

Consolidated Financial Statements of

TELEHOP COMMUNICATIONS INC.

Years ended December 31, 2013 and 2012



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INDEPENDENT AUDITORS' REPORT

To the Shareholders of Telehop Communications Inc.

We have audited the accompanying consolidated financial statements of Telehop Communications Inc., which comprise the consolidated statements of financial position as at December 31, 2013 and 2012, the consolidated statements of operations and comprehensive income, changes in shareholders' equity and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated 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 consolidated financial statements based on our audits. We conducted our audits 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Telehop Communications Inc. as at December 31, 2013 and 2012, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

Chartered Professional Accountants, Licensed Public Accountants

April 29, 2014
Toronto, Canada

TELEHOP COMMUNICATIONS INC.

Consolidated Statements of Financial Position

December 31, 2013 and 2012

	Notes	2013	2012
Assets			
Current assets:			
Cash and cash equivalents	4	\$ 773,154	\$ 712,787
Trade and other receivables, net of allowance for doubtful accounts	5	1,217,137	1,293,324
Prepaid expenses and other		78,618	52,967
		2,068,909	2,059,078
Non-current assets:			
Property and equipment	6	466,541	501,976
Intangible assets	7	185,450	42,648
		651,991	544,624
		\$ 2,720,900	\$ 2,603,702
Liabilities and Shareholders' Equity			
Current liabilities:			
Accounts payable and accrued liabilities	11	\$ 1,345,173	\$ 1,350,327
Provisions	16	20,000	75,000
Note payable	7	50,830	—
Obligations under finance lease - current	14	8,478	6,981
		1,424,481	1,432,308
Non-current liabilities:			
Obligations under finance lease	14	6,291	9,279
		1,430,772	1,441,587
Shareholders' equity:			
Share capital	8(a)	2,319,265	2,319,265
Warrants	8(e)	185,625	185,625
Options reserve	8(d)	286,213	247,322
Deficit		(1,500,975)	(1,590,097)
		1,290,128	1,162,115
Commitments	13		
Contingencies	16		
Subsequent events	10, 13, 20		
		\$ 2,720,900	\$ 2,603,702

See accompanying notes to consolidated financial statements.

Approved on behalf of the Board:

/s/ Lawrence Cyna Director /s/ Rajiv Jagota Director

TELEHOP COMMUNICATIONS INC.

Consolidated Statements of Operations and Comprehensive Income

Years ended December 31, 2013 and 2012

	Notes	2013	2012
Revenue	18	\$ 8,319,885	\$ 9,023,874
Telecommunications costs		4,783,914	5,002,409
Gross margin		3,535,971	4,021,465
Operating expenses:			
General and administrative		2,084,713	2,320,147
Marketing and selling		644,896	1,069,618
Development and technical support		395,370	444,183
Depreciation and amortization	6, 7	153,947	113,967
Acquisition transaction costs	19	149,030	—
		3,427,956	3,947,915
Operating income		108,015	73,550
Finance income and finance costs, net		(27,132)	(33,233)
Other income		8,239	3,778
Gain on disposal of equipment		—	354
		(18,893)	(29,101)
Income before income taxes		89,122	44,449
Income taxes	3	—	—
Net income		89,122	44,449
Other comprehensive income		—	—
Comprehensive income		\$ 89,122	\$ 44,449
Earnings per share			
Basic and diluted	9	\$ 0.004	\$ 0.002

See accompanying notes to consolidated financial statements.

TELEHOP COMMUNICATIONS INC.

Consolidated Statements of Changes in Shareholders' Equity

Years ended December 31, 2013 and 2012

	Share capital	Options reserve	Warrants	Hedge reserve	Deficit	Total
Balance, December 31, 2011	\$ 1,846,190	\$ 157,176	\$ -	\$ -	\$ (1,634,546)	\$ 368,820
Net income	-	-	-	-	44,449	44,449
Proceeds of private placement, net of costs (note 8(b))	467,399	-	185,625	-	-	653,024
Exercise of options	5,676	(2,343)	-	-	-	3,333
Stock-based compensation	-	92,489	-	-	-	92,489
Balance, December 31, 2012	2,319,265	247,322	185,625	-	(1,590,097)	1,162,115
Net income	-	-	-	-	89,122	89,122
Stock-based compensation	-	38,891	-	-	-	38,891
Balance, December 31, 2013	\$ 2,319,265	\$ 286,213	\$ 185,625	\$ -	\$ (1,500,975)	\$ 1,290,128

See accompanying notes to consolidated financial statements.

TELEHOP COMMUNICATIONS INC.

Consolidated Statements of Cash Flows

Years ended December 31, 2013 and 2012

	2013	2012
Cash provided by (used in):		
Operating activities:		
Net income	\$ 89,122	\$ 44,449
Adjustment for non-cash items:		
Depreciation and amortization	153,947	113,967
Gain on disposal of equipment	–	(354)
Finance income and finance costs, net	27,132	33,233
Stock-based compensation	38,891	92,489
	<u>309,092</u>	<u>283,784</u>
Change in non-cash operating working capital:		
Trade and other receivables	76,187	177,240
Prepaid expenses and other	(25,651)	14,142
Accounts payable, accrued liabilities and provisions	(60,154)	(692,600)
	<u>299,474</u>	<u>(217,434)</u>
Financing activities:		
Proceeds of note payable	120,000	–
Principal payments on note payable	(69,170)	–
Payments of obligations under finance lease	(1,491)	(6,610)
Finance costs paid	(27,132)	(35,615)
Net proceeds of private placement	–	653,024
Net proceeds of exercise of options	–	3,333
	<u>22,207</u>	<u>614,132</u>
Investing activities:		
Acquisition of property and equipment	(56,061)	(57,414)
Proceeds on disposal of equipment	–	354
Acquisition of intangible assets	(205,253)	(40,935)
	<u>(261,314)</u>	<u>(97,995)</u>
Increase in cash and cash equivalents	60,367	298,703
Cash and cash equivalents, beginning of year	712,787	414,084
Cash and cash equivalents, end of year	<u>\$ 773,154</u>	<u>\$ 712,787</u>

See accompanying notes to consolidated financial statements.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements

Years ended December 31, 2013 and 2012

1. Nature of business:

Telehop Communications Inc. (the "Company") is a company incorporated under the laws of the Province of Ontario. The Company's registered office and its head office is located at 200 Consumers Road, Toronto, Ontario M2J 4R4. The consolidated financial statements of the Company as at and for the years ended December 31, 2013 and 2012 comprise the Company and its wholly-owned subsidiaries including International Telehop Network Systems Inc., Telehop Long-Distance Service Ltd., Telehop Premium Business Services Inc. and CardTel Corp. The Company is a full service telecommunication provider and is registered with the Canadian Radio-Television and Telecommunications Commission as a licensed Class "A" Telecom Carrier.

2. Significant accounting policies:

(a) Statement of compliance:

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

The consolidated financial statements were approved by the Board of Directors and authorized for issue on April 29, 2014.

(b) Basis of preparation:

The consolidated financial statements have been prepared on the historical cost basis except for certain assets and financial instruments that are measured at their fair values, as explained in the significant accounting policies below. Historical cost is based on the fair value of the consideration given in exchange for assets.

The consolidated financial statements are prepared in Canadian dollars, which is the Company's functional currency.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

2. Significant accounting policies (continued):

(c) Basis of consolidation:

(i) Subsidiaries:

Subsidiaries are entities controlled by the Company where control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The financial statements of subsidiaries are included in the consolidated financial statements. All subsidiaries of the Company are wholly owned and controlled by the Company.

(ii) Transactions eliminated on consolidation:

Inter-company balances and transactions between subsidiaries are eliminated in preparing the consolidated financial statements.

(d) Revenue:

The Company earns its revenue from access to, and usage of, its telecommunications network by its customers. Its main service is to provide long-distance services through access to its network, which has the capability to track pertinent data for each individual call to a particular country destination. This allows the Company to rate each call by applying predetermined long-distance rates by country to the volume of minutes provided. The Company recognizes revenue at the fair value of the consideration received or receivable, including billed and unbilled, when it is probable that the consideration will be received, and services have been performed as described below.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

2. Significant accounting policies (continued):

The Company has two operating segments - retail and wholesale services. The Company's services are packaged in different forms that include casual calling, subscriptions (equal access service, Telehop Home Phone and Telehop Business Services), prepaid calling cards and wholesale as follows:

(i) Retail:

(a) Casual calling:

This service allows customers to access the Company's network without the need to subscribe to a service contract or pay any direct fees. Customers can complete a long-distance call by dialing one of two carrier identification codes ("CIC"), "10-10-100" or "10-10-620", owned by the Company. Revenue is recognized when a customer dials a CIC code and completes a connected long-distance call. In 2013, the Company launched a #100 service on the Telus Mobility network that offers a similar service allowing customers to access the Company's network from their prepaid or postpaid Telus cell phone and receive the charges on their Telus bill, without having to sign up to a contract with the Company.

(b) Subscriptions:

This service allows a customer to directly dial their long-distance number, by dialing "1+" or "011+". The customer subscribes to this long-distance service and is required to transfer carriers upon entering into a contract with the Company. For monthly block plans, the customer is provided a fixed number of minutes per month for a flat monthly fee, and revenue is recognized during the month of service. For per-minute plans, customers are charged a fixed rate per minute for each call, and revenue is recognized when a customer completes a long-distance call as access and usage of the Company's network has occurred.

(c) Telehop Home Phone:

The Company markets a VoIP (voice-over-internet-protocol) service under its Telehop Home Phone brand. This service allows a customer to place local and long-distance calls through a high-speed Internet connection allowing the customers to replace their home phone line with the Company's network for a stated monthly fee. Revenue is recognized monthly over the term of the contract.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

2. Significant accounting policies (continued):

(d) Telehop Business Services:

Following the acquisition of certain customers during the second quarter of 2013 (note 7), the Company offers hosted PBX (Private Branch Exchange) business services. These services target small and medium size businesses and provides the customer with business telephone services for a stated monthly fee per line. Revenue is recognized monthly over the term of the contract and as additional services are used.

(e) Prepaid calling cards:

The Company offers prepaid long-distance calling cards, where the customers dial a toll free number to make their long-distance call through the Company's network. Proceeds on the sale of cards are deferred and revenue is recognized when a customer completes a connected long-distance call or at the time allotment on the card has expired.

(ii) Wholesale:

The Company offers discounted rates to high volume resellers to carry their calls through the Company's network. Bulk minutes are sold by destination. Revenue is recognized when the resellers' customers make long-distance calls through the Company's network.

(e) Share-based payment transactions:

Equity-settled share-based payments granted to employees are measured at the fair value of the equity instruments at the grant date. Details regarding the determination of the fair value of equity-settled share-based payment transactions are set out in note 10.

The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period of each tranche of the award, based on the Company's estimate of equity instruments that will eventually vest, with a corresponding increase in equity.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

2. Significant accounting policies (continued):

Equity-settled share-based payment transactions with parties other than employees are measured at the fair value of goods or services received, except where that fair value cannot be estimated reliably, in which case they are measured at the fair value of the equity instruments granted, measured at the date the Company obtains the goods or the counterparty renders the service.

(f) Income taxes:

Income tax expense is comprised of current and deferred taxes. Current tax and deferred tax are recognized in profit or loss except to the extent that they relate to a business combination, or items recognized directly in equity or in other comprehensive income.

Current tax is the expected tax payable or recoverable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, as well as any adjustment to tax payable in respect of previous years.

Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and reduced to the extent that it is no longer probable that the related tax benefit will be realized.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

2. Significant accounting policies (continued):

(g) Foreign currency translation:

In preparing the financial statements of each individual entity, transactions in currencies other than the entity's functional currency are recognized at the rates of exchange prevailing at the dates of the transactions. At the end of each reporting period, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date. Exchange differences on monetary items are recognized in profit or loss in the period in which they arise.

(h) Financial instruments:

Financial assets and financial liabilities are recognized in the statements of financial position when the Company has become party to the contractual provisions of the instruments.

The Company's financial instruments primarily consist of cash and cash equivalents (classified as held-for-trading), trade and other receivables (classified as loans and receivables), accounts payable and accrued liabilities (classified as other financial liabilities), notes payable (classified as other financial liabilities) and finance leases (classified as other financial liabilities). The fair values of these financial instruments approximate their carrying values. Initial and subsequent measurement and recognition of changes in the value of financial instruments depend on their initial classification:

Loans and receivables and other financial liabilities are initially measured at fair value plus any directly attributable transaction costs and are subsequently measured at amortized cost. Amortization of premiums or discounts and losses due to impairment are included in current period profit and loss.

Held-for-trading financial instruments are measured at fair value. All gains and losses are included in profit and loss for the periods in which they arise.

A fair value hierarchy is used to determine the significance of inputs used in fair value measurement.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

2. Significant accounting policies (continued):

The three levels of the fair value hierarchy are:

- Level 1 - unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2 - inputs other than quoted prices included within Level 1 that are observable for the asset or liability either directly or indirectly; and
- Level 3 - inputs that are not based on observable market data.

(i) Provisions:

A provision is recognized if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation (note 16).

(j) Employee benefits:

(i) Short-term employee benefits:

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided.

(ii) Termination benefits:

Termination benefits are recognized as an expense when the Company is committed demonstrably, without realistic possibility of withdrawal, to a formal detailed plan to either terminate an employee's employment before the normal retirement date, or to provide termination benefits as a result of an offer made to encourage voluntary redundancy. Termination benefits for voluntary redundancies are recognized as an expense if the Company has made an offer of voluntary redundancy, it is probable that the offer will be accepted, and the number of acceptances can be estimated reliably. If benefits are payable more than 12 months after the reporting period, they are discounted to their present value.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

2. Significant accounting policies (continued):

(k) Property and equipment:

(i) Recognition and measurement:

Items of property and equipment are measured at cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset.

When parts of an item of property and equipment have different useful lives, they are accounted for as separate items (major components) of property and equipment.

Gains and losses on disposal of an item of property and equipment are determined by comparing the proceeds from disposal with the carrying amount of property and equipment, and are recognized in profit or loss.

(ii) Cost of replacements:

The cost of replacing a part of an item of property and equipment is recognized in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Company, and its cost can be measured reliably. The carrying amount of the replaced part is derecognized on replacement. The costs of the day-to-day servicing of property and equipment are recognized in profit or loss as incurred.

(iii) Depreciation:

Depreciation is calculated over the depreciable amount, which is the cost of an asset, less its estimated residual value.

Depreciation is recognized in profit or loss on a straight-line basis over the estimated useful lives of each major component of property and equipment, since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Company will obtain ownership by the end of the lease term.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

2. Significant accounting policies (continued):

The estimated useful lives of property and equipment for the current and comparative years are as follows:

Switch equipment	10 years
Telecommunication equipment	5 years
Furniture and fixtures	5 years
Computer and customer equipment	3 years
Computer software	5 years
Website development	3 years
Leasehold improvements	Term of lease

Depreciation methods, useful lives and residual values are reviewed at each financial year-end and adjusted if appropriate.

(I) Intangible assets:

(i) Recognition and measurement:

Intangible assets that are acquired by the Company and have finite useful lives are measured at cost less accumulated amortization and accumulated impairment losses.

(ii) Amortization:

Amortization is calculated over the cost of the asset less its estimated residual value.

Amortization is recognized in profit or loss on a straight-line basis over the estimated useful lives of intangible assets from the date that they are available for use, since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. The estimated useful life for the current and comparative periods is as follows:

Software	5 years
Customer lists	3 years

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

2. Significant accounting policies (continued):

(m) Leased assets:

Leases whereby the Company assumes substantially all the risks and rewards of ownership of the underlying assets are classified as finance leases. Upon initial recognition, the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments over the lease term. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

Other leases are classified as operating leases and the leased assets are not recognized in the Company's consolidated statements of financial position.

(n) Impairment of assets:

The carrying amount of property and equipment and intangible assets is reviewed at each statements of financial position date to determine whether there is any indication of impairment. If such indication exists, the recoverable amount of the asset or cash generating unit ("CGU") is estimated in order to determine the extent of the impairment loss. Recoverability of assets to be held and used is measured by a comparison of the carrying value of the asset or CGU to the recoverable amount. The recoverable amount is the higher of the asset's or CGU's value in use and fair value less costs to sell and is determined based on the future discounted net cash flows expected to be generated by the asset or CGU.

An impairment loss is recognized whenever the carrying amount of an asset or the CGU exceeds its recoverable amount. Impairment losses are recorded in the consolidated statements of operations. Impairment losses recognized in prior periods are assessed at each reporting period for any indication that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount, however, not to an amount higher than the carrying amount that would have been determined had no impairment loss been recognized in previous years, net of accumulated depreciation and amortization.

(o) Use of estimates and critical judgments:

The preparation of the consolidated financial statements in conformity with IFRSs requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

2. Significant accounting policies (continued):

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Key areas requiring judgment and estimation uncertainty include:

- Allowance for doubtful accounts - In developing the estimates for an allowance against existing receivables, the Company considers general and industry economic and market conditions as well as credit information available for the customer and the aging of the account. Changes in the carrying amount due to changes in economic and market conditions could significantly affect the income for the period;
- Useful lives of property and equipment - Management's judgment involves determining the expected useful lives of depreciable assets, to determine depreciation methods, and the asset's residual value;
- Impairment of non-financial assets - The process to determine whether there are triggering events of impairment of non-financial assets as well as the calculation of value in use requires use of assumptions such as estimates of future cash flows, discount rates and terminal growth rates;
- Stock-based compensation - In valuing stock options granted, the Company uses the Black-Scholes option pricing model. Several assumptions are used in the underlying calculation of fair values of the Company's stock options using the Black-Scholes option pricing model including the expected life of the option, risk-free interest rate and volatility of the underlying stock;
- Provisions - Judgment is required to assess the likelihood of an outflow of the economic benefits to settle contingencies, such as litigations, which may require a liability to be recognized. Significant judgments include assessing estimates of future cash flows and the probability of the occurrence of future events; and
- Valuation of deferred income tax assets and liabilities - A deferred tax asset is recognized for unused losses, tax credits and deductible temporary differences to the extent that it is probable that future taxable income will be available against which they can be utilized. Significant estimates are required in evaluating the probability that deferred tax assets will be utilized. The Company's assessment is based on existing tax laws, estimates of future profitability, and tax planning strategies.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

2. Significant accounting policies (continued):

(p) Cash and cash equivalents:

Cash and cash equivalents is defined as cash and short-term investments having an original maturity of three months or less.

(q) Earnings per share:

The Company presents basic and diluted earnings per share data for its common shares. Basic earnings per share is calculated by dividing the profit or loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the year. Diluted earnings per share is determined by dividing the profit or loss attributable to common shareholders by the weighted average number of common shares outstanding and for the effects of all dilutive potential common shares, which comprise warrants and share options granted to employees.

(r) Segment reporting:

A business segment is a component of the Company that engages in business activities from which it may earn revenue and incur expenses, including revenue and expenses that relate to transactions with the Company's other components. All operating segments' operating results are reviewed regularly by the Company's Chief Executive Officer ("CEO") to make decisions about the allocation of resources and to assess their performance, and for which discrete financial information is available.

Segment results that are reported to the CEO include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items comprise mainly corporate assets (primarily the Company's corporate office), head office expenses, personnel costs, depreciation and amortization, finance income and finance costs, net, other income and income tax expenses.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

2. Significant accounting policies (continued):

(s) Adoption of new accounting pronouncements:

(i) Consolidated financial statements:

On January 1, 2013, the Company adopted IFRS 10, Consolidated Financial Statements ("IFRS 10"). IFRS 10, which replaced the consolidation requirements of SIC-12, Consolidation - Special Purpose Entities, and International Accounting Standard ("IAS") 27, Consolidation and Separate Financial Statements, establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more entities. In accordance with the provisions of IFRS 10, the Company re-assessed the control conclusion for its investees as at January 1, 2013. The Company has assessed the impact of this standard and determined there is no impact on its consolidated financial statements in the current or comparative period.

(ii) Disclosure of interests in other entities:

On January 1, 2013, the Company adopted IFRS 12, Disclosure of Interests in Other Entities ("IFRS 12"). IFRS 12 is a new and comprehensive standard on disclosure requirements for all forms of interests in other entities, including subsidiaries, joint arrangements, associates and unconsolidated structured entities. The Company has assessed the impact of this standard and determined there is no impact on its consolidated financial statements.

(iii) Fair value measurement:

On January 1, 2013, the Company adopted IFRS 13, Fair Value Measurement ("IFRS 13"). IFRS 13 aims to improve consistency and reduce complexity by providing precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRS. It does not introduce new fair value measurements, nor does it eliminate the exceptions to fair value measurements that exist under certain standards. These disclosures are set out in note 12 to these consolidated financial statements.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

2. Significant accounting policies (continued):

(iv) Other comprehensive income:

On January 1, 2013, the Company adopted amendments to IAS 1, Presentation of Financial Statements ("IAS 1"). The amendments require companies preparing financial statements in accordance with IFRS to group together items within other comprehensive income ("OCI") that may be reclassified to the profit or loss section of the statement of comprehensive income separately from those items that will never be reclassified. The amendments also reaffirm existing requirements that items in OCI and profit or loss should be presented as either a single statement or two consecutive statements. The Company has assessed the impact of these amendments and determined there is no impact on its consolidated financial statements.

(v) Disclosures - offsetting financial assets and financial liabilities:

On January 1, 2013, the Company adopted amendments to the disclosure requirements in IFRS 7, Financial Instruments: Disclosures ("IFRS 7"). The amendments require information about all recognized financial instruments that are set off in accordance with paragraph 42 of IAS 32, Financial Instruments: Presentation ("IAS 32"). The amendments also require disclosure of information about recognized financial instruments subject to enforceable master netting arrangements and similar agreements even if they are not set off under IAS 32. The Company has assessed the impact of these amendments and determined there is no impact on its consolidated financial statements.

(vi) Annual Improvements to IFRSs 2009-2011 Cycle - various standards:

On January 1, 2013, the Company adopted Annual Improvements to IFRSs 2009-2011, which contain amendments to certain existing standards. The Company has assessed the impact of these amendments and determined there is no impact on its consolidated financial statements.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

2. Significant accounting policies (continued):

(vii) Recoverable amount disclosures for non-financial assets:

On January 1, 2013, the Company early adopted the amendments to IAS 36, Impairment of Assets, which reduce the circumstances in which the recoverable amounts of assets or CGU's are required to be disclosed, clarify the disclosures required, and to introduce an explicit requirement to disclose the discount rate used in determining impairment (or reversals) where the recoverable amount (based on fair value less costs to sell) is determined using a present value technique.

(t) Recent accounting pronouncements:

Certain new standards, interpretations, amendments and improvements to existing standards have been issued by the IASB and become applicable at a future date. The standards impacted that may be applicable to the Company are as follows:

(i) Financial instruments:

The IASB issued IFRS 9, Financial Instruments ("IFRS 9") which replaces IAS 39, Financial Instruments: Recognition and Measurement, and establishes principles for the financial reporting of financial assets and financial liabilities that will present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of an entity's future cash flows. This new standard also includes a new general hedge accounting standard which will align hedge accounting more closely with risk management. The new mandatory effective date for IFRS 9 is January 1, 2018.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

2. Significant accounting policies (continued):

(ii) Levies:

In May 2013, the IASB issued IFRIC 21, Levies, which provides guidance on when to recognize a liability for a levy imposed by a government, both for levies that are accounted for in accordance with IAS 37, Provisions, Contingent Liabilities and Contingent Assets and those where the timing and amount of the levy is certain. The Interpretation identifies the obligating event for the recognition of a liability as the activity that triggers the payment of the levy in accordance with the relevant legislation. It provides the following guidance on recognition of a liability to pay levies:

- The liability is recognized progressively if the obligating event occurs over a period of time.
- If an obligation is triggered on reaching a minimum threshold, the liability is recognized when that minimum threshold is reached.

This new standard is effective for the Company's annual consolidated financial statements commencing January 1, 2014.

(iii) Annual Improvements to IFRSs 2010-2013 Cycle - various standards:

In December 2013, the IASB issued narrow-scope amendments to a total of nine standards as part of its annual improvements process. Most amendments will apply prospectively for annual periods beginning on or after July 1, 2014.

The Company is assessing the impact of these upcoming standards on its consolidated financial statements.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

3. Income taxes:

(a) Unrecognized deferred income tax asset:

Deferred income tax assets have not been recognized in respect of the following:

	2013	2012
Deductible temporary differences:		
Property and equipment	\$ 36,333	\$ 69,504
Intangible assets	11,338	—
Tax loss carried forward	521,548	552,565
	<u>\$ 569,219</u>	<u>\$ 622,069</u>

No deferred tax assets have been recognized as management does not consider it probable that future profits will be available to utilize these assets.

As at December 31, 2013, the Company has income tax losses of a non-capital nature of \$1,968,000 (2012 - \$2,085,000) available to reduce taxable income in future years, expiring between 2029 and 2032.

(b) Reconciliation of income tax expense:

The reconciliation of income taxes at Canadian statutory income tax rates to the income tax expense is as follows:

	2013	2012
Income before income taxes	\$ 89,122	\$ 44,449
Approximate applicable statutory tax rate	26.5%	26.5%
Income taxes at statutory tax rates	\$ 23,617	\$ 11,779
Current year losses not recognized	—	20,178
Non-deductible expenses - permanent differences	16,323	24,036
Benefit of other temporary differences not recognized	(12,660)	(55,993)
Utilization of previously unrecognized tax losses	(27,280)	—
	<u>\$ —</u>	<u>\$ —</u>

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

4. Cash and cash equivalents:

	2013	2012
Bank balances	\$ 773,154	\$ 712,787

The Company's exposure to interest rate risk for both 2013 and 2012 was not considered significant and is disclosed in note 12.

5. Trade and other receivables:

	2013	2012
Trade receivables	\$ 1,157,603	\$ 1,320,388
Allowance for doubtful accounts	(75,556)	(61,613)
	1,082,047	1,258,775
Other receivables	135,090	34,549
	\$ 1,217,137	\$ 1,293,324

(a) Trade receivables:

The average credit period for receivables is 30 days. Interest and late payment charges are charged thereafter at 2% per month on the outstanding balance.

The Company has credit evaluation, approval and monitoring processes to assess new customers' credit quality that mitigate potential credit risks. Credit limits are imposed on each customer, which are reviewed annually.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

5. Trade and other receivables (continued):

(b) Allowance for doubtful accounts:

The Company has recognized an allowance for doubtful accounts of 100% against receivables over 90 days except for certain accounts that are deemed collectible or have been collected subsequent to period-end. Allowance for doubtful accounts is also recognized against current and under 90 days receivables based on account status at end of the reporting period. The concentration of credit risk is limited due to the large and unrelated customer base serviced by the Company. The total allowance for doubtful accounts is comprised of the following receivables by aging:

	2013	2012
Current	\$ –	\$ 120
Past due 0-30 days	160	2,147
Past due 31 -60 days	161	1,904
Past due 61-90 days	–	–
Past due more than 90 days	75,235	57,442
	<u>\$ 75,556</u>	<u>\$ 61,613</u>

(c) Receivables from factoring company:

In November 2011, the Company entered into a two-year master purchase and sale agreement where certain receivables of the Company are factored for interest and fees. 50% of the face values of factored receivables are advanced upon presentation of verified invoices, with the other 50% remitted back to the Company, net of interest and fees upon payment by the end customers. The facility bears an administration fee of 0.5% of the face value of the amounts factored and an advance fee calculated as interest upon the daily net outstanding balance at prime rate, based on the Bank of America rate for loans in Canadian dollars, plus 2.5%. Other facility fees, including shortfall and chargeback fees, also apply. The facility is secured by a general security agreement over all of the assets of the Company. The agreement ended September 28, 2013 and the Company has no amounts owing to the factoring company as of December 31, 2013.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

6. Property and equipment:

	Switch equipment	Telecommunication equipment	Furniture and fixtures	Computer and customer equipment	Computer software	Website development	Leasehold improvements	Total
Cost								
Balance, December 31, 2011	\$ 465,260	\$ 935,657	\$ 104,659	\$ 250,047	\$ 212,792	\$ 27,351	\$ 80,382	\$ 2,076,148
Additions	11,264	13,107	–	30,293	–	2,750	–	57,414
Balance, December 31, 2012	476,524	948,764	104,659	280,340	212,792	30,101	80,382	2,133,562
Additions	–	22,057	6,021	27,983	–	–	–	56,061
Balance, December 31, 2013	\$ 476,524	\$ 970,821	\$ 110,680	\$ 308,323	\$ 212,792	\$ 30,101	\$ 80,382	\$ 2,189,623
Accumulated depreciation								
Balance, December 31, 2011	\$ 11,632	\$ 903,889	\$ 79,127	\$ 221,751	\$ 212,792	\$ 27,351	\$ 80,382	\$ 1,536,924
Additions	47,934	8,440	9,260	28,662	–	366	–	94,662
Balance, December 31, 2012	59,566	912,329	88,387	250,413	212,792	27,717	80,382	1,631,586
Additions	47,664	12,782	8,936	21,564	–	550	–	91,496
Balance, December 31, 2013	\$ 107,230	\$ 925,111	\$ 97,323	\$ 271,977	\$ 212,792	\$ 28,267	\$ 80,382	\$ 1,723,082
Carrying amounts								
December 31, 2012	\$ 416,958	\$ 36,435	\$ 16,272	\$ 29,927	\$ –	\$ 2,384	\$ –	\$ 501,976
December 31, 2013	369,294	45,710	13,357	36,346	–	1,834	–	466,541

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

6. Property and equipment (continued):

Leased property and equipment:

The Company entered into a lease in 2009 for a mailing machine, included in furniture and fixtures that will expire in 2014. As at December 31, 2013, the net carrying value of the mailing machine is \$7,010 (2012 - \$14,021). Depreciation expense relating to the leased mailing machine total \$7,011 in 2013 (2012 - \$7,011).

The Company entered into a lease in 2013 for a copier, included in furniture and fixtures that will expire in 2018. As at December 31, 2013, the net carrying value of the copier is \$5,490 (2012 - nil). Depreciation expense relating to the copier totaled \$602 in 2013 (2012 - nil).

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

7. Intangible assets:

	Software	Customer lists	Total
Cost			
Balance, December 31, 2011	\$ 311,836	\$ —	\$ 311,836
Additions	40,935	—	40,935
Balance, December 31, 2012	352,771	—	352,771
Additions	5,253	200,000	205,253
Balance, December 31, 2013	\$ 358,024	\$ 200,000	\$ 558,024
Accumulated amortization			
Balance, December 31, 2011	\$ 290,818	\$ —	\$ 290,818
Amortization	19,305	—	19,305
Balance, December 31, 2012	310,123	—	310,123
Amortization	12,451	50,000	62,451
Balance, end of year	\$ 322,574	\$ 50,000	\$ 372,574
Carrying amount			
As at December 31, 2012	\$ 42,648	\$ —	\$ 42,648
As at December 31, 2013	35,450	150,000	185,450

On April 1, 2013, the Company completed an asset purchase with G3 Telecom Corp. ("G3"), under which the Company acquired G3's business services customer lists. The purchase price of \$200,000 included a cash portion of \$80,000 paid immediately and a note payable of \$120,000, repayable over eighteen months with an annual interest rate of 5%. The Company has made principal payments on the note payable of \$69,170 during 2013 and the balance of \$50,830 will be paid during fiscal 2014.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

8. Capital and other components of equity:

(a) Share capital:

The Company is authorized to issue an unlimited number of common shares. The number of outstanding common shares are as follows:

	2013		2012	
	Number of shares	Amount	Number of shares	Amount
Shares issued and outstanding, beginning of year	24,272,083	\$ 2,319,265	16,738,750	\$ 1,846,190
Issued for cash through private placement, net of costs and fair value of associated warrants (note 8(b))	—	—	7,500,000	467,399
Exercise of options	—	—	33,333	5,676
Shares issued and outstanding, end of year	24,272,083	\$ 2,319,265	24,272,083	\$ 2,319,265

The holders of common shares are entitled to receive dividends as declared from time to time, and are entitled to one vote per share at meetings of the Company.

(b) Issuance of common shares:

On July 26, 2012 the Company completed a private placement for gross proceeds of \$750,000 through the issuance of 7,500,000 units (each, a "Unit" and collectively, the "Units") at a price of \$0.10 per Unit, where each Unit consists of one common share and one-half of one common share purchase warrant ("Warrant") (note 8(e)). Net proceeds of the capital raised was \$653,024, of which \$467,399 was allocated to share capital and \$185,625 was allocated to warrants.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

8. Capital and other components of equity (continued):

(c) Issuance of share options:

As at December 31, 2013, directors and senior employees held 1,908,875 (2012 - 1,648,875) options of the Company, with variable expiration dates from 2014 to 2018 (2012 - 2014 to 2017). Share options granted under the Company's Employee Share Option Plan carry no rights to dividends and no voting rights.

(d) Options reserve:

The options reserve comprises the impact of stock option expense and any related exercise.

	2013	2012
Balance, beginning of year	\$ 247,322	\$ 157,176
Reclassification to share capital for exercised options	–	(2,343)
Stock-based compensation expense	38,891	92,489
Balance, end of year	\$ 286,213	\$ 247,322

(e) Warrants:

In connection with the private placement on July 26, 2012, the Company issued 4,218,750 warrants, consisting of:

- 3,750,000 warrants issued to subscribers to the private placement. Each Warrant entitles the holder to purchase one common share over a two-year period (subject to acceleration in the event that the closing price of the Company's common shares on the TSX Venture Exchange, for a period of 10 consecutive trading days, exceeds \$0.25 per common share) at a price of \$0.15 per common share.
- 468,750 warrants issued to a third party as a finder's fee for the private placement. Each Warrant entitles the holder to purchase one common share over a one-year period (subject to acceleration in the event that the closing price of the Company's common shares on the TSX Venture Exchange, for a period of 10 consecutive trading days, exceeds \$0.25 per common share) at a price of \$0.15 per common share.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

8. Capital and other components of equity (continued):

The pro-rata fair value of the 4,218,750 warrants issued was determined to be \$185,625, using the Black-Scholes option pricing model with the following weighted average assumptions:

Expected volatility	146%
Expected life	2 years
Dividend yield	0%
Risk-free interest rate	1.1%

(f) Hedge reserve:

The hedge reserve was primarily related to unrealized gains/losses on cash flow hedges. The hedging reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet occurred. As at December 31, 2013, the Company does not have any foreign currency forward contracts outstanding.

9. Earnings per share:

	2013	2012
Net income	\$ 89,122	\$ 44,449
Basic and diluted - earnings per share	\$ 0.004	\$ 0.002

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

9. Earnings per share (continued):

The weighted average number of common shares used in the calculation of basic and diluted earnings per share is as follows:

	2013	2012
Shares outstanding, beginning of year	24,272,083	16,738,750
Options exercised	–	16,667
Effects of shares issued in July 2012 related to private placement	–	3,125,000
Weighted average number of shares, end of year	24,272,083	19,880,417

At December 31, 2013 and 2012, there is no effect of potentially dilutive securities. All warrants and outstanding stock options were excluded from the diluted weighted average number of common shares calculation, as their effect would have been anti-dilutive. If applicable, the average market value of the Company's shares for purposes of calculating the dilutive effect of share options would be based on quoted market prices for the period during which the options were outstanding.

10. Share-based payment transactions:

Employee Share Option Plan of the Company:

The Company has a share option plan (the "2005 Plan") for directors, officers, employees and consultants under written contract of the Company and its subsidiaries, as approved by the shareholders of the Company.

In 2011, the Company adopted a new 10% rolling Incentive Stock Option Plan (the "2011 Plan"), which replaced the fixed 2005 Plan where only a maximum of 1,800,000 options could be granted. Under the 2011 Plan, the aggregate number of optioned shares that may be issued will not exceed 10% of the number of issued and outstanding shares of the Company at the time of the granting of options. As at December 31, 2013, there are 2,008,875 options outstanding and the Company can issue 418,333 additional options under the 2011 Plan.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

10. Share-based payment transactions (continued):

On February 27, 2014, subsequent to year end, the Company made a special option grant of 400,000 options to management and the chairman of the board at a strike price of \$0.12 per share.

Each employee share option converts into one ordinary common share of the Company on exercise. No amounts are paid or payable by the recipient on receipt of the option. The options carry neither rights to dividends nor voting rights. Options may be exercised at any time from the date of vesting to the date of their expiry.

The Board administers the granting of all options under the 2011 Plan and 2005 Plan and has the discretion to prescribe vesting restrictions for options granted.

The following share based payment arrangements were in existence during the current and prior years:

Option series	Number of options	Grant date	Expiry date	Exercise price	Per option fair value at grant date
1	100,000	January 23, 2009	January 23, 2014	\$ 0.215	\$ 0.19
2	300,000	May 13, 2010	May 13, 2015	0.170	0.15
3	98,500	January 31, 2011	January 31, 2016	0.101	0.08
4	100,000	April 11, 2011	April 11, 2016	0.200	0.18
5	201,500	May 27, 2011	May 27, 2016	0.100	0.09
6	500,000	January 1, 2012	January 1, 2017	0.100	0.07
7	223,875	March 21, 2012	March 21, 2017	0.100	0.07
8	100,000	May 1, 2012	May 1, 2017	0.100	0.07
9	125,000	August 27, 2012	August 27, 2017	0.120	0.11
10	260,000	April 4, 2013	April 4, 2018	0.100	0.10

Options granted vest over a period not exceeding five years and expire 90 days after a recipient ceases to qualify as a director, officer, employee or consultant under written contract. All stock options granted have an exercise price equal to the higher of the fair market value of the common shares at grant date and \$0.10.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

10. Share-based payment transactions (continued):

The fair value of share options granted were priced using the Black Scholes option pricing model. Expected volatility is based on the historical share price volatility over the past five years. The inputs used in the measurement of the fair values at grant date of the share-based payment plans are the following:

Option series	1	2	3	4	5	6	7	8	9	10
Grant date share price	\$0.21	\$0.17	\$0.09	\$0.20	\$0.08	\$0.08	\$0.08	\$0.08	\$0.12	\$0.08
Exercise price	\$0.21	\$0.17	\$0.10	\$0.20	\$0.10	\$0.10	\$0.10	\$0.10	\$0.12	\$0.10
Expected volatility	145%	144%	125%	122%	124%	147%	147%	147%	147%	151%
Expected life	5 years	5 years	5 years	5 years	5 years	5 years	5 years	5 years	5 years	5 years
Dividend yield	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Risk-free interest rate	2.5%	2.5%	2.5%	2.5%	2.5%	1.5%	1.5%	1.5%	1.5%	1.2%

The following table presents information concerning stock options movement under the Plan:

	2013		2012	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Options outstanding, beginning of year	1,748,875	\$ 0.126	850,000	\$ 0.154
Granted	260,000	0.100	1,048,875	0.104
Exercised	—	—	(33,333)	0.100
Cancelled	—	—	(116,667)	0.126
Options outstanding, end of year	2,008,875	0.122	1,748,875	0.126
Options exercisable, end of year	1,535,542	\$ 0.127	1,048,875	\$ 0.129

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

10. Share-based payment transactions (continued):

The following table summarizes information regarding stock options outstanding as at December 31, 2013:

Exercise price	Options outstanding		Options exercisable	
	Number of options	Weighted average life in years	Number of options	Weighted average exercise price
\$0.100	1,383,875	3.23	943,875	\$ 0.100
\$0.120	125,000	3.74	125,000	0.120
\$0.170	300,000	1.31	300,000	0.170
\$0.200	100,000	2.36	66,667	0.200
\$0.210	100,000	0.15	100,000	0.210
	2,008,875	2.78	1,535,542	0.127

11. Accounts payable and accrued liabilities:

	2013	2012
Trade payables and accruals	\$ 1,116,123	\$ 1,237,270
Personnel related accruals	141,390	86,380
Other	87,660	26,677
	\$ 1,345,173	\$ 1,350,327

The Company's exposure to currency and liquidity risk related to trade and other payables is disclosed in note 12.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

12. Financial risk management:

The Company has exposure to the following risks from its use of financial instruments:

- Credit risk;
- Liquidity risk;
- Market risk; and
- Operational risk.

Risk management framework:

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Board is responsible for developing and monitoring the Company's risk management policies. The Company's Audit Committee oversees how management monitors compliance with the Company's risk management policies and procedures, and reviews the adequacy of the risk management framework in relation to the risks faced by the Company.

The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Company's activities.

(a) Credit risk:

Trade and other receivables:

The Company's exposure to credit risk is influenced mainly by the individual characteristics of each customer. However, management also considers the demographics of the Company's customer base, including the default risk of the industry, as these factors may have an influence on credit risk, particularly in the currently deteriorating economic circumstances.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

12. Financial risk management (continued):

A credit policy is established under which each new customer is analyzed individually or in groups for creditworthiness and given appropriate credit limits. The Company's review includes agent review, external ratings when available, and in some cases, bank references. Credit limits are established for each customer and these limits are reviewed on an ongoing basis. Customers that fail to meet the Company's creditworthiness benchmark may transact with the Company only on a prepayment basis.

Trade and other receivables relate mainly to the Company's retail and wholesale customers. Sales made to "high risk" customers are made on a prepayment basis.

The Company establishes an allowance for doubtful accounts that represents its estimate of uncollectible accounts in respect of trade and other receivables. The allowance for doubtful accounts is used to record potential impairment losses unless the Company is satisfied that no recovery of the amount owing is possible, at which point the amounts are written off against the financial asset directly. The Company makes significant estimates pertaining to allowance for doubtful accounts.

The carrying amount of financial assets represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date:

	2013	2012
Cash and cash equivalents	\$ 773,154	\$ 712,787
Trade and other receivables, before allowance	1,292,693	1,354,937
	<u>\$ 2,065,847</u>	<u>\$ 2,067,724</u>

Credit risk associated with cash and cash equivalents are minimized significantly by ensuring that these financial instruments are placed with major financial institutions. Credit risk associated with trade and other receivables is mitigated by the Company's large and unrelated customer base and the application of its credit evaluation, control and monitoring processes.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

12. Financial risk management (continued):

Allowance for doubtful accounts:

The Company maintains an allowance for doubtful accounts that is assessed on an ongoing basis. The aging of accounts receivable and the related allowance at the reporting date was as follows:

	Trade and other receivables		Allowance for doubtful accounts	
	2013	2012	2013	2012
Current	\$ 652,320	\$ 1,162,050	\$ –	\$ 120
Past due 0-30 days	326,528	40,389	160	2,147
Past due 31 -60 days	51,986	22,224	161	1,904
Past due 61-90 days	11,441	13,921	–	–
Past due more than 90 days	115,328	116,353	75,235	57,442
	<u>\$ 1,157,603</u>	<u>\$ 1,354,937</u>	<u>\$ 75,556</u>	<u>\$ 61,613</u>

The movement in the allowance for doubtful accounts during the year in respect to trade receivables was as follows:

	2013	2012
Balance, beginning of year	\$ 61,613	\$ 247,140
Bad debts	116,425	244,111
Accounts written off	(102,482)	(429,638)
Balance, end of year	<u>\$ 75,556</u>	<u>\$ 61,613</u>

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

12. Financial risk management (continued):

(b) Liquidity risk:

Liquidity risk is the risk that the Company will encounter difficulty in meeting the obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. The Company manages liquidity risk by continuously monitoring forecast and actual cash flows and working capital levels. The following are the contractual maturities of financial liabilities, including estimated interest payments:

2013	Carrying amount	Contractual cash flows	6 months or less	6 - 12 months	More than 1 year
Accounts payable and accrued liabilities	\$ 1,345,173	\$ 1,345,173	\$ 1,345,173	\$ -	\$ -
Notes payable	50,830	50,830	30,244	20,586	-
Finance leases	14,769	14,769	4,181	4,297	6,291
	<u>\$ 1,410,772</u>	<u>\$ 1,410,772</u>	<u>\$ 1,379,598</u>	<u>\$ 24,883</u>	<u>\$ 6,291</u>

2012	Carrying amount	Contractual cash flows	6 months or less	6 - 12 months	More than 1 year
Accounts payable and accrued liabilities	\$ 1,350,327	\$ 1,350,327	\$ 1,350,327	\$ -	\$ -
Finance leases	16,260	16,260	3,443	3,538	9,279
	<u>\$ 1,366,587</u>	<u>\$ 1,366,587</u>	<u>\$ 1,353,770</u>	<u>\$ 3,538</u>	<u>\$ 9,279</u>

It is not expected that the cash flows included in the maturity analysis could occur significantly earlier, or at significantly different amounts. The Company does not currently believe it will encounter difficulty in meeting its obligations associated with its financial liabilities.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

12. Financial risk management (continued):

(c) Market risk:

(i) Currency risk:

The Company's functional currency is the Canadian dollar, but it regularly transacts in U.S. dollars for a portion of its business activities. The value of financial instruments or cash flows associated with the instruments denominated in U.S. dollars will be affected by changes in the exchange rate fluctuations in the market between the Canadian and U.S. dollar.

On occasion, the Company utilizes a hedging program to mitigate a portion of its currency risks. As at December 31, 2013, the Company does not hold any derivative instrument or cash flow hedges.

A sensitivity analysis of the Canadian dollar against the U.S. dollar was performed as at December 31 of each year based on the Company's currency risk exposure. The results of the sensitivity analysis resulting in an increase or decrease on the Company's profit or loss and equity was not considered significant.

(ii) Interest rate risk:

The Company's primary interest rate risk consists of interest rate fluctuations, which may affect the Company's factoring and lease obligations. The Company does not currently use derivative instruments to limit interest rate risks.

There has been no change to the Company's exposure to market risks or the manner in which these risks are managed and measured from prior year.

(d) Operational risk:

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Company's processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks such as those arising from legal and regulatory requirements and generally accepted standards of corporate behaviour. Operational risks arise from all of the Company's operations.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

12. Financial risk management (continued):

The Company's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Company's reputation with overall cost effectiveness and to avoid control procedures that restrict initiative and creativity.

The primary responsibility for the development and implementation of controls to address operational risk is assigned to senior management within each business unit. This responsibility is supported by the development of overall Company standards for the management of operational risk in the following areas:

- requirements for appropriate segregation of duties, including the independent authorization of transactions;
- requirements for the reconciliation and monitoring of transactions;
- compliance with regulatory and other legal requirements;
- documentation of controls and procedures;
- requirements for the periodic assessment of operational risks faced, and the adequacy of controls and procedures to address the risks identified;
- requirements for the reporting of operational losses and proposed remedial action;
- development of contingency plans;
- training and professional development;
- Ethical and business standards; and
- risk mitigation, including insurance when this is effective.

Compliance with Company standards is supported by a program of periodic reviews undertaken by senior management. The results are discussed with the management of the business unit to which they relate, with summaries submitted to the Audit Committee.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

12. Financial risk management (continued):

Fair value of financial instruments:

The Company has determined the estimated fair values of its financial instruments based on appropriate valuation methodologies. Where quoted market values are not readily available, the Company may use considerable judgment to develop estimates of fair value. Accordingly, any estimated values are not necessarily indicative of the amounts the Company could realize in a current market exchange and could be materially affected by the use of different assumptions or methodologies. The Company classifies its fair value measurements within a fair value hierarchy, which reflects the significance of the inputs used in making the measurements as defined in IFRS 7, Financial Instruments - Disclosures.

- Level 1 - unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2 - inputs other than quoted prices included in Level 1, that are observable for the asset or liability, either directly or indirectly; and
- Level 3 - unobservable inputs for the asset or liability which are supported by little or no market activity.

The fair values of cash and cash equivalents are based on quoted market values. The fair values of short-term financial assets and liabilities, including trade and other receivables, accounts payable and accrued liabilities and provisions, as presented in the consolidated statements of financial position, approximate their carrying amounts due to their short-term maturities. The fair value of finance leases and notes payable approximates its carrying value because management believes the interest rates approximate the market interest rate for similar debt with similar security. There are no financial assets or liabilities measured using Level 3.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

13. Commitments:

The Company has entered into lease agreements for premises expiring at various periods up to 2017. The future minimum annual rental payments on the non-cancellable operating leases are payable as follows:

2014	\$ 298,318
2015	150,000
2016	155,200
2017	26,400

The Company leases its corporate office that expires in July 2014. During the year ended December 31, 2013, the Company recognized \$180,474 as an expense in profit or loss as part of general and administrative cost in respect to this operating lease (2012 - \$176,000).

On March 1, 2014, the Company entered into a lease for new corporate office that expires in March 2017. The commitment associated with this lease is included in the table above.

In September 2011, the Company entered into an operating lease for its switch facility that includes hosting and connectivity service, which will expire in September 2014. During the year ended December 31, 2013, the Company recognized \$91,200 as the expense in profit or loss as part of telecommunication costs in respect to the operating lease for the switch facility (2012 - \$87,000).

During the year ended December 31, 2012, the Company entered into a carrier billing services agreement with a major national telecommunications provider (the "Telco") to create a long-distance dial-around service for wireless customers of that Telco. Under the terms of the agreement, which has a term of five years and ends on December 31, 2017, the Company is required to pay a Carrier Billing Processing Fee to the Telco that is calculated based on a fixed percentage of the amount of gross billings received by the Company for use of the service. Under the terms of the agreement, the Company has committed to remitting a minimum amount of Carrier Billing Processing Fees to the Telco based on revenue earned under the service by the Company of \$7 million through the first two years of the agreement, and an aggregate of \$25 million through the entire five-year term of the agreement. To the extent that the minimum Carrier Billing Processing Fees are not paid to the Telco by the second and fifth anniversary dates, the Telco has the right to require the Company to remit the shortfall on demand. No liability has been recorded relating to this commitment as a shortfall of the obligation as management does not consider it probable that such a payment will be required based on current facts and circumstances.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

13. Commitments (continued):

If a remittance to the Telco is required, the Company would utilize existing cash resources. If existing cash resources are not sufficient, the Company may be required to secure additional sources of financing; however, there can be no assurances that any such financing will be available to the Company or that such funds will be available on acceptable terms.

14. Obligations under finance lease:

The following obligations under finance lease exist during the current and prior years:

	Currency	Interest rate	Expiration	Carrying amount	
				2013	2012
Mailing machine	CDN	5.50%	2015	\$ 9,279	\$ 16,260
Copier	CDN	5.50%	2018	5,490	–
				2013	2012
Total minimum lease payments				\$ 15,576	\$ 17,162
Less amount representing imputed interest				807	902
Present value of obligations under finance lease				14,769	16,260
Less current portion				8,478	6,981
				\$ 6,291	\$ 9,279

The finance leases are secured by the assets leased (note 6).

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

15. Capital management:

The Company's objective in managing capital is to ensure sufficient liquidity to pursue its strategy of organic growth combined with strategic acquisitions, so that it can provide above-average returns for its shareholders. The Company defines capital that it manages as the aggregate of its shareholders' equity, which consists of issued capital, warrants, reserves and deficit.

The Company manages its capital structure and makes adjustments to it in light of general economic conditions and the risk characteristics of the underlying assets and the Company's working capital requirements. In order to maintain or adjust the capital structure, the Company, upon approval from its Board of Directors, may issue long-term debt, issue shares, repurchase shares through a normal course issuer bid and pay dividends. The Board of Directors reviews and approves any material transactions not in the ordinary course of business that may include various acquisition proposals, as well as capital and operating budgets.

There were no changes in the Company's approach to capital management during the year.

16. Contingencies:

From time to time, the Company has been, and expects to continue to be, subject to legal proceedings and claims in the ordinary course of business. Such claims, even if lacking merit, could result in the expenditure of significant financial and managerial resources. The Company is not aware of any legal proceedings or claims that it believes will have, individually or in the aggregate, a material adverse effect on the Company's financial condition or results of operations. The Company has recorded provisions of \$20,000 (2012 - \$75,000) related to litigation matters as December 31, 2013.

17. Related parties:

Key management personnel compensation:

In addition to their salaries and allowances, key management personnel also participate in the Company's share option program and short-term health and dental benefits.

Certain executive officers are subject to a mutual term of notice of two months. Upon resignation at the Company's request, they are entitled to certain termination benefits, either cash or a percentage of gross salary.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

17. Related parties (continued):

Key management personnel compensation comprised:

	2013	2012
Wages, salaries and other benefits	\$ 324,556	\$ 331,856
Canada Pension Plan, Employment Insurance and other remittances	8,352	13,636
Share-based compensation	28,590	84,426
	<u>\$ 361,498</u>	<u>\$ 429,918</u>

Directors received compensation for their services as directors to the Company. Additionally, the directors are able to participate in the Company's share option program. Outside of directors' fees, certain directors or companies affiliated with these directors also participated in transactions with the Company for consulting and related services and received amounts totaling \$13,499 (2012 - \$32,290), which is the amount agreed to by the parties.

In connection with the private placement in 2012 (note 8(b)), directors of the Company subscribed to a total of 1,020,000 units for proceeds of \$102,000. The units issued to directors had the same terms and conditions as the units issued to all other subscribers.

18. Operating segments:

The Company has two reportable segments based on the customers it serves, retail and wholesale. These strategic business units are managed separately and require different marketing and selling strategies. All assets of the business supporting these business units are located in Canada.

The following summary describes the operations in each of the Company's reportable segments:

- Retail - includes casual calling, subscriptions, home phone, business phone and prepaid calling cards services serving non telecommunication customers.
- Wholesale - involves selling of bulk minutes to resellers at discounted rates.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

18. Operating segments (continued):

(a) Segment revenue and results:

	Segment revenue		Segment profit	
	2013	2012	2013	2012
Retail	\$ 7,785,528	\$ 8,340,183	\$ 3,507,116	\$ 3,980,444
Wholesale	534,357	683,691	28,855	41,021
	<u>\$ 8,319,885</u>	<u>\$ 9,023,874</u>	3,535,971	4,021,465
Operating expenses			(3,427,956)	(3,947,915)
Other expenses			(18,893)	(29,101)
Income before income taxes			89,122	44,449
Income taxes			-	-
Net income			\$ 89,122	\$ 44,449

Segment revenue reported above represents revenue generated from external customers. There were no inter-segment sales in the current year (2012 - nil).

The accounting policies of the reportable segments are the same as the Company's accounting policies described in note 2. Segment profit represents the profit earned by each segment after telecommunication costs, both fixed and variable, without allocation of operating costs, depreciation and amortization, finance costs, other income and income tax expense. This is the measure reported to the CEO for purposes of resource allocation and assessment of segment performance. