Financial Statements of

NATIONAL CAPITAL FREENET INCORPORATED

Years ended December 31, 2012 and 2011

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

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

REVIEW ENGAGEMENT REPORT

To the Members of National Capital FreeNet Incorporated

We have reviewed the statements of financial position of National Capital FreeNet Incorporated as at December 31, 2012, December 31, 2011 and January 1, 2011 and the statements of operations, changes in net assets and cash flows for the years ended December 31, 2012 and December 31, 2011. Our reviews were made in accordance with Canadian generally accepted standards for review engagements and accordingly consisted primarily of enquiry, analytical procedures and discussion related to information supplied to us by the Company.

A review does not constitute an audit and consequently we do not express an audit opinion on these financial statements.

Based on our reviews, nothing has come to our attention that causes us to believe that these financial statements are not, in all material respects, in accordance with Canadian accounting standards for not-for-profit organizations.

KPMG LLP

Chartered Accountants, Licensed Public Accountants

February 27, 2013

Ottawa, Canada

NATIONAL CAPITAL FREENET INCORPORATED

Statements of Financial Position
(Unaudited)

December 31, 2012, December 31, 2011 and January 1, 2011

	December 31, 2012	December 31, 2011	January 1, 2011
Assets			
Current assets:			
Cash	$ 113,362	$ 91,006	$ 71,960
Amounts receivable	15,250	612	612
Inventory	1,289	1,575	3,360
Prepaid expenses	6,613	6,279	6,279
	136,514	99,472	82,211
Capital assets (note 9)	65,023	17,625	14,088
Donated service contract (note 4)	14,953	–	–
	$ 216,490	$ 117,097	$ 96,299
Liabilities and Net Assets			
Current liabilities:			
Accounts payable and accrued liabilities (note 2)	$ 87,540	$ 41,848	$ 48,525
Loan payable (note 5)	14,753	–	–
Current portion of obligation under capital lease (note 6)	9,805	–	–
	112,098	41,848	48,525
Obligations under capital lease (note 6)	12,256	–	–
Deferred capital contributions (note 3)	19,610	–	–
Deferred contributions (note 4)	14,953	–	–
Net assets:			
Unrestricted	(7,450)	57,624	33,686
Invested in capital assets	65,023	17,625	14,088
	57,573	75,249	47,774
	$ 216,490	$ 117,097	$ 96,299

See accompanying notes to financial statements.

On behalf of the Board:

__________________________ Director

__________________________ Director

NATIONAL CAPITAL FREENET INCORPORATED

Statements of Operations
(Unaudited)

Years ended December 31, 2012 and 2011

	2012	2011
Revenue:		
DSL service	$ 1,057,393	$ 1,011,777
Donations	99,838	144,674
DSL equipment	39,798	54,378
Interest	524	578
Amortization of deferred contribution revenue	11,164	–
	1,208,717	1,211,407
Expenses:		
DSL service	863,877	867,669
Administration and professional fees	231,698	203,974
Telecommunications equipment	53,283	55,724
Amortization of capital assets	41,642	13,955
Office and supplies	18,832	18,101
DSL equipment	15,702	24,285
Amortization of donated service contract	1,359	–
Loss on disposal of capital assets	–	224
	1,226,393	1,183,932
Excess (deficiency) of revenue over expenses	$ (17,676)	$ 27,475

See accompanying notes to financial statements.

NATIONAL CAPITAL FREENET INCORPORATED

Statements of Changes in Net Assets
(Unaudited)

Years ended December 31, 2012 and 2011

December 31, 2012	Unrestricted	Invested in capital assets	Total
Balance, January 1, 2012	$ 57,624	$ 17,625	$ 75,249
Deficiency of revenue over expenses	(17,676)	–	(17,676)
Additions to capital assets	(89,040)	89,040	–
Amortization of capital assets	31,837	(31,837)	–
Amortization of deferred capital contributions related to capital assets	9,805	(9,805)	–
Balance, December 31, 2012	$ (7,450)	$ 65,023	$ 57,573

December 31, 2011	Unrestricted	Invested in capital assets	Total
Balance, January 1, 2011	$ 33,686	$ 14,088	$ 47,774
Excess of revenue over expenses	27,475	–	27,475
Additions to capital assets	(17,716)	17,716	–
Amortization and loss on disposal of capital assets	14,179	(14,179)	–
Balance, December 31, 2011	$ 57,624	$ 17,625	$ 75,249

See accompanying notes to financial statements.

