

Financial Statements of

**NATIONAL CAPITAL FREENET
INCORPORATED**

Year ended December 31, 2004



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REVIEW ENGAGEMENT REPORT TO THE MEMBERS

We have reviewed the statement of financial position of National Capital FreeNet Incorporated as at December 31, 2004 and the statements of operations, changes in net assets and cash flows for the year then ended. These financial statements have been prepared in accordance with Canadian generally accepted accounting principles. Our review was 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 review, 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 generally accepted accounting principles.

A handwritten signature in black ink that reads 'KPMG LLP'. The letters are cursive and slanted to the right.

Chartered Accountants

Ottawa, Canada

March 5, 2005

NATIONAL CAPITAL FREENET INCORPORATED

Statement of Financial Position
(Unaudited)

December 31, 2004, with comparative figures for 2003

	2004	2003
Assets		
Current assets:		
Cash	\$ 28,365	\$ 38,183
Segregated cash	–	54,263
Accounts receivable	–	64,889
Prepaid expenses	7,600	4,856
	<u>35,965</u>	<u>162,191</u>
Capital assets:		
Computer equipment	190,094	187,949
Telecommunications equipment	77,536	77,536
Systems software	624,069	619,871
Business equipment	2,793	2,793
	<u>894,492</u>	<u>888,149</u>
Less accumulated amortization	<u>688,609</u>	<u>521,369</u>
	<u>205,883</u>	<u>366,780</u>
	<u>\$ 241,848</u>	<u>\$ 528,971</u>

Liabilities and Net Assets

Current liabilities:		
Accounts payable and accrued liabilities	\$ 876	\$ 100,200
Deferred revenue	–	5,809
	<u>876</u>	<u>106,009</u>
Deferred contributions related to equipment and software (note 2)	202,141	366,575
Net assets:		
Unrestricted	35,089	56,182
Invested in capital assets	3,742	205
	<u>38,831</u>	<u>56,387</u>
Commitment (note 3)		
	<u>\$ 241,848</u>	<u>\$ 528,971</u>

See accompanying notes to financial statements.

On behalf of the Board:

_____ Director

_____ Director

NATIONAL CAPITAL FREENET INCORPORATED

Statement of Operations
(Unaudited)

Year ended December 31, 2004, with comparative figures for 2003

	2004	2003
Revenue:		
Donations	\$ 206,187	\$ 185,979
Network projects	99,532	321,676
Amortization of deferred contributions (note 2)	166,579	182,757
	<u>472,298</u>	<u>690,412</u>
Expenses:		
Telecommunications	108,377	98,739
Network projects	100,870	321,676
Administration and professional fees	39,861	36,273
Office and supplies	6,574	39,401
Amortization of capital assets	167,240	182,893
Systems administration	66,932	18,026
	<u>489,854</u>	<u>697,008</u>
Deficiency of revenue over expenses	<u>\$ (17,556)</u>	<u>\$ (6,596)</u>

See accompanying notes to financial statements.

NATIONAL CAPITAL FREENET INCORPORATED

Statement of Changes in Net Assets (Unaudited)

Year ended December 31, 2004, with comparative figures for 2003

	Unrestricted	Invested in capital assets	2004 Total	2003 Total
Balance, beginning of year	\$ 56,182	\$ 205	\$ 56,387	\$ 62,983
Deficiency of revenue over expenses	(17,556)	—	(17,556)	(6,596)
Additions to capital assets	(6,343)	6,343	—	—
Amortization of capital assets	167,240	(167,240)	—	—
Deferred contributions related to capital assets	2,145	(2,145)	—	—
Amortization of deferred contributions related to capital assets	(166,579)	166,579	—	—
Balance, end of year	\$ 35,089	\$ 3,742	\$ 38,831	\$ 56,387

See accompanying notes to financial statements.

NATIONAL CAPITAL FREENET INCORPORATED

Statement of Cash Flows
(Unaudited)

Year ended December 31, 2004, with comparative figures for 2003

	2004	2003
Cash provided by (used in):		
Operations:		
Deficiency of revenue over expenses	\$ (17,556)	\$ (6,596)
Items not involving cash:		
Amortization of deferred contributions	(166,579)	(182,757)
Amortization of capital assets	167,240	182,893
Changes in non-cash working capital items:		
Accounts receivable	64,889	(19,925)
Prepaid expenses	(2,744)	(4,297)
Accounts payable and accrued liabilities	(99,324)	65,964
Deferred revenue	(5,809)	(75,850)
	<u>(59,883)</u>	<u>(40,568)</u>
Investing activities:		
Contribution of capital assets	2,145	4,396
Contribution of capital assets put in service	(2,145)	(4,396)
Additions to capital assets	(4,198)	—
	<u>(4,198)</u>	<u>—</u>
Decrease in cash and cash equivalents	(64,081)	(40,568)
Cash and cash equivalents, beginning of year	92,446	133,014
Cash and cash equivalents, end of year	<u>\$ 28,365</u>	<u>\$ 92,446</u>
Cash and cash equivalents comprise of:		
Cash	\$ 28,365	\$ 38,183
Segregated cash	—	54,263
	<u>\$ 28,365</u>	<u>\$ 92,446</u>

See accompanying notes to financial statements.

NATIONAL CAPITAL FREENET INCORPORATED

Notes to Financial Statements
(Unaudited)

Year ended December 31, 2004

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.

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Notes to Financial Statements, page 2
(Unaudited)

Year ended December 31, 2004

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:

	2004	2003
Balance, beginning of year	\$ 366,575	\$ 544,936
Add contributed equipment and software	2,145	4,396
Less amount recognized as revenue	(166,579)	(182,757)
Balance, end of year	\$ 202,141	\$ 366,575

3. Commitment:

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

2005	\$ 56,680
2006	23,200
	\$ 79,880

4. Fair value of financial assets and financial liabilities:

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