

CLANCY SYSTEMS INTERNATIONAL, INC.
CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED SEPTEMBER 30, 2010 AND 2011
WITH
ACCOUNTANTS' REPORT

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ACCOUNTANTS' REPORT

Board of Directors
Clancy Systems International, Inc.
and Subsidiary

We are not independent with respect to Clancy Systems International, Inc and Subsidiary, and the accompanying consolidated balance sheets as of September 30, 2010 and 2011, and the related consolidated statements of income, stockholders' equity, and cash flows for the years then ended were not audited by us and, accordingly, we do not express an opinion on them.

Denver, Colorado
February 3, 2012

Causey Demgen & Moore Inc.

CLANCY SYSTEMS INTERNATIONAL, INC.
CONSOLIDATED BALANCE SHEETS
September 30, 2010 and 2011
(unaudited)

ASSETS

	<u>2010</u>	<u>2011</u>
Current assets:		
Cash and cash equivalents	1,252,648	\$ 1,463,409
Accounts receivable, net of allowance for doubtful accounts of \$13,300 (2010) and \$13,300 (2011)	479,169	391,098
Income tax receivable	17,576	114,735
Inventories	154,566	79,819
Prepaid expenses	42,816	57,043
Deferred tax asset	6,100	4,900
	<hr/>	<hr/>
Total current assets	1,952,875	2,111,004
Property and equipment, at cost:		
Land	82,000	82,000
Building and building improvements	356,477	356,477
Office furniture and equipment	188,640	189,337
Equipment under service contracts	2,927,924	3,024,236
Leasehold improvements	13,000	13,000
Vehicles, including vehicles under capital leases	162,141	163,583
	<hr/>	<hr/>
3,730,182	3,828,633	
	<hr/>	<hr/>
Less accumulated depreciation	(2,719,482)	(2,929,658)
	<hr/>	<hr/>
Net furniture and equipment	1,010,700	898,975
Other assets:		
Marketable securities	1,101,640	1,092,899
Deposits and other	15,426	26,001
Goodwill	404,547	404,547
Software development costs, net of accumulated amortization of \$684,424 (2010) and \$770,253 (2011)	216,676	217,532
	<hr/>	<hr/>
Total other assets	1,738,289	1,740,979
	<hr/>	<hr/>
	\$ 4,701,864	\$ 4,750,958

See accompanying notes to consolidated financial statements.

CLANCY SYSTEMS INTERNATIONAL, INC.
CONSOLIDATED BALANCE SHEETS
September 30, 2010 and 2011
(unaudited)

LIABILITIES AND STOCKHOLDERS' EQUITY

	<u>2010</u>	<u>2011</u>
Current liabilities:		
Accounts payable	\$ 592,198	\$ 351,013
Accrued expenses	65,365	34,375
Income taxes payable	2,363	-
Notes payable - related party	250,000	250,000
Current portion of obligations under capital leases	4,050	4,434
Deferred revenue	<u>43,791</u>	<u>30,936</u>
Total current liabilities	957,767	670,758
Deferred tax liability	62,200	57,700
Obligations under capital leases, net of current portion	<u>16,251</u>	<u>11,820</u>
Total liabilities	1,036,218	740,278
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$.0001 par value; 100,000,000 shares authorized, none issued	-	-
Common stock, \$.0001 par value, 800,000,000 shares authorized, 354,095,195 (2010) and 352,545,195 (2011) shares issued and outstanding	35,410	35,255
Additional paid-in-capital	1,258,372	1,252,860
Unrealized gain on marketable securities	57,761	49,020
Retained earnings	<u>2,314,103</u>	<u>2,673,545</u>
Total stockholders' equity	<u>3,665,646</u>	<u>4,010,680</u>
	<u><u>\$ 4,701,864</u></u>	<u><u>\$ 4,750,958</u></u>

See accompanying notes to consolidated financial statements.

