

Consolidated Financial Statements of

TELEHOP COMMUNICATIONS INC.

December 31, 2001



Auditors' Report

To the Shareholders of
Telehop Communications Inc.

We have audited the consolidated balance sheets of Telehop Communications Inc. as at December 31, 2001 and 2000 and the consolidated statements of operations and retained earnings and of cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these 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, 2001 and 2000 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.


Chartered Accountants

Toronto, Ontario
March 15, 2002

TELEHOP COMMUNICATIONS INC.

Consolidated Balance Sheets

December 31, 2001

	<u>2001</u>	<u>2000</u>
ASSETS		
CURRENT		
Cash	\$ 450,205	\$ 771,990
Accounts receivable	2,785,969	1,837,135
Income taxes recoverable	87,478	117,725
Prepaid expenses	30,643	59,727
Advances to shareholders (Note 2)	31,067	-
	<u>3,385,362</u>	<u>2,786,577</u>
ADVANCES TO SHAREHOLDERS (Note 2)	-	51,514
FUTURE INCOME TAXES (Note 6)	22,741	4,358
CAPITAL ASSETS (Note 3)	767,930	994,025
DEFERRED CHARGES	-	1,657
	<u>\$ 4,176,033</u>	<u>\$ 3,838,131</u>
LIABILITIES		
CURRENT		
Accounts payable and accrued charges	\$ 2,918,862	\$ 2,512,006
Obligations under capital lease - current portion (Note 4)	93,351	96,478
	<u>3,012,213</u>	<u>2,608,484</u>
OBLIGATIONS UNDER CAPITAL LEASE (Note 4)	13,459	89,296
	<u>3,025,672</u>	<u>2,697,780</u>
SHAREHOLDERS' EQUITY		
CAPITAL STOCK (Note 5)	1,094,164	1,094,164
RETAINED EARNINGS	56,197	46,187
	<u>1,150,361</u>	<u>1,140,351</u>
	<u>\$ 4,176,033</u>	<u>\$ 3,838,131</u>

APPROVED BY THE BOARD

Hersh Spiegelman
..... Director

Ruth Bartholomeusz
..... Director

TELEHOP COMMUNICATIONS INC.
Consolidated Statements of Operations and Retained Earnings
Year ended December 31, 2001

	<u>2001</u>	<u>2000</u>
REVENUE	\$ 10,877,445	\$ 8,163,262
EXPENSES		
Telecommunication costs	7,263,709	5,780,981
General and administration	1,555,424	1,321,482
Marketing and selling	1,105,470	684,124
Development and technical support	416,397	223,106
Depreciation and amortization	457,513	303,172
Interest expense	57,055	17,606
	<u>10,855,568</u>	<u>8,330,471</u>
EARNINGS (LOSS) BEFORE INCOME TAXES	21,877	(167,209)
INCOME TAXES EXPENSE (RECOVERY) (Note 6)	11,867	(46,347)
NET EARNINGS (LOSS) FOR THE YEAR	10,010	(120,862)
RETAINED EARNINGS, BEGINNING OF YEAR	46,187	167,049
RETAINED EARNINGS, END OF YEAR	\$ 56,197	\$ 46,187
EARNINGS (LOSS) PER SHARE (Note 5)	\$ 0.00	\$ (0.01)

TELEHOP COMMUNICATIONS INC.
Consolidated Statements of Cash Flows
Year ended December 31, 2001

	<u>2001</u>	<u>2000</u>
CASH FLOW PROVIDED BY (USED FOR)		
OPERATING ACTIVITIES		
Net earnings (loss) for the year	\$ 10,010	\$ (120,862)
Items not affecting cash		
Depreciation and amortization	308,488	303,172
Loss on disposal of capital assets	149,026	-
Future income taxes	(18,383)	(45,012)
Deferred charges written off	1,657	580
	<u>450,798</u>	<u>137,878</u>
Changes in operating working capital items		
Accounts receivable	(948,834)	(858,228)
Prepaid expenses	29,084	26,172
Accounts payable and accrued charges	406,856	1,149,496
Income taxes recoverable	30,247	259,734
	<u>(31,849)</u>	<u>715,052</u>
INVESTING ACTIVITIES		
Repayments of advances to shareholders	20,447	6,970
Additions to capital assets	(231,419)	(181,064)
	<u>(210,972)</u>	<u>(174,094)</u>
FINANCING ACTIVITY		
Repayment of obligations under capital lease	(78,964)	(62,726)
NET (DECREASE) INCREASE IN CASH	(321,785)	478,232
CASH, BEGINNING OF YEAR	771,990	293,758
CASH, END OF YEAR	\$ 450,205	\$ 771,990

**SUPPLEMENTAL DISCLOSURE
OF CASH FLOW INFORMATION**

Interest paid	\$ 60,383	\$ 49,152
Interest earned	\$ (3,328)	\$ (31,546)
Income tax paid	-	-

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements

December 31, 2001 and 2000

1. 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.

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. Actual results could differ from those estimates.

