

*Consolidated Financial Statements of*

**TELEHOP COMMUNICATIONS INC.**

*December 31, 2006 and 2005*

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# Schwartz Levitsky Feldman llp

CHARTERED ACCOUNTANTS  
LICENSED PUBLIC ACCOUNTANTS  
TORONTO • MONTREAL



## AUDITORS' REPORT

To the Shareholders of  
Telehope Communications Inc.

We have audited the consolidated balance sheets of Telehope Communications Inc. as at December 31, 2006 and 2005 and the consolidated statements of income, 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 audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform the 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 Company as at December 31, 2006 and 2005 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 cursive script that reads "Schwartz Levitsky Feldman llp".

Toronto, Ontario  
March 20, 2007

Chartered Accountants  
Licensed Public Accountants

# TELEHOP COMMUNICATIONS INC.

## Consolidated Balance Sheets

December 31, 2006 and 2005

	<u>2006</u>	<u>2005</u>
<b>ASSETS</b>		
<b>CURRENT</b>		
Cash and cash equivalents	\$ 2,778,664	\$ 832,735
Accounts receivable (net of allowance for doubtful accounts of \$13,899; \$62,247 in 2005)	3,319,359	3,156,492
Prepaid expenses and deposits	236,881	61,851
	<b>6,334,904</b>	<b>4,051,078</b>
PROPERTY, PLANT AND EQUIPMENT (Note 4)	809,543	854,430
INTANGIBLES (Note 5)	358,328	327,245
	<b>\$ 7,502,775</b>	<b>\$ 5,232,753</b>
<b>LIABILITIES</b>		
<b>CURRENT</b>		
Accounts payable and accrued liabilities	\$ 3,020,690	\$ 1,884,722
Income taxes payable	187,310	32,874
Obligations under capital lease (Note 6)	-	14,363
	<b>3,208,000</b>	<b>1,931,959</b>
FUTURE INCOME TAX LIABILITY (Note 3)	69,050	69,207
	<b>3,277,050</b>	<b>2,001,166</b>
<b>SHAREHOLDERS' EQUITY</b>		
CAPITAL STOCK (Note 7)	1,277,968	1,200,419
CONTRIBUTED SURPLUS (Note 7(b))	174,261	154,819
RETAINED EARNINGS	2,773,496	1,876,349
	<b>4,225,725</b>	<b>3,231,587</b>
	<b>\$ 7,502,775</b>	<b>\$ 5,232,753</b>

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

APPROVED BY THE BOARD

*"Barry Dixon"*

..... Director

*"Bryan Ceresne"*

..... Director

# TELEHOP COMMUNICATIONS INC.

## Consolidated Statements of Income

Years ended December 31, 2006 and 2005

	<u>2006</u>	<u>2005</u>
REVENUE	\$ 21,181,302	\$ 20,770,191
EXPENSES		
Telecom costs	11,749,483	12,082,369
General and administration	3,110,327	3,153,637
Marketing and selling	3,478,640	3,537,118
Development and technical support	844,844	596,853
Amortization expense	420,548	419,522
Interest expense	11,727	2,545
	<u>19,615,569</u>	<u>19,792,044</u>
INCOME BEFORE INCOME TAXES	1,565,733	978,147
INCOME TAX EXPENSE (Note 3)	541,551	367,082
NET INCOME FOR THE YEAR	<u>1,024,182</u>	<u>611,065</u>
EARNINGS PER SHARE (Note 9)	\$ 0.08	\$ 0.05
DILUTED EARNINGS PER SHARE (Note 9)	\$ 0.08	\$ 0.05

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

**TELEHOP COMMUNICATIONS INC.**  
**Consolidated Statements of Retained Earnings**  
**Years ended December 31, 2006 and 2005**

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	<u>2006</u>	<u>2005</u>
Balance at beginning of year	\$ 1,876,349	\$ 1,265,284
Income for the year	1,024,182	611,065
Dividend declared	(127,035)	-
Balance end of year	<u>\$ 2,773,496</u>	<u>\$ 1,876,349</u>

