.

Stock-Based Compensation and Other Stock-Based Payments

The Company applies a fair value based method of accounting to all stock-based payments. Accordingly, stock-based payments for employees are measured at the fair value of the equity instruments issued and stock-based payments for non-employees are measured at the fair value of the consideration received or liabilities incurred, whichever is more reliably measurable. Each tranch is an award is considered a separate award with its own vesting period and fair value. Stock-based compensation is charged to operations over the tranche's vesting period and the offset is credited to contributed surplus. Consideration received upon the exercise of stock options is credited to share capital and the related contributed surplus is transferred to share capital.

Valuation of Warrants

Warrants issued are valued at fair value of the warrants on the date of the grant, determined using the Black-Scholes option-pricing model. Option pricing models require input of highly subjective assumptions, including the expected price volatility. Changes to these assumptions can materially affect the fair value estimate.

Share Issuance Costs

Costs incurred in connection with the issuance of capital stock are deferred and netted against the proceeds received.

Income Taxes

The Company accounts for income taxes using the asset and liability method whereby future income tax assets and liabilities are recorded based on temporary differences between the financial reporting and tax bases of the Company's assets and liabilities. The deferred benefits of income tax assets, including unused tax losses, are recognized subject to a valuation allowance, to the extent that it is more likely than not that such losses will be ultimately realized. These deferred income tax assets and liabilities are measured using substantially enacted tax rates and laws that are expected to apply when the tax assets or liabilities are to be settled or realized.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Accounting Estimates and Judgements

The preparation of interim consolidated financial statements in compliance with IFRS requires the Company's management to make certain estimates and assumptions that they consider reasonable and realistic. Despite regular reviews of these estimates and assumptions, based in particular on past achievements or anticipations, facts and circumstances may lead to changes in these estimates and assumptions which could impact the reported amount of the Company's assets, liabilities, equity or earnings. These estimates and assumptions notably relate to the measurement of impairment in assets, stock-based compensation, deferred income taxes, provisions and contingencies.

Financial Instruments

Financial assets are classified into one of the following categories based on the purpose for which the asset was acquired. All transactions related to financial instruments are recorded on a trade date basis. The Company's accounting policy for each category is as follows:

Financial assets at fair value through profit or loss ("FVTPL")

A financial asset is classified at fair value through profit or loss if it is classified as held for trading or is designated as such upon initial recognition. Financial assets are designated as at FVTPL if the Company manages such investments and makes purchase and sale decisions based on their fair value in accordance with the Company's risk management strategy. Attributable transaction costs are recognized in profit or loss when incurred. FVTPL are measured at fair value, and changes are recognized in profit or loss.

Held-to-maturity ("HTM")

These assets are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Company's management has the positive intention and ability to hold to maturity. These assets are measured at amortized costs using the effective interest method. If there is objective evidence that the asset is impaired, determined by reference to external credit ratings and other relevant indicators, the financial asset is measured at the present value of estimated future cash flows. Any changes to the carrying amount of the investment, including impairment losses, are recognized in profit or loss.

Loans and receivables

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

## 3. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Available for sale ("AFS")

Non-derivative financial assets not included in the above categories are classified as available-for-sale. They are carried at fair value with changes in fair value recognized directly in equity. Where a decline in the fair value of an available-for-sale financial asset constitutes objective evidence of impairment, the amount of the loss is removed from equity and recognized in profit or loss.

Financial liabilities

Financial liabilities are classified into one of two categories:

- Fair value through profit or loss;
- Other financial liabilities.

Fair value through profit or loss

This category comprises derivatives, or liabilities, acquired or incurred principally for the purpose of selling or repurchasing it in the near term. They are carried in the statement of financial position at fair value with changes in fair value recognized in profit or loss.

Other financial liabilities

This category is recognized at amortized cost.

Impairment of financial assets

Financial assets, other than those at FVTPL, are assessed for indicators of impairment at the end of each reporting period. Financial assets are impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial assets, the estimated future cash flows of the investments have been impacted.

For all financial assets objective evidence of impairment could include:

- significant financial difficulty of the issuer or counterparty; or
- default or delinquency in interest or principal payments; or
- it becoming probable that the borrower will enter bankruptcy or financial re-organization.

For certain categories of financial assets, such as receivables, assets that are assessed not to be impaired individually are subsequently assessed for impairment on a collective basis. The carrying amount of financial assets is reduced by the impairment loss directly for all financial assets with the exception of receivables, where the carrying amount is reduced through the use of an allowance account. When a receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognized in profit or loss.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Financial Instruments (Cont'd)

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date of impairment is reversed does not exceed what the amortized cost would have been had the impairment not be recognized.

The company has classified its financial assets and liabilities as follows:

| Financial Instrument | Classification |
|---|---|
| Cash and cash equivalents | FVTPL |
| Accounts receivable | Loans and receivables |
| Accounts payable and accrued liabilities | Other liabilities |
| Due to related parties | Other liabilities |
| Other payables | Other liabilities |
| Finance lease obligation | Other liabilities |

The Company had no other comprehensive income or loss transactions during the period ended September 30, 2011.

Fair Value Hierarchy

The following summarizes the methods and assumptions used in estimating the fair value of the Company's financial instruments where measurement is required. The fair value of financial instruments approximates their carrying amounts due to the relatively short period to maturity. These include cash and cash equivalents. Fair value amounts represent point-in-time estimates and may not reflect fair value in the future. The measurements are subjective in nature, involve uncertainties and are a matter of significant judgement. The methods and assumptions used to develop fair value measurements, for those financial instruments where fair value is recognized in the balance sheet, have been prioritized into three levels as per the fair value hierarchy included in IFRS. Level one includes quoted prices (unadjusted) in active markets for identical assets or liabilities. Level two includes inputs that are observable other than quoted prices included in level one. Level three includes inputs that are not based on observable market data.

## 3. **SIGNIFICANT ACCOUNTING POLICIES** (Cont'd)

Fair Value Hierarchy (Cont'd)

| **September 30, 2011** | **Level One** | **Level Two** | **Level Three** |
|---|---|---|---|
| Cash and cash equivalents | **$ 733,152** | **$ -** | **$ -** |

| June 30, 2011 | Level One | Level Two | Level Three |
|---|---|---|---|
| Cash and cash equivalents | $ 1,721,524 | $ - | $ - |

| July 1, 2010 | Level One | Level Two | Level Three |
|---|---|---|---|
| Cash and cash equivalents | $ 2,022,926 | $ - | $ - |

## 4. RECENT ACCOUNTING PRONOUNCEMENTS ISSUES AND NOT YET APPLIED

Future IFRS changes

Certain pronouncements were issued by the IASB or the IFRIC that are mandatory for accounting periods after December 31, 2010 or later periods. Many are not applicable or do not have a significant impact to the Company. The following have not yet been adopted and are being evaluated to determine the resultant impact on the Company.

(i) IFRS 9 *Financial Instruments* was issued by the IASB in October 2010 and will replace IAS 39 *Financial Instruments: Recognition and Measurement*. IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. IFRS 9 is effective for annual periods beginning on or after January 1, 2013. The IASB has proposed to move the effective date of IFRS 9 to January 1, 2015.

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

## 4. RECENT ACCOUNTING PRONOUNCEMENTS ISSUES AND NOT YET APPLIED (Cont'd)

Future IFRS changes (Cont'd)

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

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

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

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

## 5. PROPERTY AND EQUIPMENT

| | Leasehold Improvement | Aircraft | Furniture and Equipment | Computer Equipment and Software | Computer Equipment under Finance Lease | Vehicles | Production Equipment | **Total** |
|---|---|---|---|---|---|---|---|---|
| **Cost** | | | | | | | | |
| **Balance at July 1, 2010** | $81,114 | $- | $69,180 | $107,225 | $8,262 | $6,690 | $146,305 | **$418,776** |
| Additions | 2,600 | 50,951 | - | 31,510 | - | - | 241,073 | **326,134** |
| **Balance at June 30, 2011** | 83,714 | 50,951 | 69,180 | 138,735 | 8,262 | 6,690 | 387,378 | **744,910** |
| Additions | - | - | - | - | - | - | - | **-** |
| **Balance at September 30, 2011** | $83,714 | $50,951 | $69,180 | $138,735 | $8,262 | $6,690 | $387,378 | **$744,910** |
| **Accumulated amortization** | | | | | | | | |
| **Balance at July 1, 2010** | $12,270 | $- | $57,096 | $92,692 | $6,133 | $3,492 | $- | **$171,683** |
| Amortization for period | 16,613 | 6,369 | 2,418 | 15,144 | 1,064 | 959 | - | **42,567** |
| **Balance at June 30, 2011** | 28,883 | 6,369 | 59,514 | 107,836 | 7,197 | 4,451 | - | **214,250** |
| Amortization for period | 4,186 | 2,787 | 385 | 3,862 | 133 | 169 | - | **11,522** |
| **Balance at September 30, 2011** | $33,069 | $9,156 | $59,899 | $111,698 | $7,330 | $4,620 | $- | **$225,772** |
| **Carrying Amounts** | | | | | | | | |
| As at July 1, 2010 | $68,844 | $- | $12,084 | $14,533 | $2,219 | $3,198 | $- | **$247,093** |
| As at June 30, 2011 | 54,831 | 44,582 | 9,666 | 30,899 | 1,065 | 2,239 | - | **530,660** |
| **As at September 30, 2011** | $50,645 | $41,795 | $9,281 | $27,037 | $932 | $2,070 | $- | **$519,138** |

(a) Production equipment was not ready for use at September 30, 2011 and accordingly, no amortization has been recorded.

## 6. LICENSES

| | |
|---|---|
| **Cost** | |
| **Balance at July 1, 2010, June 30, 2011 and September 30, 2011** | **$133,006** |
| | |
| **Accumulated amortization** | |
| **Balance at July 1, 2010** | **$124,143** |
| Amortization for period | **1,000** |
| **Balance at June 30, 2011** | **125,143** |
| Amortization for period | **250** |
| **Balance at September 30, 2011** | **$125,393** |
| | |
| **Carrying Amounts** | |
| As at July 1, 2010 | **$8,863** |
| As at June 30, 2011 | **7,863** |
| As at September 30, 2011 | **$7,613** |

In 2002, the Company acquired the license rights to the STAR-ISMS® from a director and a former The underlying patents are now owned by one director of the Company (see Note 12). The Company owns the exclusive, worldwide license for the lifetime of the patents.

## 7. FINANCE LEASE OBLIGATION

During the year ended June 30, 2008, the Company entered into a finance lease for computer equipment. The gross amount of the minimum lease payments related to assets under the finance lease was $7,650. The lease bears interest at 15.92%. The term of the lease is for 48 monthly payments, expiring on January 10, 2012. The following is a schedule of the future minimum lease payments under this capital lease expiring by 2012 together with the balance of the obligation under the finance lease.

| | **Sept 30, 2011** | **June 30, 2011** | **July 1, 2010** |
|---|---|---|---|
| 2011 | **$ -** | **$ -** | **$ 2,809** |
| 2012 | **853** | **1,639** | **1,639** |
| Total minimum payments | **853** | **1,639** | **4,448** |
| Less: interest at the implicit rate of 15.9% | **-** | **(84)** | **(359)** |
| Balance of the obligation | **853** | **1,555** | **4,089** |
| Less: current portion | **(853)** | **(1,555)** | **(2,534)** |
| | **$ -** | **$ -** | **$ 1,555** |

## 8. DUE TO RELATED PARTIES

Amounts due to related parties represent amounts accrued with respect to compensation and rent due to directors and officers and former directors and officers of the Company as well as a corporation formerly controlled by an officer who is also a director of the Company. Such amounts are non-interest bearing and unsecured.

See notes 3, 6, 12, 16.

## 9. OTHER PAYABLES

Other payables are amounts due to a former employee of the Company with respect to compensation, and are unsecured, non-interest bearing with no fixed terms of repayment.

