



**INFORMATION AND DISCLOSURE STATEMENT**

**FOR THE QUARTER ENDED MARCH 31, 2009**

# NATIONAL SCIENTIFIC CORPORATION

**Item 1 Exact name of the issuer and its principal executive offices.**

Exact Name: National Scientific Corporation  
Address: 8361 E. Evans Road, Suite 106  
Scottsdale, AZ 85260-3617  
Telephone (480) 948-8324

**Item 2 Shares outstanding.**

As of March 31, 2009 and as of the filing of this Quarterly Report, there were 165,276,879 shares of the Company's Common Stock issued and outstanding.

**Item 3 Interim financial statements.**

The Company's financial statements for the period ended March 31, 2009 are attached hereto.

**Item 4 Management's discussion and analysis or plan of operation.**

Please refer to the Annual Information and Disclosure Statement for the years ended September 30, 2008 and 2007 published on our website on April 30, 2009 as information contained therein is unchanged.

**Item 5 Legal proceedings.**

The Company is involved in legal actions in the ordinary course of its business, including those outlined in the Company's Annual OTC Information and Disclosure Statement for the fiscal year ended September 30, 2008. Although the outcome of any such legal actions cannot be predicted, in the opinion of management, there are no legal proceedings pending or asserted against or involving the Company the net outcome of which are likely to have a material adverse effect upon the financial position or results of operations of the Company.

**Item 6 Defaults upon senior securities**

None for the period ended March 31, 2009 and through the date of this report.

**Item 7 Other information**

**a) Entry into a material definitive agreement:**

None for the period ended March 31, 2009 and through the date of this report.

**b) Termination of a material definitive agreement:**

None for the period ended March 31, 2009 and through the date of this report.

**c) Completion of acquisition or disposition of assets, including but not limited to merger:**

None for the period ended March 31, 2009 and through the date of this report.

**d) Creation of a direct financial obligation or an obligation under an off-balance sheet arrangement of an issuer:**

None for the period ended March 31, 2009 and through the date of this report.

**e) Triggering events that accelerate or increase a direct financial obligation or an obligation under an off-balance sheet arrangement:**

None for the period ended March 31, 2009 and through the date of this report.

**f) Costs associated with exit or disposal activities:**

None for the period ended March 31, 2009 and through the date of this report.

**g) Material impairments:**

None for the period ended March 31, 2009 and through the date of this report.

**h) Sales of equity securities:**

None for the period ended March 31, 2009 and through the date of this report.

**i) Material modification to rights of security holders:**

None for the period ended March 31, 2009 and through the date of this report. 4

**j) Changes in issuer's certifying accountant:**

None for the period ended March 31, 2009 and through the date of this report.

**k) Non-reliance on previously issued financial statements or a related audit report or completed interim review:**

None for the period ended March 31, 2009 and through the date of this report.

**l) Changes in control of issuer:**

None for the period ended March 31, 2009 and through the date of this report.

**m) Departure of directors or officers; election of directors; appointment of principal officers:**

On April 30, 2009, Michael A. Grollman submitted his resignation as Chairman and Chief Executive Officer of the Company, in order to pursue other career opportunities. He will remain involved with the

Company as a strategic consultant, Director and Chief Technology Officer. Mr. Grollman's resignation was effective April 30, 2009.

On May 4<sup>th</sup> 2009, Gregory F Szabo, the company's Director, was appointed by the Board of Directors of the Company to assume the responsibilities as Chief Executive Officer and Chairman, on an acting basis.

On the same date, Graham L Clark, the company's President, Secretary and Director, was appointed by the Board of Directors of the Company to assume the responsibilities as Chief Financial Officer, on an acting basis.

**n) Amendments to Articles of Incorporation or Bylaws; Change in Fiscal Year:**

None for the period ended March 31, 2009 and through the date of this report.

**o) Amendments to the Issuer's Code of Ethics, or Waiver of a provision of the Code of Ethics:**

None for the period ended December 31, 2008 and through the date of this report.

None for the period ended March 31, 2009 and through the date of this report.

**Item 8. Exhibits:**

None for the period ended March 31, 2009 and through the date of this report.