CLANCY SYSTEMS INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF INCOME AND
OTHER COMPREHENSIVE INCOME
For the years ended September 30, 2010 and 2011
(unaudited)

	<u>2010</u>	<u>2011</u>
Revenues	\$ 4,509,452	\$ 4,344,084
Costs of sales	<u>1,347,059</u>	<u>1,215,237</u>
Gross profit	3,162,393	3,128,847
Costs and expenses:		
General and administrative	2,927,150	2,686,956
Research and development	<u>27,637</u>	<u>19,379</u>
Total costs and expenses	<u>2,954,787</u>	<u>2,706,335</u>
Income from operations	207,606	422,512
Other income (expense):		
Gain on disposal of assets	4,874	-
Interest income	46,335	45,673
Interest expense	(9,460)	(20,205)
Other income	<u>38,452</u>	<u>8,581</u>
Total other income (expense)	<u>80,201</u>	<u>34,049</u>
Income before provision for income taxes	287,807	456,561
Provision for income taxes:		
Current expense	211,138	90,586
Deferred expense (benefit)	<u>14,100</u>	<u>(3,300)</u>
Total income tax expense	<u>225,238</u>	<u>87,286</u>
Net income	62,569	369,275
Other comprehensive income:		
Unrealized gain (loss) on marketable securities	<u>15,918</u>	<u>(8,741)</u>
Comprehensive income	<u>\$ 78,487</u>	<u>\$ 360,534</u>
Basic and diluted:		
Net income per common share	*	*
Weighted average number of shares outstanding	<u>357,004,575</u>	<u>353,173,414</u>

* Less than \$.01 per share

See accompanying notes to consolidated financial statements.

CLANCY SYSTEMS INTERNATIONAL, INC.
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
For the years ended September 30, 2010 and 2011
(unaudited)

	<u>Common Shares</u>	<u>Stock Amount</u>	<u>Additional paid-in capital</u>	<u>Other compre- hensive income</u>	<u>Retained earnings</u>
Balance, September 30, 2009	362,081,211	\$ 36,208	\$ 1,286,773	\$ 41,843	\$ 2,302,100
Common stock repurchased	(7,986,016)	(798)	(28,401)	-	(50,566)
Unrealized gain on marketable securities	-	-	-	15,918	-
Net income for the year ended September 30, 2010	-	-	-	-	62,569
Balance, September 30, 2010	354,095,195	35,410	1,258,372	57,761	2,314,103
Common stock repurchased	(1,550,000)	(155)	(5,512)	-	(9,833)
Unrealized loss on marketable securities	-	-	-	(8,741)	-
Net income for the year ended September 30, 2011	-	-	-	-	369,275
Balance, September 30, 2011	<u>352,545,195</u>	<u>\$ 35,255</u>	<u>\$ 1,252,860</u>	<u>\$ 49,020</u>	<u>\$ 2,673,545</u>

See accompanying notes to consolidated financial statements.

CLANCY SYSTEMS INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the years ended September 30, 2010 and 2011
(unaudited)

	<u>2010</u>	<u>2011</u>
Cash flows from operating activities:		
Net income	\$ 62,569	\$ 369,275
Adjustments to reconcile net income to net cash cash provided by operating activities:		
Depreciation and amortization	316,089	293,778
Gain on disposal of assets	(4,874)	-
Deferred income tax (benefit) expense	14,100	(3,300)
Changes in assets and liabilities:		
Accounts receivable	74,964	88,071
Inventories	3,431	74,747
Income taxes refundable	46,927	(97,159)
Prepaid expenses	21,684	(14,227)
Accounts payable	321,111	(241,185)
Accrued expenses	(52,405)	(30,990)
Income taxes payable	2,363	(2,363)
Deferred revenue	<u>(7,692)</u>	<u>(12,855)</u>
Total adjustments	<u>735,698</u>	<u>54,517</u>
Net cash provided by operating activities	<u>798,267</u>	<u>423,792</u>
Cash flows from investing activities:		
Acquisition of furniture and equipment	(723,622)	(96,224)
Increase in software licenses and software development costs	<u>(79,238)</u>	<u>(86,685)</u>
Decrease in deposits and other assets	<u>1,312</u>	<u>(10,575)</u>
Net cash used in investing activities	<u>(801,548)</u>	<u>(193,484)</u>
Cash flows from financing activities:		
Repurchase of common stock	(79,765)	(15,500)
Proceeds from notes payable and notes payable - related party	450,000	-
Payments on notes payable	(200,000)	-
Payments on capital leases	<u>(4,806)</u>	<u>(4,047)</u>
Net cash provided by (used in) financing activities	<u>165,429</u>	<u>(19,547)</u>
Increase in cash and cash equivalents	162,148	210,761
Cash and cash equivalents at beginning of period	<u>1,090,500</u>	<u>1,252,648</u>
Cash and cash equivalents at end of period	<u>\$ 1,252,648</u>	<u>\$ 1,463,409</u>

(continued on following page)

See accompanying notes to consolidated financial statements.

