

Financial Statements of

**NATIONAL CAPITAL FREENET
INCORPORATED**

Year ended December 31, 2014



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INDEPENDENT AUDITORS' REPORT

To the Members of National Capital FreeNet Incorporated

We have audited the financial statements of National Capital FreeNet Incorporated, which comprise the statement of financial position as at December 31, 2014, the statements of operations, changes in net assets and cash flows for the year then ended, and notes, comprising 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 financial statements in accordance with Canadian accounting standards for not-for-profit organizations, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the 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 financial statements.

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



Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of National Capital FreeNet Incorporated as at December 31, 2014, and its results of operations, its changes in net assets and its cash flows for the year then ended in accordance with Canadian accounting standards for not-for-profit organizations.

KPMG LLP

Chartered Professional Accountants, Licensed Public Accountants

March 24, 2015

Ottawa, Canada

NATIONAL CAPITAL FREENET INCORPORATED

Statement of Financial Position

December 31, 2014, with comparative information for 2013

| | 2014 | 2013 |
|--|-------------------|-------------------|
| | | (Unaudited) |
| Assets | | |
| Current assets: | | |
| Cash | \$ 406,741 | \$ 343,520 |
| Amounts receivable | 5,768 | 10,262 |
| Inventory | 1,701 | 792 |
| Prepaid expenses | 11,166 | 10,908 |
| | <u>425,376</u> | <u>365,482</u> |
| Capital assets (note 2) | 10,386 | 37,492 |
| Donated service contract (note 3) | 8,427 | 11,690 |
| | <u>\$ 444,189</u> | <u>\$ 414,664</u> |
| Liabilities and Net Assets | | |
| Current liabilities: | | |
| Accounts payable and accrued liabilities (note 4) | \$ 83,214 | \$ 109,550 |
| Current portion of obligation under capital lease (note 5) | 2,451 | 9,805 |
| | <u>85,665</u> | <u>119,355</u> |
| Obligation under capital lease (note 5) | – | 2,451 |
| Deferred capital contributions (note 6) | – | 9,805 |
| Deferred contributions (note 3) | 8,427 | 11,690 |
| Net assets: | | |
| Unrestricted | 349,516 | 233,871 |
| Invested in capital assets | 581 | 37,492 |
| | <u>350,097</u> | <u>271,363</u> |
| Commitments and contingencies (note 7) | | |
| | <u>\$ 444,189</u> | <u>\$ 414,664</u> |

See accompanying notes to financial statements.

On behalf of the Board:

_____ Director

_____ Director

NATIONAL CAPITAL FREENET INCORPORATED

Statement of Operations

Year ended December 31, 2014, with comparative information for 2013

| | 2014 | 2013 |
|---|-----------------|------------------|
| | | (Unaudited) |
| Revenue: | | |
| DSL service | \$ 1,216,951 | \$ 1,173,735 |
| Donations | 79,728 | 95,225 |
| DSL equipment | 67,299 | 43,586 |
| Amortization of deferred contribution revenue | 13,068 | 13,068 |
| Interest | 2,931 | 1,526 |
| | <hr/> 1,379,977 | <hr/> 1,327,140 |
| Expenses: | | |
| DSL service | 877,126 | 766,150 |
| Administration and professional fees | 278,116 | 231,000 |
| Amortization of capital assets | 35,829 | 38,583 |
| Telecommunications equipment | 27,608 | 38,566 |
| DSL equipment | 43,120 | 18,302 |
| Office and supplies | 36,181 | 17,486 |
| Amortization of donated service contract | 3,263 | 3,263 |
| | <hr/> 1,301,243 | <hr/> 1,113,350 |
| Excess of revenue over expenses | <hr/> \$ 78,734 | <hr/> \$ 213,790 |

See accompanying notes to financial statements.

NATIONAL CAPITAL FREENET INCORPORATED

Statement of Changes in Net Assets

Year ended December 31, 2014, with comparative information for 2013

| | Unrestricted | Invested in capital assets | 2014 Total | 2013 Total |
|---|--------------|-------------------------------|---------------|---------------|
| | | | | (Unaudited) |
| Balance, beginning of year | \$ 233,871 | \$ 37,492 | \$ 271,363 | \$ 57,573 |
| Excess of revenue over expenses | 78,734 | – | 78,734 | 213,790 |
| Additions to capital assets | (8,723) | 8,723 | – | – |
| Amortization of capital assets | 35,829 | (35,829) | – | – |
| Amortization of deferred capital contributions related to capital assets | 9,805 | (9,805) | – | – |
| Balance, end of year | \$ 349,516 | \$ 581 | \$ 350,097 | \$ 271,363 |

See accompanying notes to financial statements.