## 10. SHARE CAPITAL

Authorized

| | |
|---|---|
| 615,000 | Series I First preferred Shares, non-voting, entitled to non-cumulative dividends at a rate of 7% in priority to common shares, redeemable at $1.00 at the option of the Company. |
| 350,000 | Series II First Preferred Shares, non-voting, entitled to cumulative dividends at 9% per annum in priority to common shares and exchangeable for common shares at the rates of 5 common shares, 3.33 common shares and 2.5 common shares for each Series II Preferred Share in each of the first, second and third years after issue respectively. Redeemable at $1.00 per share at the option of the Company. |
| unlimited | common shares |

Issued

| | Number of Shares | | Value | | |
|---|---|---|---|---|---|
| | Series I Preferred | Common | Series I Preferred | Common | Total |
| **Balance at July 1, 2010** | 615,000 | 169,520,906 | **$ 615,000** | **$ 21,391,725** | **$ 22,006,725** |
| Private placement of units (net of issuance costs) | - | 10,875,000 | - | **1,182,325** | **1,182,325** |
| Stock options exercised | - | 400,000 | - | **55,000** | **55,000** |
| Value allocated to stock options exercised | - | - | - | **18,500** | **18,500** |
| **Balance at September 30, 2010** | 615,000 | 180,795,906 | **$ 615,000** | **$ 22,647,550** | **$ 23,262,550** |
| Private placement of units (net of issuance costs) | - | 5,064,000 | - | **1,131,742** | **1,131,742** |
| Units issued as finders' fees related to private placements [(b)] | - | 506,400 | - | **126,600** | **126,600** |
| Value allocated to warrants issued as part of private placements [(a,b)] | - | - | - | **(559,700)** | **(559,700)** |
| Stock options exercised | - | 2,628,672 | - | **366,225** | **366,225** |
| Value allocated to stock options exercised | - | - | - | **191,810** | **191,810** |
| Warrants exercised | - | 600,000 | - | **120,000** | **120,000** |
| Value allocated to warrant exercised | - | - | - | **67,146** | **67,146** |
| **Balance at June 30, 2011** | 615,000 | 189,594,978 | **$ 615,000** | **$ 24,091,373** | **$ 24,706,373** |
| Stock options exercised | - | 352,000 | - | **55,720** | **55,720** |
| Value allocated to stock options exercised | - | - | - | **18,923** | **-** |
| **Balance at September 30, 2011** | 615,000 | 189,949,978 | **$ 615,000** | **$ 24,166,016** | **$ 24,781,016** |

## 10. SHARE CAPITAL (Cont'd)

(a) On September 20, 2010, the Company completed a non-brokered private placement of 10,875,000 units (the "Units") of the Company at an issue price of $0.12 per Unit for gross proceeds totaling $1,305,000. Each Unit consists of one common share and one common share purchase warrant (a "Warrant"). Each Warrant entitles the holder to purchase one common share of the Company (a "Warrant Share") at a price of $0.20 per Warrant Share for a term of 24 months from the closing date. Finder's fee in the amount of $115,400 in cash was paid in connection with this private placement. All securities issued in the offering and any shares issued upon exercise of Warrants are subject to a four month statutory hold period from the date of issuance.

(b) On June 22, 2011, the Company completed a non-brokered private placement of 5,064,000 units (the "Units") of the Company at an issue price of $0.25 per Unit for gross proceeds totaling $1,266,000. Each Unit consists of one common share and one-half common share purchase warrant (a "Warrant"). Each full Warrant entitles the holder to purchase one common share of the Company (a "Warrant Share") at a price of $0.50 per Warrant Share for a term of 24 months from the closing date. Finder's fees in the amount of 506,400 common shares and 253,200 warrants were issued in connection with this private placement. Each warrant is exercisable at a price of $0.50 per Warrant Share for a term of 24 months from the closing date. All securities issued in the offering and any shares issued upon exercise of Warrants are subject to a four month statutory hold period from the date of issuance.

## 11. CONTRIBUTED SURPLUS, STOCK-BASED COMPENSATION AND WARRANTS

Contributed Surplus

| | |
|---|---|
| **Balance at July 1, 2010** | $ 6,437,202 |
| Fair value attributed to stock options | 723,857 |
| Fair value attributed to stock options exercised | (18,500) |
| **Balance at September 30, 2010** | $ 7,142,559 |
| Fair value attributed to stock options | 901,833 |
| Fair value attributed to stock options exercised | (191,810) |
| Fair value attributed to warrants granted | 559,700 |
| Fair value attributed to warrants exercised | (67,146) |
| Warrants modification | 1,862,824 |
| **Balance at June 30, 2011** | $10,207,960 |
| Fair value attributed to stock options exercised | (18,923) |
| Fair value attributed to stock options | 103,926 |
| **Balance at September 30, 2011** | $10,292,963 |

## 11. CONTRIBUTED SURPLUS, STOCK-BASED COMPENSATION AND WARRANTS (Cont'd)

Stock-Based Compensation

The Company has a Stock Option Plan (the "Plan") for employees, officers, directors and consultants performing special technical or other services of the Company ("Optionees"). During 2010, the Company amended the Plan whereby the number of common shares to be issued under the Plan is not to exceed 30,000,000 common shares. The designation of Optionees, amount and vesting provisions of awards under the Plan are determined by the Board of Directors.

| Stock Option Transactions | Number | Exercise Price | Weighted-Average Exercise price |
|---|---|---|---|
| **Balance at July 1, 2010** | **17,245,000** | **$0.20-$0.29** | **$ 0.21** |
| Exercised | (400,000) | $0.10-$0.20 | $ 0.12 |
| Expired | (230,000) | $0.10-$0.30 | $ 0.17 |
| **Balance at September 30, 2010** | **16,615,000** | | **$ 0.22** |
| Issued | 2,900,000 | $0.15-$0.29 | $ 0.20 |
| Exercised | (2,306,172) | $0.10-$0.22 | $ 0.14 |
| Expired | (1,885,000) | $0.11-$0.30 | $ 0.24 |
| **Balance at June 30, 2011** | **15,323,828** | | **$ 0.22** |
| Exercised | (352,000) | $0.10-$0.20 | $ 0.14 |
| **Balance at September 30, 2011** | **14,971,828** | | **$ 0.22** |