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**Item 9: Certifications:**

I, Graham L. Clark, President of the issuer, certify that:

- (1) I have reviewed this quarterly disclosure statement of National Scientific Corporation;
- (2) Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this disclosure statement; and
- (3) Based on my knowledge, the financial statements, and other financial information included in this disclosure statement, fairly present in all material respects the financial condition, results of operations and cash flows of the small business issuer as of, and for, the periods presented in this report:

/s/ Graham L Clark

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Graham L Clark  
President & acting CFO,  
May 8, 2009

NATIONAL SCIENTIFIC CORPORATION

Condensed Balance Sheets  
(Unaudited)

| <b>ASSETS</b>                                                                                                                                                           | March 31,<br>2009 | September 30,<br>2008 |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------|-----------------------|
| Current Assets:                                                                                                                                                         |                   |                       |
| Cash and cash equivalents                                                                                                                                               | \$ 121            | \$ 7,602              |
| Trade receivables                                                                                                                                                       | 23,025            | 101,561               |
| Inventory                                                                                                                                                               | 19,820            | 13,523                |
| Other assets                                                                                                                                                            | 669               | 342                   |
| Total current assets                                                                                                                                                    | 43,635            | 123,028               |
| Property and equipment, net                                                                                                                                             | –                 | 207                   |
| Deposits                                                                                                                                                                | 1,985             | 2,340                 |
| Deferred financing costs, net                                                                                                                                           | 7,600             | 10,000                |
| Total assets                                                                                                                                                            | \$ 53,220         | \$ 135,575            |
| <b>LIABILITIES AND SHAREHOLDERS' DEFICIT</b>                                                                                                                            |                   |                       |
| Current Liabilities:                                                                                                                                                    |                   |                       |
| Accounts payable - related parties                                                                                                                                      | \$ 129            | \$ 262                |
| Accounts payable – other                                                                                                                                                | 204,912           | 190,312               |
| Accrued expenses                                                                                                                                                        | 1,278,729         | 1,108,725             |
| Due to factors                                                                                                                                                          | 13,085            | 71,604                |
| Notes payable - related party                                                                                                                                           | 95,098            | 133,367               |
| Notes payable – other                                                                                                                                                   | 34,000            | 35,170                |
| Total current liabilities                                                                                                                                               | 1,625,953         | 1,539,440             |
| Notes payable, less current portion, net of discount and beneficial conversion feature of \$19,485 at March 31, 2009 and \$25,639 at September 30, 2008                 | 155,515           | 149,361               |
| Total liabilities                                                                                                                                                       | 1,781,468         | 1,688,801             |
| Commitments and contingencies                                                                                                                                           | –                 | –                     |
| Shareholders' deficit:                                                                                                                                                  |                   |                       |
| Preferred stock, par value \$0.10; 4,000,000 shares authorized, none issued and outstanding                                                                             | –                 | –                     |
| Common stock, par value \$0.01; 187,000,000 shares authorized, and shares issued and outstanding of 165,276,879 at March 31, 2009 and 137,276,879 at September 30, 2008 | 1,652,769         | 1,372,769             |
| Additional paid-in capital                                                                                                                                              | 22,379,245        | 22,623,307            |
| Accumulated deficit                                                                                                                                                     | (25,760,262)      | (25,549,302)          |
| Total shareholders' deficit                                                                                                                                             | (1,728,248)       | (1,553,226)           |
| Total liabilities and shareholder's deficit                                                                                                                             | \$ 53,220         | \$ 135,575            |

