

Consolidated Financial Statements of

TELEHOP COMMUNICATIONS INC.

December 31, 2009 and 2008



To our valued shareholders:

2009 was a year of many transitions, and a turning point for the company overall. We've "right sized" and structured our strategic initiatives towards growth and recovery along side the Canadian economy.

Looking forward to 2010 we will continue to implement our key strategic initiatives:

- We are targeting high growth niche markets. Our focus is on proven ethnic market opportunities.
- We will continue to grow our Telehop HomePhone (VoIP) service.
- We will expand our Mobile More product into several new regional markets. We believe this will continue to represent strong revenue growth for us.
- We are committed to growing our long distance customer base. We will ramp up our efforts on growing our casual calling customer base and converting them to subscriber services.
- We will launch two new "calling card" type products.
- Our new slate of Directors is engineered to be far more independent and effective.
- We continue to search for and evaluate new opportunities for strategic partnerships.

Management and the Board wish to thank all shareholders for their continued support as we continue to execute on our key strategic initiatives with a goal to increase the value of our Company.

"signed on file"

Fulvio Ciano
Chief Executive Officer

"signed on file"

David A. Smith, CMA
Chief Financial Officer

Toronto, Ontario, Canada
March 17, 2010



Management's responsibility for Financial Statements

To the Shareholders of Telehop Communications Inc.

The accompanying consolidated financial statements of Telehop Communications Inc. and its subsidiary companies (Company) and all information in the annual report have been prepared by management and approved by the Board of Directors of the Company. The consolidated financial statements were prepared in accordance with Canadian generally accepted accounting principles and where appropriate, reflect management's best estimates and judgments'. Management is responsible for the accuracy, integrity and objectivity of the consolidated financial statements within reasonable limits of materiality. Financial and operating data elsewhere in this annual report are consistent with the information contained in the consolidated financial statements.

To assist management in the discharge of these responsibilities, the Company maintains a system of internal controls designed to provide a reasonable assurance that its assets are safeguarded, that only valid and authorized transactions are executed, and that accurate, timely and comprehensive financial information is prepared.

The Board of Directors carries out its responsibility for the financial statements in this annual report by meeting with management directly and both meeting with the external auditors to discuss the results of the annual audit examinations with respect to the adequacy of the internal accounting controls, to review and discuss the consolidated financial statements and financial reporting matters.

These consolidated financial statements have been audited and reported on by Schwartz Levitsky Feldman LLP, Chartered Accountants, the Company's external auditors, who have full access to the Board of Directors.

"signed on file"
Fulvio Ciano
Chief Executive Officer

"signed on file"
David A. Smith, CMA
Chief Financial Officer

Toronto, Ontario, Canada
March 17, 2010



Schwartz Levitsky Feldman llp

CHARTERED ACCOUNTANTS
LICENSED PUBLIC ACCOUNTANTS
TORONTO • MONTREAL



AUDITORS' REPORT

To the Shareholders of
Telehop Communications Inc.

We have audited the consolidated balance sheets of Telehop Communications Inc. as at December 31, 2009 and 2008 and the consolidated statements of operations and comprehensive loss, retained earnings and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

A handwritten signature in black ink that reads 'Schwartz Levitsky Feldman llp' in a cursive script.

Toronto, Ontario
February 19, 2010

Chartered Accountants
Licensed Public Accountants

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Toronto, Ontario M6A 2X1
Tel: 416 785 5353
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TELEHOP COMMUNICATIONS INC.

Consolidated Balance Sheets

As at December 31, 2009 and 2008

	2009	2008
ASSETS		
CURRENT		
Cash and cash equivalents (Note 4)	\$ 827,412	\$ 1,273,585
Accounts receivable (net of allowance for doubtful accounts of \$309,381 in 2009; Nil in 2008)	2,424,306	2,373,500
Income taxes recoverable	150,682	835,632
Future income taxes (Note 5)	200,205	-
Prepaid expenses and deposits	107,137	142,771
	3,709,742	4,625,488
PROPERTY AND EQUIPMENT (Note 6)	476,974	576,154
INTANGIBLE ASSETS (Note 7)	118,746	161,234
	\$ 4,305,462	\$ 5,362,876
LIABILITIES		
CURRENT		
Accounts payable and accrued liabilities	\$ 2,657,444	\$ 2,324,190
Obligations under capital lease (Note 8)	16,526	16,526
	2,673,970	2,340,716
FUTURE INCOME TAXES (Note 5)	10,717	38,678
OBLIGATIONS UNDER CAPITAL LEASE (Note 8)	12,395	28,921
	2,697,082	2,408,315
SHAREHOLDERS' EQUITY		
SHARE CAPITAL (Note 9)	1,553,456	1,555,644
CONTRIBUTED SURPLUS (Note 9(b))	85,816	55,497
RETAINED EARNINGS (DEFICIT)	(30,892)	1,343,420
	1,608,380	2,954,561
	\$ 4,305,462	\$ 5,362,876
Commitments (Note 14)		
Contingent liabilities (Note 17)		
Subsequent event (Note 18)		

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

APPROVED ON BEHALF OF THE BOARD

"Stan Katz" Chairman of the Board

"Mitch Blum" Director



TELEHOP COMMUNICATIONS INC.