## 11. CONTRIBUTED SURPLUS, STOCK-BASED COMPENSATION AND WARRANTS (Cont'd)

As at September 30, 2011 the Company had stock options, issued to directors, officers, employees and key consultants of the Company outstanding as follows:

| Date of Grant | Options Granted | Options Exercisable | Exercise Price | Expiry Date |
|---|---|---|---|---|
| December 15, 2006 | 200,000 | 200,000 | $0.15 | December 15, 2011 |
| October 30, 2007 | 300,000 | 300,000 | $0.25 | October 29, 2012 |
| December 7, 2007 | 1,400,000 | 1,400,000 | $0.20 | December 12, 2012 |
| March 31, 2008 | 452,828 | 452,828 | $0.15 | March 30, 2010 |
| August 21, 2008 | 440,000 | 440,000 | $0.11 | August 20, 2013 |
| November 6, 2008 | 570,000 | 570,000 | $0.15 | November 5, 2013 |
| December 23, 2008 | 221,000 | 221,000 | $0.11 | December 30, 2012 |
| June 30, 2009 | 575,000 | 575,000 | $0.10 | June 14, 2014 |
| January 1, 2010 | 218,000 | 218,000 | $0.21 | January 1, 2012 |
| January 8, 2010 | 500,000 | 500,000 | $0.21 | January 1, 2015 |
| February 8, 2010 | 4,345,000 | 4,235,000 | $0.25 | February 7, 2013 |
| February 26, 2010 | 500,000 | 375,000 | $0.26 | January 1, 2015 |
| March 30, 2010 | 2,025,000 | 2,025,000 | $0.32 | March 31, 2015 |
| June 3, 2010 | 450,000 | 450,000 | $0.22 | March 31, 2015 |
| August 31, 2010 | 800,000 | - | $0.15 | August 31, 2011 |
| February 4, 2011 | 500,000 | 250,000 | $0.21 | January 1, 2015 |
| February 10, 2011 | 100,000 | 100,000 | $0.20 | January 1, 2015 |
| February 14, 2011 | 525,000 | 75,000 | $0.20-$0.21 | February 14, 2013 |
| February 25, 2011 | 500,000 | 125,000 | $0.29 | February 24, 2016 |
| May 31, 2011 | 350,000 | - | $0.21 | May 31, 2014 |
| | 14,971,828 | 12,511,828 | | |

## 11. CONTRIBUTED SURPLUS, STOCK-BASED COMPENSATION AND WARRANTS (Cont'd)

At September 30, 2011, 12,511,828 (2010 – 10,390,083) stock options with a weighted average exercise price of $0.23 (2010 - $0.18) were exercisable. The weighted average life of the options outstanding and exercisable is approximately 2.10 years (2010 – 3.88 years). The weighted average grant date fair value of options issued during the year ended June 30, 2011 is $0.24 per share (2010 - $0.28).

These options vest at varying rates from 25% to 100% per year. The fair value of the options is recognized over the vesting period as compensation expense and contributed surplus. Estimates are made of expected forfeitures or cancellations at the time of the grant of options. The fair value of the stock options granted is determined using the Black-Scholes model for pricing options under the following weighted average assumptions:

| | **2011** | 2010 |
|---|---|---|
| Expected dividend yield | **Nil** | Nil |
| Risk free interest rate | **1.85%** | 2% |
| Expected stock volatility | **103** | 107 |
| Expected Life | **2.71 years** | 3.63 years |

Warrants

| | **Number of Warrants** | | **Weighted-average Exercise Price** | **Expiry Date** |
|---|---|---|---|---|
| **Balance at July 1, 2010** | 54,676,446 | | $0.29 | |
| Issued | 10,875,000 | (i) | $0.20 | Sept 20, 2012 |
| **Balance at September 30, 2010** | 65,551,446 | | $0.33 | |
| Issued | 2,532,000 | (i) | $0.50 | June 22, 2013 |
| Issued | 253,200 | (i) | $0.50 | June 22, 2013 |
| Exercised | (600,000) | | $(0.20) | |
| **Balance at June 30, 2011** | 67,736,646 | | $0.26 | |
| Issued | - | | - | |
| **Balance at September 30, 2011** | 67,736,646 | | $0.26 | |

(i) These warrants were issued as part of unit financings in fiscal 2011 (Note 10).

On January 6, 2011, the Company extended the term of 11,637,766 common share purchase warrants that were issued by the Company as part of the private placements that occurred on May 17, 2007. The term of these warrants were extended by 1.36 years, accordingly, the incremental fair value of these warrants has been estimated using the Black-Scholes option pricing model using the following assumptions: risk-free rate of 1.67%, expected volatility of 100% and expected life of 1.36 years, and an expected dividend of 0%.

## 11. CONTRIBUTED SURPLUS, STOCK-BASED COMPENSATION AND WARRANTS (Cont'd)

On January 6, 2011, the Company extended the term of 4,244,465 common share purchase warrants that were issued by the Company as part of the private placements that occurred on December 3, 2008. The term of these warrants were extended by 1.9 years, accordingly, the incremental fair value of these warrants has been estimated using the Black-Scholes option pricing model using the following assumptions: risk-free rate of 1.67%, expected volatility of 101% and expected life of 1.9 years, and an expected dividend of 0%.

On January 6, 2011, the Company extended the term of 3,052,550 common share purchase warrants that were issued by the Company as part of the private placements that occurred on April 9, 2009. The term of these warrants were extended by 1.9 years, accordingly, the incremental fair value of these warrants has been estimated using the Black-Scholes option pricing model using the following assumptions: risk-free rate of 1.67%, expected volatility of 101% and expected life of 1.9 years, and an expected dividend of 0%.

On January 6, 2011 the Company extended the term of 10,501,666 common share purchase warrants that were issued by the Company as part of the private placements that occurred on November 10, 2009. The term of these warrants were extended by 1.9 years, accordingly, the incremental fair value of these warrants has been estimated using the Black-Scholes option pricing model using the following assumptions: risk-free rate of 1.67%, expected volatility of 101% and expected life of 1.9 years, and an expected dividend of 0%.

On January 6, 2011, the Company extended the term of 3,428,333 common share purchase warrants that were issued by the Company as part of the private placements that occurred on December 4, 2009. The term of these warrants were extended by 1.9 years, accordingly, the incremental fair value of these warrants has been estimated using the Black-Scholes option pricing model using the following assumptions: risk-free rate of 1.67%, expected volatility of 101% and expected life of 1.9 years, and an expected dividend of 0%.

