SUSPECT DECTECTION SYSTEMS INC.

CONSOLIDATED BALANCE SHEETS

U.S. dollars

ASSETS	December 31, 2011	December 31, 2010
Current Assets:		
Cash and cash equivalents	$ 475,945	$ 803,443
Restricted cash	14,595	115,501
Accounts receivable	21,731	288,037
Inventory	66,294	188,185
Prepaid expenses and other receivables	20,912	253,864
Total current assets	599,477	1,649,030
Property and Equipment:		
Computer and other equipment	60,766	56,556
Less - Accumulated depreciation	(37,729)	(25,687)
Property and equipment, net	23,037	30,869
Other Assets:		
Severance pay fund	32,243	89,684
Long term prepaid expenses	1,293	7,300
Goodwill	1,333,214	1,333,214
Total other assets	1,366,751	1,430,198
Total Assets	$ 1,989,265	$ 3,110,097

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

CONSOLIDATED BALANCE SHEETS

U.S. dollars

LIABILITIES AND STOCKHOLDERS' EQUITY December 31,

SUSPECT DECTECTION SYSTEMS INC.

	2011	2010
Current Liabilities:		
Accounts payable - Trade	$ 12,198	$ 43,174
Accrued liabilities	91,770	227,228
Advances from customers	19,000	1,656,249
Deferred revenues	40,825	112,890
Due to related parties	644,104	283,257
Total current liabilities	807,897	2,322,798
Long-term Debt:		
Convertible note	466,273	
Accrued severance pay	32,243	88,560
Total liabilities	498,516	2,411,358
Commitments and Contingencies		
Stockholders' Equity:		
Common stock, par value $0.0001 per share, 250,000,000 shares authorized; 79,180,892 and 76,555,493 shares issued and Outstanding at December 31, 2011 and 2010, respectively	7,918	7,655
Additional paid-in capital	5,519,011	3,399,961
Common stock subscribed	-	-
Accumulated deficit	(4,991,013)	(2,785,098)
Total incorporated stockholders' equity, Net	535,916	622,518
Less - Noncontrolling interest	146,937	76,221
Total stockholders' equity	698,739	698,739
Total Liabilities and Stockholders' Equity	$ 1,989,265	$ 3,110,097

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

SUSPECT DECTECTION SYSTEMS INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

U.S. dollars

	For the Year Ended December 31, 2011	2010
Revenues, net	$ 2,055,002	$ 1,731,384
Cost of Goods Sold	151,806	147,821
Gross Profit	1,903,196	1,583,563
Expenses:		
Research and development	384,083	417,508
Selling, general and administrative	3,514,704	2,138,196
Total operating expenses	3,898,787	2,555,704
(Loss) from Operations	(1,995,591)	(972,141)
Financial expense	(24,299)	(23,035)
Income tax	(2,143)	
Net (loss)	(2,022,023)	(995,176)
Net loss (income) Attributable to Noncontrolling Interest	(183,891)	(10,102)
Net (loss) attributable to Suspect Detection Systems Inc.	$ (2,205,914)	$ (1,005,278)
(Loss) Per Common Share:		
(Loss) per common share - Basic and Diluted	$ (0.03)	$ (0.01)
Weighted Average Number of Common Shares Outstanding - Basic and Diluted	76,805,693	69,387,293

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

SUSPECT DECTECTION SYSTEMS INC.

STATEMENTS OF STOCKHOLDERS' EQUITY

U.S. dollars

	Common stock		Additional Paid-in	Common Stock	Accumulated	Noncontroling Interest			
	Shares	Amount	Capital	Subscriptions	(Deficit)	Equity	Loss	Total	Total
Balance as of January 1, 2010	71,822,893	$ 7,182	$ 2,580,533	$ 25,000	$ (1,779,820)	$ 394,464	$ (328,345)	$ 66,119	$ 899,014
Common stock issued for services	1,432,600	143	176,830		-	-	-	-	176,973
Common stock issued for cash	3,300,000	330	219,670	(25,000)	-	-	-	-	195,000
Stock warrants issued for services	-	-	49,888	-	-	-	-	-	49,888
Stock options	-	-	373,040	-	-	-	-	-	373,040
Net (Loss) for the period	-	-	-		(1,005,278)	-	10,102	10,102	(995,176)
Balance as of December 31, 2010	76,555,493	$ 7,655	$ 3,399,961	$ -	$ (2,785,098)	$ 394,464	$ (318,243)	$ 76,221	$ 698,739

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

SUSPECT DECTECTION SYSTEMS INC.

STATEMENTS OF STOCKHOLDERS' EQUITY

U.S. dollars

	Common stock		Additional Paid-in	Common Stock	Accumulated	Noncontroling Interest			
	Shares	Amount	Capital	Subscriptions	(Deficit)	Equity	Earnings	Total	Total
Common stock issued for services	2,625,399	263	669,899	-	-	-	-	-	670,162
Acquisition on non-controlling interest	-	-	(66,053)	-	-	(113,175)	-	(113,175)	(179,,228)
Stock options	-	-	1,515,203	-	-	-	-	-	1,515,203
Net (Loss) for the period	-	-	-		(2,205,914)	-	183,891	183,891	(2,022,024)
Balance as of December 31, 2011	76,555,493	$ 7,655	$ 3,399,961	$ -	$ (4,991,012)	$ 281,289	$ (134,352)	$ 146,937	$ 682,852