CLANCY SYSTEMS INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the years ended September 30, 2010 and 2011
(unaudited)

(continued from previous page)

	<u>2010</u>	<u>2011</u>
Supplemental disclosure of cash flow information:		
Cash paid during the period for interest	<u>\$ 9,460</u>	<u>\$ 20,205</u>
Cash paid during the period for income taxes, net of refunds	<u>\$ 161,847</u>	<u>\$ 206,566</u>
Supplemental disclosure of non-cash investing and financing activities:		
Unrealized gains (losses) available for sale securities	<u>\$ 15,918</u>	<u>\$ (8,741)</u>

During the year ended September 30, 2010, the Company financed a \$30,290 vehicle
under a capital lease obligation in the amount of \$22,790.

See accompanying notes to consolidated financial statements.

CLANCY SYSTEMS INTERNATIONAL, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2010 (unaudited) and September 30, 2011 (unaudited)

1. Organization and Summary of Significant Accounting Policies

Organization:

Clancy Systems International, Inc. (the "Company") was organized in Colorado on June 28, 1984. The Company is in the business of developing and marketing parking ticket writing systems, internet payment remittance systems, and internet industry guides. The Company's revenues are derived primarily from cities, universities and car rental companies throughout the United States and Canada. The Company manufactures some of its equipment for field operations, including printers, chargers, Palmtype keypads and other items used in its applications.

The Company's subsidiary, Urban Transit Solutions, Inc. ("UTS") was incorporated on March 6, 1997 under the Laws of the Commonwealth of Puerto Rico and is engaged in providing a wide variety of services in the areas of consulting design and the management of digital parking meter systems in Puerto Rico and Latin America. The financial statements of UTS have been prepared on the basis of accounting principles generally accepted in the United States of America and denominated in U.S dollars. The functional currency of Puerto Rico is the U.S. dollar, and therefore, there are no amounts recorded for foreign currency translation or for transactions denominated in a foreign currency.

Principles of Consolidation:

The consolidated financial statements include the accounts of the Company and its subsidiary, UTS. All significant inter-company transactions and balances have been eliminated in consolidation.

Use of estimates:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Accounts receivable:

The allowance for doubtful accounts at September 30, 2010 and 2011 was \$13,300 and \$13,300, respectively. The Company evaluates trade receivables that are past due to determine the appropriate allowance for doubtful accounts. The receivables are charged off in the period which they are deemed uncollectible. The Company contracts primarily with government agencies and takes into account budget year issues in evaluating its past due receivables. Recoveries of trade receivables previously charged off are recorded when received.

CLANCY SYSTEMS INTERNATIONAL, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2010 (unaudited) and September 30, 2011 (unaudited)

1. Organization and Summary of Significant Accounting Policies (continued)

Inventories:

Inventories are carried at the lower of cost (first-in, first-out) or market. Inventory costs include materials, labor and manufacturing overhead. Inventories consist primarily of computer and printer parts and supplies and are subject to technical obsolescence.

Computer software:

Costs incurred to establish the technological feasibility of computer software are classified as research and development costs, which are charged to expense as incurred. Software development costs incurred subsequent to establishment of technological feasibility are capitalized and subsequently amortized based on the lesser of the straight line method over the remaining estimated economic life of the product (generally five years) or the estimate of current and future revenues for the related software product. Amortization expense for the years ended September 30, 2010 and 2011 amounted to \$83,854 and \$85,829, respectively, and is included in cost of services. The cost of direct labor is periodically capitalized as computer software costs.