The Black-Scholes value attributed to these modifications was $1,862,824 (2010 - $328,586) and has been recorded in deficit.

The fair value of the warrants issued is determined using the Black-Scholes model for pricing warrants under the following weighted average assumptions:

| | **2011** | 2010 |
|---|---|---|
| Expected dividend yield | **Nil** | Nil |
| Risk free interest rate | **1.68%** | 1.33% |
| Expected stock volatility | **101%** | 108% |
| Expected Life | **1.7 years** | 2 years |

## 12. GAIN ON SETTLEMENT OF DEBT

(a) On May 4, 2010, the Company approved a debt settlement agreement in which the Company issued 1,922,165 common shares at a price of $0.20 per share. The debt settlement resulted in reducing Star's debts to various creditors by $430,941. The debt settlement resulted in a gain on settlement of debt of $46,507.

(b) On December 31, 2009, one of the Company's legal counsels agreed to settle the Company's outstanding balance which resulted in a forgiven amount of $62,520. On January 6, 2010, another legal counsel agreed to settle the Company's outstanding balance which resulted in a forgiven amount of $50,907. These amounts have been recorded as a gain on settlement of debt.

(c) In April 2009, the Company reached a settlement in the action commenced by its former President and Technical Director of the Company (the "Claimant") and co-owner of the ISMS patents described in Note 4. As part of the settlement, the suit against the Company has been dismissed and the Company has in turn agreed to dismiss its counterclaim. The Claimant has also agreed to fully and completely cooperate and provide full disclosure to the Company in any current or future litigation in relation to U.S. Patent No. 7113852 ("the ISMS Patent"), including the litigation currently outstanding with Aeromechanical Services Ltd. and others (see Note 14). Pursuant to this settlement, the Company has agreed to pay to the claimant $116,000 in cash and issued 1,000,000 common shares at a value of $0.06 per share, and the claimant dismissed the claim and forgave $503,320 of amounts owed to him. Under the terms of the agreement the remainder of the settlement, will be repaid in thirty instalments of $3,000. Accordingly, the Company has reflected a long-term portion related to this liability and discounted the future payments at an implicit rate of 12% as described in the table below.

In a separate transaction, the claimant transferred his 50% interest in the ISMS Patent to the co-patent holder, a Company's director who is now the sole owner of the patent.

During 2010, the Company also paid an additional amount of $15,000 to a third party as a result of the above settlement.

| | Sept 30, 2011 | June 30, 2011 | July 1, 2010 |
|---|---|---|---|
| 2011 | $ - | $ - | $ 36,000 |
| 2012 | 9,000 | 18,000 | 18,000 |
| Total minimum payments | 9,000 | 18,000 | 54,000 |
| Less: interest at the implicit rate of 12% | - | (4,577) | (11,202) |
| Balance of the obligation | 9,000 | 13,423 | 42,798 |
| Less: current portion included in accounts payable and accrued liabilities | - | (13,423) | (29,375) |
| | $ - | $ - | $ 13,423 |

## 13. CAPITAL RISK MANAGEMENT

The Company includes equity, comprised of issued share capital, contributed surplus and deficit, in the definition of capital.

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

The Company is not subject to externally imposed capital requirements and there has been no change with respect to the overall capital risk management strategy during the three month period ended September 30, 2011.

## 14. FINANCIAL RISK MANAGEMENT

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

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

(a) Market Risk

(i) Currency risk:

The Company is exposed to foreign exchange risk from various currencies, primarily US dollars. Foreign exchange risk arises from significant sales and purchase transactions as well as recognized financial assets and liabilities denominated in foreign currencies.

The Company's main objective in managing its foreign exchange is to maintain US cash on hand to support US forecasted cash flows over a 12 month horizon. To achieve this objective the Company monitors forecasted cash flows in foreign currencies and attempts to mitigate the risk by modifying the currency of cash held. A 1% change in the foreign exchange rate would have a $5,000 impact on foreign exchange gain.

As at September 30, 2011 the Company held $483,074 (2010 - $554,637) of cash and cash equivalents in US dollars.

## 14. FINANCIAL RISK MANAGEMENT (Cont'd)

(a) Market Risk (Cont'd)

(ii) Interest rate risk:

Interest rate risk is the risk that the future cash flows or the fair value of a financial instrument will fluctuate because of changes in market interest rates. The majority of the Company's debt is at fixed rates, and due in the short term. Accordingly, there is limited exposure to cash flow or price interest rate risk.

(b) Fair Value Risk

The carrying amount of cash and cash equivalents, accounts receivables, accounts payable and accrued liabilities approximate their fair values due to the short-term maturities of these instruments. The long-term portion of accounts payable and accrued liabilities and capital lease obligation has been discounted at a rate that approximates current market rates and therefore, approximates fair value. The fair values of amounts due to related parties and other payable (Notes 8 and 9) cannot be reliably determined due to the uncertainty as to when these amounts will be paid.

(c) Credit Risk

The Company does not believe it is exposed to any significant concentration of credit risk. However, as disclosed in Note 17, the Company earns a significant amount of revenue from one customer. As at September 30, 2011, approximately $58,387 (2010 - $70,000) of the Company's receivables were past due the average credit period of 90 days.

(d) Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its obligations as they fall due.

The Company manages its liquidity risk by forecasting cash flows from operations and anticipated investing and financing activities. Senior management is also actively involved in the review and approval of planned expenditures.

As at September 30, 2011, the Company has current liabilities of $1,186,550 due within 12 months and has cash of $733,152 to meet its current obligations. As at September 30, 2011 the Company has working capital deficiency of $180,858 and accordingly, the Company is subject to liquidity risk. Management will continue to raise capital to develop, market and promote its STAR-ISMS® technology and to maintain its ongoing operations.

