

Consolidated Financial Statements of

TELEHOP COMMUNICATIONS INC.

December 31, 2010 and 2009



Report of the Chairman of the Board

To our valued shareholders:

I am pleased to have this opportunity to report to the shareholders. At the last annual shareholders' meeting, I was elected to the Board and subsequently assumed the position of Chairman.

It has been a challenging year as well as a satisfying year. This year the Board welcomed a number of new directors and the emphasis, starting with the very first directors' meeting, was on good governance, independence and reversing the Company's past performance. I am pleased to report that the committees established by the Board all conducted themselves with integrity, independence and a devotion to duty. Each Board meeting and each committee meeting was attended by all members, and each actively participated and contributed. The time spent by all directors in undertaking their duties was far greater than initially expected, and I think each Board member feels that a great deal was accomplished.

Some of the accomplishments of the Board include an active search for a new CEO, and assisting management in reversing the slide in revenues and previous lack of profits, searching for new markets and revenues, and addressing the outflow of working capital on non-production matters (including employee efficiency, expenses, administration efficiencies and coping with outlays still continuing from previous administrations).

The Board feels that the future of the Company is brighter now than at any time in recent years, and that an excellent foundation has been laid for future profits.

The directors serve at the discretion of the shareholders. One of the shareholders has requested that the current directors resign, and wishes her own slate of directors to be elected. If the current directors are not re-elected, the new Board will find the Company in excellent shape and that a great number of overhanging matters from previous boards and management have been cleaned up and dealt with in an efficient manner.

Much remains to be done. Although profits are expected in fiscal 2011 for the first time in a number of years, clearly a more aggressive search for new revenues must continue, and the Company must position itself to take advantage of opportunities as they occur. For this reason, the Board has proposed that the Company raise additional capital, and this proposal will be addressed at the upcoming annual meeting. This would be the first capital raise in a very long time, and I believe that although it would result in significant dilution, it would enable the Company to enhance shareholder value by allowing it to engage new investors and provide it with the ability to seize opportunities. This financing will not be completed until following the annual meeting.

Thank you for the opportunity of serving you. It has been an honor and an education.

Lawrence Cyna
Chairman of the Board

Toronto, Ontario, Canada
March 15, 2011



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 both management directly and 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.

Fulvio Ciano
Chief Executive Officer

David A. Smith, CMA
Chief Financial Officer

Toronto, Ontario, Canada
March 15, 2011



Schwartz Levitsky Feldman llp

CHARTERED ACCOUNTANTS
LICENSED PUBLIC ACCOUNTANTS
TORONTO • MONTREAL

INDEPENDENT AUDITORS' REPORT

To the Shareholders of Telehop Communications Inc.

We have audited the accompanying consolidated financial statements of Telehop Communications Inc, which comprise the consolidated balance sheets as at December 31, 2010 and 2009 and the consolidated statement of operations and comprehensive loss, statement of retained earnings (deficit) and consolidated statement of cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 comply with ethical requirements and plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Telehop Communications Inc. as at December 31, 2010 and 2009, and its financial performance and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

“SCHWARTZ LEVITSKY FELDMAN LLP”

Toronto, Ontario
March 15, 2011

Chartered Accountants

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TELEHOP COMMUNICATIONS INC.

Consolidated Balance Sheets

As at December 31, 2010 and 2009

	2010	2009
ASSETS		
CURRENT		
Cash and cash equivalents (Note 4)	\$ 473,712	\$ 827,412
Accounts receivable (net of allowance for doubtful accounts of \$307,878 in 2010; \$309,381 in 2009) (Note 12)	2,062,095	2,424,306
Income taxes recoverable	-	150,682
Future income taxes (Note 5)	-	200,205
Prepaid expenses and deposits	149,807	107,137
	2,685,614	3,709,742
FUTURE INCOME TAXES (Note 5)	214,293	-
PROPERTY AND EQUIPMENT (Note 6)	281,885	476,974
INTANGIBLE ASSETS (Note 7)	72,347	118,746
	\$ 3,254,139	\$ 4,305,462
LIABILITIES		
CURRENT		
Accounts Payable and accrued liabilities	\$ 1,875,522	\$ 2,657,444
Obligations under capital lease (Note 8)	13,679	16,526
	1,889,201	2,673,970
FUTURE INCOME TAXES (Note 5)	-	10,717
OBLIGATIONS UNDER CAPITAL LEASE (Note 8)	-	12,395
	1,889,201	2,697,082
SHAREHOLDERS' EQUITY		
SHARE CAPITAL (Note 9)	1,553,456	1,553,456
CONTRIBUTED SURPLUS (Note 9(c))	119,248	85,816
ACCUMULATED COMPREHENSIVE INCOME (LOSS)	(5,481)	-
RETAINED EARNINGS (DEFICIT)	(302,285)	(30,892)
	1,364,938	1,608,380
	\$ 3,254,139	\$ 4,305,462