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

SUSPECT DECTECTION SYSTEMS INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars	For the Year Ended December 31, 2011	2010
Operating Activities:		
Net (loss)	$ (2,022,024)	$ (995,176)
Adjustments to reconcile net (loss) to net cash (used in) operating activities:		
Common stock issued for officers' compensation	242,199	27,973
Stock options issued to directors	1,273,004	178,905
Stock options issued to service providers		194,135
Stock warrants issued to a consultant		49,888
Common stock issued for consulting services	669,899	149,000
Interest due to the issuance of convertible note	31,273	
Depreciation	12,042	8,153
Changes in Assets and Liabilities-		
Inventory	121,891	(132,904)
Prepaid expenses and other receivables	(232,952)	(188,521)
Severance, net	1,124	(39,876)
Accounts payable - Trade	(30,976)	33,999
Accrued liabilities	(135,458)	66,067
Advances from customers, net	(1,370,943)	448,812
Deferred revenues	(72,065)	57,259
Due to related parties	360,847	171,716
Net Cash Provided by (Used in) Operating Activities	(686,234)	29,430
Investing Activities:		
Increase (decrease) in restricted cash	100,906	(99,674)
Prepaid expenses, non-current	6,007	3,278
Purchases of Property and Equipment	(4,210)	(26,522)
Net Cash Provided by (Used in) Investing Activities	(102,703)	(122,918)
Financing Activities:		
Issuance of common stock for cash	-	195,000
Issuance of convertible note	435,000	-
Net Cash Provided by Financing Activities	435,000	195,000
Net Increase (decrease) in Cash	(148,531)	101,512
Cash and Cash Equivalents - Beginning of year	803,443	701,931
Cash and Cash Equivalents - End of year	$ 654,912	$ 803,443

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars

	For the Year Ended December 31, 2011	2010
Supplemental Disclosure of Cash Flow Information:		
Cash paid during the period for:		
Interest	$ -	$ -
Income taxes	$ -	$ -

(1) Basis of Presentation and Organization

Suspect Detection Systems Inc. ("SDS Inc." or the "Company") is a Delaware corporation that conducts its operations through its 68.6 percent owned subsidiary, Suspect Detection Systems Ltd., an Israeli Corporation ("SDS - Israel"). The Company was incorporated under the laws of the State of Delaware on October 5, 2006, as PCMT Corporation. On December 24, 2008, the Company's stockholders resolved to change its name from PCMT Corporation to Suspect Detection Systems Inc. On January 27, 2009, the Company filed an amendment to its Certificate of Incorporation with the Secretary of State of Delaware to reflect this change. The Company was in the development stage during the year ended December 31, 2008. The revised business plan of the Company is the application of proprietary technologies for law enforcement and border control, including counter terrorism efforts, immigration control and drug enforcement, as well as human resource management, asset management and the transportation sector. The accompanying consolidated financial statements were prepared from the accounts of the Company and its subsidiary under the accrual basis of accounting.

The Israeli subsidiary, Suspect Detection Systems Ltd, ("SDS – Israel") was incorporated under the Companies Law, 5759-1999, of the State of Israel in 2004. SDS – Israel specializes in the development and application of proprietary technologies for law enforcement and border control, including counter terrorism efforts, immigration control and drug enforcement, as well as human resource management, asset management and the transportation sector. SDS – Israel completed the development of its "Cognito" line of products in 2007, which are based on proprietary software and use commercially available hardware to identify individuals that pose security threats, whether or not they are carrying a weapon on their person or in their belongings. Cognito systems are comprised of a front-end test station and a back office, where multiple-station and multiple-site data is stored, managed, and distributed. The front-end test station serves as the point of contact with the individual being examined. The back-office is designed to manage and control the test stations at a given site and it stores all test histories and traveler profiles and interfaces with external systems and databases. A provisional patent application has been issued for the Cognito line of products in the United States. SDS – Israel is also engaged in the development of behavior based screening technologies for the checkpoint screening market.

On January 20, 2009, SDS Inc. completed a business combination for the purchase of 51 percent of the issued and outstanding shares of SDS – Israel for consideration of $1,100,000. The Company incurred an additional $35,000 in acquisition costs related to legal and accounting fees. The business combination was accounted for by the purchase method and accordingly, the purchase price has been allocated to the estimated fair values of the respective assets acquired and liabilities assumed of SDS – Israel, with the remaining representing goodwill in the amount of $1,333,214. The results of operations of SDS – Israel have been included in the consolidated financial statements of the Company commencing January 20, 2009.

In July 9, 2009, SDS Inc. entered into an Exchange Agreement (the "Exchange Agreement") with the Northern Group LP ("NG"), pursuant to which NG exchanged 170,295 ordinary shares of SDS – Israel for 3,199,891 of SDS Inc's common stock. The 170,295 shares of SDS- Israel represented 7 percent of the outstanding shares of SDS-Israel and increased SDS Inc.'s ownership interest in SDS- Israel to 58 percent. The acquisition of the additional equity interest was accounted for by the equity method. The increased percentage of ownership of SDS – Israel, amounting to 58 percent, has been applied to the operations of this subsidiary from July 9, 2009.

On June 16, 2011, SDS Inc. entered into a share purchase agreement with Isahyau (Sigi) Horowitz ("the Seller"), pursuant to which the Company will purchase from the Seller 250,000 ordinary shares of SDS Israel (which represents 10.6% of the outstanding shares of common stock of SDS Israel) in consideration of $75,000.