## 15. COMMITMENTS AND CONTINGENCIES

(a) The Company is committed to leases of its premises and equipment. Minimum lease payments for successive years are as follows:

| Year | Premises | Equipment | Total |
|---|---|---|---|
| 2012 | 108,000 | 6,028 | $ 114,028 |
| 2013 | 144,000 | 6,143 | 150,143 |
| 2014 | 144,000 | 6,143 | 150,143 |
| 2015 | 144,000 | 6,143 | 150,143 |
| 2016 | 36,000 | 698 | 36,698 |
| | 576,000 | 25,155 | $ 601,155 |

(b) The Company has filed a notice of dismissal of its patent infringement lawsuit against Aeromechanical Services Ltd. (TSX-V: AMS). However, there is still a pending counterclaim in Ontario yet to be settled as of this date. AMS has filed a counterclaim against the Company claiming, among other things, $5,000,000 for lost revenue and investment capital, $10,000,000 for loss of reputation and $5,000,000 for loss of goodwill. The matter is at the discovery stage. Management believes that they will be successful defending this claim and that the claim is invalid and therefore, no amount has been accrued in the financial statements.

## 16. RELATED PARTY TRANSACTIONS

The Company has accrued and carries a significant balance on its financial statements of amounts due to related parties. The amounts represent compensation accrued with respect to salary compensation for its officers, monthly compensation accrued for its directors, advisory board members and committee chairpersons that have accumulated over the past several years. The Company's Board of Directors are compensated at the rate of $2,000 per month for performing duties such as providing guidance to management in areas such as budgeting, new sales contracts or joint ventures anticipated and any other issues that management deems necessary.

Advisory Board members are business people with expertise in the Aviation industry who help the Company attain access to the decision makers of major airlines to help promote the Company's STAR-ISMS®. They are remunerated at the rate of $15,000 per year. Committee Chairperson's are selected from amongst the Directors of the Company to lead the Audit, Compensation and Corporate Governance committees. Chairpersons are remunerated at the rate of $2,000 per month. All of the above amounts are accrued in the financial statements of the Company. The terms for repayment of the amounts owing to the various Board, Advisory and Committee members are restricted.

These amounts can only be settled when individuals wish to exercise options that have been granted to them by the Company or to participate in a private placement being done by the Company.

## 16. RELATED PARTY TRANSACTIONS (Cont'd)

At September 30, 2011, management estimates that there is the potential for the amounts due to be paid in this fiscal year, and accordingly they have been classified as current liabilities. The only fixed contractual obligations the Company has with related parties are the compensation contracts it has with the CEO, COO, CTO and CFO.

The following balances are to due to related parties as of September 30, 2011:

Due to Directors - $241,000 (2010 - $158,250), Due to Advisory Board members - $84,500 (2010 - $84,500) and Due to Committee Chairpersons - $100,000 (2010 - $78,000). Due to Chief Technical Officer and member of the Board of Directors - $Nil (2010 - $1,576), which amount resulted from the accrual of salary, and Due to Chief Executive Officer and Chairman of the Board of Directors - $1,097,366 (2010 – $1,056,869) of which the terms on $1,000,000 was modified after year end (note 17). This amount resulted from salary accrual in prior years including certain years where as CEO no salary was taken due to the economic limitations the Company was experiencing at the time. The CEO also financed the Company at various times when the Company was experiencing funding shortfalls and deferred repayment until the Company attained financial stability. Due to related parties also includes due to a corporation formally controlled by an officer who is also a director of the Company - $Nil (2010 - $28,090).

Included on the statement of operations for the three month period ended September 30, 2011, in general and administrative expenses is $179,500 (2010 - $134,500) in fees paid and accrued to directors and officers of the Company; this includes rent expense of $36,000 (2010 - $30,000) that was paid to a corporation formerly controlled by an officer who is also a director of the Company. An amount of $70,500 (2010 - $65,000) was paid to the Company CEO. Board of Directors fees of $14,000 (2010 - $18,000) were accrued. Advisory Board fees of $15,500 (2010 - $15,500) and were accrued. Chairperson fees of $6,000 (2010 - $6,000). Included in research and development is $45,000 (2010 - $45,000) in fees paid and accrued to the Chief Technical Officer and a director of the Company. Payments to the Chief Operating Officer $37,500 (2010 - $Nil). Professional fees of $16,500 (2010 – $12,000) were paid to the Chief Financial Officer of the Company.

The amounts owing to the related parties are unsecured, non-interest bearing with no fixed terms of repayment.

See also Notes 3, 6, 8 and 12.

## 17. SIGNIFICANT CUSTOMER

During the period ended September 30, 2011, 67% (2010 - 71%) of the revenue was generated from one customer.

## 18. SUBSEQUENT EVENTS

- In October 2011, the Company changed the terms of advances of $1,000,000 owing to an officer and director (note 6 and 16). This amount will become interest bearing at an interest rate to be determined by the Board of Directors at an upcoming Board meeting retroactive to July 1, 2011 and will have a maturity date of October 28, 2012. Accordingly, the amount has been presented as a long term liability.

- In December, 2011, the Company entered into a new Licensing Agreement with respect to its patented technology. The new Licensing Agreement provides for the payment of royalties to the patent owner in return for the patent owner becoming a party to the Astrium/Paradigm agreement and the assumption of potential liability.

- In December, 2011 the Company extended the term of 19,948,666 common share purchase warrants issued pursuant to a private placement announced January 12, 2010. The Warrants, set to expire on January 12, 2012, will now expire on January 12, 2014. Each Warrant will continue to entitle the holder thereof to purchase one common share of Star at an exercise price of $0.30.

## 19. RECONCILIATION FROM CANADIAN GAAP TO IFRS

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

The policies set out in the Significant Accounting Policies section have been applied in preparing the financial statements for the three month periods ended September 30, 2011, the comparative information presented in these financial statements for the year ended June 30, 2011 and in the preparation of an opening IFRS balance sheet at July 1, 2010 (the Company's date of transition).

The Company has followed the recommendations in IFRS-1 First-time adoption of IFRS, in preparing its transitional statements. IFRS-1 provides specific one-time choices and mandates specific one-time exceptions with respect to first-time adoption of IFRS.

(a) Business Combinations

IFRS 1 allows that a first-time adopter may elect not to apply IFRS 3 Business Combinations retrospectively to business combinations that occurred before the date of transition to IFRS. The Company has taken advantage of this election and has not applied IFRS 3 to business combinations that occurred before July 1, 2010.