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

# TELEHOP COMMUNICATIONS INC.

## Consolidated Statements of Cash Flows

Years ended December 31, 2006 and 2005

	<u>2006</u>	<u>2005</u>
<b>CASH FLOW PROVIDED BY (USED FOR)</b>		
<b>OPERATING ACTIVITIES</b>		
Net income for the year	\$ 1,024,182	\$ 611,065
Adjustments for non-cash items:		
Amortization expense	420,548	419,522
Future income tax liability	(157)	(7,836)
Stock compensation (Note 7(b))	43,692	14,901
	<u>1,488,265</u>	<u>1,037,652</u>
Changes in working capital items:		
Accounts receivable	(162,867)	(614,983)
Prepaid expenses and deposits	(175,030)	42,814
Accounts payable and accrued liabilities	1,008,933	(598,560)
Income taxes payable	154,436	188,114
Cash provided by operating activities	<u>2,313,737</u>	<u>55,037</u>
<b>INVESTING ACTIVITIES</b>		
Acquisitions of property, plant and equipment	(353,081)	(469,847)
Acquisition of intangibles	(53,664)	-
Cash used for investing activities	<u>(406,745)</u>	<u>(469,847)</u>
<b>FINANCING ACTIVITIES</b>		
Capital lease financing	(14,363)	(14,946)
Issuance of common shares	53,300	-
Cash provided by (used for) financing activities	<u>38,937</u>	<u>(14,946)</u>
<b>NET INCREASE (DECREASE) IN CASH POSITION</b>	<b>1,945,929</b>	<b>(429,756)</b>
<b>CASH POSITION, BEGINNING OF YEAR</b>	<b>832,735</b>	<b>1,262,491</b>
<b>CASH POSITION, END OF YEAR</b>	<b>\$ 2,778,664</b>	<b>\$ 832,735</b>

### SUPPLEMENTARY DISCLOSURE OF CASHFLOW INFORMATION

#### Non-cash Financing Activities

Dividend declared	\$ 127,035	\$ -
Contributed surplus allocated to share capital on exercise of employee stock options during year	\$ 24,250	\$ -

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

# TELEHOP COMMUNICATIONS INC.

## Notes to the Consolidated Financial Statements

December 31, 2006 and 2005

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### 1. NATURE OF BUSINESS

Telehop Communications Inc. 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 and reflect the following policies:

#### *Basis of consolidation*

The consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are wholly owned. All intercompany transactions and accounts have been eliminated on consolidation. Subsidiaries are as follows:

- Telehop Communications Inc.
- International Telehop Network Systems Inc.
- Telehop Long Distance Services Limited.
- Telehop Long Distance Limited.
- Card Tel Corp.
- Telehop Agencies Inc.
- Telehop Global Israel Inc.
- Telehop Carrier Services Inc.
- Telehop Premium Business Services Inc.
- Telehop Rebillers Limited.
- Ten-Ten-Six-Twenty Ltd.
- The Friend Network Inc.
- The Friend Network Services Inc.
- Worldhop. Com.Inc.

#### *Measurement uncertainty*

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. The valuation of the allowance for doubtful accounts, recoverability of intangible assets, and specific telecom accruals are the key areas where management employs the use of estimates and assumptions. Given the use of estimates inherent in the financial reporting process, actual results could differ from those estimates.

#### *Cash and cash equivalents*

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

**TELEHOP COMMUNICATIONS INC.**  
**Notes to the Consolidated Financial Statements**  
**December 31, 2006 and 2005**

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**2. SIGNIFICANT ACCOUNTING POLICIES (continued)**

*Impairment of long-lived assets*

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 statement of income (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.

*Property, plant and equipment*

Property, plant 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
Automobile	- 5 years
Furniture and equipment	- 5 years
Computer Equipment	- 2 years
Leasehold improvements	- 5 years
Telecom switch	- 7 years
Computer software	- 5 years

*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 3,000 softphones. 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 undiscounted amounts of expected future cash flows.