On June 27, 2011 the Company entered into a Share Purchase Agreement with Shabtai Shoval ("Shoval"), a shareholder of SDS, Ltd. and its former chief executive officer. Pursuant to the Agreement, Shoval will sell and transfer, under certain conditions as described herewith, to the Company all shares of SDS Israel held by him on the date of the Agreement, namely, NIS 0.01 par value 750,000 ordinary shares, which constitute 31.4% of SDS Israel outstanding shares as of the date of the agreement. In consideration for the shares, the Company will pay Shoval $1,174,500 ("Purchase Price") which shall be paid in 35 installments. Shares shall only be transferred to the Company upon (1) the payment of fifty percent (50%) of the Purchase Price plus any and all accrued and outstanding interest as of the date of payment and/or (2) the passing of five (5) years from the date of closing provided that prior to such time, payment of no less than $225,000 on the account of the purchase price shall have been made to Shoval, plus any and all accrued and outstanding interest. The Company may defer the payment of all or a portion of any of the installments (except for the first installment, which was payable on the day of the closing) if and to the extent: (i) prior to the payment of $225,000 on the account of the aggregate purchase price to Shoval (the "Initial Threshold Amount") the obtainable cash (cash or cash equivalents less any amounts of signed checks or any other instruments that were issued or wire transfer instructions which were executed as of the payment date of the relevant Installment) is less than the Initial Threshold Amount; or (ii) following payment of the Initial Threshold Amount, if the obtainable cash as of the payment date of the relevant Installment is less than $500,000 (the "Obtainable Cash") as of the relevant payment date. The Company records payments as a Minority Interest balance sheet item until such payments reach the Initial Threshold Amount, at which time the Company will have title of the percentage of shares that would have been paid for. As of December 31, 2011 the Company has not made the required payments according to the Share Purchase Agreement. The Company received a letter from Shoval consenting to postpone the payments until the earlier of: (1) Closing of a merger agreement with another company (2) until the company has Obtainable Cash of $500,000 (3) May 1st 2012.

On October 24, 2011 the Company entered into a non-binding letter of intent ("LOI") with DVTel, Inc., a Delaware corporation ("DVTel"). If the parties sign a definitive merger agreement incorporating the terms of the LOI and the parties consummate the transactions contemplated by the LOI, a newly-formed wholly-owned subsidiary of the Company will merge with and into DVTel (the "Merger") with DVTel surviving the Merger as a wholly-owned subsidiary of the Company.

If the transaction contemplated by the LOI is consummated, all currently outstanding shares, options, warrants and other rights to receive shares of the Company will equal 15% of the fully diluted capital stock of the Company post-Merger and the existing security holders of DVTel will have 85% (or such higher percentage reasonably acceptable to DVTel if the Company's outstanding debt is not converted into equity prior to the execution of the merger agreement). Said percentages are prior to the future security issuances to investors making an investment in the Company, on terms acceptable to DVTel, of not less than $5,000,000; this proposed financing is one of the conditions to closing of the Merger. Some of the other conditions to closing include the Company acquiring the balance of the shares it owns in Suspect Detection Services Ltd., its Israeli subsidiary, the stockholders of the Company approving a reverse split and/or increase in the authorized share capital of the Company, unless the exchange ratio above is adjusted, the holders of the Company's convertible debt converting to equity (prior to the execution of the merger agreement), key employees of the Company being subject to employment agreements acceptable to DVTel and, if required by DVTel, the receipt of a fairness opinion. If the Merger closes, designees of DVTel will be appointed as members of the board and management of the Company.

The Company has agreed in the LOI to use its commercially reasonable efforts to file a definitive proxy statement within 30 days of the date of the LOI to approve a reverse stock split and/or increase its share capital necessary to effectuate the Merger and related transactions contemplated by the LOI.

Pursuant to the LOI, the Company agreed for a period of 120 days or the earlier written notice from DVTel that it no longer desires to pursue the Merger not to, directly or indirectly, solicit, negotiate with or discuss any proposal to acquire the business, assets or stock of the Company, to issue any equity or debt securities of the Company, to provide non-public information regarding any acquisition proposal, or to enter into any agreement or understanding to abandon, terminate or fail to consummate the Merger with DVTel. The Company is required to immediately notify DVTel regarding any such interests or proposals from third parties.

In the event that an agreement between the parties is not entered into prior to February 27, 2012, the LOI will terminate unless extended by the parties.

(2) Summary of Significant Accounting Policies

Principles of Consolidation:

The consolidated financial statements include the accounts of the Company and its 68.6 percent owned Israeli subsidiary, SDS-Israel. All significant intercompany accounts and transactions have been eliminated in consolidation.

Cash and Cash Equivalents:

For purposes of reporting within the consolidated statements of cash flows, the Company considers all cash on hand, cash accounts not subject to withdrawal restrictions or penalties, and all highly liquid debt instruments purchased with a maturity of three months or less to be cash and cash equivalents.

Restricted cash:

Restricted Cash is defined as Cash and cash equivalents, which are restricted as to withdrawal or usage. Restricted cash includes legally restricted deposits held as compensating balances against a rent agreement and identification agreement with the CEO of SDS- Israel to assure future credit availability (please refer to footnote number 9).

Revenue Recognition, Deferred Revenues and advances from customers:

The Company recognizes revenues in accordance with ASC 605-10-S99, “Revenue Recognition” when the significant risks and rewards of ownership have been transferred to the customer pursuant to applicable laws and regulations, including factors such as when there has been evidence of a sales arrangement, the performance has occurred, or service have been rendered, the price to the buyer is fixed or determinable, and collectability is reasonably assured. The Company's revenue arrangements included multiple deliverables, software or technology license, non-recurring engineering services and post-contract customer support.
For these arrangements, we considered the revenue recognition - multiple-element arrangements accounting guidance. Accordingly, we evaluated each deliverable in the arrangement to determine whether it represented a separate unit of accounting. Services sold separately are generally billed on a time basis at agreed-upon billing rates, and revenue is recognized as the services are performed. If an arrangement included specified upgrade rights, revenue is deferred until the specified upgrade was delivered. The timing and amount of revenue recognition depended upon a variety of factors, including the specific terms of each arrangement and the nature of our deliverables and obligations. Determinations of the appropriate amount of revenue recognized involved judgments and estimates that our management believed were reasonable.