Property and equipment:

Property and equipment are stated at cost. Depreciation is provided by the Company on the straight line method over the assets' estimated useful lives as follows:

Building and building improvements	10 to 30 years
Office furniture and equipment	5 years
Equipment under service contracts	3 to 5 years
Leasehold improvements	The shorter of useful life and lease term
Vehicles	3 to 5 years

Property and equipment consists partly of computers and printers which are subject to technical obsolescence. Depreciation expense for the years ended September 30, 2010 and 2011 amounted to \$232,235 and \$207,949, respectively.

Sales and retirements of depreciable property are recorded by removing the related cost and accumulated depreciation from the accounts. Gains and losses on sales and retirements of property are reflected in results of operations.

CLANCY SYSTEMS INTERNATIONAL, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2010 (unaudited) and September 30, 2011 (unaudited)

1. Organization and Summary of Significant Accounting Policies (continued)

Other assets:

The excess of the purchase price over net assets acquired by the Company from unrelated third parties is recorded as goodwill. Goodwill resulted from the acquisition of UTS. In accordance Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 350-20, goodwill and intangible assets with indefinite lives are to be tested for impairment at least annually and also in the event of an impairment indicator. There is no impairment of goodwill considered necessary as of September 30, 2010 or 2011.

Revenue recognition:

Revenue derived from professional service contracts on equipment and support services is included in income as earned over the contract term; related costs consist mainly of depreciation, supplies and sales commissions. The Company defers revenue for equipment and services under service contracts that are billed to customers on a quarterly, semi-annual, annual or other basis. Revenue from the issuance of parking tickets is recognized on a cash basis when received. Revenue derived from professional service contracts on parking meter and lots fees collections is recognized on a cash basis when received. Related costs consist mainly of municipalities' fees, depreciation and lot rents.

The Company recognizes revenue in accordance with the Securities and Exchange Commission Staff Accounting Bulletin 104 ("SAB 104"). SAB 104 provides the conditions for realization of revenue areas as follows: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or services have been rendered; (3) the seller's price to the buyer is fixed or determinable, and (4) collectibility is reasonably assured.

In addition, in accordance with FASB ASC 605-45, revenue is presented gross, determined on a contract by contract basis, where the Company acts as principal, takes title to the products sold, has the risks and rewards of ownership, such as the risk of loss for collection, delivery or product returns. Revenue is presented net of direct costs, determined on contract by contract basis, where the Company primarily acts as agent by providing services for a commission or fee.

Before the Company recognizes revenue, a contract is entered into with the client (which details the fees to be charged), all software and equipment per the contract is delivered, and as most of the Company's clients are municipalities or universities, collectability is reasonably assured.

CLANCY SYSTEMS INTERNATIONAL, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2010 (unaudited) and September 30, 2011 (unaudited)

1. Organization and Summary of Significant Accounting Policies (continued)

Contracts for the Company's ticket writing system are entered into under one of four different pricing options. The Company (1) sells the equipment and ticket stock and licenses the software separately, (2) charges a monthly fee for the use of the equipment and software, (3) charges a fee per ticket at the time the ticket stock is provided to the client, or (4) provides a full privatization program. In a sale transaction, revenue is recognized on the sale of the equipment, license and ticket stock (less an amount for customer support). When the Company charges a monthly fee, that fee is recognized in income in the period the services are provided. When the Company charges a fee per ticket, the Company recognizes revenue for the portion considered a sale of the ticket stock on delivery of the tickets to the client and the remainder is recognized as revenue over the period of estimated usage of the tickets based on past history with the client.

In a privatization program, client revenue guarantees may be entered into for a period of time, generally one year at a time. A ratable portion of the client revenue guarantee is recognized each month as an expense. In revenue split arrangements, the portion of the cash collected and owed each month is recognized as a liability and an expense.

The Company does not offer a right of return on sales of equipment or ticket stock. Equipment sold, other than the Company's proprietary products, is covered under the manufacturer's warranty.

Warranty expense for the Company's products has been immaterial in the past. Revenue recognition commences after the equipment has been delivered and the software has been installed and is operational.

Shipping and handling costs:

The Company pays all shipping costs for its contract services. Customers are provided prepaid shipping labels for returning equipment to the Company for repair and shipping repaired equipment back to the client is paid for by the Company.