## 19. RECONCILIATION FROM CANADIAN GAAP TO IFRS (Cont'd)

(b) Share-based payment transactions

IFRS 1 encourages, but does not require, first-time adopters to apply IFRS 2 Share-based Payment to equity instruments that were granted on or before November 7, 2002, or equity instruments that were granted subsequent to November 7, 2002 and vested before the date of transition to IFRS, July 1, 2010. The Company did not to apply IFRS 2 to awards that were granted on or before November 7, 2002 and granted after November 7, 2002 and vested by July 1, 2010.

(c) Property and equipment and intangibles

IFRS 1 permits first-time preparers to measure selected assets at fair value and use that fair value as deemed cost of those assets on the transition date. The Company has chosen not to utilize this optional exemption and continue to use the cost model for its property and equipment and intangibles as of the date of transition to IFRS.

Additionally, the Company has applied the following mandatory exception as at the transition date.

Estimates

In accordance with IFRS 1, an entity's estimates under IFRS at the date of transition to IFRS must be consistent with estimates made for the same date under previous GAAP, unless there is objective evidence that those estimates were in error. The Company's IFRS estimates as of July 1, 2010 are consistent with its Canadian GAAP estimates for the same date.

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

There are also no material differences between the cash flow statement presented under Canadian GAAP and that presented under IFRS for the period ended September 30, 2010 and for the year ended June 30, 2011.

Notes to the reconciliation of assets, liabilities and equity;

a) Stock based compensation

Under IFRS, graded vesting awards must be accounted for as though each instalment is a separate award. IFRS doesn't provide for an election to treat the instruments as a pool, determine the aggregate fair value using an average life of the instruments and recognize compensation cost on a straight-line basis, as elected by the Company under Canadian GAAP.

a) Stock based compensation (Cont'd)

Under IFRS, the estimates of the number of equity-settled awards that vest are adjusted to the actual number that vest, unless forfeitures are due to market-based conditions. There is no choice to accrue compensation cost as if all instruments granted were expected to vest and recognize the effect of the forfeitures as they occur as elected by the Company under Canadian GAAP.

Under IFRS, when the grant date occurs after the service commencement date, the recognition of services during the period from service commencement date until grant date would be based on the estimated fair value at grant date and adjusted subsequently to the actual grant date fair value. Unlike IFRS, unless the award is granted, there is no ability to commence the recognition of the cost under Canadian GAAP.

The above differences resulted in a significant transitional impact as follows;

For the period of beginning July 1, 2010, the use of grading vesting awards resulted in an adjustment to increase the opening deficit by $1,151,047 and a corresponding increase to contributed surplus of the same amount.

For the period ending September 30, 2010, the use of grading vesting awards resulted in an increase to stock-based compensation of $477,735. This increased the loss for that period to $1,334,842.

For the year-ended June 30, 2011 the net adjustment to stock-based compensation was $375,933 resulting in a loss of $4,483,728.

The cumulative impact to the Company's financial statements for the change-over to IFRS was an increase to deficit of $1,526.980 for the year-ended June 30, 2011.

b) Reclassification of long-term liability to current liability.

Under CGAAP the Company had reclassified a portion of its current liabilities due to a director of the Company from current to long-term. Under IFRS this reclassification is not allowed and as such the long-term portion has been reallocated to current from long-term for June 30, 2011 and September 30, 2011.

## 19. Reconciliation from Canadian GAAP to IFRS (Cont'd)

### Statement of Financial Position

| At date of IFRS transition July 1, 2010 | Note | Canadian GAAP | Effect of Transition to IFRS | IFRS |
|---|---|---|---|---|
| **Assets** | | | | |
| **Current** | | | | |
| Cash and cash equivalents | | $ 2,022,926 | $ - | $ 2,022,926 |
| Accounts receivable | | 150,189 | - | 150,189 |
| Prepaid expenses and sundry receivables | | 88,681 | - | 88,681 |
| | | 2,261,796 | - | 2,261,796 |
| Property and equipment | | 247,093 | - | 247,093 |
| Licenses | | 8,863 | - | 8,863 |
| | | $ 2,517,752 | $ - | $ 2,517,752 |
| **Liabilities** | | | | |
| **Current** | | | | |
| Accounts payables and accrued liabilities | | $ 365,721 | $ - | $ 365,721 |
| Current portion of finance lease obligation | | 2,534 | | 2,534 |
| Due to related parties | | 1,709,782 | | 1,709,782 |
| Other payables | | 196,000 | | 196,000 |
| Deferred revenue | | - | | - |
| | | 2,274,037 | | 2,274,037 |
| Due to related parties | | - | | - |
| Long term portion of accounts payable and accrued liabilities | | 13,423 | | 13,423 |
| Finance lease obligation | | 1,555 | | 1,555 |
| | | 2,289,015 | | 2,289,015 |
| **Shareholders' Equity (Deficiency)** | | | | |
| Share capital | | 22,006,725 | - | 22,006,725 |
| Contributed Surplus | (a) | 5,286,155 | 1,151,047 | 6,437,202 |
| Deficit | (a) | (27,064,143) | (1,151,047) | (28,215,190) |
| | | 228,737 | - | 228,737 |
| | | $ 2,517,752 | $ - | $ 2,517,752 |