Accounts receivable:

Accounts receivable are recorded at net realizable value consisting of the carrying amount less the allowance for uncollectible accounts. As of December 31, 2011 and 2010, the Company has not accrued an allowance for uncollectible accounts.

Property and equipment:

Property and equipment are stated at cost, net of accumulated depreciation. Depreciation is calculated by the straight-line method over the estimated useful lives of the assets. The annual depreciation rates are as follows:

	%
Office furniture and equipment	7
Computers and electronic equipment	33

Depreciation expenses for the years ended December 31, 2011 and 2010 were $12,042 and $8,153, respectively.
The Company reviews the carrying value of its long-lived assets, including intangible assets subject to amortization, for impairment whenever events and circumstances indicate that the carrying value of the assets may not be recoverable. Recoverability of these assets is measured by comparing the carrying value of the assets to the undiscounted cash flows estimated to be generated by those assets over their remaining economic life. If the undiscounted cash flows are not sufficient to recover the carrying value of the assets, the assets are considered impaired. The impairment loss is measured by comparing the fair value of the assets to their carrying value. Fair value is determined by either a quoted market price or a value determined by a discounted cash flow technique, whichever is more appropriate under the circumstances involved. No impairments were recognized for the years ended December 31, 2011 and 2010.

Research and development costs and participations:

Research and development (or “R&D”) costs are expensed as they are incurred and consist of salaries, benefits and other personnel related costs, fees paid to consultants and related manufacturing costs, facilities and overhead costs.
Research and development expenses for the years ended December 31, 2011 and 2010 were $384,083 and $417,508, respectively.

Royalty-bearing grants:

Royalty-bearing grants from the Government of Israel for funding approved research and development projects are recognized at the time the Company is entitled to such grants, on the basis of the costs incurred and included as a deduction of research and development costs. Research and development grants received by the Company from April 19, 2004 (inception date) through December 31, 2011 amounted to $177,263. Royalty expenses to the Israeli government for the years ended December 31, 2011 and 2010 were $19,855 and $75,295, respectively.

Severance pay:

The liability of SDS Israel for severance pay is calculated pursuant to the Severance Pay Law in Israel, based on the most recent salary of the employees multiplied by the number of years of employment as of the balance sheet date and is presented on an undiscounted basis. The Company's employees are entitled to one month's salary for each year of employment or a portion thereof. On December 31, 2008 SDS Israel entered into an agreement with its CEO and President implementing Section 14 of the Severance Pay Law and the General Approval of the Labor Minister dated June 30, 1998, issued in accordance to the said Section 14, mandating that upon termination of such employees' employment, SDS Israel shall release to them all the amounts accrued in their insurance policies. The severance pay liabilities and deposits covered by these plans since December 31, 2008 are not reflected in the balance sheet as the severance pay risks have been irrevocably transferred to the severance funds. Severance expenses for the years ended December 31, 2011 and 2010 amounted to $0 and $37,789 respectively.

Loss per Common Share

Basic loss per share is computed by dividing the net loss attributable to the common stockholders by the weighted average number of shares of common stock outstanding during the periods. Diluted loss per share is computed similar to basic loss per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potential common shares had been issued and if the additional common shares were dilutive. Restricted shares, outstanding share options and warrants have been excluded from the calculation of the diluted loss per share because all such securities are antidilutive. The total weighted average number of ordinary shares related to restricted shares, outstanding options and warrants excluded from the calculations of diluted loss per share were 30,746,868 and 27,053,539 for the years ended December 31, 2011 and 2010, respectively.

Income Taxes

The Company accounts for income taxes pursuant to FASB ASC 740, "*Accounting for Income Taxes"* Under FASB ASC 740-10-25, deferred tax assets and liabilities are determined based on temporary differences between the bases of certain assets and liabilities for income tax and financial reporting purposes. The deferred tax assets and liabilities are classified according to the financial statement classification of the assets and liabilities generating the differences.

The Company maintains a valuation allowance with respect to deferred tax assets. SDS Inc. establishes a valuation allowance based upon the potential likelihood of realizing the deferred tax asset and taking into consideration SDS Inc.'s financial position and results of operations for the current period. Future realization of the deferred tax benefit depends on the existence of sufficient taxable income within the carryforward period under the Federal tax laws.

Changes in circumstances, such as the Company generating taxable income, could cause a change in judgment about the realizability of the related deferred tax asset. Any change in the valuation allowance will be included in income in the year of the change in estimate.

Fair Value Measurement

As defined in ASC 820-10, Fair Value Measurements and Disclosures ("ASC 820-10"), fair value is based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In order to increase consistency and comparability in fair value measurements, ASC 820-10 establishes a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels, which are described below:

Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

Level 2: Other inputs those are observable directly or indirectly, such as quoted prices for similar assets and liabilities or market corroborated inputs.

Level 3: Unobservable inputs are used when little or no market data is available, which requires the Company to develop its own assumptions about how market participants would value the assets or liabilities. The fair value hierarchy gives the lowest priority to Level 3 inputs.

In determining fair value, the Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible in its assessment of fair value.

The following table presents the Company's financial assets and liabilities that are carried at fair value, classified according to the three categories described above:

	Fair Value Measurements at December 31, 2011			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and cash equivalents	$ 475,945	$ 475,945	$ -	$ -
Restricted Cash	14,595	14,595	-	-
Total assets at fair value	$ 490,540	$ 490,540	$ -	$ -

Concentration of Risk

The Company's has a reliance on its major customers. When revenues from transactions with a single external customer amount to 10 percent or more of an enterprise's revenues, the enterprise must disclose that fact, and the total amount of revenues from each such customer, see major customers' disclosure in note 10.