Advertising costs:

The Company expenses the costs of advertising as incurred. Advertising expense was \$44,936 and \$20,251 for the years ended September 30, 2010 and 2011, respectively.

Deferred Income taxes:

The Company accounts for deferred income taxes under FASB ASC 740-10. Under ASC 740-10, deferred income taxes are accounted for under an asset and liability approach that requires recognition of deferred tax assets and liabilities for the expected future tax consequences of transactions based on temporary differences. Temporary differences are differences between the tax basis of assets and liabilities and their reported amounts in the financial statements that

CLANCY SYSTEMS INTERNATIONAL, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2010 (unaudited) and September 30, 2011 (unaudited)

1. Organization and Summary of Significant Accounting Policies (continued)

will result in taxable or deductible amounts in future years. The Company's temporary differences consist primarily of tax operating loss carry forwards, depreciation differences and capitalized section 263A costs.

Cash equivalents:

For purposes of the statement of cash flows, the Company considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

Marketable securities:

The Company accounts for marketable securities in accordance with ASC 320-10. In accordance with ASC 320-10, the investment in securities has been classified as available-for-sale because the securities are being held for an indefinite period of time. Under the available-for-sale classification, the securities are recorded as an asset at current market value on the balance sheet with an amount representing unrealized gains and losses recorded as comprehensive income in stockholders' equity. The current market value is derived from published market quotations. At the time of sale, a gain or loss is recognized in the statement of operations using the cost basis of securities sold as determined by specific identification.

Investments in marketable securities at September 30, 2010 and 2011 consist of Colorado local government and municipal bonds that are triple A rated and insured that are subject to market risk related to changes in interest rates and are available for sale. At September 30, 2011, the securities had a cost basis of \$1,043,879 and fair market value of \$1,092,899.

The adjustment to unrealized holding losses on available-for-sale securities included in accumulated other comprehensive income as a component of stockholders' equity increased by \$15,918 for the year ended September 30, 2010 and decreased by \$8,741 for the year ended September 30, 2011, and totaled \$49,020 at September 30, 2011.

Fair value of financial instruments:

All financial instruments are held for purposes other than trading. The following methods and assumptions were used to estimate the fair value of each financial instrument for which it is practicable to estimate that value.

For cash and cash equivalents, accounts receivable, accounts payable and current portions of long-term debt and obligations under capital leases, the carrying amount is assumed to approximate fair value due to the short-term maturities of these instruments. For long-term debt obligations under capital leases, the carrying value approximates fair value due to the interest rates approximating prevailing market rates.

CLANCY SYSTEMS INTERNATIONAL, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2010 (unaudited) and September 30, 2011 (unaudited)

1. Organization and Summary of Significant Accounting Policies (continued)

Marketable securities – the carrying amounts approximate the fair value because the securities are valued at prices based on published market quotations.

Concentrations of credit risk:

Financial instruments which potentially subject the Company to concentrations of credit risk consist principally of cash, trade receivables and marketable securities. The Company places its cash with high quality financial institutions. At September 30, 2010 and 2011 and at various times during the years ended September 30, 2010 and 2011, the balance at one of the financial institutions exceeded FDIC insurance limits on interest bearing accounts.

The Company provides credit, in the normal course of business, to customers throughout the United States, Puerto Rico and Canada. All transactions are denominated in U.S. Dollars. The Company performs ongoing credit evaluations of its customers. Credit terms are typically 30 days from billing date.

Significant portions of the Company's revenues are derived from contracts with universities, car rental companies and municipalities.

Earnings per share:

The Company follows ASC 260-10 in presenting earnings per share which establishes the methodology of calculating basic earnings per share and diluted earnings per share. The calculations differ by adding any instruments convertible to common stock (such as stock options, warrants, and convertible preferred stock) to weighted average shares outstanding when computing diluted earnings per share. At September 30, 2010 and 2011, the Company had no potentially dilutive securities.

Impairment of long-lived assets:

The Company evaluates the carrying value of assets, other than investments in marketable securities, for potential impairment on an ongoing basis. In accordance with ASC 360-10, the Company periodically evaluates the carrying value of long-lived assets and long-lived assets to be disposed of and certain identifiable intangibles related to those assets for potential impairment. The Company considers projected future operating results, cash flows, trends and other circumstances in making such estimates and evaluations and, if necessary, reduces the carrying value of impaired assets to fair value. At September 30, 2010 and 2011 the Company determined that no such impairments existed.