*Translation of foreign currencies*

Monetary assets and liabilities denominated in foreign currencies are translated at exchange rates in effect at the balance sheet dates. Revenues and expenses are translated at exchange rates prevailing during the period. Translation gains and losses are reflected in net income and have been disclosed in Note 10.

*Post-employment 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. The cost of providing benefits through defined contribution pension plans is charged to earnings when contributions become payable.

**TELEHOP COMMUNICATIONS INC.**  
**Notes to the Consolidated Financial Statements**  
**December 31, 2006 and 2005**

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**2. SIGNIFICANT ACCOUNTING POLICIES (continued)**

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.

*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.

*Revenue recognition*

The Company records revenue from retail and wholesale services at the time of customer usage primarily based upon minutes of use. The Company recognizes revenues on the accrual basis and includes an estimate of revenues earned but not billed. Revenue is only recognized where there is reasonable assurance of collection. Royalty revenue is received monthly in arrears and accrued in the applicable month it is earned.

The Company makes a provision for bad debts using management's best estimate. The provision is netted against accounts receivable. The provision is reviewed on a regular basis by management.

*Stock option plan and change in accounting policy*

The Company has an employee stock option plan, which is described in Note 7.

The Company accounts for stock-based compensation in accordance with the CICA Handbook Section 3870, "Stock-based Compensation & Other Stock-based Payments". Section 3870 requires that all stock-based awards made to employees and non-employees be measured and recognized using a fair value based method, such as the Black-Scholes option pricing model. Previously the standard encouraged the use of a fair value based method for all awards granted to employees but only required the use of a fair value based method for direct awards of stock, stock appreciation rights, and awards that call for settlement in cash or other assets.

Refer to Note 7(a) for additional disclosure on stock-based compensation.

**TELEHOP COMMUNICATIONS INC.**  
**Notes to the Consolidated Financial Statements**  
**December 31, 2006 and 2005**

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**2. SIGNIFICANT ACCOUNTING POLICIES (continued)**

*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.

*Guarantees*

In 2003 the Company adopted the new recommendations of the Canadian Institute of Chartered Accountants' Accounting Guideline 14, "Disclosure of Guarantees". In the normal course of business, the Company has guaranteed a portion of the residual values of certain assets under operating leases with expiry dates between June 2004 and November 2006, for the benefit of the lessor, the carrying values of which are \$NIL (2005 \$NIL). If the Company elects not to purchase or release the assets at the end of their respective lease term, then the Company must, under certain conditions, compensate the lessor for a portion of any shortfall between the fair value and the residual value. The maximum exposure in respect of these guarantees is approximately \$5,000.

**3. INCOME TAXES**

*Income tax expense*

The income tax expense for the years ended December 31, is as follows:

	<u>2006</u>	<u>2005</u>
Current	\$ 541,708	\$ 374,918
Future	(157)	(7,836)
	<u>\$ 541,551</u>	<u>\$ 367,082</u>

**TELEHOP COMMUNICATIONS INC.**  
**Notes to the Consolidated Financial Statements**  
December 31, 2006 and 2005

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**3. INCOME TAXES (continued)**

*Future income tax assets and liabilities*

Future income tax assets and liabilities as at December 31, 2006 and 2005 were as follows:

	<u>2006</u>	<u>2005</u>
Future income tax liability		
Accounting base of property, plant and equipment in excess of tax value	\$ 69,050	\$ 69,207
	<hr/>	
Long-term	\$ 69,050	\$ 69,207
	<hr/>	

*Reconciliation of provisions to statutory rates*

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

	<u>2006</u>	<u>2005</u>
Net income before income taxes	\$ 1,565,733	\$ 978,147
Approximate applicable statutory tax rate	36.12%	36.12%
Income taxes at statutory tax rates	565,543	353,307
Non-deductible amounts	2,552	7,757
Other	(26,544)	6,018
	<u>\$ 541,551</u>	<u>\$ 367,082</u>

**TELEHOP COMMUNICATIONS INC.**  
**Notes to the Consolidated Financial Statements**  
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**4. PROPERTY, PLANT AND EQUIPMENT**

	2006			2005		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Telecom equipment	\$ 1,411,966	\$ 832,583	\$ 579,383	\$ 1,222,463	\$ 619,192	\$ 603,271
Telecom switch	938,139	938,139	-	938,139	938,139	-
Computer software	284,756	120,853	163,903	253,892	72,947	180,945
Computer Equipment	1,544	386	1,158	-	-	-
Leasehold improvements	190,539	152,408	38,131	162,698	124,936	37,762
Furniture and equipment	100,694	76,948	23,746	91,969	65,317	26,652
Automobile	12,889	9,667	3,222	12,889	7,089	5,800
	<b>\$ 2,940,527</b>	<b>\$ 2,130,984</b>	<b>\$ 809,543</b>	<b>\$ 2,682,050</b>	<b>\$ 1,827,620</b>	<b>\$ 854,430</b>

Amortization expense for the year-end December 31, 2006 is \$303,363 (2005: \$311,541).

**5. INTANGIBLES**

	2006			2005		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Internally Developed Software	\$ 634,633	\$ 329,075	\$ 305,558	\$ 540,029	\$ 212,784	\$ 327,245
Software Licenses	53,664	894	52,770	-	-	-
	<b>\$ 688,297</b>	<b>\$ 329,969</b>	<b>\$ 358,328</b>	<b>\$ 540,029</b>	<b>\$ 212,784</b>	<b>\$ 327,245</b>

Amortization expense for the year end December 31, 2006 is \$117,185 (2005: \$107,981).

**TELEHOP COMMUNICATIONS INC.**  
**Notes to the Consolidated Financial Statements**  
**December 31, 2006 and 2005**

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**6. CAPITAL LEASE OBLIGATIONS**

The company had entered into leases in prior years for certain equipment that had been capitalized. No capital leases exist as at December 31, 2006.

	<u>2006</u>	<u>2005</u>
	-	14,929
Total minimum lease payments	-	14,929
Less amount representing imputed interest of approximately 6%	-	566
Present value of obligations under capital lease	-	14,363
Current portion - due within one year	-	14,363
Long-term obligations under capital lease	\$ -	\$ -

Interest expense for the year end December 31, 2006 is \$867 (2005 \$2,545).

**TELEHOP COMMUNICATIONS INC.**  
**Notes to the Consolidated Financial Statements**  
**December 31, 2006 and 2005**

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**7. SHAREHOLDERS' EQUITY**

Authorized

An unlimited number of common shares

Issued and outstanding

The changes in common shares for 2006 and 2005 are as follows:

	2006		2005	
	No. of Shares	Amount	No. of Shares	Amount
Balance, beginning of year	12,437,000	\$ 1,200,419	12,437,000	\$ 1,200,419
Issued on exercise of employee stock options (Note 7(a))	266,500	77,549	-	-
Balance, end of year	12,703,500	\$ 1,277,968	12,437,000	\$ 1,200,419

*(a) 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.

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

	2006		2005	
	Number of options	Weighted Average Exercise Price	Number of options	Weighted Average Exercise Price
Options outstanding, beginning of year	1,289,500	\$ 0.26	1,089,500	\$ 0.24
Options granted	100,000	0.37	200,000	0.34
Options exercised	(266,500)	0.20		
Options cancelled	(8,000)	0.20		
Options outstanding, end of year	1,115,000	\$ 0.26	1,289,500	\$ 0.26
Options exercisable, end of year	1,085,000	\$ 0.25	1,164,500	\$ 0.25

**TELEHOP COMMUNICATIONS INC.**  
**Notes to the Consolidated Financial Statements**  
December 31, 2006 and 2005

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**7. SHAREHOLDERS' EQUITY (continued)**

The following table summarizes information about stock options outstanding at December 31, 2006:

Options Outstanding			Options Exercisable	
Weighted Average Exercise Price	Number Outstanding	Weighted Average Remaining Contractual Life (years)	Number Exercisable	Weighted Average Exercise Price
\$ 0.20	510,000	1.05	510,000	\$ 0.20
\$ 0.30	100,000	3.46	100,000	\$ 0.30
\$ 0.32	5,000	2.94	5,000	\$ 0.32
\$ 0.35	300,000	1.72	300,000	\$ 0.35
\$ 0.37	200,000	3.90	170,000	\$ 0.37
	<b>1,115,000</b>	<b>1.27</b>	<b>1,085,000</b>	<b>\$ 0.28</b>

All options were below market value at the time of granting.

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:

	<b>December 31, 2006</b>	December 31, 2005
	<b>Weighted Average</b>	Weighted Average
Estimated fair value at the date of grant for options granted in the period	<b>\$0.30 - \$0.50</b>	\$0.18 - \$0.19
Assumptions utilized:		
Risk-free interest rate	<b>3.90%</b>	3.29%
Expected volatility	<b>72%</b>	75%
Expected life of the options	<b>5 years</b>	5 years
Expected Dividend Yield	<b>0%</b>	0%

**TELEHOP COMMUNICATIONS INC.**  
**Notes to the Consolidated Financial Statements**  
**December 31, 2006 and 2005**

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**7. SHAREHOLDERS' EQUITY (continued)**

(b) Contributed Surplus

The following is a continuity of the changes in contributed surplus for the year ended December 31, 2006:

	<b>2006</b>	<b>2005</b>
Balance at beginning of year	\$ <b>154,819</b>	139,918
Stock-based compensation expense during the year	<b>43,692</b>	14,901
Allocated to share capital on exercise of options during the year	<b>(24,250)</b>	-
Balance at end of year	\$ <b>174,261</b>	\$ 154,819

**TELEHOP COMMUNICATIONS INC.**  
**Notes to the Consolidated Financial Statements**  
December 31, 2006 and 2005

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**8. EMPLOYEE BENEFIT PLANS**

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

	<u>Registered Pension Plans</u>	
	<u>2006</u>	<u>2005</u>
Change in benefit obligations		
Projected benefit obligation, beginning of year	\$ 308,414	\$ 243,875
Current service cost	47,921	44,577
Interest cost	27,147	19,962
Actuarial (gains) losses	(29,582)	-
Benefit payments		-
Employee contributions		-
Prior service costs	-	-
<b>Benefit obligation, end of year</b>	<b>353,900</b>	<b>308,414</b>
Change in fair value of plan assets		
Fair value of plan assets, beginning of year	161,592	-
Return on plan assets	19,682	6,102
Benefit payments	-	-
Employer contributions	55,894	105,912
Employee contributions	-	49,578
<b>Fair value of plan assets, end of year</b>	<b>237,168</b>	<b>161,592</b>
Funded status (plan deficit)	(116,732)	(146,822)
Unamortized net actuarial (gain) loss	-	-
Unamortized past service costs	150,628	163,181
Unamortized transitional (asset) obligation	(27,610)	-
Valuation allowance	-	-
<b>Accrued benefit asset (liability)</b>	<b>6,286</b>	<b>16,359</b>

**TELEHOP COMMUNICATIONS INC.**  
**Notes to the Consolidated Financial Statements**  
December 31, 2006 and 2005

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**8. EMPLOYEE BENEFIT PLANS (continued)**

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.

	Registered Pension Plans	
	2006	2005
Current service cost	\$ 47,921	\$ 44,577
Interest cost	27,147	19,962
Actual return on assets	(19,682)	(6,102)
Actuarial loss on accrued benefit obligation	-	-
Elements of employee future benefit plans cost, before recognizing its long-term nature	55,386	58,437
Actuarial loss	-	-
Difference between the actual return and estimated return on plan assets	-	-
Amortization of transitional asset (obligation)	-	-
Amortization of past service cost	12,553	12,553
Amortization of net actuarial loss	(1,972)	-
Others	-	-
Adjustment to recognize long-term nature of employee future benefit plans credit	10,581	12,553
Increase in valuation allowance	-	-
Net benefit plans cost recognized	\$ 65,967	\$ 70,990

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

	2006	2005
Discount rate	7.5%	7.5%
Expected long-term rate of return on plan assets	7.5%	7.5%
Rate of compensation increase	5.5%	5.5%

**TELEHOP COMMUNICATIONS INC.**  
**Notes to the Consolidated Financial Statements**  
December 31, 2006 and 2005

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**9. EARNINGS PER SHARE**

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

	<u>2006</u>	<u>2005</u>
Net Income	\$ 1,024,182	\$ 611,065
Weighted-average shares for earnings per share	12,508,844	12,437,000
Effect of dilutive securities Employee stock options	310,040	242,887
Adjusted weighted-average shares and assumed conversions for diluted earnings per share	<u>12,818,884</u>	<u>12,679,887</u>
Earnings per share	\$ 0.08	0.05
Diluted earnings per share	\$ 0.08	0.05

**10. FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT**

*Credit risk*

The Company is subject to credit risk through accounts receivables, which is limited by the large number of customers and their 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.

More than 50% of the Company's receivables are owed by a few Competitive Local Exchange Carriers (CLEC's) across Canada. These CLEC's provide billing and collection services to the Company's customers through an arrangement whereby the Company is limited to a fixed percentage exposure. In mitigation the Company purchases long distance services from these carriers for similar amounts owed at any time.

The Company is dependent in Ontario, Quebec, British Columbia, Alberta, Saskatoon and Manitoba upon carriers to provide billing and collection services to its customers under renewable agreements. Management expects that these agreements will automatically renew.

The Company purchases long distance services from a number of carriers and does not feel there is any economic dependence on any one carrier.

**TELEHOP COMMUNICATIONS INC.**  
**Notes to the Consolidated Financial Statements**  
**December 31, 2006 and 2005**

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**10. FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT (continued)**

*Fair value of financial instruments*

The carrying amounts of financial instruments included in current assets and current liabilities approximate their estimated fair values at December 31, 2006 and 2005, reflecting the short-term maturity and normal trade credit terms of these instruments. The carrying value of the Company's long-term obligation associated with the capital lease approximates fair value of the instrument, given prevailing interest rates for such arrangements.

*Foreign exchange risk*

Foreign exchange risk arose because of fluctuations in exchange rates. The Company conducts a portion of its business activities in the United States. The assets, liabilities, revenues and expenses denominated in United States dollars will be affected by changes in the exchange rate between the Canadian dollar and the United States dollar.

The net foreign exchange loss for 2006 was \$14,932 (2005 \$13,248) and has been recorded in the general and administration expense.

*Foreign Exchange Contracts*

The company enters into forward foreign exchange contracts ("Forwards") to mitigate its foreign currency exposure on expenses incurred for its operations. The forwards obligate the Company to buy US dollars with Canadian dollars in the future at predetermined exchange rates and are matched with anticipated future operating expenses that are transacted in US dollars.

As at December 31, 2006, the company had \$1,000,000 in US dollar forwards, with no maturity dates, at an average exchange rate of 1.134. An unrealized foreign exchange gain of \$31,495 exists as at December 31, 2006.

**11. COMMITMENTS**

*Operating Leases*

The future minimum payments under operating leases as at December 31, 2006 are as follows:

2007	184,185
2008	184,185
2009	184,185
2010	184,185
2011	157,616
	<hr/>
	\$ 894,356

**TELEHOP COMMUNICATIONS INC.**  
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**12. 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 sectors. All assets of the business support these operations and are located in Canada.

**13. SUBSEQUENT EVENTS**

Between January and February of 2007, 100,000 shares were issued from the exercise of stock options by a former director. The issuance of shares raised total proceeds of \$20,000.

**14. CONTINGENT LIABILITY**

The Company is in negotiations with a former executive involving a dispute that pertains to the terms of a settlement with the company dating back to 2004. One of the terms of the settlement is being disputed as to whether it has been fully satisfied by the Company. The Company is pursuing to bring closure to this settlement with the former executive. The outcome cannot be determined at this time and no provision has been recorded.

**15. COMPARATIVE FIGURES**

Certain of the comparative figures have been reclassified to conform to the current period's presentation.