As of December 31, 2011, and 2010, the Company maintained its cash account at two commercial banks. The balances in the accounts are subject to FDIC coverage of up to

$250,000 per institution. Cash and cash equivalents invested in a major bank in Israel are not insured, Management believes that the financial institutions that hold the Company's investments are financially sound and, accordingly, minimal credit risk exists with respect to these investments. The Company has no off-balance-sheet concentration of credit risk such as foreign exchange contracts or other foreign hedging arrangements.

Common Stock Registration Expenses

The Company considers incremental costs and expenses related to the registration of equity securities with the SEC, whether by contractual arrangement as of a certain date or by demand, to be unrelated to original issuance transactions. As such, subsequent registration costs and expenses are reflected in the accompanying financial statements as general and administrative expenses, and are expensed as incurred.

Accounting for stock-based compensation

The Company's stock-based compensation are recorded according to ASC 718-10, "Compensation - Stock Compensation", which requires the measurement and recognition of compensation expense for all stock-based payment awards made to directors, including employee stock options under the Company's stock plans, based on estimated fair values. ASC 718-10 requires companies to estimate the fair value of equity-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the Company's consolidated statement of operations. The Company estimates the fair value of stock options granted using the Black-Scholes-Merton option-pricing model.

Lease Obligations

All noncancellable leases with an initial term greater than one year are categorized as either capital or operating leases. Assets recorded under capital leases are amortized according to the methods employed for property and equipment or over the term of the related lease, if shorter.

Goodwill

The Company accounts for Goodwill in accordance with the FASB ASC Topic 350, "Intangible-Goodwill and Other." The Company evaluates Goodwill, at a minimum, on an annual basis and whenever events and changes in circumstances suggest that the carrying amount may not be recoverable. Impairment of Goodwill is tested at the reporting unit level by comparing the reporting unit's carrying amount, including Goodwill, to the fair value of the reporting unit. The fair values of the reporting units are estimated using discounted projected cash flows. If the carrying amount of the reporting unit exceeds its fair value, Goodwill is considered impaired, and a second step is performed to measure the amount of impairment loss, if any. The Company conducts its annual impairment test as of December 31 of each year, and determines if there is any impairment. No impairments were recognized for the years ended December 31, 2011 and 2010.

Use of Estimate

The accompanying consolidated financial statements are prepared on the basis of accounting principles generally accepted in the United States of America. The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of consolidated assets and liabilities as of December 31, 2011, and 2010, and consolidated revenues and expenses for the years ended December 31, 2011, and 2010. Actual results could differ from those estimates made by management.

Subsequent events

The Company has evaluated subsequent events for potential recognition and/or disclosure through, the date these consolidated financial statements were issued.

Financial statements in U.S. dollars

The functional currency of the Company is the U.S dollar, as the U.S. dollar is the primary currency of the economic environment in which the Company has operated and expects to continue to operate in the foreseeable future. The majority of SDS Israel's revenues and expenses are currently determined and paid in U.S. dollars. Financing and investing activities including loans and equity transactions are made in U.S. dollars. Accordingly, the functional and reporting currency of the Company is the dollar. Monetary accounts maintained in currencies other than the dollar are remeasured into U.S. dollars. All transaction gains and losses from the remeasurement of monetary balance sheet items are reflected in the statements of operations as financial income or expenses, as appropriate.

Comprehensive Income (Loss)

Accounting guidance requires financial statements to include the reporting of comprehensive income (loss), which includes net income (loss) and certain transactions that have generally been reported in the statement of stockholders' equity. The Company's comprehensive income (loss) consists of net income (loss).

Segment Reporting

A business segment is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products or services and that is subject to risks and returns that are different from those of other business segments. Management believes that the Company meets the criteria for aggregating its operating segments into a single reporting segment.

(3) Going Concern

The Company's current activities include sales of its products, marketing, capital formation, research and development, and building infrastructure. The Company incurred a loss of $2,205,914 for the year ended December 31, 2011 (2010-$1,005,278) and, as of December 31, 2011, the Company had an accumulated deficit of $4,991,012 (2010-$2,785,098). The Company's ability to continue as a going concern is uncertain. The revised business plan of the Company is the application of proprietary technologies for law enforcement and border control, including counter terrorism efforts, immigration control and drug enforcement, as well as human resource management, asset management and the transportation sector.

While management of the Company believes that the Company will be successful in its current and planned operating activities, there can be no assurance that the Company will be successful in the achievement of sales of its products that will generate sufficient revenues to earn a profit and sustain the operations of the Company. The Company also intends to conduct additional capital formation activities through the issuance of its common stock and loans from related parties.

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplate continuation of the Company as a going concern. The Company has not established sufficient sources of revenues to cover its operating costs and expenses. As such, it has incurred an operating loss since inception. Further, as of December 31, 2011, the cash resources of the Company were insufficient to meet its planned business objectives. These and other factors raise substantial doubt about the Company's ability to continue as a going concern. The accompanying consolidated financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the possible inability of the Company to continue as a going concern.

(4) Appointment of Directors and Officers

On January 13, 2010, the board of directors of the Company, appointed Mr. Yoav Krill as Chairman of the Board, to serve until the next annual meeting of the Company and until his successor is duly appointed and qualified. In connection with Mr. Krill's appointment, the Company entered into an Agreement (the "Consulting Agreement") to perform such duties as will be required of him as the Chairman of the Board. In consideration of the services to be performed under the Consulting Agreement, Mr. Krill shall receive an annual director's fee of $25,000 per annum for the first twelve (12) month period. Mr. Krill was also granted 1,500,000 options of common stock of the Company, exercisable at $0.15 per share, from the Global Incentive Stock Option Plan adopted by the Company at December 30, 2009. The agreement calls for 250,000 options vested simultaneously with the execution and delivery of the agreement, and the balance shall vest at the rate of 104,166 options each calendar quarter for the next three years, commencing on March 31, 2010. The options shall terminate forty-eight (48) months from the date of vesting. The terms of the Consulting Agreement continue until either party provides the other with no less than 90 days prior written notice. The failure of the Company to maintain directors' and officers' liability insurance covering Mr. Krill shall be deemed a material breach of the agreement and shall automatically terminate the Agreement.