CLANCY SYSTEMS INTERNATIONAL, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2010 (unaudited) and September 30, 2011 (unaudited)

1. Organization and Summary of Significant Accounting Policies (continued)

Segment Information

The Company follows ASC 280-10 for segment reporting. Certain information is disclosed, based on the way management organizes financial information for making operating decisions and assessing performance. The Company currently operates in a single segment and will evaluate additional segment disclosure requirements as it expands its operations.

Comprehensive income:

The Company reports comprehensive income in accordance with ASC 220-10, which requires the reporting of all changes in equity during a period, except those resulting from investment by owners and distribution to owners, in a financial statement for the period in which they are recognized. This encompasses unrealized gains and losses from available-for-sale securities held.

Recently issued accounting standards:

In 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*. This update requires all non-owner changes in stockholders' equity be presented in either (a) a single, continuous statement of comprehensive income where entities include the components of net income, a total for net income, the components of other comprehensive income, a total for other comprehensive income and a total for comprehensive income or (b) two separate but consecutive statements, where entities report components of net income and total net income in the income statement, which must be immediately followed by a statement of other comprehensive income that must include all components of other comprehensive income, a total of other comprehensive income, and a total of comprehensive income. This update is effective for fiscal years and interim periods, beginning after December 15, 2011 for public entities with retrospective application. Later in 2011, the FASB issued ASU 2011-12, *Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*. This amendment defers changes to ASU 2011-05 that pertain to how, when, and where reclassification adjustments are presented. All other requirements in ASU 2011-05 are not affected by this update. The Company has adopted these updates on October 1, 2011, and they will not have a significant impact on the Consolidated Financial Statements.

CLANCY SYSTEMS INTERNATIONAL, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2010 (unaudited) and September 30, 2011 (unaudited)

1. Organization and Summary of Significant Accounting Policies (continued)

In 2011, the FASB issued ASU 2011-08, Intangibles – Goodwill and Other (Topic 350): *Testing Goodwill for Impairment*. This amendment is intended to simplify how entities, both public and nonpublic, test goodwill for impairment in response to concerns regarding the cost and complexity of performing the first of the two-step goodwill impairment test. The amendment permits an entity 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 described in Topic 350. This update is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted. The Company has adopted this update on October 1, 2011, and the Company does not believe it will have a significant impact on the Consolidated Financial Statements.

2. Inventories

Inventories consist of the following at September 30:

	<u>2010</u> (unaudited)	<u>2011</u> (unaudited)
Finished goods	\$ 39,713	\$ 38,528
Work in process	57,427	20,647
Purchased parts and supplies	<u>57,426</u>	<u>20,644</u>
	<u>\$ 154,566</u>	<u>\$ 79,819</u>

3. Related party transactions

During the year ended September 30, 2010, the Company entered into a note payable agreement with two officers of the Company in the amount of \$250,000. Interest is payable monthly at 6.75% per annum. The amount of interest expense paid to the officers amounted to \$8,196 and \$16,875 for the years ended September 30, 2010 and 2011, respectively. The note is payable on demand.

CLANCY SYSTEMS INTERNATIONAL, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2010 (unaudited) and September 30, 2011 (unaudited)

4. Fair value measurements

Financial Accounting Standards Board ASC 820, establishes a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under ASC 820 are described below:

Level 1: Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Company has the ability to access.

Level 2: Inputs to the valuation methodology include:

- Quoted prices for similar assets or liabilities in active markets;
- Quoted prices for identical or similar assets or liabilities in inactive markets;
- Inputs other than quoted prices that are observable for the asset or liability;
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets measured at fair value.

Municipal bonds: Valued at the closing price reported on the active market on which the individual securities are traded.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Company believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

CLANCY SYSTEMS INTERNATIONAL, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2010 (unaudited) and September 30, 2011 (unaudited)

4. Fair value measurements (continued)

The following table set forth by level, within the fair value hierarchy, the Company's assets at fair value as of September 30, 2010 and 2011.