Commitments (Note 14), Contingent liabilities (Note 18), Related party transactions (Note 19), Subsequent events (Note 20),

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

Approved on behalf of the board

Lawrence Cyna, Chairman of the Board

Derek van der Plaats, Director

March 15, 2011



TELEHOP COMMUNICATIONS INC.
Consolidated Statements of Operations and Comprehensive Loss

Years ended December 31, 2010 and 2009

	2010	2009
OPERATING REVENUES	\$ 11,758,098	\$ 13,397,801
Telecommunications costs	6,679,660	7,717,003
GROSS MARGIN	5,078,438	5,680,798
OPERATING EXPENSES		
General and administration	2,509,268	3,107,008
Marketing and selling	1,627,657	2,372,265
Development and technical support	848,506	914,995
Amortization	259,213	346,838
Loss on disposal of equipment	3,758	1,035
Interest	6,204	6,614
	5,254,606	6,748,755
OPERATING INCOME (LOSS)	(176,168)	(1,067,957)
Severance (Note 15)	-	(676,179)
Other income	3,517	9,217
INCOME (LOSS) BEFORE INCOME TAXES	(172,651)	(1,734,919)
Income taxes (recovery) (Note 5)	98,742	(360,607)
NET INCOME (LOSS)	(271,393)	(1,374,312)
Other comprehensive income (Loss)	(5,481)	-
COMPREHENSIVE INCOME (LOSS)	(276,874)	(1,374,312)
EARNINGS (LOSS) PER SHARE BASIC AND DILUTED (Note 11)	\$ (0.02)	\$ (0.10)

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



TELEHOP COMMUNICATIONS INC.
Consolidated Statements of Retained Earnings (Deficit)
Years ended December 31, 2010 and 2009

	2010	2009
Retained earnings (deficit), beginning of year	\$ (30,892)	\$ 1,343,420
Net income (loss) for the year	(271,393)	(1,374,312)
Retained earnings (deficit), end of year	\$ (302,285)	\$ (30,892)

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



TELEHOP COMMUNICATIONS INC.

Consolidated Statements of Cash Flows

Years ended December 31, 2010 and 2009

	2010	2009
CASH FLOW PROVIDED BY (USED FOR)		
OPERATING ACTIVITIES		
Net income (loss) for the year	\$ (271,393)	\$ (1,374,312)
Adjustments for non-cash items:		
Amortization expense	259,213	346,838
Loss on disposal of equipment	3,758	1,035
Future income tax provision	(24,805)	(228,166)
Stock-based compensation	33,432	32,242
	205	(1,222,363)
Changes in working capital items:		
Accounts receivable	362,211	(50,806)
Prepaid expenses and deposits	(42,670)	35,634
Accounts payable and accrued liabilities	(787,403)	333,254
Income taxes recoverable	150,682	684,950
Cash provided (used) by operating activities	(316,975)	(219,331)
INVESTING ACTIVITIES		
Acquisition of property and equipment	(33,401)	(192,025)
Proceeds on sale of customer equipment (Note 16)	12,509	-
Proceeds on sale of equipment	-	3,056
Acquisition of intangible assets	(591)	(17,237)
Cash used by investing activities	(21,483)	(206,206)
FINANCING ACTIVITIES		
Capital lease payments	(15,242)	(16,526)
Buy back of company shares	-	(4,110)
Cash used by financing activities	(15,242)	(20,636)
INCREASE (DECREASE) IN CASH POSITION	(353,700)	(446,173)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	827,412	1,273,585
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 473,712	\$ 827,412

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, 2010 and 2009

	2010	2009
Taxes paid	\$ -	\$ -
Interest paid	6,204	6,614

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



TELEHOP COMMUNICATIONS INC.
Notes to the Consolidated Financial Statements
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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., CardTel Corp., 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 existing arrangement, 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), prepaid calling cards 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.