## 19. Reconciliation from Canadian GAAP to IFRS (Cont'd)

### Statement of Financial Position

| At September 30, 2010 | Note | Canadian GAAP | Effect of Transition to IFRS | IFRS |
|---|---|---|---|---|
| **Assets** | | | | |
| **Current** | | | | |
| Cash and cash equivalents | | $ 2,373,053 | $ - | $ 2,373,053 |
| Accounts receivable | | 150,576 | - | 150,576 |
| Prepaid expenses and sundry receivables | | 114,440 | - | 114,440 |
| | | 2,638,069 | - | 2,638,069 |
| Property and equipment | | 326,641 | - | 326,641 |
| Licenses | | 8,863 | - | 8,863 |
| | | $ 2,973,573 | $ - | $ 2,973,573 |
| **Liabilities** | | | | |
| **Current** | | | | |
| Accounts payables and accrued liabilities | | $ 501,402 | $ - | $ 501,402 |
| Current portion of finance lease obligation | | 2,534 | | 2,534 |
| Due to related parties | | 1,379,195 | | 1,379,195 |
| Other payables | | 224,090 | | 224,090 |
| Deferred revenue | | - | | - |
| | | 2,107,221 | | 2,107,221 |
| Due to related parties | | - | | - |
| Long term portion of accounts payable and accrued liabilities | | 10,423 | | 10,423 |
| Finance lease obligation | | 852 | | 852 |
| | | 2,118,496 | | 2,118,496 |
| **Shareholders' Equity (Deficiency)** | | | | |
| Share capital | | 23,262,550 | - | 23,262,550 |
| Contributed Surplus | (a) | 5,513,777 | 1,628,782 | 7,142,559 |
| Deficit | (a) | (27,921,250) | (1,628,782) | (29,550,032) |
| | | 855,077 | - | 855,077 |
| | | $ 2,973,573 | $ - | $ 2,973,573 |

## 19. Reconciliation from Canadian GAAP to IFRS (Cont'd)

### Statement of Financial Position

| At June 30, 2011 | Note | Canadian GAAP | Effect of Transition to IFRS | IFRS |
|---|---|---|---|---|
| **Assets** | | | | |
| **Current** | | | | |
| Cash and cash equivalents | | $ 1,721,524 | $ - | $ 1,721,524 |
| Accounts receivable | | 69,921 | - | 69,921 |
| Prepaid expenses and sundry receivables | | 404,356 | - | 404,356 |
| | | 2,195,801 | - | 2,195,801 |
| Property and equipment | | 530,660 | - | 530,660 |
| Licenses | | 7,863 | - | 7,863 |
| | | $ 2,734,324 | $ - | $ 2,734,324 |
| **Liabilities** | | | | |
| **Current** | | | | |
| Accounts payables and accrued liabilities | | $ 538,221 | $ - | $ 538,221 |
| Current portion of finance lease obligation | | 1,555 | | 1,555 |
| Due to related parties | (b) | 635,957 | 1,000,000 | 1,635,957 |
| Other payables | | 196,000 | | 196,000 |
| Deferred revenue | | 10,000 | | 10,000 |
| | | 1,381,733 | | 2,381,733 |
| Due to related parties | (b) | 1,000,000 | (1,000,000) | - |
| Long term portion of accounts payable and accrued liabilities | | - | | - |
| Finance lease obligation | | - | | - |
| | | 2,381,733 | | 2,381,733 |
| **Shareholders' Equity (Deficiency)** | | | | |
| Share capital | | 24,706,373 | - | 24,706,373 |
| Contributed Surplus | (a) | 8,680,980 | 1,526,980 | 10,207,960 |
| Deficit | (a) | (33,034,762) | (1,526,980) | (34,561,742) |
| | | 352,591 | | 352,591 |
| | | $ 2,734,324 | $ - | $ 2,734,324 |

## 19. Reconciliation from Canadian GAAP to IFRS (Cont'd)

### Statement of Comprehensive Income

| For the period ended September 30, 2010 | Notes | Canadian GAAP | Effect of Transition to IFRS | IFRS |
|---|---|---|---|---|
| **Revenue** | | $ 31,804 | $ - | $ 31,804 |
| **Cost of Sales** | | 29,892 | | 29,892 |
| **Gross Profit** | | 1,912 | | 1,912 |
| **Expenses** | | | | |
| General and administrative | | 205,459 | | 205,459 |
| Research and development | | 135,544 | | 135,544 |
| Marketing and promotion | | 120,650 | | 120,650 |
| Professional fees | | 102,963 | | 102,963 |
| Stock-based compensation | (a) | 246,122 | 477,735 | 723,857 |
| Amortization | | 22,951 | | 22,951 |
| | | 833,689 | 477,735 | 1,311,424 |
| **Loss before undernoted items and income taxes** | | (831,777) | (477,735) | (1,309,512) |
| **Other income (expenses)** | | | | |
| Interest income | | 2,044 | | 2,044 |
| Foreign exchange gain (loss) | | (35,136) | | (35,136) |
| Income tax recovery | | 7,762 | | 7,762 |
| | | (25,330) | | (25,330) |
| **Net loss and comprehensive loss for the period** | | (857,107) | (477,735) | (1,334,842) |
| **Deficit, beginning of period** | | (27,064,143) | (1,151,047) | (28,215,190) |
| **Deficit, end of period** | | $ (27,921,250) | $ (1,628,782) | $ (29,550,032) |

## 19. Reconciliation from Canadian GAAP to IFRS (Cont'd)

### Statement of Comprehensive Income

| For the year ended June 30, 2011 | Note | Canadian GAAP | Effect of Transition to IFRS | IFRS |
|---|---|---|---|---|
| **Revenue** | | $ 98,591 | $ - | $ 98,591 |
| **Cost of Sales** | | 78,979 | | 78,979 |
| **Gross Profit** | | 19,612 | | 19,612 |
| **Expenses** | | | | |
| General and administrative | | 953,091 | | 953,091 |
| Research and development | | 717,807 | | 717,807 |
| Marketing and promotion | | 413,339 | | 413,339 |
| Professional fees | | 646,050 | | 646,050 |
| Stock-based compensation | (a) | 1,249,757 | 375,933 | 1,625,690 |
| Amortization | | 46,707 | | 46,707 |
| | | 4,026,751 | 375,933 | 4,402,684 |
| **Loss before undernoted items and income taxes** | | (4,007,139) | (375,933) | (4,383,072) |
| **Other income (expenses)** | | | | |
| Interest income | | - | | - |
| Foreign exchange gain (loss) | | (83,441) | | (83,441) |
| Lawsuit settlement | | (17,215) | | (17,215) |
| Income tax recovery | | - | | - |
| | | (100,656) | | (100,656) |
| **Net loss and comprehensive loss for the period** | | (4,107,795) | (375,933) | (4,483,728) |
| **Deficit, beginning of period** | | (27,064,143) | (1,151,047) | (28,215,190) |
| **Modification of warrants** | | (1,862,824) | - | (1,862,824) |
| **Deficit, end of period** | | $ (33,034,762) | $ (1,526,980) | $ (34,561,742) |