<u>Assets at fair value as of September 30, 2010 (unaudited)</u>					
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>		<u>Total</u>
Municipal Bonds	\$ 1,010,640	\$ -	\$ -		\$ 1,010,640
	<u>\$ 1,010,640</u>	<u>\$ -</u>	<u>\$ -</u>		<u>\$ 1,010,640</u>

<u>Assets at fair value as of September 30, 2011 (unaudited)</u>					
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>		<u>Total</u>
Municipal Bonds	\$ 1,092,899	\$ -	\$ -		\$ 1,092,899
	<u>\$ 1,092,899</u>	<u>\$ -</u>	<u>\$ -</u>		<u>\$ 1,092,899</u>

5. Lease Commitments

During the year ended September 30, 2010, the Company leased approximately 1,700 square feet of office space for its corporate offices for \$2,127 per month, plus common area maintenance expenses of approximately \$400 per month, pursuant to a lease agreement with an unaffiliated party which expired on May 31, 2010. The Company also leased approximately 3,000 square feet of manufacturing space from an unaffiliated party. Rental payments were \$650 per month on a month to month agreement. In March 2010, the Company purchased land and a building for its corporate offices and manufacturing space.

In addition, the Company and wholly owned subsidiary, UTS, leases office spaces in Aibonito, Ponce, San German, Auguas Buenas, Caaguas, and San Juan, Puerto Rico that expire over the next two years. These leases generally contain renewal options ranging from 3 to 5 years.

The following is a schedule by years of the future minimum lease payments under operating and capital leases together with the present value of the net minimum lease payments for capital leases as of September 30, 2011:

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5. Lease Commitments (continued)

	Capital Leases	Real Estate Leases	Total
Year ended September 30,			
2012	\$ 5,525	\$ 20,475	\$ 26,000
2013	5,525	7,150	12,675
2014	5,525	-	5,525
2015	<u>1,843</u>	<u>-</u>	<u>1,843</u>
Total minimum lease payments	18,418	<u>\$ 27,625</u>	<u>\$ 46,043</u>
Amount representing interest	<u>(2,164)</u>		
Present value of future minimum lease payments	16,254		
Current portion of lease obligations	<u>4,434</u>		
Obligations under capital leases due after one year	<u>\$ 11,820</u>		

Total rent expense under all operating leases for the years ended September 30, 2010 and 2011, amounted to \$140,848 and \$105,854, respectively.

The Company's property under capital leases, which is included in property and equipment, is summarized as follows:

	2010 (unaudited)	2011 (unaudited)
Vehicles	\$ 30,290	\$ 30,290
Accumulated depreciation	<u>(4,039)</u>	<u>(10,097)</u>
Net capitalized leased property	<u>\$ 26,251</u>	<u>\$ 20,193</u>

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6. Income Taxes

The components of the Company's current deferred tax assets and liabilities at September 30 are as follows:

	<u>2010</u> <u>(unaudited)</u>	<u>2011</u> <u>(unaudited)</u>
Current deferred tax assets:		
Section 263A capitalization	\$ 1,800	\$ 600
Allowance for doubtful accounts	<u>4,300</u>	<u>4,300</u>
Current deferred tax assets	<u>\$ 6,100</u>	<u>\$ 4,900</u>

The components of the Company's deferred tax assets and liabilities at September 30 are as follows:

	<u>2010</u> <u>(unaudited)</u>	<u>2011</u> <u>(unaudited)</u>
Non current deferred tax assets:		
Loss on equity investment	\$ 382,800	\$ 331,300
Section 263A capitalization	<u>35,800</u>	<u>38,600</u>
	<u>418,600</u>	<u>369,900</u>
Valuation allowance	<u>(382,800)</u>	<u>(331,300)</u>
	<u>35,800</u>	<u>38,600</u>
Non current deferred tax liabilities:		
Depreciation and amortization	<u>(98,000)</u>	<u>(96,300)</u>
Net non current deferred tax liabilities	<u>\$ (62,200)</u>	<u>\$ (57,700)</u>

The following is a reconciliation of the statutory federal income tax rate applied to pre-tax accounting net income compared to the income taxes in the consolidated statements of income:

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6. Income Taxes (continued)

	2010 (unaudited)	2011 (unaudited)
Income tax expense at the statutory rate	\$ 97,854	\$ 155,231
State and local income taxes, net of federal income tax	19,420	9,652
Tax exempt income	(15,517)	(15,517)
Nondeductible expenses	267	153
Change in deferred tax asset valuation allowance	101,100	(51,500)
Other	<u>22,114</u>	<u>(10,733)</u>
	<hr/> <u>\$ 225,238</u>	<hr/> <u>\$ 87,286</u>

UTS, the Company's wholly owned subsidiary, is a separate tax-paying entity. The Company does not file consolidated federal or state income tax returns. UTS is accounted for as an equity investment by the parent company.