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(b) Subscriptions

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; allowing the customer to replace their home phone. Revenue is recognized when the customer is billed each month for usage of the service.

(c) Prepaid calling cards

The Company offers prepaid long distance calling cards which through dialing a toll free number the customer accesses the Company’s network to make their long distance call. Revenue recognition is deferred until the customer completes a long-distance call as access and usage of the Company’s network has occurred or the time allotment on the card has expired.

(d) 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, 2010 and 2009, there were no impairment losses recognized in the consolidated statements of operations and comprehensive loss.



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(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
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 Company wound up its remaining defined benefit pension plan in 2009 following the death of the sole plan member. The pension plan was settled in 2010.

There are no assumptions as to future return and salary increases, as the amount owing was reflected in the financial results at the end of 2009 and settled 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



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adjusted for the effects of changes in tax laws and rates on the date of substantive enactment.

(x) Use of estimates

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 future income tax assets and liabilities

(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 9(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 9(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



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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. During the year the Company recognized a comprehensive loss from cash flow hedges in the amount of \$5,581 (\$ nil in 2009).

(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 Financial 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.

3. DEVELOPMENT IN ACCOUNTING POLICIES

(i) Convergence with International Financial Reporting Standards

The Accounting Standards Board issued a mandate to fully converge Canadian GAAP with IFRS effective January 1, 2011. The convergence will occur over a transitional period, with certain



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standards adopted prior to 2011 and other standards at the date of transition. We will prepare our financial statements in accordance with IFRS commencing January 1, 2011.

The Company is presently finalizing preliminary accounting policy decisions, preparing our IFRS opening balance sheet as at January 1, 2010, preparing our comparative financial statements and notes under IFRS for 2010.

For 2010, we reported our results under Canadian GAAP but also internally recorded preliminary results under IFRS. We will continue to refine these results throughout the year as processes are improved and accounting policy choices are finalized.

(ii) Consolidated Financial Statements and Non-Controlling Interests

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 does not anticipate that the adoption of this standard will impact its financial results.

(iii) 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 does not anticipate that the adoption of this standard will impact its financial results.

TELEHOP COMMUNICATIONS INC.
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4. CASH AND CASH EQUIVALENTS

	2010	2009
Operating cash	\$ 473,412	\$ 817,028
Short-term investments	-	10,384
	\$ 473,412	\$ 827,412

Short-term investments consisted of term deposits with maturities less than three months.

5. INCOME TAXES

(i) Income tax expense

The income tax expense for the years ended December 31, 2010 and 2009 are as follows:

	2010	2009
Current	\$ -	\$ (142,502)
Future	24,805	(228,166)
	24,805	(370,668)
Prior years' income tax reassessment	73,937	10,061
	\$ 98,742	\$ (360,607)



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(ii) Future income taxes

Future income tax assets and liabilities as at December 31, 2010 and 2009 were as follows:

	2010	2009
Future income tax asset		
Property and equipment	\$ 82,845	\$ 45,880
Severance	45,960	104,219
General bad debt provision	86,795	112,844
Loss carried forward	338,709	209,714
	<u>554,309</u>	<u>472,657</u>
Valuation allowance	(340,016)	(272,452)
Current	\$ -	\$ 200,205
Long-term	\$ 214,293	\$ -
Future income tax liability		
Accounting base of property and equipment in excess of tax value	\$ -	\$ 10,717
Long-term	\$ -	\$ 10,717

As at December 31, 2010 the Company has non-capital losses of \$1,398,000 (\$655,000 in 2009) available to reduce taxable income in future years expiring between 2029 and 2030.

(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:

	2010	2009
Net income (loss) before income taxes	\$ (172,651)	\$ (1,734,919)
Approximate applicable statutory tax rate	31.0%	33.5%
Income taxes at statutory tax rates	(53,522)	(581,198)
Rate adjustment on future taxes	50,798	9,384
Prior years' reassessments	-	10,061
Change in valuation allowance	67,564	-
Non-deductible expenses	19,324	228,395
Temporary differences	46,672	(29,200)
Other	(32,094)	1,951
	<u>\$ 98,742</u>	<u>\$ (360,607)</u>



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6. PROPERTY AND EQUIPMENT

	2010			2009		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Telecom equipment	\$ 895,947	\$ 805,531	\$ 90,416	\$ 933,113	\$ 779,283	\$ 153,830
Telecom equipment under capital lease	66,105	53,710	12,395	66,105	37,184	28,921
Computer software	240,143	223,036	17,107	240,143	179,482	60,661
Computer Equipment	113,242	90,778	22,464	104,317	57,221	47,096
Customer equipment (Note 16)	103,981	13,877	90,104	93,133	4,657	88,476
Unprovisioned equipment	13,826	-	13,826	34,691	-	34,691
Leasehold improvements	80,381	63,638	16,743	80,381	48,527	31,854
Furniture and equipment	65,856	47,026	18,830	65,856	34,411	31,445
	\$ 1,579,481	\$ 1,297,596	\$ 281,885	\$ 1,617,739	\$ 1,140,765	\$ 476,974

Amortization expense for the year ended December 31, 2010 was \$212,223 (2009 - \$287,112). Amortization expense relating to assets under capital lease was \$16,526 in each year. Unprovisioned equipment is not amortized until it enters service at the customers' location, at which time it is reclassified into Customer equipment and amortized.

7. INTANGIBLE ASSETS

	2010			2009		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Software licences and reporting system	\$ 311,836	\$ 239,489	\$ 72,347	\$ 311,245	\$ 192,499	\$ 118,746
	\$ 311,836	\$ 239,489	\$ 72,347	\$ 311,245	\$ 192,499	\$ 118,746

Amortization expense for the year ended December 31, 2010 was \$46,990 (2009 - \$59,726).

8. OBLIGATIONS UNDER CAPITAL LEASE

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 2010 was \$2,169 (2009 - \$2,916).



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	2010	2009
Total minimum lease payments	\$ 14,582	\$ 34,024
Less: amount representing imputed interest of 6.2%	903	5,103
Present value of obligations under capital lease	13,679	28,921
Current portion - due within one year	13,679	16,526
Long-term obligations under capital lease	\$ -	\$ 12,395

9. SHAREHOLDERS' EQUITY

Authorized:

An unlimited number of common shares:

The changes in common shares for 2010 and 2009 are as follows:

Issued	2010		2009	
	No. of Shares	Amount	No. of Shares	Amount
Balance, beginning of year	13,391,000	\$ 1,553,456	13,410,000	\$ 1,555,644
Buy back of common shares	-	-	(19,000)	(2,188)
Balance, end of year	13,391,000	\$ 1,553,456	13,391,000	\$ 1,553,456

(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 13,391,000 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 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") originally reserved 1,800,000 common shares of the Company for issuance in accordance with the terms of the ESOP.



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The company can presently issue 98,500 additional options under this plan. 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. Subsequent to the year end, the Company issued the remaining 98,500 options (see Note 20).

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

	2010		2009	
	Number of options	Weighted Average Exercise Price	Number of options	Weighted Average Exercise Price
Options outstanding, beginning of year	300,000	\$ 0.215	100,000	\$ 0.600
Options granted	525,000	\$ 0.190	400,000	\$ 0.215
Options exercised	-	\$ -	-	\$ -
Options cancelled	(100,000)	\$ 0.215	(200,000)	\$ 0.408
Options outstanding, end of year	725,000	\$ 0.197	300,000	\$ 0.215
Options exercisable, end of year	133,333	\$ 0.215	100,000	\$ 0.215

The following table summarizes information about stock options outstanding at December 31, 2010:

Options outstanding			Options exercisable	
Weighted average exercise price	Number outstanding	Weighted average remaining contractual life (years)	Number exercisable	Weighted average exercise price
\$ 0.215	200,000	3.08	133,333	\$ 0.215
\$ 0.210	100,000	4.08	-	\$ -
\$ 0.220	125,000	4.17	-	\$ -
\$ 0.170	300,000	4.25	-	\$ -
\$ 0.197	725,000		133,333	\$ 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.



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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, 2010	December 31, 2009
	Weighted Average	Weighted Average
Estimated fair value at the date of grant for options granted in the year	\$ 0.190	\$ 0.215
Assumptions utilized:		
Risk-free interest rate	2.50%	2.50%
Expected volatility	144.60%	124.00%
Expected life of the options (years)	5.00	5.00
Expected dividend yield	0.00%	0.00%

(c) Contributed surplus

The following is a continuity of the changes in contributed surplus for the year ended December 31, 2010 and 2009. Contributed surplus is made up of stock based compensation expense and \$(1,923) for an allocation for common share buy back in 2009.

	2010	2009
Balance, beginning of year	\$ 85,816	\$ 55,497
Allocation to contributed surplus for common share buy back	-	(1,923)
Stock-based compensation expense during the year	33,432	32,242
Balance, end of year	\$ 119,248	\$ 85,816



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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:

	Registered Pension Plans	
	2010	2009
Change in benefit obligations		
Projected benefit obligation, beginning of year	\$ 355,923	\$ 472,526
Current service cost	-	24,345
Interest cost	-	42,284
Actuarial (gains) losses	-	(88,261)
Benefit Payments	(355,923)	(94,971)
Projected benefit obligation, end of year	-	355,923
Change in fair value of plan assets		
Fair value of plan assets, beginning of year	355,923	308,298
Return on plan assets (deficiency)	-	17,241
Benefit payments	(355,923)	(94,971)
Employer contributions	-	164,381
Employee contributions	-	(39,026)
Fair value of plan assets, end of year	-	355,923
Funded status (plan deficit)	-	-
Unamortized net actuarial (gain) loss	-	-
Unamortized past service costs	-	-
Unamortized transitional (asset) obligation	-	-
Valuation allowance	-	-
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	
	2010	2009
Current service cost	\$ -	\$ 24,345
Interest cost	-	42,284
Actual return on assets	-	(29,287)
Actuarial loss on accrued benefit obligation	-	-
Elements of employee future benefit plans cost, before recognizing its long-term nature	-	37,342
Pension plan curtailment	-	127,039
Amortization of transitional asset (obligation)	-	-
Amortization of past service cost	-	-
Amortization of net actuarial loss	-	-
Others	-	-
Adjustment to recognize long-term nature of employee future benefit plans credit	-	127,039
Increase (decrease) in valuation allowance	-	-
Net benefit plans cost recognized	\$ -	\$ 164,381

The net benefit cost of \$ nil (\$40,717 in 2009) is recorded as an operating expense in general and administration.

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

	2010	2009
Discount rate	n/a	7.4%
Expected long-term rate of return on plan assets	n/a	7.5%
Rate of compensation increase	n/a	3.0%

Pension plans

The Company wound up its remaining defined benefit pension plan in 2009 following the death of the sole plan member. The pension plan was settled in 2010.

There are no assumptions as to future return and salary increases, as the amount owing was reflected in the financial results at the end of 2009 and settled in early 2010.



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11. EARNINGS PER SHARE

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

	2010	2009
Net Income (loss)	\$ (271,393)	\$ (1,374,312)
Weighted-average number of shares for computing earnings per share	13,391,000	13,399,641
Effect of dilutive securities Employee stock options	-	-
Adjusted weighted-average shares and assumed conversions for diluted earnings per share	13,391,000	13,399,641
Earnings (loss) per share	\$ (0.02)	\$ (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.

	2010	2009
Cash and cash equivalents	\$ 473,712	\$ 827,412
Accounts receivable	2,062,095	2,424,306
	\$ 2,535,807	\$ 3,251,718

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:

	2010	2009
Customer accounts receivable net of allowance for doubtful accounts		
Current	\$ 1,947,052	\$ 2,107,633
30-60 days past billing date	32,328	186,215
61-90 days past billing date	51,313	112,211
Greater than 90 days past billing date	31,402	18,247
	\$ 2,062,095	\$ 2,424,306

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, 2010 and 2009:



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	2010	2009
Balance, beginning of year	\$ 309,381	\$ -
Additions to allowance for doubtful accounts	202,199	309,381
Reductions to allowance for doubtful accounts	(203,702)	-
Balance, end of year	\$ 307,878	\$ 309,381

(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, 2010

	Capital lease
2011	13,679
	\$ 13,679

(iv) Market and Currency 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, 2010 the Company did possess foreign currency forward contracts. The contracts entered into fix the exchange rate at which the company will acquire U.S. dollars to the extent of its forecasted requirements until February 28, 2011. Subsequent to the year end substantial amounts of these contracts were extended until April 30, 2011.

We document all relationships between derivatives and the items they hedge and our risk management objective and strategy for using hedges. This process includes linking every derivative to:

- A specific asset or liability, or



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- A specific firm commitment, or
- An anticipated transaction.

We assess the effectiveness of a derivative in managing an identified risk when hedge accounting is initially applied, and on an ongoing basis thereafter. If a hedge becomes ineffective, we stop using hedge accounting. Any premiums paid for derivatives used in hedging relationships are deferred and expensed to operations over the life of the contract. Any forward premiums or discounts on forward foreign exchange contracts that are used to hedge debt denominated in foreign currencies are amortized to expense as utilized.

Our cash flow hedges are used to mitigate the foreign currency risk on certain debt instruments and purchase commitments. We use foreign exchange forward contracts to manage the exposure to anticipated transactions denominated in foreign currencies. Changes in the fair value of these derivatives are recognized in our statement of comprehensive loss, except for any ineffective portion, which is recognized immediately in income. Realized gains and losses in accumulated other comprehensive loss are reclassified to the statement of operations in the same periods as the corresponding hedged items are recognized in income. Cash flow hedges that mature within one year are included in Prepaid and other expenses or Accounts payable and accrued liabilities.

The net foreign exchange gain for 2010 was \$59,864 (\$705 in 2009) and has been recorded in cost of goods sold and general and administration expenses.

(v) Fair value of financial instruments

The amended Section 3862, financial instruments disclosures, requires an explanation about how fair value is determined for assets and liabilities measured in the financial statements at fair value and establishes a hierarchy under which these assets and liabilities must be grouped based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources while unobservable inputs reflect the Company's assumptions. The two types of inputs create the following fair value hierarchy:

Level 1: Observable inputs such as quoted prices in active markets;

Level 2: inputs, other than the quoted market prices in active markets, which are observable, either directly and/or indirectly; and

Level 3: unobservable input for the asset or liability in which little or no market data exists, therefore require the entity to develop its own assumptions.

Cash and cash equivalents have been classified as level 1, all other financial instruments have been classified as level 2.



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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 *is not subject to any externally imposed capital requirements.*

14. COMMITMENTS

(i) Operating Leases

The Company has operating leases for its switch facility and corporate office both of which expire in 2011 and lease of office equipment which expires in 2015. The future minimum payments under operating leases as at December 31, 2010 are as follows:

2011	310,356
2012	8,748
2013	8,748
2014	8,748
2015	2,919
	<hr/>
	\$ 339,519

(ii) Capital Leases

The future minimum payments under capital leases as at December 31, 2010 are as follows:

2011	13,679
	<hr/>
	\$ 13,679



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15. SEVERANCE

In 2009, Mr. Hersh Spiegelman, the Company's founder passed away and the Company recorded liabilities relating to Mr. Spiegelman's employment contract of \$676,179.

The remaining liability to the estate of \$162,692 will be paid in 2011.

16. SALE OF CUSTOMER EQUIPMENT

The company holds certain Voice over IP telephone equipment classified as property plant and equipment which are rented to its customers in the normal course of business. The rental for the use of this equipment is included in operating revenues. The customer may choose to purchase the equipment at any time during the rental period. Upon sale of equipment to the customer, the net book value is transferred from property plant and equipment to telecommunications costs. (see Note 6).

17. 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 residential and business customers. All assets of the business support these operations and are located in Canada.

18. 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.

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19. RELATED PARTY TRANSACTIONS

One of the Company's Directors who operates a community newspaper and received a commission on sales of \$9,616 (\$11,250 in 2009) valued at current market rate.

20. SUBSEQUENT EVENT

Early in 2011, the Company hired a President for its re-activated calling card division (CardTel Corp) and issued 98,500 options, the terms of which are similar to the ones existing at year end. 98,500 options were issued January 31st 2011. The options have 5 year term and will vest equally over the first 3 years. The value of the options was estimated to be \$7,978. The Company evaluated the fair value of options granted using the Black-Scholes option pricing model with the noted assumptions:

	<u>January 31, 2011</u> <u>Weighted Average</u>
Estimated fair value at the date of grant for options granted	\$ 0.081
Assumptions utilized:	
Risk-free interest rate	2.50%
Expected volatility	147.76%
Expected life of the options (years)	5.00
Expected dividend yield	0.00%

21. COMPARATIVE FIGURES

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