Consolidated Statements of Operations and Comprehensive Loss

Years ended December 31, 2009 and 2008

	2009	2008
OPERATING REVENUES	\$ 13,397,801	\$ 16,384,290
Telecommunications costs	7,717,003	10,257,246
GROSS MARGIN	5,680,798	6,127,044
OPERATING EXPENSES		
General and administration	3,107,008	4,260,064
Marketing and selling	2,372,265	2,493,450
Development and technical support	914,995	1,034,913
Amortization	346,838	419,609
Loss on disposal of equipment	1,035	39,354
Interest	6,614	2,648
	6,748,755	8,250,038
OPERATING INCOME (LOSS)	(1,067,957)	(2,122,994)
Severance (Note 15)	(676,179)	-
Other income	9,217	69,653
INCOME (LOSS) BEFORE INCOME TAXES	(1,734,919)	(2,053,341)
Income taxes (recovery) (Note 5)	(360,607)	(717,787)
NET INCOME (LOSS)	(1,374,312)	(1,335,554)
Other comprehensive income	-	-
COMPREHENSIVE INCOME (LOSS)	(1,374,312)	(1,335,554)
EARNINGS (LOSS) PER SHARE (Note 11)	\$ (0.10)	\$ (0.10)
DILUTED EARNINGS (LOSS) PER SHARE (Note 11)	\$ (0.10)	\$ (0.10)

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



TELEHOP COMMUNICATIONS INC.
Consolidated Statements of Retained Earnings
Years ended December 31, 2009 and
2008

	2009	2008
Retained earnings, beginning of year	\$ 1,343,420	\$ 2,678,974
Net income (loss) for the year	(1,374,312)	(1,335,554)
Retained earnings (deficit), end of year	\$ (30,892)	\$ 1,343,420

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



TELEHOP COMMUNICATIONS INC.

Consolidated Statements of Cash Flows

Years ended December 31, 2009 and 2008

	2009	2008
CASH FLOW PROVIDED BY (USED FOR)		
OPERATING ACTIVITIES		
Net income (loss) for the year	\$ (1,374,312)	\$ (1,335,554)
Adjustments for non-cash items:		
Amortization expense	346,838	419,609
Loss on disposal of equipment	1,035	39,354
Future income tax provision	(228,166)	6,394
Stock-based compensation	32,242	26,747
	(1,222,363)	(843,450)
Changes in working capital items:		
Accounts receivable	(50,806)	501,702
Prepaid expenses and deposits	35,634	(68,748)
Accounts payable and accrued liabilities	333,254	(241,226)
Income taxes recoverable	684,950	(529,914)
Cash provided (used) by operating activities	(219,331)	(1,181,636)
INVESTING ACTIVITIES		
Acquisition of property and equipment	(192,025)	(90,680)
Proceeds on sale of equipment	3,056	-
Acquisition of intangible assets	(17,237)	(68,870)
Cash used by investing activities	(206,206)	(159,550)
FINANCING ACTIVITIES		
Capital lease payments	(16,526)	(16,991)
Dividend paid	-	(267,270)
Buy back of company shares	(4,110)	(773)
Issuance of common shares	-	17,500
Cash used by financing activities	(20,636)	(267,534)
INCREASE (DECREASE) IN CASH POSITION	(446,173)	(1,608,720)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	1,273,585	2,882,305
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 827,412	\$ 1,273,585

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



TELEHOP COMMUNICATIONS INC.

SUPPLEMENTARY DISCLOSURE OF CASH FLOW INFORMATION

Years ended December 31, 2009 and 2008

	2009	2008
Obligations under capital lease	\$ 28,921	\$ 45,447
Taxes paid	\$ -	\$ -
Interest paid	\$ 6,614	\$ 2,648

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



TELEHOP COMMUNICATIONS INC.
Notes to the Consolidated Financial Statements
December 31, 2009 and 2008

NATURE OF BUSINESS

1 Telehop Communications Inc. (the Company) is a full-service long distance provider operating within the telecommunications industry and is registered with the Canadian Radio-television and Telecommunications Commission (“CRTC”) as a licensed Class ‘A’ Telecom Carrier.

2. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) and reflect the following policies:

(i) Basis of consolidation

The consolidated financial statements include the accounts of the Company and its operating subsidiaries, International Telehop Network Systems Inc., Telehop Long Distance Services Inc., all of which are wholly owned, of which the principal company is Telehop Communications Inc. All inter company transactions and accounts have been eliminated on consolidation.

(ii) Revenue recognition

The Company earns its revenues from access to, and usage of, its telecommunications network. Its main service is to provide long-distance services through access of its network, which has the capability to track pertinent data for each individual call to a particular country destination. This allows the Company to rate each call by applying pre-determined long-distance rates by country to the volume of minutes provided. The Company recognizes revenues on the accrual basis and includes an estimate of revenues earned but not billed. Revenue is only recognized once there is persuasive evidence of an arrangement exists, services have been rendered and a price to the customer is fixed or determinable and collectability is reasonably assured. There were no revenue arrangements with multiple deliverables during the year. The Company's services are packaged in different forms which include casual calling, subscriptions (equal access service and Telehop HomePhone) and wholesale.

(a) Casual Calling

This service allows customers to access the Company's network without the need to subscribe to the service, sign a contract or pay any direct fees. Customers can complete a long-distance call by dialing one of two carrier identification codes (CIC), “10-10-100” or “10-10-620”, that are owned by the Company. Revenue is recognized when a customer dials a CIC's and completes a connected long-distance call.

(b) Subscriptions



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Equal access service- This service allows a customer to directly dial their long distance number, by dialing “1+” or “011+”. The customer subscribes to this service and is required to transfer carriers upon sign up. Revenue is recognized when a customer completes a long-distance call as access and usage of the Company’s network has occurred.