The taxable income (loss) of UTS is subject to the Puerto Rico income tax at the 20% to 39% rates provided for by the 1994 Puerto Rico Internal Revenue Code, as amended. UTS deferred tax assets were created from the future income tax benefit of using available operating loss carry-forwards. A 100% valuation allowance was established for both years because of the uncertainty of realizing such operating loss carry-forwards. During the year ended September 30, 2011, UTS had taxable income of approximately \$160,000 which utilized approximately \$51,500 of net operating loss carryforwards. The current and deferred tax provisions were \$0 for the years ended September 30, 2010 and 2011. As of September 30, 2010, UTS has available net operating losses of approximately \$1,190,000 which expire in varying amounts through 2017, under the Puerto Rico income tax regulations.

The Company is subject to guidance issued by the FASB relating to "Accounting for Uncertainty in Income Taxes." The guidance applies to all tax positions accounted for in the financial statements, including positions taken in a previously filed tax return or expected to be taken in a future tax return.

The Company has analyzed its filing positions in Federal and significant state jurisdictions where it is required to file income tax returns. Management believes the Company's positions and deductions will be sustained on audit and does not anticipate any adjustments that will result in a material adverse effect on its financial conditions, results of operations or cash flows.

Interest and penalties, if any are recorded as income taxes in the consolidated income statement. The Company is no longer subject to U.S. Federal income tax examinations for years prior to 2008 and 2007 for state tax examinations.

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7. Basic and diluted net income per common share

Basic and diluted net income per common share is based on the weighted average number of shares outstanding of 357,004,575 and 353,173,414 during the years ended September 30, 2010 and 2011, respectively.

8. Professional service contracts

Clancy provides equipment and support services under 12 month professional service contracts. At September 30, 2010 and 2011, all of the contracts contained cancellation provisions requiring notice of 30 days or less.

The cost of the equipment provided in the contracts and related accumulated depreciation are as follows at September 30:

	<u>2010</u> (unaudited)	<u>2011</u> (unaudited)
Equipment under service contract	\$ 2,928,024	\$ 3,024,236
Accumulated depreciation	<u>(2,401,903)</u>	<u>(2,583,780)</u>
	<u>\$ 526,121</u>	<u>\$ 440,456</u>

Parking citation collection services:

Clancy formed an agreement with the town of Logan City, Utah for the period of June 1998 through May 1999, for the purpose of providing parking citation issuance, ticket processing, meter collections and maintenance, and ticket collection services. In conjunction with the contract, Clancy and the town each receive half of all revenues after payment of all associated costs related to the collections. The terms of the agreements can be extended or discontinued with 30 days written notice.

The Company has professional service contracts with the Municipal Governments of Aibonito, San German, Ponce, Aguas Buenas, Caguas and San Juan, Puerto Rico, to provide the equipment and management of its digital parking meter system. Under the terms of the contracts, the Company will pay to the municipalities between 25% and 50% of the income before income taxes.

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9. Sales by geographic region

The Company's sales for the years ended September 30, by geographic region, are as follows:

	2010 (unaudited)	2011 (unaudited)
United States	\$ 2,237,600	\$ 2,234,600
Puerto Rico	2,248,928	2,334,894
Canada	<u>22,924</u>	<u>-</u>
Total	<u>\$ 4,509,452</u>	<u>\$ 4,569,494</u>

10. Subsequent events

The Company has evaluated subsequent events from September 30, 2011 through February 3, 2012, which is the date the financial statements were issued. There have been no material events noted in this period which would impact the results reflected in this report, the Company's results going forward or require additional disclosure.