NATIONAL CAPITAL FREENET INCORPORATED

Statement of Cash Flows

Year ended December 31, 2014, with comparative information for 2013

| | 2014 | 2013 |
|--|------------|-------------|
| | | (Unaudited) |
| Cash provided by (used in): | | |
| Operating activities: | | |
| Excess of revenue over expenses | \$ 78,734 | \$ 213,790 |
| Items not involving cash: | | |
| Amortization of deferred contribution revenue | (13,068) | (13,068) |
| Amortization of capital assets | 35,829 | 38,583 |
| Amortization of donated service contract | 3,263 | 3,263 |
| Changes in non-cash working capital items: | | |
| Accounts receivable | 4,494 | 4,448 |
| Inventory | (909) | 497 |
| Prepaid expenses | (258) | (4,295) |
| Accounts payable and accrued liabilities | (26,336) | 22,550 |
| | 81,749 | 265,768 |
| Investing activities: | | |
| Additions to capital assets | (8,723) | (11,052) |
| Financing activities: | | |
| Principal payments on obligation under capital lease | (9,805) | (9,805) |
| Principal payments on loan payable | — | (14,753) |
| | (9,805) | (24,558) |
| Increase in cash | 63,221 | 230,158 |
| Cash, beginning of year | 343,520 | 113,362 |
| Cash, end of year | \$ 406,741 | \$ 343,520 |

See accompanying notes to financial statements.

NATIONAL CAPITAL FREENET INCORPORATED

Notes to Financial Statements

Year ended December 31, 2014

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.

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 CPA Canada Handbook - Accounting.

(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 |

(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.

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Notes to Financial Statements, page 2

Year ended December 31, 2014

1. Significant accounting policies (continued):

(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.

(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.

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Notes to Financial Statements, page 3

Year ended December 31, 2014

1. Significant accounting policies (continued):

(g) Financial instruments (continued):

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. Capital assets:

| | | | | 2014 | 2013 |
|--------------------------------|------------|-----------------------------|-------|-------------------|-------------------|
| | Cost | Accumulated amortization | | Net book value | Net book value |
| Computer equipment | \$ 77,535 | \$ 73,112 | \$ | 4,423 | \$ 19,610 |
| Telecommunication equipment | 3,397 | 3,397 | | – | – |
| Systems software | 64,149 | 59,881 | | 4,268 | 15,129 |
| Business equipment | 10,871 | 9,176 | | 1,695 | 2,753 |
| | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> |
| | \$ 155,952 | \$ 145,566 | \$ | 10,386 | \$ 37,492 |

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Year ended December 31, 2014

2. Capital assets (continued):

Cost and accumulated amortization at December 31, 2013 amounted to \$149,846 and \$112,354 respectively.

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, 2014 is \$20,987. The net book value of the leased router as at December 31, 2014 is \$Nil.

In 2014, the Company disposed of fully amortized capital assets in the amount of \$2,617 (2013 - \$1,267).

3. 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:

| | 2014 | 2013 |
|---|-----------|-----------|
| Balance, beginning of year | \$ 11,690 | \$ 14,953 |
| Less amortization recognized as revenue | (3,263) | (3,263) |
| Balance, end of year | \$ 8,427 | \$ 11,690 |

4. Accounts payable and accrued liabilities:

Included in accounts payable and accrued liabilities are government remittances payable of \$2,087 (2013 - \$22,243), which includes amounts payable for harmonized sales tax and payroll-related taxes.

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Year ended December 31, 2014

5. 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:

| | | |
|------------------------------|----|-------|
| 2015 | \$ | 2,451 |
| Total minimum lease payments | | 2,451 |
| Less current portion | | 2,451 |
| | \$ | - |

6. 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:

| | 2014 | 2013 |
|--|-----------|-----------|
| Capital contributions, beginning of year | \$ 36,996 | \$ 36,996 |
| Accumulated amortization, beginning of year | (27,191) | (17,386) |
| Add amount recognized as revenue during the year | (9,805) | (9,805) |
| Accumulated amortization, end of year | (36,996) | (27,191) |
| Balance, end of year | \$ - | \$ 9,805 |

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Notes to Financial Statements, page 6

Year ended December 31, 2014

7. Commitments and contingencies:

Lease commitments:

The Company rents office space and has a commitment related to a three-year service contract with Cisco Systems having future minimum annual lease payments approximately as follows:

| | Office | Cisco Router | Total |
|------|------------|--------------|------------|
| 2015 | \$ 28,937 | \$ 816 | \$ 29,753 |
| 2016 | 28,937 | – | 28,937 |
| 2017 | 28,937 | – | 28,937 |
| 2018 | 28,937 | – | 28,937 |
| | \$ 115,748 | \$ 816 | \$ 116,564 |

There is also a new Bell ICS contract for an initial term of three years starting August 2014. The minimum commitment is \$3,600 per month as follows:

| | |
|------|------------|
| 2015 | \$ 43,200 |
| 2016 | 43,200 |
| 2017 | 28,800 |
| | \$ 115,200 |

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, 2013.

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Year ended December 31, 2014

9. 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 2013.

(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 through 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.