Telehop HomePhone – The Company markets a VoIP (voice-over-INTERNET-protocol) service under its Telehop HomePhone brand. This service allows a customer to place local and long-distance calls through a high-speed INTERNET connection; thus, allowing the customer to replace their home phone. Revenue is recognized when the customer is billed each month for usage of the service.

(c) Wholesale

The Company offers discounted rates to high volume users who typically want to carry their calls through the Company’s network. Bulk minutes are sold by destination to these users who frequently repackage them with their own unique services which are then sold to their customers. Revenue is recognized when the reseller’s customers make long-distance calls through the access and usage of the Company’s network.

(iii) Cash and cash equivalents

For purposes of the consolidated financial statements, cash and cash equivalents is defined as cash and short-term investments having a maturity of three months or less.

(iv) Impairment of long-lived assets

Annually or when events or changes in circumstances indicate the carrying amount of a long-lived asset may not be recoverable, an impairment loss is recognized when the carrying amount of those assets exceeds the sum of the undiscounted future cash flows related to them. The impairment loss is included in the consolidated statements of operations and comprehensive loss and the carrying value of the asset is reduced to its fair value as determined by the sum of the discounted future cash flows related to those assets. For the year ended December 31, 2009 and 2008, there were no impairment losses recognized in the consolidated statements of operations and comprehensive loss.

(v) Property and equipment

Property and equipment are recorded at cost and are amortized based on the estimated useful lives of the assets using the straight-line method over the following periods:

Telecom equipment	- 5 years
Furniture and equipment	- 5 years
Computer equipment	- 3 years
Customer equipment	- 10 years
Leasehold improvements	- 5 years
Telecom switch equipment	- 7 years



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Computer software

- 5 years

(vi) Intangible assets

Intangible assets are comprised of the following items: a system for telephone call data management and billing, a system for enhanced accounting and financial reporting, and software licenses for soft phones. All intangible assets are amortized over their estimated useful life on a straight-line basis over 5 years. Management reviews the intangible assets for amortization and useful life annually and also for impairment whenever events or changes in circumstances indicate that full recoverability is questionable. Management measures any potential impairment by comparing the carrying value to the fair value of the assets.

(vii) Translation of foreign currencies

Monetary assets and liabilities denominated in foreign currencies are translated at exchange rates in effect at the balance sheet date with any resulting gain or loss being included in the consolidated statements of operations and comprehensive loss. Trade transactions are translated at exchange rates prevailing during the year.

(viii) Employee future benefits

The cost of providing benefits through defined benefit pensions is actuarially determined and recognized in earnings using the projected benefits method pro-rated on service. Differences arising from plan amendments, changes in assumptions and experience gains and losses are recognized in earnings over the expected average remaining service life of employees. Actuarial gains and losses that fall outside a corridor defined as the greater of (a) 10% of the accrued benefit obligation and (b) 10% of the fair market value of the plan assets at the beginning of the year are amortized over the average remaining service period of active employees on a straight-line basis. The expected return on plan assets is based on the fair value of plan assets. For 2009, the accrued benefit obligation at the end of the year is equal to the benefit payment owing to the spouse of the member, as the remaining pension plan is being wound up and a settlement is expected to occur in early 2010.

(ix) Income taxes

The Company uses the asset and liability method for accounting for income taxes which requires the establishment of future tax assets and liabilities, as measured by substantively enacted tax rates, for all temporary differences caused when tax bases of assets and liabilities differ from those reported in the financial statements. Future tax assets are recognized only to the extent that, in the opinion of management, it is more likely than not that the future income tax assets will be realized. Future tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of substantive enactment.

(x) Use of estimates



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The preparation of financial statements in conformity with Canadian generally accepted accounting principles 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. Given the use of estimates inherent in the financial reporting process, actual results could differ from those estimates. Examples of significant estimates include:

- Allowance for doubtful accounts
- Estimated useful lives of assets
- Recoverability of intangible and tangible assets
- The amount of income tax assets and liabilities
- Certain actuarial and economic assumptions used in calculating defined benefit pension costs, accrued pension obligations and pension plan assets

(xi) Telecommunications costs

Telecommunications costs primarily include fixed and variable carrier costs, billing and collections charges from Local Exchange Carriers (LECs) and operating lease expenses related to telecommunications equipment facilities.

(xii) Stock-based compensation

The Company has an employee share option plan, which is described in Note 10 (b). Canadian GAAP requires that all share-based awards made to employees and non-employees be measured and recognized in the financial statements using a fair value based method, such as the Black-Scholes option pricing model. Proceeds arising from the exercise of share options are credited to share capital. When stock-based compensation vests in fixed amounts at a future point in time, the expense is recognized by the Company in the Consolidated Statements of Operations and Comprehensive Loss on a straight-line basis over the vesting period. Refer to Note 10 (b) for additional disclosure on stock-based compensation.

(xiii) Earnings per share

The Company uses the treasury stock method of calculating the dilutive effect of options on earnings per share, whereby any proceeds obtained upon exercise of options is assumed to be used to purchase common shares at the average market share price during the period, except in the instance where such a calculation would be anti-dilutive.

(xiv) Leases

Leases are classified as capital or operating depending upon the terms and conditions of the contracts. Asset values recorded under capital leases are amortized on a straight-line basis over the

TELEHOP COMMUNICATIONS INC.
Notes to the Consolidated Financial Statements
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period of expected use. Obligations recorded under capital leases are reduced by lease payments net of imputed interest.