NATIONAL CAPITAL FREENET INCORPORATED

Statements of Cash Flows
(Unaudited)

Years ended December 31, 2012 and 2011

	2012	2011
Cash provided by (used in):		
Operating activities:		
Excess (deficiency) of revenue over expenses	$ (17,676)	$ 27,475
Items not involving cash:		
Amortization of deferred contribution revenue	(11,164)	–
Amortization of capital assets	41,642	13,955
Amortization of donated service contract	1,359	–
Loss on disposal of capital assets		224
Changes in non-cash working capital items:		
Accounts receivable	(14,638)	–
Inventory	286	1,785
Prepaid expenses	(334)	–
Accounts payable and accrued liabilities	45,692	(6,677)
	45,167	36,762
Investing activities:		
Additions to capital assets	(59,625)	(17,716)
Financing activities:		
Increase in obligations under capital lease	29,415	–
Principal payments on obligations under capital lease	(7,354)	–
Increase in loan payable	35,000	–
Principal payments on loan payable	(20,247)	–
	36,814	–
Increase in cash	22,356	19,046
Cash, beginning of year	91,006	71,960
Cash, end of year	$ 113,362	$ 91,006

See accompanying notes to financial statements.

National Capital FreeNet Incorporated ("the Company") 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.

On January 1, 2012, the Company adopted Canadian Accounting Standards for Not-For-Profit Organizations in Part III of the CICA Handbook. These are the first financial statements prepared in accordance with Not-For-Profit Standards.

In accordance with the transitional provisions in Not-For-Profit Standards, the Company has adopted the changes retrospectively, subject to certain exemptions allowed under these standards. The transition date is January 1, 2011 and all comparative information provided has been presented by applying Not-For-Profit Standards.

There were no adjustments to net assets as at January 1, 2011 or net assets for the year ended December 31, 2011 as a result of the transition to these standards.

1. Significant accounting policies:

The financial statements have been prepared by management in accordance with Canadian Accounting Standards for Not-For-Profit Organizations in Part III of the CICA Handbook.

(a) Capital assets:

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

Amortization is provided using the following methods and annual rates:

Asset	Basis	Rate
Systems software	Straight-line	3 years
Telecommunications equipment	Straight-line	3 years
Business equipment	Straight-line	3 years
Furniture and fixtures	Straight-line	5 years

1. Significant accounting policies (continued):

(b) Impairment of long-lived assets:

Long-lived assets, including property, plant and equipment and intangible assets subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability is measured by a comparison of the asset's carrying amount to the estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of the asset exceeds its estimated future cash flows, an impairment charge is recognized for the amount by which the carrying amount of the asset exceeds the fair value of the asset. When quoted market prices are not available, the Company uses the expected future cash flows discounted at a rate commensurate with the risks associated with the recovery of the asset as an estimate of fair value.

(c) Revenue recognition:

The Company follows the deferral method of accounting for contributions which include donations from customers, corporations and other organizations. Contributions of capital assets are deferred and amortized into revenue on a straight-line basis, at a rate corresponding with the amortization rate for the related capital assets.

Donations are recognized as revenue when received. Revenue from the sale of DSL service and equipment is recognized when the services are provided or the goods are shipped to the customer.

(d) Inventory:

Inventory consists of modems and filters for resale. Inventory is valued at the lower of cost on a first-in, first-out basis, and net realizable value.

(e) Contributed services:

A substantial number of volunteers contribute a significant amount of their time each year. Because of the difficulty of determining the fair value, contributed services are not recognized in the financial statements unless they are professional services rendered by third parties for which a fair value is easily determinable.

1. Significant accounting policies (continued):

(f) Use of estimates:

The preparation of the financial statements 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 year. Actual results could differ from those estimates.

(g) Financial instruments:

The Company has classified amounts receivable as loans and receivables and accounts payable and accrued liabilities and loans payable as other liabilities. Upon initial recognition, these financial assets and liabilities are recorded at fair value and are subsequently measured at amortized cost using the effective interest method of amortization.

Financial instruments are recorded at fair value on initial recognition. Equity instruments that are quoted in an active market are subsequently measured at fair value. All other financial instruments are subsequently recorded at cost or amortized cost, unless management has elected to carry the instruments at fair value. The Company has not elected to carry any such financial instruments at fair value.

Transaction costs incurred on the acquisition of financial instruments measured subsequently at fair value are expensed as incurred. All other financial instruments are adjusted by transaction costs incurred on acquisition and financing costs, which are amortized using the straight-line method.

Financial assets are assessed for impairment on an annual basis at the end of the fiscal year if there are indicators of impairment. If there is an indicator of impairment, the Company determines if there is a significant adverse change in the expected amount or timing of future cash flows from the financial asset. If there is a significant adverse change in the expected cash flows, the carrying value of the financial asset is reduced to the highest of the present value of the expected cash flows, the amount that could be realized from selling the financial asset or the amount the Company expects to realize by exercising its right to any collateral. If events and circumstances reverse in a future period, an impairment loss will be reversed to the extent of the improvement, not exceeding the initial carrying value.

2. Accounts payable and accrued liabilities:

Included in accounts payable and accrued liabilities are government remittances payable of $7,468 (December 31, 2011 - $Nil; January 1, 2011 - $1,876), which includes amounts payable for harmonized sales tax and payroll related taxes.

