Financial Statements of

NATIONAL CAPITAL FREENET INCORPORATED

Year ended December 31, 2003

KPMG LLP
Chartered Accountants
Suite 2000
160 Elgin Street
Ottawa, ON K2P 2P8
Canada

Telephone (613) 212-KPMG (5764)
Telefax (613) 212-2896
www.kpmg.ca

AUDITORS' REPORT TO THE BOARD OF DIRECTORS

We have examined the statement of financial position of National Capital FreeNet Incorporated as at December 31, 2003 and the statements of operations, changes in net assets and cash flows for the year 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 audit.

Except as explained in the following paragraph, we conducted our audit 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 common with many not-for-profit organizations, the Company derives revenue from donations and fundraising, the completeness of which is not susceptible of satisfactory audit verification. Accordingly, our verification of these revenues was limited to the amounts recorded in the records of the company and we were not able to determine whether any adjustments might be necessary to donations, excess (deficiency) of revenue over expenses, assets and net assets.

In our opinion, except for the effect of adjustments, if any, which we might have determined to be necessary had we been able to satisfy ourselves concerning the completeness of the revenue referred to in the preceding paragraph, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2003 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by the Canada Corporations Act, we report that, in our opinion, these principles have been applied on a consistent basis.

KPMG LLP

Chartered Accountants

Ottawa, Canada

February 25, 2004

NATIONAL CAPITAL FREENET INCORPORATED

Statement of Financial Position

December 31, 2003, with comparative figures for 2002

	2003	2002
Assets		
Current assets:		
Cash	$ 38,183	$ 51,355
Segregated cash (note 3)	54,263	81,659
Accounts receivable	64,889	44,964
Prepaid expenses	4,856	559
	162,191	178,537
Capital assets:		
Computer equipment	187,949	188,449
Telecommunications equipment	77,536	136,524
Systems software	619,871	626,746
Business equipment	2,793	1,793
	888,149	953,512
Less accumulated amortization	521,369	408,235
	366,780	545,277
	$ 528,971	$ 723,814
Liabilities and Net Assets		
Current liabilities:		
Accounts payable and accrued liabilities (note 3)	$ 100,200	$ 34,236
Deferred revenue (note 3)	5,809	81,659
	106,009	115,895
Deferred contributions related to equipment and software (note 2)	366,575	544,936
Net assets:		
Unrestricted	56,182	62,642
Invested in capital assets	205	341
	56,387	62,983
Commitment (note 4)		
	$ 528,971	$ 723,814

See accompanying notes to financial statements.

On behalf of the Board:

__________________________Director

__________________________Director

NATIONAL CAPITAL FREENET INCORPORATED

Statement of Operations

Year ended December 31, 2003, with comparative figures for 2002

	2003	2002
Revenue:		
Donations	$ 185,979	$ 162,423
Network projects	321,676	208,035
Amortization of deferred contributions (note 2)	182,757	131,186
Gain on disposal of capital assets	–	12,632
	690,412	514,276
Expenses:		
Telecommunications	98,739	61,359
Network projects	321,676	191,816
Administration and professional fees	36,273	44,573
Office and supplies	39,401	38,556
Amortization of capital assets	182,893	133,273
Systems administration	18,026	16,031
	697,008	485,608
Excess (deficiency) of revenue over expenses	$ (6,596)	$ 28,668

See accompanying notes to financial statements.

NATIONAL CAPITAL FREENET INCORPORATED

Statement of Changes in Net Assets

Year ended December 31, 2003, with comparative figures for 2002

	Unrestricted	Invested in capital assets	2003 Total	2002 Total
Balance, beginning of year	$ 62,642	$ 341	$ 62,983	$ 34,315
Excess (deficiency) of revenue over expenses	(6,596)	–	(6,596)	28,668
Proceeds of disposition of capital assets			–	–
Amortization of capital assets	182,893	(182,893)	–	–
Amortization of deferred contributions related to capital assets	(182,757)	182,757	–	–
Balance, end of year	$ 56,182	$ 205	$ 56,387	$ 62,983

See accompanying notes to financial statements.

NATIONAL CAPITAL FREENET INCORPORATED

Statement of Cash Flows

Year ended December 31, 2003, with comparative figures for 2002

	2003	2002
Cash provided by (used in):		
Operations:		
Excess (deficiency) of revenue over expenses	$ (6,596)	$ 28,668
Items not involving cash:		
Amortization of deferred contributions	(182,757)	(131,186)
Amortization of capital assets	182,893	133,273
Gain on disposal of capital assets	–	(12,632)
Changes in non-cash working capital items:		
Accounts receivable	(19,925)	(39,229)
Prepaid expenses	(4,297)	(94)
Accounts payable and accrued liabilities	65,964	7,249
Deferred revenue	(75,850)	55,599
	(40,568)	41,648
Investing activities:		
Contribution of capital assets	4,396	477,624
Contribution of capital assets put in service	(4,396)	(477,624)
Proceeds on disposition of capital assets	–	28,756
	–	28,756
Increase (decrease) in cash and cash equivalents	(40,568)	70,404
Cash and cash equivalents, beginning of year	133,014	62,610
Cash and cash equivalents, end of year	$ 92,446	$ 133,014
Cash and cash equivalents comprise of:		
Cash	$ 38,183	$ 51,355
Segregated cash	54,263	81,659
	$ 92,446	$ 133,014

See accompanying notes to financial statements.

National Capital FreeNet Incorporated is a not-for-profit organization, the aims and objectives of which are to establish and operate a community based computer network to store, access and exchange information between individuals and organizations in the national capital region.

The Company was incorporated on September 29, 1992 under the Canada Corporations Act as a not-for-profit organization without share capital within the meaning of the Income Tax Act (Canada) and accordingly is exempt from income tax.

1. Significant accounting policies:

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The significant accounting policies are summarized as follows:

(a) Capital assets:

Purchased equipment and systems software are recorded at cost. Contributed equipment and software are recorded as a capital asset at fair value at the date of contribution. Contributed equipment and software are recorded as a deferred contribution and recognized as revenue at an amount equal to the related amortization on those assets.

Amortization is provided on the straight-line basis using an annual rate of 25%. One half of the rate is used in the year of acquisition.

(b) Revenue recognition:

Project revenue to fund specific future project expense is deferred and recognized in the period in which the related expenses are incurred.

Donations are recognized in the year received.

(c) Contributed services:

Contributed services are recognized when a fair value can be reasonably estimated and when the services would otherwise have been purchased.

(d) 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 revenue and expenses during the period. Actual results could differ from those estimates.

2. Deferred contributions:

Deferred contributions relate to the unrecognized portion of contributed equipment and software. The changes in the deferred contributions balance for the year are as follows:

	2003	2002
Balance, beginning of year	$ 544,936	$ 198,498
Add contributed equipment and software	4,396	477,624
Less amount recognized as revenue	(182,757)	(131,186)
Balance, end of year	$ 366,575	$ 544,936

3. Deferred revenue:

Deferred revenue includes revenue received for projects contracted for in the year and to be completed in the following year.

Details of the year-end balance are as follows:

	2003	2002
Office of Learning Technologies Thin Client Startup	$ 5,809	$ 81,659

Segregated cash at December 31, 2003 includes the deferred revenue of $5,809 and $48,454 included in accounts payable to be returned to the contributor.

4. Commitment:

The Company is committed to payments under an agreement for telephone lines to May 30, 2006. Payments over the next three years are as follows:

2004	$ 56,680
2005	56,680
2006	23,200
	$ 136,560

5. Fair value of financial assets and financial liabilities:

The carrying values of all financial assets and liabilities approximate their fair market values.