(xv) Comprehensive Income

Section 1530 requires the presentation of comprehensive income, which consists of net income and other comprehensive income (“OCI”). Comprehensive income is defined as the change in equity from transactions and other events from non-owner sources. OCI refers to items recognized in comprehensive income but that are excluded from net income calculated in accordance with generally accepted accounting principles.

(xvi) Financial Instruments – Recognition and Measurement and Disclosure and Presentation

Section 3855 establishes standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives. All financial assets and financial liabilities, including derivatives, are measured in the balance sheet at fair value, except for loans and receivables, investments held-to-maturity and other financial liabilities, which are measured at amortized cost.

Measurement in subsequent periods depends on whether the financial instrument had been classified as held-for-trading, available-for-sale, held-to-maturity, loans and receivables, or other liabilities.

Held-for-trading financial investments are measured at fair value and all gains and losses are included in net income in the period in which they arise. Available-for-sale financial instruments are measured at fair value with revaluation gains and losses included in other comprehensive income until the assets are removed from the balance sheet. All changes in the fair value of derivatives are recognized in earnings unless specific hedge criteria are met in accordance with Section 3865 which requires that a company must formally document, designate and assess the effectiveness of transactions that receive hedge accounting.

The Company has elected to apply the following classifications to each of its significant categories of financial instruments:

<u>Asset/Liability</u>	<u>Category</u>	<u>Measurement</u>
Cash and cash equivalents	Held for trading	Fair value
Accounts receivable	Loans and receivables	Amortized cost
Accounts payable and accrued liabilities	Other liabilities	Amortized cost

As a result of the adoption of these standards, the company designated its cash and cash equivalents as held-for-trading. Held-for-trading financial assets are measured at fair value



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with unrealized gains and losses recognized in the consolidated statement of operations and comprehensive loss. Accounts receivable are classified as loans and receivables, which are measured at amortized cost. Accounts payable and accrued liabilities are classified as financial liabilities, which are measured at amortized cost.

The company classifies derivative instruments, such as foreign exchange forward contracts and foreign exchange options contracts, as held-for-trading unless the instruments meet all the criteria of a hedge. If the criteria are met, then any unrealized gains and losses will be reported in other comprehensive income.

(xvii) CICA Section 1535, requires the Company to disclose its objectives, policies and procedures for managing capital, whether the Company has complied with any externally imposed capital requirements and, if the Company has not complied with them, any consequences of non-compliance with these capital requirements. The new recommendations are set out in Note 13 – Capital Management.

(xviii) CICA Sections 3862 and 3863 replace Section 3861 (*“Financial Instruments – Disclosure and Presentation”*). Disclosure requirements are revised and enhanced, while presentation requirements remain essentially unchanged. The new disclosure requirements expand discussion around the significance of financial instruments for the Company’s financial position and performance, the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the balance sheet date and how the entity manages those risks. The new recommendations are set out in Note 12 – Financial Instruments and Risk Management.

(xix) Goodwill and Intangible Assets

During the year the company adopted CICA Handbook Section 3064 (*“Goodwill and Intangible Assets”*), replacing Section 3062 (*“Goodwill and Other Intangible Assets”*), and Section 3450 (*“Research and Development Costs”*). The new Section 3064 addresses when an internally developed intangible asset meets the criteria for recognition of an asset.

The Section also issued amendments to Section 1000 (*“Financial Statement Concepts”*). The adoption of this section did not have any significant impact on these financial statements.

(xx) Inventories

CICA Handbook Section 3031, Inventories, replaces section 3030 and establishes new standards for the measurement and disclosure of inventories. The main features of the new Section are as follows:

1. Measurement of inventories at the lower of cost and net realizable value



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2. Consistent use of either first-in, first-out or a weighted average cost formula to measure cost
3. Reversal of previous write-downs to net realizable value when there is a subsequent increase to the value of inventories.

(xxi) Assessing Going Concern

Effective January 1, 2008 the company adopted the new recommendations of CICA Handbook Section 1400, General Standards of Financial Statement Presentation, to include requirements for management to assess and disclose an entity's ability to continue as a going concern. The Company has assessed the impact of adopting Section 1400 and has determined that it doesn't impact the Company's financial statements

3. DEVELOPMENT IN ACCOUNTING POLICIES

(i) Convergence with International Financial Reporting Standards

In February 2008, the Accounting Standards Board ("AcSB") confirmed that the use of IFRS will be required in 2011 for publicly accountable enterprises in Canada. In April 2008, the AcSB issued an IFRS Omnibus Exposure Draft proposing that publicly accountable enterprises be required to apply IFRS, in full and without modification, on January 1, 2011. The adoption date of January 1, 2011 will require the restatement, for comparative purposes, of amounts reported by the Company for its year ended December 31, 2010, and of the opening balance sheet as at January 1, 2010. The AcSB proposes that CICA Handbook Section, Accounting Changes, paragraph 1506.30, which would require an entity to disclose information relating to a new primary source of GAAP that has been issued but is not yet effective and that the entity has not applied, not be applied with respect to the IFRS Omnibus Exposure Draft. The Company will monitor changes to IFRS and assess the impact that these new standards will have on the financial results and on the IFRS changeover project. The financial impacts on changeover to IFRS may be material to the financial statements, and it is expected that the impact will be similar nature to other companies in the same line of business. Based on the work to date, the Company believes that the areas of highest impact will be property, plant and equipment. Further information regarding the selection of IFRS compliant accounting policies and quantification of the impacts will be provided as the Company moves closer to the changeover date. The Company does anticipate a significant increase in disclosure resulting from the adoption of IFRS and is continuing to assess the level of disclosure required, as well as system changes that may be necessary to gather and process the required information.