On June 29, 2011 SDS Inc. approved an Amended Consulting Agreement with Mr. Yoav Krill, the Company's Chairman of the Board. In consideration of the services to be performed under the Amended Consulting Agreement, Mr. Krill shall receive an annual director's fee of $25,000 for the first twelve-month period. Thereafter, the parties shall agree in writing prior to November 30th of each calendar year as to the amount to be paid as director's fees, which amount shall not be less than $25,000 and shall be increased, proportionately, with any increase in the Company's paid-in capital, sales revenues or net profits. In addition, under the Amended Consulting Agreement, Mr. Krill was granted 2,400,000 shares of common stock of the Company valued at $240,000 and 10,500,000 stock options valued at $978,936.

The Options vests as follows: 4,666,660 shares were vested upon execution of the Amended Agreement and the balance of 5,833,340 shares shall vest in equal monthly amounts of 291,667 shares during each and every calendar month during the twenty month period commencing on July 1, 2011. The price of the Company's share at date of grant of shares and options was $0.10, the exercise price of the options $0.10 and the expiration date 10 years from grant.

On January 13, 2010, the board of directors of the Company appointed Mr. Gil Boosidan as Chief Executive Officer of the Company and executed an employment agreement with Mr. Boosidan as of January 14, 2010 (the "Employment Agreement"). In consideration of the services to be performed under the Employment Agreement, Mr. Boosidan shall receive an aggregate of $30,000; $20,000 in cash over four equal quarterly installments commencing March 31, 2010, and $10,000 in shares of commons stock of the Company, whereas the number of the shares will be determined by the market value of the shares of the date of issuance. The Company has the right to terminate such agreement for cause in the event of a material breach by Mr. Boosidan which is not cured after notice of such breach.

On January 13, 2010, the board of directors of the Company appointed Dr. Kevin Schatzle to the Board of Advisors. The advisory agreement calls for 500,000 options of common stock of the Company, exercisable at $0.15 per share, from the Global Incentive Stock Option Plan adopted by the Company at December 30, 2009. The agreement calls for 250,000 options vested simultaneously with the execution and delivery of the agreement, and the balance shall vest at the rate of 20,833 options each calendar quarter for the next three years, commencing on March 31, 2010. The options shall terminate forty-eight (48) months from the date of vesting.

On June 29, 2011 SDS Inc. approved an Amended Employment Agreement with Mr. Gil Boosidan will serve as the Company's Chief Executive Officer. In consideration of the services to be performed under the Amended Employment Agreement, Mr. Boosidan shall receive (i) an aggregate of $30,000 in cash in four equal quarterly installments commencing September 30, 2011, and (ii) 1,200,000 shares of common stock of the Company valued at $120,000 and 6,000,000 stock options valued at $559,392. The Options vests as follows: 2,666,680 shares vested upon the execution of his Amended Employment Agreement and the balance of 3,333,320 shares shall vest in equal monthly amounts of 166,667 shares during each and every calendar month during the twenty month period commencing on July 1, 2011. The price of the Company's share at date of grant of shares and options was $0.10, the exercise price of the options $0.10 and the expiration date 10 years from grant.

On June 1, 2011 SDS Inc signed a consulting agreement with Mr. Daniel Krill, the son of Mr. Yoav Krill, chairman of the board of director. In consideration for services Mr. Daniel Krill was granted 400,000 shares valued at $32,000 and 200,000 stock options valued at $15,032. 5,555 options shall vest each calendar month commencing the date of the execution of the consulting Agreement. The price of the Company's share at date of grant of shares and options was $0.08, the exercise price of the options $0.10 and the expiration date 10 years from grant.

(5) Convertible Note

On March 21, 2011, the Company issued a convertible note (the "Note") to Investor (the "Lender") whereby the Lender made a loan to the Company in an amount equal to $300,000 and accruing interest at a rate of 10% per annum. Similar notes were issued on May 12, 2011 and August 3, 2011 for an amount equal to $100,000 and $35,000, respectively, (together the loans are referred to as the "loan"). The Loan and the accrued interest will be repayable in one installment on the date that is eighteen months after the date the Loan is made; provided that such date may be extended at the Company's request by another six months. The Lender shall have the right, at any time, to convert the principal and interest outstanding under the Note into common share issued by the Company at a conversion rate of $0.07 per a common share. In addition, the Lender is entitled to (i) 500 Class C warrants to purchase an additional 500 Common Shares for each 1000 Common Shares converted at exercise price of $0.12 per Common Share and (ii) 500 Class D warrants to purchase an additional 500 Common Shares for each 1000 Common Shares converted at exercise price of $0.21 per Common Share. The Class C Warrants shall be exercisable at any time from the conversion date to and excluding the first anniversary thereof and the Class D Warrants shall be exercisable at any time from the conversion date to and excluding the third anniversary thereof. There will be no restrictions on shares being registered upon exercise of the loan and the warrants will be registered under the Securities Act, or any state securities laws, and may be offered or sold in the United States upon registration or an applicable exemption from the registration requirements of the Securities Act.