3. Deferred capital contributions:

Deferred capital contributions relate to the unrecognized portion of contributed capital assets (Cisco router donated by Cisco Systems). The changes in the deferred contributions balance for the year are as follows:

	December 31, 2012	December 31, 2011	January 1, 2011
Capital contributions, beginning of year	$ 390,956	$ 410,956	$ 410,956
Less dispositions of contributed capital	(383,375)	(20,000)	–
Add contributions received	29,415	–	–
Capital contributions, end of year	36,996	390,956	410,956
Accumulated amortization, beginning of year	(390,956)	(410,956)	(410,336)
Less accumulated amortization on disposed assets	383,375	20,000	–
Add amount recognized as revenue during the year	(9,805)	–	(620)
Accumulated amortization, end of year	(17,386)	(390,956)	(410,956)
Balance, end of year	$ 19,610	$ –	$ –

4. Deferred contributions:

Deferred contributions relate to the unamortized portion of a contributed five year service contract donated by Cisco Systems. The changes in the deferred contributions balance for the year are as follows:

	December 31, 2012	December 31, 2011	January 1, 2011
Balance, beginning of year	$ –	$ –	$ –
Contributions received	16,312	–	–
Less amortization recognized as revenue	(1,359)	–	–
Balance, end of year	$ 14,953	$ –	$ –

5. Loan payable:

The Company entered into a loan payable on June 12, 2012. Interest is payable at prime plus 2.55% per annum. A blended payment (interest and principal) of $3,005 is payable monthly on the last day of the month. The loan is due on June 29, 2013.

6. Obligation under capital lease:

The Company entered into a three-year capital lease agreement with Cisco Systems on April 4, 2012, to acquire a Cisco router. The total value of the leased asset is $29,415. Under the lease agreement, the Company is required to make monthly payments of $817.

The following is a schedule of minimum lease payments under the capital lease expiring March 31, 2015, together with the balance of the obligation:

Year ending December 31,	
2013	$ 9,805
2014	9,805
2015	2,451
Total minimum lease payments	22,061
Less current portion	9,805
	$ 12,256

7. Commitments and contingencies:

At December 31, 2012, minimum annual lease payments under operating leases expiring August 31, 2013 are $7,762. Commitments relate to the lease of National Capital Freenet's office space. As at December 31, 2012, the Company also has a commitment related to a three-year service contract with Cisco Systems (2013 - $3,263; 2014 - $3,263; 2015 - $816).

8. Capital disclosure:

The Company considers its capital to consist of its net assets. The Company's overall objective with respect to its capital is to fund the acquisition of capital assets, future projects and ongoing operations. The Company is not subject to externally imposed capital requirements and its overall strategy with respect to capital remains unchanged from the year ended December 31, 2011.

9. Capital assets:

December 31, 2012	Cost	Accumulated amortization	Net book value
Computer equipment	$ 74,783	$ 34,442	$ 40,341
Telecommunication equipment	3,397	3,397	–
Systems software	53,432	29,897	23,535
Business equipment	8,449	7,302	1,147
	$ 140,061	$ 75,038	$ 65,023

December 31, 2011	Cost	Accumulated amortization	Net book value
Computer equipment	$ 82,446	$ 78,500	$ 3,946
Telecommunication equipment	12,546	12,546	–
Systems software	332,273	319,055	13,218
Business equipment	6,728	6,267	461
	$ 433,993	$ 416,368	$ 17,625

January 1, 2011	Cost	Accumulated amortization	Net book value
Computer equipment	$ 82,484	$ 76,485	$ 5,999
Telecommunication equipment	32,546	32,546	–
Systems software	317,925	310,620	7,305
Business equipment	6,728	5,944	784
	$ 439,683	$ 425,595	$ 14,088

9. Capital assets (continued):

Computer equipment includes a router under a capital lease agreement. The cost of the leased router is $29,415. The accumulated amortization of the leased router as at December 31, 2012 is $9,805. The net book value of the leased router as at December 31, 2012 is $19,610.

Total additions to capital assets in 2012 were $89,040. This includes a donated router with a value of $29,415.

In 2012, the Company disposed of fully amortized capital assets in the amount of $382,610.

10. Financial risks and concentration of credit risk:

(a) Currency risk:

The Company is not exposed to currency risk.

(b) Liquidity risk:

Liquidity risk is the risk that the Company will be unable to fulfill its obligations on a timely basis or at a reasonable cost. The Company manages its liquidity risk by monitoring its operating requirements. The Company prepares budget and cash forecasts to ensure it has sufficient funds to fulfill its obligations. There has been no change to the risk exposures from 2011.

(c) Credit risk:

Credit risk refers to the risk that a counterparty may default on its contractual obligations resulting in a financial loss. The Company's DSL users are charged a monthly fee. Payment is usually made automatically though an electronic funds transfer through the customers' credit cards or debit cards. As a result, credit risk is low because customer payments are made automatically. The Company is still exposed to credit risk if customers do not have sufficient funds in their bank accounts (if they are paying by debit card) or if they have reached their credit limit (if they are using a credit card). The Company will incur a service charge from the bank if a customer's automatic payment cannot be made for the reasons described above. Therefore, the Company is still exposed to credit risk.