(ii) Consolidated Financial Statements and Non-Controlling Interests



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CICA HB Section 1601, Consolidated Financial Statements and HB Section 1602, Non-controlling Interests replace CICA HB Section 1600, Consolidated Financial Statements. HB Section 1601 establishes standards for the preparation of consolidated financial statements. HB Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. HB Section 1602 is equivalent to the corresponding provisions of International Financial Reporting Standard IAS 27, Consolidated and Separate Financial Statements. These standards are effective for interim and annual financial statements beginning on or after January 1, 2011, which for this Company is January 1, 2011. The Company has not yet determined the impact of the adoption of these changes on its Financial Statements.

(iv) Business combinations

In January 2009, the CICA issued Section 1582, Business Combinations. This section is effective January 1, 2011 and applies prospectively to business combinations for which the acquisition date is on or after the first annual reporting period of the Corporation beginning on or after January 1, 2011, which for this Company is January 1, 2011. Early adoption is permitted. This section replaces Section 1581, Business Combinations and harmonizes the Canadian standards with international financial reporting standards (IFRS). The Company does not anticipate that the adoption of this standard will impact its financial results.

(iv) Multiple deliverable revenue arrangements

In December 2009, CICA issued EIC-175, Multiple Deliverable Revenue Arrangements ("EIC-175"), EIC-175 which replaces EIC-142, Revenue Arrangements with Multiple Deliverables, addresses some aspects of the accounting by a vendor for arrangements under which it will perform multiple revenue-generating activities. This new standard is effective for the Company's interim and annual consolidated financial statements commencing on January 1, 2011 with earlier adoption permitted as of the beginning of a fiscal year. The Company is assessing the impact of the new standard on its consolidated financial statements.

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4. CASH AND CASH EQUIVALENTS

	2009	2008
Operating cash	\$ 817,028	\$ 684,853
Short-term investments	10,384	588,732
	\$ 827,412	\$ 1,273,585

Short-term investments consist of term deposits and bankers acceptances with maturities less than three months.

5. INCOME TAXES

(i) Income tax expense

The income tax expense for the years ended December 31, 2009 and 2008 are as follows:

Current	\$ (142,502)	\$ (703,000)
Future	(228,166)	6,394
	(370,668)	(696,606)
Prior years' income tax reassessment	10,061	(21,181)
	\$ (360,607)	\$ (717,787)

(ii) Future income taxes

Future income tax assets and liabilities as at December 31, 2009 and 2008 were as follows:



TELEHOP COMMUNICATIONS INC.
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	2009	2008
Future income tax asset		
Property and equipment	\$ 45,880	\$ 52,195
Severance	104,219	-
General bad debt provision	112,844	-
Loss carried forward	209,714	-
	472,657	52,195
Valuation allowance	(272,452)	(52,195)
Current	\$ 200,205	\$ -
Future income tax liability		
Accounting base of property and equipment in excess of tax value	\$ 10,717	\$ 38,678
Long-term	\$ 10,717	\$ 38,678

As at December 31, 2009 the Company has non-capital losses of \$655,000 (\$nil in 2008) available to reduce taxable income in future years expiring in 2029.

(iii) Reconciliation of provision to statutory rates

The reconciliation of income taxes at Canadian statutory rates to the provision for income taxes is as follows:

	2009	2008
Net income (loss) before income taxes	\$ (1,734,919)	\$ (2,053,341)
Approximate applicable statutory tax rate	33.50%	33.50%
Income taxes at statutory tax rates	(581,198)	(687,869)
Rate adjustment on future taxes	9,384	-
Prior years' reassessments	10,061	(21,181)
Increase in non-deductible expenses	228,395	-
Other	(27,249)	(8,737)
	\$ (360,607)	\$ (717,787)



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6. PROPERTY AND EQUIPMENT

	2009			2008		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Telecom equipment	\$ 933,113	\$ 779,283	\$ 153,830	\$ 889,923	\$ 624,172	\$ 265,751
Telecom equipment under capital lease	66,105	37,184	28,921	66,105	20,658	45,447
Computer software	240,143	179,482	60,661	240,143	131,453	108,690
Computer Equipment	104,317	57,221	47,096	87,601	24,440	63,161
Customer equipment	93,133	4,657	88,476	-	-	-
Unprovisioned equipment	34,691	-	34,691	-	-	-
Leasehold improvements	80,381	48,527	31,854	80,381	32,451	47,930
Furniture and equipment	65,856	34,411	31,445	66,572	21,397	45,175
	\$ 1,617,739	\$ 1,140,765	\$ 476,974	\$ 1,430,725	\$ 854,571	\$ 576,154

Amortization expense for the year ended December 31, 2009 was \$287,112 (2008 - \$283,872). During the year, the Company did not eliminate any fully amortized assets (2008 \$514,552 were removed from cost and accumulated amortization). Amortization expense relating to assets under capital lease was \$16,526 (2008 - \$15,797). Unprovisioned equipment is not amortized until it is ready to enter service at the customers' location, at which time it is reclassified into Customer equipment and amortized.

7. INTANGIBLE ASSETS

	2009			2008		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Software licences and reporting system	\$ 311,245	\$ 192,499	\$ 118,746	\$ 294,007	\$ 132,773	\$ 161,234
	\$ 311,245	\$ 192,499	\$ 118,746	\$ 294,007	\$ 132,773	\$ 161,234

Amortization expense for the year ended December 31, 2009 was \$59,726 (2008 - \$175,091). During the year, the Company did not eliminate any fully amortized assets, 2008 \$462,131 were removed from cost and accumulated amortization. In 2008 there was a write down of intangible assets of \$39,354 (2009 - Nil).

8. CAPITAL LEASE OBLIGATIONS



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The Company entered into a lease during 2007 for telecommunications equipment that had been capitalized. The security value of the capital equipment is \$77,771, and the maturity date of the lease is September, 2011. The interest expense for 2009 was \$2,916 (2008 - \$2,916).

	2009	2008
Total minimum lease payments	\$ 34,024	\$ 53,467
Less: amount representing imputed interest of 6.2%	5,103	8,020
Present value of obligations under capital lease	28,921	45,447
Current portion - due within one year	16,526	16,526
Long-term obligations under capital lease	\$ 12,395	\$ 28,921

9. SHAREHOLDERS' EQUITY

Authorized:

An unlimited number of common shares issued and outstanding

The changes in common shares for 2009 and 2008 are as follows:

	2009		2008	
	No. of Shares	Amount	No. of Shares	Amount
Balance, beginning of year	13,410,000	\$ 1,555,644	13,363,500	\$ 1,527,177
Buy back of common shares (Note 10 (a))	(19,000)	(2,188)	(3,500)	(403)
Issued on exercise of employee stock options	-	-	50,000	28,870
Balance, end of year	13,391,000	\$ 1,553,456	13,410,000	\$ 1,555,644

(a) *Normal course issuer bid*

The Company had filed a normal course issuer bid authorizing the Company to purchase up to 650,000 common shares, which is approximately 5% of the 13,410,000 issued and outstanding common shares. Telehop's normal course issuer bid was made in accordance with the by-laws, rules and policies of the Toronto Stock Exchange. The Company had plans to re-purchase common shares at prevailing market prices over a twelve-month period which



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commenced November 10, 2008. Purchases under the bid were made from time to time over this twelve-month period, which ended November 10, 2009.

(b) Stock options

The Company's employee stock option plan ("ESOP") authorized the Company to reserve 1,800,000 common shares of the Company for issuance in accordance with the terms of the ESOP. Options granted vest over a period not exceeding five years and the purchase price is payable in full at the time the options are exercised. In the event of a reorganization, consolidation or change in control, the optionee has the right to exercise the share option.

The following table presents information concerning stock options granted under the Company's stock option plan:

	2009		2008	
	Number of options	Weighted Average Exercise Price	Number of options	Weighted Average Exercise Price
Options outstanding, beginning of year	100,000	\$ 0.600	355,000	\$ 0.55
Options granted	400,000	\$ 0.215	-	-
Options exercised	-	\$ -	(50,000)	0.35
Options cancelled	(200,000)	\$ 0.408	(205,000)	0.57
Options outstanding, end of year	300,000	\$ 0.215	100,000	\$ 0.60
Options exercisable, end of year	100,000	\$ 0.215	60,000	\$ 0.60

The following table summarizes information about stock options outstanding at December 31, 2009:



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Options Outstanding			Options Exercisable	
Weighted Average Exercise Price	Number Outstanding	Weighted Average Remaining Contractual Life (years)	Number Exercisable	Weighted Average Exercise Price
\$ 0.215	300,000	4.08	100,000	0.215
\$ 0.215	300,000	4.08	100,000	0.215

Options granted vest over a period not exceeding five years. All stock options granted have an exercise price equal to the fair market value at the grant date.

The Company has evaluated the fair value of all options granted during the past two years using the Black-Scholes option pricing model with the noted assumptions:

	December 31, 2009 Weighted Average	December 31, 2008 Weighted Average
Estimated fair value at the date of grant for options granted in the year	\$ 0.215	none granted
Assumptions utilized:		
Risk-free interest rate	2.50 %	n/a
Expected volatility	124.00 %	n/a
Expected life of the options (years)	5.00	n/a
Expected Dividend Yield	0.00 %	n/a

(b) Contributed surplus

The following is a continuity of the changes in contributed surplus for the year ended December 31, 2009. Contributed surplus is made up of stock based compensation expense and \$(1,923) for an allocation for common share buy back.

	2009	2008
Balance, beginning of year	\$ 55,497	\$ 40,489
Allocation to contributed surplus for common share buy back	(1,923)	(369)
Stock-based compensation expense during the year	32,242	26,747
Allocated to share capital on exercise of options during the year	-	(11,370)
Balance, end of year	\$ 85,816	\$ 55,497

10. EMPLOYEE FUTURE BENEFITS

The changes in the benefit obligations and in the fair value of assets and the funded status of the defined benefit plans are as follows:



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	Registered Pension Plans	
	2009	2008
Change in benefit obligations		
Projected benefit obligation, beginning of year	\$ 472,526	\$ 448,363
Current service cost	24,345	27,206
Interest cost	42,284	37,052
Actuarial (gains) losses	(88,261)	(40,095)
Benefit Payments	(94,971)	-
Projected benefit obligation, end of year	355,923	472,526
Change in fair value of plan assets		
Fair value of plan assets, beginning of year	308,298	336,975
Return on plan assets (deficiency)	17,241	(66,994)
Benefit payments	(94,971)	-
Employer contributions	164,381	38,317
Employee contributions	(39,026)	-
Fair value of plan assets, end of year	355,923	308,298
Funded status (plan deficit)	-	(164,228)
Unamortized net actuarial (gain) loss	-	108,501
Unamortized past service costs	-	73,500
Unamortized transitional (asset) obligation	-	-
Valuation allowance	-	(17,773)
Accrued benefit asset (liability)	-	-

The table below shows the net benefit plan cost before and after recognizing its long-term nature. The recognized net benefit plan cost reflects the amount reported in the Company's statement of income and is calculated according to the Company's accounting policy.



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	Registered Pension Plans	
	2009	2008
Current service cost	\$ 24,345	\$ 27,206
Interest cost	42,284	37,052
Actual return on assets	(29,287)	(26,710)
Actuarial loss on accrued benefit obligation	-	-
Elements of employee future benefit plans cost, before recognizing its long-term nature	37,342	37,548
Pension plan curtailment	127,039	-
Amortization of transitional asset (obligation)	-	(25,638)
Amortization of past service cost	-	14,700
Amortization of net actuarial loss	-	12,250
Others	-	-
Adjustment to recognize long-term nature of employee future benefit plans credit	127,039	1,312
Increase (decrease) in valuation allowance	-	(543)
Net benefit plans cost recognized	\$ 164,381	\$ 38,317

The net benefit cost is recorded as an operating expense in general and administration to the extent of \$40,717 and the balance in the severance expense.

The significant actuarial assumptions adopted in measuring the Company's accrued benefit obligations are as follows:

	2009	2008
Discount rate	7.4%	7.4%
Expected long-term rate of return on plan assets	7.5%	7.5%
Rate of compensation increase	3.0%	3.0%

Pension plans

The Company maintained two defined benefit pension plans that provide pension benefits for two key executives. Both pension plans were wound up as a result of a termination of employment in one case and untimely death in the other. The first plan was settled in March 2009 and the second plan was curtailed at the end of October 2009. A pending settlement of the second plan is expected to occur in early 2010. The amounts reported in the financial



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statements relating to these benefits are determined using actuarial calculations that are based on several assumptions.

The Company's actuary performs a valuation at least every three years to determine the actuarial present value of the accrued pension and other retirement benefits. The valuation uses management's assumptions for the discount rate, expected long-term rate of return on plan assets, rate of compensation increase and expected average remaining years of service of employees. While we believe that these assumptions are reasonable, differences in actual results or changes in assumptions could affect employee benefit obligations and future net benefit plans costs.

The two most significant assumptions used to calculate the net employee benefit plans cost are the discount rate and the expected long-term rate of return on plan assets.

Discount Rate

The discount rate is the interest rate used to determine the present value of the future cash flows that the Company expects will be needed to settle employee benefit obligations. It is based on the yield on long-term high-quality corporate fixed income investments, with maturities matching the estimated cash flows from the plan.

The Company determines the appropriate discount rate at the end of every year. The discount rate was 7.38% at December 31, 2008, and has been kept the same for 2009, due to the wind up of the second plan, and the fact that the entitlement is a known amount based on assumptions prescribed by applicable pension legislation. A higher discount rate results in a lower accrued benefit obligation and unfunded liability.

Expected Long-Term Rate of Return

The expected long-term rate of return is a weighted average rate of the forward-looking view of long-term returns on each of the major plan asset categories in the pension funds.

The Company determines the appropriate expected long-term rate of return at the end of every year. We assumed an expected long-term rate of return on plan assets of 7.5% in 2009, which is the same as it was in 2008. Although there is no immediate impact on the balance sheet, poor fund performance results in a lower fair value of plan assets and a higher unfunded liability. This means that The Company may have to increase cash contributions to the plan in the future. Within the current context of an actual settlement during 2009 and an impending settlement in early 2010, this assumption only applies for the accumulation of assets during the 2009 fiscal year.

11. EARNINGS PER SHARE



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The following table sets forth the computation of basic and diluted earnings per share:

	2009	2008
Net Income (loss)	\$ (1,374,312)	\$ (1,335,554)
Weighted-average number of shares for computing earnings per share	13,399,641	13,377,610
Effect of dilutive securities Employee stock options	-	-
Adjusted weighted-average shares and assumed conversions for diluted earnings per share	13,399,641	13,377,610
Earnings (loss) per share	\$ (0.10)	\$ (0.10)
Diluted (loss) earnings per share	\$ (0.10)	\$ (0.10)

12. FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT

(i) Risks – Overview

The Company's financial instruments and the nature of risks which they may be subject to are summarized as follows:

Financial instrument	Risks		
	Credit	Liquidity	Market risks Currency
Measured at cost			
Cash and cash equivalents	x		x
Accounts receivable	x		x
Accounts payable		x	
Obligations under capital lease		x	



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ii) Credit Risk

The following table summarizes the Company's exposure to credit risk.

	2009	2008
Cash and cash equivalents	\$ 827,412	\$ 1,273,585
Accounts receivable	2,424,306	2,373,500
	\$ 3,251,718	\$ 3,647,085

Cash and cash equivalents: Credit risk associated with cash and cash equivalents, which are held in short-term deposits, are minimized significantly by ensuring that these financial instruments are placed with major financial institutions with investment grade ratings and the avoidance of asset-backed commercial papers.

Accounts receivable: Credit risk associated with accounts receivable is minimized by the Company's large customer base and its geographic dispersion across Canada. The Company has credit evaluation, approval and monitoring processes intended to mitigate potential credit risks, and maintains provisions for potential credit losses that are assessed on an ongoing basis.

The following table presents an analysis of the age of accounts receivable as at the dates of the Consolidated Balance Sheets.

	2009	2008
Customer accounts receivable net of allowance for doubtful accounts		
Current	\$ 2,107,633	\$ 1,646,066
30-60 days past billing date	186,215	663,581
61-90 days past billing date	112,211	41,304
Greater than 90 days past billing date	18,247	22,549
	\$ 2,424,306	\$ 2,373,500

The Company must make significant estimates pertaining to allowance for doubtful accounts. Historical information, current economic conditions, exceptional circumstances are all considered when determining the provision for allowance for doubtful accounts. The following table presents a summary of the activity related to the Company's allowance for doubtful accounts for the twelve month period ending December 31, 2009.

	2009	2008
Balance, beginning of period	\$ -	\$ 74,648
Additions to allowance for doubtful accounts	309,381	-
Reductions to allowance for doubtful accounts	-	(74,648)
Balance, end of period	\$ 309,381	\$ -



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(iii) Liquidity Risk

The Company manages liquidity risk by continuously monitoring forecast and actual cash flows and working capital changes. The Company does not currently believe it will encounter difficulty in meeting its obligations associated with financial liabilities. The Company's undiscounted financial liability that shows the remaining contractual maturities are as follows:

As at December 31, 2009

	Capital lease
2010	\$ 19,443
2011	14,581
	<u>\$ 34,024</u>

(iv) Market Risk

The Company's functional currency is the Canadian dollar, but it regularly transacts in U.S. dollars for a portion of its business activities. The assets, liabilities, revenues and expenses denominated in U.S. dollars will be affected by changes in the exchange rate fluctuations in the market between the Canadian and U.S. dollar.

The Company makes use of foreign currency forward contracts and options contracts to fix the exchange rates on the U.S. dollar to mitigate its foreign exchange exposure on expenses. As at December 31, 2009 the Company did not hold foreign currency forward contracts and options contracts. However, the Company has and may make use of such contracts in the future.

The net foreign exchange gain for 2009 was \$705 compared to a loss of \$79,576 in 2008 and has been recorded in general and administration expenses.

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13. CAPITAL MANAGEMENT

The Company's objective in managing capital is to ensure sufficient liquidity to pursue its strategy of organic growth combined with strategic acquisitions, so that it can provide above-average returns for its shareholders. The Company defines capital that it manages as the aggregate of its shareholders' equity, which consists of issued capital, contributed surplus, accumulated other comprehensive income (loss) and retained earnings.

The Company manages its capital structure and makes adjustments to it in light of general economic conditions and the risk characteristics of the underlying assets and the Company's working capital requirements. In order to maintain or adjust the capital structure, the Company, upon approval from its Board of Directors, may issue long-term debt, issue shares, repurchase shares through a normal course issuer bid and pay dividends. The Board of Directors reviews and approves any material transactions not in the ordinary course of business which may include various acquisition proposals, as well as capital and operating budgets.

The Company monitors debt to equity ratios as part of the management of liquidity and return to shareholders under the following basis:

	2009	2008
Obligations under capital lease	\$ 12,395	\$ 28,921
Total long-term debt	\$ 12,395	\$ 28,921
Less: cash and cash equivalents	\$ (827,412)	\$ (1,273,585)
	\$ (815,017)	\$ (1,244,664)
Equity	\$ 1,608,380	\$ 2,954,561
Debt-to-equity ratio	0.01	0.01

The Company is not subject to externally imposed capital requirements.



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14. COMMITMENTS

(i) Operating Leases

The Company has operating leases for its switch facility and corporate office both of which expire on July 31, 2011 and lease of office equipment which expires in 2015. The future minimum payments under operating leases as at December 31, 2009 are as follows:

2010	\$	394,571
2011		310,356
2012		8,748
2013		8,748
2014		8,748
2015		8,748
	\$	<u>739,919</u>

(ii) Capital Leases

The future minimum payments under capital leases as at December 31, 2009 are as follows:

2010	\$	19,443
2011		14,581
	\$	<u>34,024</u>

15. SEVERANCE

The Company's founder Mr. Hersh Spiegelman, Chairman and CEO of Telehop became ill. As a result, on October 9th, 2009 the Board made management changes and appointed a new temporary Chairman and a new temporary CEO.

On October 29, 2009, Mr. Spiegelman passed away. In the fourth quarter, the Company recorded liabilities relating to Mr. Spiegelman's employment contract of \$676,179.

16 SEGMENTED INFORMATION

The Company has determined that it has one reportable segment. The Company's operations are substantially all related to the provision of telecommunication services to the residential and business customers. All assets of the business support these operations and are located in Canada.



17. CONTINGENT LIABILITIES

- (i) The Company received a notice of claim from a vendor for marketing services it believes the Company was committed to pay. The amount of the claim against the Company is approximately \$230,000. The Company is vigorously defending such claims as it strongly believes it had never made such commitments. The outcome is not currently determinable. No amount has been recorded in the Consolidated Financial Statements in relation to this claim.
- (ii) From time to time the Company has been, and expects to continue to be, subject to legal proceedings and claims in the ordinary course of business. Such claims, even if lacking merit, could result in the expenditure of significant financial and managerial resources. The Company is not aware of any legal proceedings or claims that it believes will have, individually or in the aggregate, a material adverse effect on the Company's financial condition or results of operation.

18. SUBSEQUENT EVENT

The Company issued 225,000 options to various of its Officers and Directors, the terms of which are similar to the ones existing at year end. 100,000 were issued February 1st and the balance on February 24th, 2010 both issuances have 5 years terms and vest equally over the first 3 years.

19. COMPARATIVE FIGURES

Certain comparative figures have been reclassified from statements previously presented to conform to the current presentation.