Cash and cash equivalents

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

Capital assets and amortization

Capital assets are stated at cost. Amortization is based on the estimated useful lives of the assets and is provided as follows:

Computer and telecommunications equipment	20%	straight-line
Computer software	20%	straight-line
Office furniture and equipment	20%	straight-line
Leasehold improvements		Lesser of estimated useful life and period of lease agreement
Telecommunications switch	14.3%	straight-line

Assets under capital lease are amortized on a straight-line basis using rates that are consistent with similar capital assets.

Income taxes

Effective January 1, 2000 the Company adopted 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 income tax assets are evaluated and if realization is not considered more likely than not, a valuation allowance is provided. Adoption of this new accounting policy had no effect on the amounts previously reported.

TELEHOP COMMUNICATIONS INC.
Notes to Consolidated Financial Statements
December 31, 2001 and 2000

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

Employee future benefits

In 2000, the Company adopted the new Canadian Institute of Chartered Accountants ("CICA") recommendations for employee future benefits. Under this new rule, the cost of retirement benefits and certain post-employment benefits are recognized over the period in which the employee renders services in return for those benefits. Other post-employment benefits are recognized when the event triggering the obligation occurs. The adoption of the new rule for employee future benefits has no effect on recorded amounts.

Revenue recognition

The Company records revenue from the sale of telecommunications 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.

Stock option plan

The Company has an employee stock option plan, which is described in Note 5. No compensation expense is recognized for this plan when stock or stock options are issued to employees. Any consideration paid by employees on exercise of stock options or purchase of stock is credited to capital stock. If stock or stock options are repurchased from employees, the excess of the consideration paid over the carrying amount of the stock or stock option cancelled is charged to retained earnings.

The CICA also recently issued a new Handbook Section 3870, Stock-based Compensation and Other Stock-based Payments. This section establishes standards for the recognition, measurement and disclosure of stock-based compensation and other stock-based payments made in exchange for goods and services and applies to transactions, including non-reciprocal transactions, in which an enterprise grants shares of common stock, stock options, or other equity instruments, or incurs liabilities based on the price of common stock or other equity instruments. This section sets out a fair value based method of accounting and is required for certain stock-based transactions, effective January 1, 2002 and applied to awards granted on or after that date.

Earnings per share

Effective January 1, 2001 the Company adopted the CICA standard for calculating earnings per share. This standard adopts the treasury stock method of calculating the dilutive effect of options on earnings per share instead of the imputed earnings approach. The Company has adopted this method on a retroactive basis. There was no effect on previous periods reported.

2. ADVANCES TO SHAREHOLDERS

Advances to shareholders bear interest at 7% per annum and are repayable in monthly instalments aggregating \$1,000 with the balance due on June 30, 2002.

TELEHOP COMMUNICATIONS INC.
Notes to Consolidated Financial Statements
December 31, 2001 and 2000

3. CAPITAL ASSETS

	2001			2000		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Computer and telecommunications equipment	\$ 290,209	\$ 87,529	\$ 202,680	\$ 837,348	\$ 485,874	\$ 351,474
Office furniture and equipment	38,478	22,159	16,319	136,382	76,286	60,096
Leasehold improvements	73,701	8,449	65,252	16,002	7,113	8,889
Telecommunications switch	455,752	262,704	193,048	436,722	196,962	239,760
Computer software	43,877	19,521	24,356	49,385	39,976	9,409
	902,017	400,362	501,655	1,475,839	806,211	669,628
Assets under capital lease						
Computer and telecommunications equipment	482,387	216,112	266,275	471,319	146,922	324,397
	\$ 1,384,404	\$ 616,474	\$ 767,930	\$ 1,947,158	\$ 953,133	\$ 994,025

Depreciation and amortization of assets under capital lease was \$64,059 in the year ended December 31, 2001 (for year ended December 31, 2000 - \$63,229).

During the third and fourth quarters of 2001 the Company consolidated its premises into one new location and wrote down the net book value of its capital assets by \$149,026.

4. COMMITMENTS

A. Details of obligations under capital lease as at December 31, 2001 are as follows:

2002	\$ 98,061
2003	8,376
2004	3,379
Total minimum lease payments	109,816
Less amount representing imputed interest at 8%	3,006
Present value of obligations under capital lease	106,810
Current portion - due within one year	93,351
Long-term obligations under capital lease	\$ 13,459

B. The future minimum payments under operating leases as at December 31, 2001 are as follows:

2002	\$ 44,731
2003	44,731
2004	44,731
2005	44,731
2006	44,731
Thereafter	225,352
	\$ 449,007

TELEHOP COMMUNICATIONS INC.
Notes to Consolidated Financial Statements
December 31, 2001 and 2000

5. CAPITAL STOCK

	<u>2001</u>	<u>2000</u>
Authorized		
An unlimited number of common shares		
Issued and outstanding		
12,067,500 common shares	\$ 1,094,164	\$ 1,094,164

Earnings per share is the amount of earnings for the period available to each common share outstanding during the reporting period. Earnings per share was calculated using earnings of \$10,010 (2000 – loss of \$120,862) and weighted average number of common shares of 12,067,500 (2000 – 12,067,500). There was no adjustment arising from the effect of dilutive securities on the adjusted weighted average number of shares outstanding.