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

**NATIONAL SCIENTIFIC CORPORATION**

**Condensed Statements of Operations  
(Unaudited)**

|                                                       | Three months ended |              | Six months ended |              |
|-------------------------------------------------------|--------------------|--------------|------------------|--------------|
|                                                       | March 31,          |              | March 31,        |              |
|                                                       | 2009               | 2008         | 2009             | 2008         |
| Revenue                                               | \$ 78,345          | \$ 156,216   | \$ 243,259       | \$ 371,755   |
| Cost of revenue                                       | 38,477             | 83,033       | 130,367          | 206,473      |
| Gross profit                                          | 39,868             | 73,183       | 112,892          | 165,282      |
| Costs and expenses                                    |                    |              |                  |              |
| Salaries and benefits                                 | 64,030             | 71,055       | 130,021          | 137,293      |
| Research and development                              | 41,377             | 41,457       | 84,227           | 84,708       |
| Stock compensation                                    | 138                | 14           | 138              | 14,319       |
| Other                                                 | 26,995             | 62,608       | 64,832           | 98,761       |
| Total costs and expenses                              | 132,540            | 175,134      | 279,218          | 335,081      |
| Loss from operations                                  | (92,672)           | (101,951)    | (166,326)        | (169,799)    |
| Other income (expense)                                |                    |              |                  |              |
| Other income                                          | —                  | —            | 30               | —            |
| Interest expense                                      | (20,751)           | (21,772)     | (42,264)         | (44,620)     |
| Amortization of deferred financing costs              | (1,200)            | (1,200)      | (2,400)          | (2,400)      |
|                                                       | (21,951)           | (22,972)     | (44,634)         | (47,020)     |
| Income (loss) before income taxes                     | (114,623)          | (124,923)    | (210,960)        | (216,819)    |
| Income tax expense                                    | —                  | —            | —                | —            |
| Net income (loss)                                     | \$ (114,623)       | \$ (124,923) | \$ (210,960)     | \$ (216,819) |
| Net income (loss) per common share, basic and diluted | \$ (0.00)          | \$ (0.00)    | \$ (0.00)        | \$ (0.00)    |
| Weighted average number of shares outstanding         | 153,121,323        | 122,303,826  | 148,793,363      | 122,230,098  |

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

**NATIONAL SCIENTIFIC CORPORATION**

**Condensed Statements of Cash Flows  
(Unaudited)**

|                                                                                    | <b>Six months ended</b> |                 |
|------------------------------------------------------------------------------------|-------------------------|-----------------|
|                                                                                    | <b>March 31,</b>        |                 |
|                                                                                    | <b>2009</b>             | <b>2008</b>     |
| <b>Cash flows from operating activities:</b>                                       |                         |                 |
| Net loss                                                                           | \$ (210,960)            | \$ (216,819)    |
| <b>Adjustments to reconcile net loss to net cash used in operating activities:</b> |                         |                 |
| Depreciation                                                                       | 207                     | 207             |
| Stock issued for services                                                          | –                       | 2,000           |
| Stock options issued for services                                                  | 138                     | 12,319          |
| Amortization of deferred financing costs                                           | 2,400                   | 2,400           |
| Amortization of debt discount                                                      | 5,160                   | 5,160           |
| Amortization of beneficial conversion feature                                      | 994                     | 993             |
| <b>Changes in assets and liabilities:</b>                                          |                         |                 |
| Decrease (increase) in inventory                                                   | (6,297)                 | 7,560           |
| Decrease (increase) in receivables                                                 | 78,536                  | (41,176)        |
| Decrease (increase) in other assets and deposits                                   | 28                      | (12,565)        |
| Increase in accounts payable and accrued expenses                                  | 220,271                 | 154,470         |
| <b>Net cash provided by (used) in operating activities</b>                         | <b>90,477</b>           | <b>(85,451)</b> |
| <b>Cash flows from financing activities:</b>                                       |                         |                 |
| Repayment of notes payable                                                         | (39,439)                | (17,424)        |
| Net proceeds from factors                                                          | (58,519)                | 19,310          |
| <b>Net cash provided (used) by financing activities</b>                            | <b>(97,958)</b>         | <b>1,886</b>    |
| <b>Net decrease in cash and cash equivalents</b>                                   | <b>(7,481)</b>          | <b>(83,565)</b> |
| Cash and cash equivalents, beginning of period                                     | 7,602                   | 85,887          |
| <b>Cash and cash equivalents, end of period</b>                                    | <b>\$ 121</b>           | <b>\$ 2,322</b> |
| <b>Supplementary Disclosure of Cash Flow Information:</b>                          |                         |                 |
| Cash paid for interest                                                             | \$ 7,365                | \$ 7,407        |
| Conversion of accounts payable and accrued expenses to equity                      | \$ 35,800               | \$ 5,000        |

