

Financial Statements of

**NATIONAL CAPITAL FREENET
INCORPORATED**

Year ended December 31, 2002

AUDITORS' REPORT TO THE BOARD OF DIRECTORS

We have examined the statement of financial position of National Capital FreeNet Incorporated as at December 31, 2002 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 and fundraising revenue, 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, 2002 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.

Chartered Accountants

Ottawa, Canada

February 21, 2003

NATIONAL CAPITAL FREENET INCORPORATED

Statement of Financial Position

December 31, 2002, with comparative figures for 2001

	2002	2001
Assets		
Current assets:		
Cash	\$ 51,355	\$ 36,550
Segregated cash (note 3)	81,659	26,060
Accounts receivable	44,964	5,735
Prepaid expenses	559	465
	<u>178,537</u>	<u>68,810</u>
Capital assets:		
Computer equipment	188,449	123,785
Telecommunications equipment	136,524	156,131
Systems software	626,746	238,220
Business equipment	1,793	8,075
	<u>953,512</u>	<u>526,211</u>
Less accumulated amortization	<u>408,235</u>	<u>309,161</u>
	<u>545,277</u>	<u>217,050</u>
	<u>\$ 723,814</u>	<u>\$ 285,860</u>
Liabilities and Net Assets		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 34,236	\$ 26,987
Deferred revenue (note 3)	81,659	26,060
	<u>115,895</u>	<u>53,047</u>
Deferred contributions related to equipment and software (note 2)	544,936	198,498
Net assets:		
Unrestricted	62,642	15,763
Invested in capital assets	341	18,552
	<u>62,983</u>	<u>34,315</u>
Commitment (note 4)		
	<u>\$ 723,814</u>	<u>\$ 285,860</u>

See accompanying notes to financial statements.

On behalf of the Board:

_____ Director

_____ Director

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Statement of Operations

Year ended December 31, 2002, with comparative figures for 2001

	2002	2001
Revenue:		
Donations	\$ 162,423	\$ 159,666
Network projects	208,035	47,463
Amortization of deferred contributions (note 2)	131,186	57,103
Gain on disposal of capital assets	12,632	—
	514,276	264,232
Expenses:		
Telecommunications	61,359	64,000
Network projects	191,816	53,022
Administration and professional fees	44,573	38,715
Office and supplies	38,556	41,798
Amortization of capital assets	133,273	64,742
Systems administration	16,031	27,301
	485,608	289,578
Excess (deficiency) of revenue over expenses	\$ 28,668	\$ (25,346)

See accompanying notes to financial statements.

NATIONAL CAPITAL FREENET INCORPORATED

Statement of Changes in Net Assets

Year ended December 31, 2002, with comparative figures for 2001

	Unrestricted	Invested in capital assets	2002 Total	2001 Total
Balance, beginning of year	\$ 15,763	\$ 18,552	\$ 34,315	\$ 59,661
Excess (deficiency) of revenue over expenses	28,668	—	28,668	(25,346)
Gain on disposal of capital assets	(12,632)	12,632	—	—
Proceeds of disposition of capital assets	28,756	(28,756)	—	—
Amortization of capital assets	133,273	(133,273)	—	—
Amortization of deferred contributions related to capital assets	(131,186)	131,186	—	—
Balance, end of year	\$ 62,642	\$ 341	\$ 62,983	\$ 34,315

See accompanying notes to financial statements.

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Statement of Cash Flows

Year ended December 31, 2002, with comparative figures for 2001

	2002	2001
Cash provided by (used in):		
Operations:		
Excess (deficiency) of revenue over expenses	\$ 28,668	\$ (25,346)
Items not involving cash:		
Amortization of deferred contributions	(131,186)	(57,103)
Amortization of capital assets	133,273	64,742
Gain on disposal of capital assets	(12,632)	—
Changes in non-cash working capital items:		
Accounts receivable	(39,229)	(4,685)
Prepaid expenses	(94)	(33)
Accounts payable and accrued liabilities	7,249	19,659
Deferred revenue	55,599	(32,723)
	41,648	(35,489)
Investing activities:		
Contribution of capital assets	477,624	147,263
Contribution of capital assets put in service	(477,624)	(147,263)
Proceeds on disposition of capital assets	28,756	(541)
	28,756	(541)
Increase (decrease) in cash and cash equivalents	70,404	(36,030)
Cash and cash equivalents, beginning of year	62,610	98,640
Cash and cash equivalents, end of year	\$ 133,014	\$ 62,610
Cash and cash equivalents comprise of:		
Cash	\$ 51,355	\$ 36,556
Segregated cash	81,659	26,060
	\$ 133,014	\$ 62,616

See accompanying notes to financial statements.

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Notes to Financial Statements

Year ended December 31, 2002

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%.

(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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Year ended December 31, 2002

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:

	2002	2001
Balance, beginning of year	\$ 198,498	\$ 108,338
Add contributed equipment and software	477,624	147,263
Less amount recognized as revenue	(131,186)	(57,103)
Balance, end of year	\$ 544,936	\$ 198,498

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:

	2002	2001
Office of Learning Technologies Thin Client Startup	\$ –	\$ 26,060
OCRI Sm@rtCapital	81,659	–
	\$ 81,659	\$ 26,060

4. Commitment:

The Company is committed to payments under an agreement for telephone lines to May 31, 2003. Required remaining payments amount to \$11,135.

5. Comparative figures:

Certain 2001 comparative figures have been reclassified to conform with the financial statement presentation adopted in 2002.