Stock option plan

The shareholders of the Company approved an employee stock option plan (“ESOP”) and authorized the Company to reserve 1,500,000 common shares of the Company for issuance in accordance with the terms of the ESOP. Options granted may be exercised over a period not exceeding five years and the purchase price is payable in full at the time the options are exercised.

Summarized information relative to the Company’s stock option plan as follows:

	<u>2001</u>	<u>Weighted Average Exercise Price</u>	<u>2000</u>	<u>Weighted Average Exercise Price</u>
Options outstanding, beginning of year	1,058,500	\$ 0.40	1,329,500	\$ 0.40
Options granted	523,000	0.40	300,000	0.40
Options exercised	-	0.40	-	0.40
Options cancelled	(226,000)	0.40	(571,000)	0.40
Options outstanding, end of year	1,355,500	\$ 0.40	1,058,500	\$ 0.40
Options exercisable, end of year	528,000	\$ 0.40	361,500	\$ 0.40

TELEHOP COMMUNICATIONS INC.
Notes to Consolidated Financial Statements
December 31, 2001 and 2000

5. CAPITAL STOCK (continued)

The following table summarizes information about stock options outstanding at December 31, 2001:

<u>Range of Exercise Prices</u>	<u>Number Outstanding</u>	<u>Weighted Average Remaining Life</u>	<u>Weighted Average Exercise Price</u>	<u>Number Exercisable</u>	<u>Weighted Average Exercise Price</u>
\$ 0.40	1,355,500	2.64	\$ 0.40	528,000	\$ 0.40

6. INCOME TAXES

The Company has adopted the new recommendations of the Canadian Institute of Chartered Accountants concerning accounting for income taxes.

Future income tax assets and liabilities result primarily from: (1) the difference between depreciation recorded for accounting purposes and that claimed for income tax purposes; (2) non-capital loss; (3) share issue expenses.

As at December 31, 2001 the company's future income tax assets and liabilities are as follows:

	<u>2001</u>	<u>2000</u>
Future income tax assets		
Losses available for carry forward	\$ -	\$ 47,216
Tax value of fixed assets in excess of tax base	22,001	-
Share issue expenses	-	15,317
Other	740	-
	22,741	62,533
Future income tax liability		
Other assets	-	58,175
Net future income tax asset	\$ 22,741	\$ 4,358

TELEHOP COMMUNICATIONS INC.
Notes to Consolidated Financial Statements
December 31, 2001 and 2000

6. INCOME TAXES (continued)

The reconciliation of the provision for income taxes reflected in the financial statements with the amount of tax that would result from the application of Canadian statutory tax rates to reported income, is as follows:

	<u>2001</u>	<u>2000</u>
Income (loss) before income taxes	\$ 21,877	\$ (167,209)
Approximate applicable statutory tax rate	42%	44%
Income taxes at statutory tax rates	9,133	(73,488)
Add (deduct) the tax effect of		
Rate adjustment	(3,239)	(1,109)
Non-deductible amounts	3,623	831
Other	2,350	27,419
	<u>\$ 11,867</u>	<u>\$ (46,347)</u>

7. RELATED PARTY TRANSACTIONS

A company owned by a significant shareholder provided managerial and consulting services in the amount of \$69,360 (2000 - \$51,360). At the year end amounts owing in connection with these services were \$8,560 (2000 - \$25,680).

A director of the Company is also a partner in the firm providing legal services to the Company. Fees paid to the firm were \$15,712 (2000 - \$26,216) of which \$4,224 (2000 - \$19,030) remained payable at year end.

TELEHOP COMMUNICATIONS INC.
Notes to Consolidated Financial Statements
December 31, 2001 and 2000

8. FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT

Fair value of financial instruments

The carrying amounts of financial assets and financial liabilities approximate their fair value.

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 Ontario. The Company also mitigated the majority of its credit risk through an arrangement with the BCE group of companies.

9. FRANCHISES

	<u>2001</u>	<u>2000</u>
Number of franchises, beginning of year	26	26
Less acquired during the year	-	-
Number of franchises, end of year	<u>26</u>	<u>26</u>
Revenues associated with franchised operations are follows:		
Royalties and franchise fees	<u>\$ 155,000</u>	<u>\$ 275,000</u>

10. CONTINGENT LIABILITY

The Company initiated legal proceedings against a former director who was also vice president and a senior employee. A defense and countersuit has been filed. Management is unable to determine the eventual outcome of this matter, however, it is anticipated that there will be no significant affect on the Company's financial position or results of its operations.

11. SEGMENTED INFORMATION

The Company operates in one industry and one operating segment, being the telecommunications industry. All of the Company's assets are located in Canada and substantially all of the Company's revenues are derived in Canada.

12. COMPARATIVE FIGURES

Certain of the comparative figures have been reclassified to conform with the current presentation.