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

**NATIONAL SCIENTIFIC CORPORATION**

**Condensed Statement of Changes in Shareholders' Deficit  
For the Six months Ended March 31, 2009  
(Unaudited)**

|                                                  | <u>Common</u>               | <u>Stock</u>         |                                           |                                |                       |
|--------------------------------------------------|-----------------------------|----------------------|-------------------------------------------|--------------------------------|-----------------------|
|                                                  | <u>Number of<br/>Shares</u> | <u>Par<br/>Value</u> | <u>Additional<br/>Paid-In<br/>Capital</u> | <u>Accumulated<br/>Deficit</u> | <u>Total</u>          |
| Balance at September 30, 2008                    | 137,276,879                 | \$ 1,372,769         | \$ 22,623,307                             | \$ (25,549,302)                | \$ (1,553,226)        |
| Stock options granted                            | -                           | -                    | 138                                       | -                              | 138                   |
| Stock issued in exchange of accrued expenses for |                             |                      |                                           |                                |                       |
| \$0.002                                          | 5,000,000                   | 50,000               | (40,000)                                  | -                              | 10,000                |
| \$0.003                                          | 5,000,000                   | 50,000               | (35,000)                                  |                                | 15,000                |
| \$0.0006                                         | 18,000,000                  | 180,000              | (169,200)                                 |                                | 10,800                |
| Net loss for the six months ended March 31, 2009 | -                           | -                    | -                                         | (210,960)                      | (210,960)             |
| Balance at March 31, 2009                        | <u>165,276,879</u>          | <u>\$ 1,652,769</u>  | <u>\$ 22,379,245</u>                      | <u>\$ (25,760,262)</u>         | <u>\$ (1,728,248)</u> |

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

## NATIONAL SCIENTIFIC CORPORATION

### NOTES TO FINANCIAL STATEMENTS

March 31, 2009

(Unaudited)

#### 1. Summary of Significant Accounting Policies and Use of Estimates

##### *Nature of Business*

Our primary business involves the research, development, manufacture, and sale of mobile Digital Video Recording systems (DVR's) based on small embedded computers that are configured to record digital video and take GPS generated location bread crumbs and then wirelessly communicates this data back to a base station for subsequent review. We write all of our firmware and assemble the hardware components into a finished product.

Our primary customer focus for these products is the safety market, related in many cases to the safety of school age children. Our products and services are typically sold to school district transportation departments or to other distributors who then sell into the school districts. The majority of our distributors are major school bus manufacturer distributors.

Our primary SIC Code is 8711.

##### *Basis of Presentation*

The following is a summary of the significant accounting policies followed by National Scientific Corporation (the "Company" or "us").

**The accompanying un-audited financial statements do not include all information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements.**

In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of financial position and the results of operations for the interim periods presented have been included. Operating results for the interim periods are not necessarily indicative of the results that may be expected for the respective full year.

These financial statements should be read in conjunction with the financial statements and notes included in the Company's Annual OTC Information and Disclosure Statement for the fiscal year ended September 30, 2008 and the Company's quarterly OTC Information and Disclosure Statement for the period ended December 31, 2008.

The results of operations for the six months ended March 31, 2009 are not necessarily indicative of the results to be expected for the entire fiscal year.

### ***Going Concern***

The financial statements have been prepared on the basis that the Company will continue as a going concern, which assumes that adequate sources of financing will be obtained as required and that our assets will be realized and liabilities settled in the ordinary course of business. Accordingly, the financial statements do not include any adjustments related to the recoverability of assets and classification of assets and liabilities that might be necessary should we be unable to continue as a going concern.

The Company's ability to continue as a going concern is contingent upon its ability to attain profitable operations and secure financing. There can be no assurance that additional financing will be available to us when needed or, if available, that it can be obtained on commercially reasonable terms. If we are not able to continue as a going concern, we would likely be unable to realize the carrying value of our assets reflected in the balances set out in our financial statements. Historically, our auditors have expressed substantial doubt about the Company's ability to continue as a going concern.

### ***Use of Estimates***

In preparing financial statements in conformity with generally accepted accounting principles, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the reported period. Actual results could differ from those estimates.

### ***Revenue Recognition***

The Company recognizes revenue when persuasive evidence of an arrangement exists, the sales price is fixed or determinable, collection is reasonably assured and delivery of products has occurred or services have been rendered. Accordingly, the Company recognizes revenues upon shipment of product to customers.

### ***Fair Value of Financial Instruments***

The Company's financial instruments consist of cash and cash equivalents, accounts receivables, other receivables, accounts payable and accrued liabilities and notes payable. Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from these financial instruments. The fair value of these financial instruments approximates their carrying values due to their short duration, unless otherwise noted or their market interest rate.

### ***Earnings per Share***

Statement of Financial Accounting Standards No. 128, "Earnings per Share," ("SFAS 128") provides for the calculation of Basic and Diluted earnings per share. Basic earnings per share includes no dilution and is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflect the potential dilution of securities that could share in the earnings of the Company calculated using the treasury stock method.