FSP APB 14-1 requires issuers of convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement) to initially record the liability and equity components of the convertible debt separately. The liability component is computed based on the

fair value of a similar liability that does not include the conversion option. The equity component is computed based on the total debt proceeds less the fair value of the liability component. The equity component (debt discount) and debt issuance costs are amortized as interest expense over the expected term of the debt facility. The liability component of our convertible notes is classified as long-term debt and presented as a long-term debt and the equity component of our convertible debt will be considered a redeemable security and presented as redeemable equity on our consolidated balance sheet if our stock price is above the conversion prices of $0.07 at the grant date. We concluded there the liability value is equal to similar liability that does not include a conversion option and therefore the equity component is zero.
We did not calculate a beneficial conversion feature, in determining whether an instrument contains a beneficial conversion option, intrinsic value should be calculated using the effective conversion price, which is based on the proceeds received for the convertible instrument. The Company's shares market price at grant date of the notes was below the conversion price, therefore there was no beneficial conversion feature on the loans.

(6) Common Stock

On January 6, 2010, the Company issued 152,600 shares of common stock to a a none related party for services rendered valued at $22,890.

On January 6, 2010, the Company issued 660,000 shares of common stock to none related parties and shareholders for services valued at $99,000. Not related party

On April 10, 2010, the Company issued 500,000 shares of common stock to a consultant for services provided. These services were valued at $50,000.

On April 23, 2010, the Company issued 120,000 shares of common stock at par $0.0001, valued at $18,000, to an officer and Director for the services provided.

During November, 2010 the Company issued 2,500,000 shares of common stock, 833,333 Class A Warrant with the exercise price at $0.08 per share, which expired one year from the date of subscription, and Class B Warrants with the exercise price at $0.15 per share, which will be expired two years from the date of subscription for a cash payment of $100,000.

During June, 2011, the Company issued 3,025,399 shares of common stock to consultants for services provided. These services were valued at $607,000.

(7) Stock warrants

A summary of the warrants granted is as follows:

	For the year ended December 31, 2011	
	Number of warrants	Weighted Average Exercise Price

Outstanding and exercisable at the beginning of the period	17,170,007	$0.303
Granted		
Forfeited	(13,073,339)	0.301
Outstanding and exercisable at the end of the period	4,096,668	$0.305

	For the year ended December 31, 2010	
	Number of warrants	Weighted Average Exercise Price
Outstanding and exercisable at the beginning of the period	16,019,667	$0.317
Granted	3,896,668	0.240
Forfeited	(2,746,328)	0.297
Outstanding and exercisable at the end of the period	17,170,007	$0.303

(8) Stock options

On December 30, 2009, the Company approved 2009 Global Stock Incentive Plan (the "stock option plan"), under which 35,000,000 shares of common stock are authorized for issuance. As of December 31, 2011 19,800,000 stock options were granted under the Stock Option Plan.

During 2009, the Company granted 1,550,200 options valued at $326,108 in consideration for consulting services to nine sales agents of SDS- Ltd. The options are vested within one year of the grant date and they are execrable at $0.15 per share and no later than three years from the grant date. The number of the options exercisable at December 31, 2010 and 2011 was 1,550,200 options. As of the date of the grant, the average expected term of the options was 3 years, expected volatility was 114.78 percent, expected dividend rate was 0 percent, and the risk free rate of return was 2.3 percent.

On December 30, 2009 the Company authorized 35,000,000 shares of Common Stock for issuance under the SDSS Inc., 2009 the stock option plan, of which as of December 31, 2010 1,500,000 options were granted to Mr. Yoav krill, the Chairman of the Board of Directors and 500,000 to a member of the Advisory Board. The Options granted were valued at $ 236,970. The options were granted to Mr. Yoav Krill on January 13, 2010, under the consultancy agreement with Mr., Krill and they are exercisable at $0.15 per share. A total of 250,000 options were vested at the date of the grant, while the remaining options will vest at a rate of 104,167 options each calendar quarter over three years. The options terminate forty-eight (48) months from the date of vesting. The options were granted to the member of the Advisory Board on January 14, 2010, under the consultancy agreement and they are exercisable at $0.15 per share. A total of 250,000 options were vested at the date of the grant, while the remaining options will vest at a rate of 20,833 options each calendar quarter over three years. The options terminate forty-eight (48) months from the date of vesting. The number of the options exercisable at December 31, 2010 and 2011 was 1,000,000 and 1,500,000 options, respectively. As of the date of the grant, the average expected term of the options was 5.32 years, expected volatility was 147.51 percent, expected dividend rate was 0 percent, and the risk free rate of return was 2.77 percent.

During 2011, the Company granted 23,100,200 options valued at $2,001,706 to four employees of SDS- Ltd. and to five of the company's consultants in consideration for consulting services. The options are vested up to 36 months of the grant date and they are execrable at a range of $0.10-$0.15 per. The number of the options exercisable at December 31, 2011 was 15,683,338 options. The average expected term of the options was 6.5 years, expected volatility was 151.62 percent, expected dividend rate was 0 percent, and the risk free rate of return was 1.91 percent.

The Company accounts for stock based compensation using the fair value recognition provisions of ASC No. 718 “Compensation – stock compensation”.

The fair value of the stock options is estimated based upon grant date fair value using the Black-Scholes option-pricing model with the following weighted average assumptions used:

	Options granted under 2009 Global Stock Incentive Plan
annual dividends of	$0.00
expected volatility of	140.44-156.58%
risk-free interest rate of	1.25-2.19%
expected average options expiration (in years)	5-10

	For the year ended December 31, 2010	
	Number of options	**Weighted Average Exercise Price**
Outstanding and exercisable at the beginning of the period	3,550,200	$0.15
Granted	23,100,000	0.11
Exercised	-	-
Forfeited	-	-
Outstanding and exercisable at the end of the period	26,650,200	$0.12

	For the year ended December 31, 2010	
	Number of options	**Weighted Average**

		Exercise Price
Outstanding and exercisable at the beginning of the period	1,550,200	$0.15
Granted	2,000,000	0.15
Exercised	-	-
Forfeited	-	-
Outstanding and exercisable at the end of the period	3,550,200	$0.15

(9) Commitments

On March 15, 2008, SDS Inc. entered into a written commitment with a third-party consultant to provide marketing and promotional assistance for up to 50 hours per month, beginning April 2008. In return for these services, the consultant will receive a monthly service fee of $7,000, a stock option for purchasing 100,000 shares of common stock at $0.15 per share, and an annual performance-based bonus at the discretion of SDS Inc. In May 2008, this agreement was placed on hold. As of December 31, 2010, the options were not issued and may not be issued in the future depending on the resolution of the agreement.

On April 1, 2009, the Company entered into a Consulting Agreement with L.A. Investments Ltd. (the “Consultant”). The Consultant agreed to render assistance and advice to the Company relating to capitalization and financing of the Company. The Consulting Agreement is for a term of three years, commencing on April 1, 2009. In consideration for such services, the Company agreed to compensate the Consultant in the amount of $6,500 quarterly, commencing on April 1, 2009. In addition, the Company agreed to issue to the Consultant warrants to purchase an aggregate of 1,800,000 shares of the Company’s common stock. On each of April 1, 2009, September 1, 2009, March 1, 2010, and September 1, 2010, provided that the Consulting Agreement is still in force, the Company shall issue a warrant to purchase 450,000 shares of the Company’s common stock. Each common stock purchase warrant entitles the Consultant to purchase one share of the Company’s common stock at an exercise price of $0.15 per share and is exercisable for a period of two years. As of April 1st, 2010 the Company and the consultant mutually agreed not to continue the consultants’ engagement. Therefore the consultant was not entitled to compensation in the amount of $6,500 quarterly and 450,000 warrants which were conditionally granted to him under the consulting agreement.

SDS-Israel is committed to pay royalties to the Government of Israel with respect to the proceeds from sales of products which were developed in the framework of projects in which the Israeli Government participated in its expense. Under the terms of the funding SDS Israel received from the Chief Scientist, royalty payments are computed on the sales proceeds from such products at the rate of 3% in the first three years and 3.5% from the forth year and forth. The contingent liability to the Chief Scientists is limited to the amount of the grants received. Some grants bear interest at the rate of LIBOR. SDS Israel is committed to the Chief Scientist to keep the know-how and production rights under the Company's possession.

During 2010, SDS Ltd. executed Identification and Exemption Agreement with Mr. Shabtai Shoval, the CEO of SDS Ltd. The agreement calls for the indemnification of Mr. Shoval and advance of expenses for any personal liability that may be imposed on Mr. Shoval in his capacity as an officer of SDS Ltd. Per the agreement, the maximum amount payable by SDS LTD. to Mr. Shoval shall be the higher of $1,000,000 or 80% of SDS Ltd.'s cash reserves, measured promptly after receipt by SDS Ltd. of notice from MR. Shoval of the commencement of any action, suit or proceeding regarding which Mr. Shoval may seek indemnification thereafter. SDS Ltd, agreed to reserve $100,000 from its cash and cash equivalents in order to assure the fulfillment the Company's identification obligation under the agreement until such time as determined by the Board of Directors of SDS Ltd.

SDS Israel rents its offices under non-cancelable lease operating agreement. Aggregate minimum lease commitments, as of December 31, 2011, are as follows:

For the year ended on December 31	$
2012	30,157

Rent expenses for the years ended December 31, 2011 and 2010 were $56,251 and $55,311 respectively.

(1) Major Customers

The Company's revenues from 3 customers accounted for $1,926,692 or 94% of total revenues in the year ended December 31, 2011 and 4 customers accounted for $1,651,980 or 95% of total revenues in the year ended December 31, 2010.

	Year ended December 31, 2011	
	Revenues in $	Revenues in % of total revenues
Customer A	1,774,824	87
Customer B	92,110	4
Customer C	59,759	3
Other customers	128,310	6
Total Revenues	$2,055,002	100%

	Year ended December 31, 2010	
	Revenues in $	Revenues in % of total revenues
Customer A	1,090,075	63
Customer B	324,933	19
Customer C	169,266	10
Customer D	67,707	4
Other customers	79,853	5
Total Revenues	$1,731,834	100%

(11) Recent Accounting Pronouncements

In May 2011, the FASB issued ASU 2011-04, "Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards ("IFRSs")." Under ASU 2011-04, the guidance amends certain accounting and disclosure requirements related to fair value measurements to ensure that fair value has the same meaning in U.S. GAAP and in IFRS and that their respective fair value measurement and disclosure requirements are the same. ASU 2011-03 is effective for public entities during interim and annual periods beginning after December 15, 2011. Early adoption is not permitted. The Company does not believe that the adoption of ASU 2011-04 will have a material impact on the Company's consolidated results of operation and financial condition.

In June 2011, the FASB issued ASU No. 2011-05, "Comprehensive Income (ASC Topic 220): Presentation of Comprehensive Income," ("ASU 2011-05") which amends current comprehensive income guidance. This accounting update eliminates the option to present the components of other comprehensive income as part of the statement of shareholders' equity. Instead, comprehensive income must be reported in either a single continuous statement of comprehensive income which contains two sections, net income and other comprehensive income, or in two separate but consecutive statements. ASU 2011-05 will be effective for public companies during the interim and annual periods beginning after Dec. 15, 2011 with early adoption permitted. The Company does not believe that the adoption of ASU 2011-05 will have a material impact on the Company's consolidated results of operation and financial condition.

In September 2011, the FASB issued ASU No. 2011-08, Intangibles — Goodwill and Other (Topic 350) — Testing Goodwill for Impairment (ASU 2011-08), on the testing of goodwill for impairment that will permit to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. This guidance eliminates the requirement to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. The guidance will be effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. We are in the process of evaluating this guidance and currently do not believe that it will have a material effect on our consolidated financial statements.