### ***Stock-Based Compensation***

Effective October 1, 2006, the Company adopted the fair value recognition provisions of Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123R"), using the

modified prospective transition method and therefore the Company has not restated its results for prior periods. Under this method, compensation cost recognized in

the six months ended March 31, 2009 and 2008 include compensation cost for all share-based payments, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123R. All stock based compensation awards were fully vested as of October 1, 2006.

We estimate fair value using the Black-Scholes option-pricing model.

### **Recent Accounting Pronouncements**

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS 159"). The Company is currently evaluating the impact of SFAS 159 on its financial statements, but does not expect this new accounting pronouncement to have a material impact.

In June 2007, the FASB ratified EITF 06-11 "Accounting for the Income Tax Benefits of Dividends on Share-Based Payment Awards" ("EITF 06-11"). We do not expect EITF 06-11 will have a material impact on our financial statements.

In December 2007, the FASB issued SFAS No. 160 "Non-controlling Interests in Consolidated Financial Statements-an amendment of ARB No. 51".The Company does not expect SFAS 160 will have a material impact on our financial statements.

In December 2007, the FASB issued SFAS No. 141 (Revised) "Business Combinations". The Company does not expect this new accounting pronouncement to have a material impact on our financial statements.

In February 2008, FASB Staff Position (FSP) FSP No. 157-2, "*Effective Date of FASB Statement No. 157*" (FSP No. 157-2) was issued. We do not expect FSP No. 157-2 will have a material impact on our financial statements.

In March 2008, the FASB issued FASB Statement No. 161 "Disclosures about Derivative Instruments and Hedging Activities" ("SFAS 161"). We do not expect SFAS 161 will have a material impact on our financial statements.

In April 2008, the FASB FSP 142-3, "*Determination of the Useful Life of Intangible Assets.*" We do not expect FASB FSP 142-3 will have a material impact on our financial statements.

In May 2008, the FASB FSP No. APB 14-1 "*Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)*" The Company does not expect the adoption of FSP APB 14-1 to have a material effect on its results of operations and financial condition.

In May 2008, the FASB issued SFAS No. 162, "*The Hierarchy of Generally Accepted Accounting Principles (SFAS 162), which becomes effective upon approval by the SEC*". It is not expected to change any of our current accounting principles or practices and therefore, is not expected to have a material impact on our financial statements.

There were various other accounting standards and interpretations issued during 2009 and 2008, none of which are expected to have a material impact on the Company's financial position, operations or cash flows.

## 2. Stock-Based Compensation

The Company accounts for stock-based compensation utilizing the fair value recognition provisions of SFAS 123R.

As of March 31, 2009, the Company has the following stock-based compensation plan:

### **Stock Options**

Our board of directors adopted the 2000 Stock Option Plan effective January 1, 2001. Our stockholders formally approved the 2000 Stock Option Plan on February 14, 2001.

As of December 31, 2008, we have granted options to purchase an aggregate of 3,628,666 shares of our common stock, under the plan, leaving a balance of 3,371,334 available for grant. Also as of December 31, 2008, 3,628,666 options are exercisable and 3,628,666 are vested. We have reserved the right to issue a total of 7,000,000 shares of our common stock for issuance under the 2000 Stock Option Plan.

During the six months ended March 31, 2009, the following options were granted:

On January 12, 2009, 20,000 options were granted to Greg Szabo, a director, for board services. The weighted average grant date fair value of these options was \$0.0069. Stock based compensation of \$138 was recognized in the financial statements using the Black-Scholes option pricing model value on the grant date. The options have a life of ten years, an exercise price of \$0.0075 and vested immediately.

During the six months ended March 31, 2009, no options were exercised

As required by SFAS 123R, the fair value of each grant is estimated on the date of the grant using the Black-Scholes option pricing method with the following assumptions to value options for the six months ended March 31, 2009 and 2008:

|                                        | <u>2009</u> | <u>2008</u>        |
|----------------------------------------|-------------|--------------------|
| Risk - free interest rate              | 1.45%       | 3.06% to 4.23%     |
| Expected life (years)                  | 5           | 5                  |
| Expected volatility                    | 223.1%      | 116.0% to 124.9%   |
| Expected dividends                     | None        | None               |
| Forfeitures assumed                    | None        | None               |
| Weighted average grant date fair value | \$0.0069    | \$0.005 to \$0.018 |

The following table summarizes the stock option activity during the first six months of fiscal year 2009:

|                                         | Number<br>of<br>Shares | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Term (1) | Aggregate<br>Intrinsic<br>Value (2) |
|-----------------------------------------|------------------------|------------------------------------------|-------------------------------------------------------------|-------------------------------------|
| Options Outstanding, September 30, 2008 | 3,628,666              | \$ 0.21                                  | 6.83                                                        |                                     |
| Granted                                 | 20,000                 | -                                        |                                                             |                                     |
| Exercised                               | -                      | -                                        |                                                             |                                     |
| Forfeited or expired                    | -                      | -                                        |                                                             |                                     |
| Options Outstanding, March 31, 2009     | <u>3,648,666</u>       | <u>\$ 0.21</u>                           | <u>6.58</u>                                                 | <u>\$ -</u>                         |
| Options Exercisable March 31, 2009      | <u>3,648,666</u>       | <u>\$ 0.43</u>                           | <u>6.58</u>                                                 | <u>\$ -</u>                         |

(1) Remaining contractual term is presented in years

(2) The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the closing price of our common stock as of March 31, 2009, for those awards that have an exercise price currently below the closing price as of March 31, 2009. Awards with an exercise price above the closing price of \$0.0006 as of March 31, 2009 are considered to have no intrinsic value.

### **Warrants**

During the six months ended March 31, 2009, no awards were granted, no share purchase warrants were exercised, and no warrants were forfeited.

|                                        | <u>2008</u>     |
|----------------------------------------|-----------------|
| Risk - free interest rate              | 4.60% to 4.91%  |
| Expected life (years)                  | 2 to 5          |
| Expected volatility                    | 83.5% to 184.8% |
| Expected dividends                     | None            |
| Forfeitures assumed                    | None            |
| Weighted average grant date fair value | \$0.0147        |

The following table summarizes the warrant activity during the first six months of fiscal year 2009:

|                                          | Number<br>Of<br>Shares | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Term (1) | Aggregate<br>Intrinsic<br>Value (2) |
|------------------------------------------|------------------------|------------------------------------------|-------------------------------------------------------------|-------------------------------------|
| Warrants Outstanding, September 30, 2008 | 17,529,197             | \$ 0.16                                  | 0.94                                                        |                                     |
| Granted                                  | -                      | -                                        | -                                                           |                                     |
| Exercised                                | -                      | -                                        | -                                                           |                                     |
| Expired                                  | -                      | -                                        | -                                                           |                                     |
| Warrants Outstanding, March 31, 2009     | 17,529,197             | \$ 0.16                                  | 0.59                                                        | \$ -                                |

(1) Remaining contractual term is presented in years.

(2) The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the closing price of our common stock as of March 31, 2009, for those awards that have an exercise price currently below the closing price as of March 31, 2009. Awards with an exercise price above the closing price as of March 31, 2009 of \$0.0006 are considered to have no intrinsic value.

### 3. Trade Receivables

Trade Receivables of \$23,025 at March 31, 2009 included factored invoices totaling \$16,356. Trade Receivables of \$101,561 at September 30, 2008 included factored invoices totaling \$89,505. There were no reserves for doubtful accounts at March 31, 2009 and September 30, 2008, as all amounts were deemed collectible.

### 4. Inventory

Inventories, primarily purchased parts and finished goods, are stated at the lower of cost or market values. Cost is determined on a FIFO (first-in, first-out) basis. There were no reserves at March 31, 2009 and September 30, 2008.

## 5. Accrued Expenses

Accrued expenses consisted of the following at March 31, 2009 and September 30, 2008:

|                                                          | <u>March 31, 2009</u> | <u>September 30, 2008</u> |
|----------------------------------------------------------|-----------------------|---------------------------|
| Salaries and vacation pay - current management and staff | \$ 911,766            | \$ 786,653                |
| Salaries and vacation pay - former employee              | 29,375                | 29,375                    |
| Payroll taxes for accrued back pay                       | 75,889                | 62,224                    |
| Interest                                                 | 242,453               | 216,471                   |
| Other liabilities                                        | 19,246                | 14,002                    |
|                                                          | <u>\$ 1,278,729</u>   | <u>\$ 1,108,725</u>       |

## 6. Notes Payable and Long-Term Debt

As of March 31, 2009 and September 30, 2008, long-term debt consisted of the following notes payable:

|                                                                                                                                | <u>March 31, 2009</u> | <u>September 30, 2008</u> |
|--------------------------------------------------------------------------------------------------------------------------------|-----------------------|---------------------------|
| 8% note payable to a related party; unsecured; principal and interest due on demand                                            | 95,098                | 133,367                   |
| 12% note payable; secured; due on demand                                                                                       | 11,625                | 11,625                    |
| 12% note payable; secured; due on demand                                                                                       | 20,000                | 20,000                    |
| 8% note payable; unsecured; principal payable in full in November 2010; with semi-annual interest payments in May and November | 175,000               | 175,000                   |
| 6% note payable; unsecured; due on demand with 30 days prior notice                                                            | 2,375                 | 3,545                     |
|                                                                                                                                | <u>304,098</u>        | <u>343,537</u>            |
| Less:                                                                                                                          |                       |                           |
| Current portion of long term debt                                                                                              | (129,098)             | (168,537)                 |
| Discount                                                                                                                       | (16,340)              | (21,500)                  |
| Beneficial conversion feature                                                                                                  | (3,145)               | (4,139)                   |
| Long-term debt, net of current portion                                                                                         | <u>\$ 155,515</u>     | <u>\$ 149,361</u>         |

The aggregate maturities of long-term debt were as follows:

|      | <u>March 31, 2009</u> | <u>September 30, 2008</u> |
|------|-----------------------|---------------------------|
| 2009 | 129,098               | 168,537                   |
| 2010 | 175,000               | 175,000                   |
|      | <u>\$ 304,098</u>     | <u>\$ 343,557</u>         |

## 8. Earnings Per Share

Statement of Financial Accounting Standards No. 128, "Earnings per Share," provides for the calculation of Basic and Diluted earnings per share. Basic income (loss) per share includes no dilution and is computed by dividing income (loss) available to common shareholders by the weighted average number of common shares outstanding for the period.

The following table reconciles weighted average shares outstanding to amounts used to calculate basic and diluted earnings per share for the three and six months ended March 31, 2009 and 2008.

|                                                            | Three months ended<br>March 31, |              | Six months ended<br>March 31, |              |
|------------------------------------------------------------|---------------------------------|--------------|-------------------------------|--------------|
|                                                            | 2009                            | 2008         | 2009                          | 2008         |
| Net loss                                                   | \$ (114,623)                    | \$ (124,923) | \$ (210,960)                  | \$ (216,819) |
| Weighted average shares:                                   |                                 |              |                               |              |
| Average shares outstanding                                 | 153,121,323                     | 122,303,826  | 148,793,363                   | 122,230,098  |
| Effect of diluted shares                                   | —                               | —            | —                             | —            |
| Average shares outstanding adjusted<br>for dilutive effect | 153,121,323                     | 122,303,826  | 148,793,363                   | 122,230,098  |
| Income (loss) per share - basic                            | \$ 0.00                         | \$ (0.00)    | \$ (0.00)                     | \$ (0.00)    |
| Income (loss) per share - diluted                          | \$ 0.00                         | \$ (0.00)    | \$ (0.00)                     | \$ (0.00)    |

Incremental common shares (not included in denominator of diluted earnings per share because of their anti-dilutive nature):

|                              | March 31, 2009 | March 31, 2008 |
|------------------------------|----------------|----------------|
| Options                      | 3,648,666      | 5,251,756      |
| Warrants                     | 17,529,197     | 17,714,197     |
| Potential common equivalents | 21,177,863     | 22,965,953     |

## 9. Subsequent Events

On April 30, 2009, Michael A. Grollman submitted his resignation as Chairman and Chief Executive Officer of the Company, in order to pursue other career opportunities. He will remain involved with the Company as a strategic consultant, Director and Chief Technology Officer. Mr. Grollman's resignation was effective April 30, 2009.

On May 4<sup>th</sup> 2009, Gregory F Szabo, the company's Director, was appointed by the Board of Directors of the Company to assume the responsibilities as Chief Executive Officer and Chairman, on an acting basis.

On the same date, Graham L Clark, the company's President, Secretary and Director, was appointed by the Board of Directors of the Company to assume the responsibilities as Chief Financial Officer, on an acting basis.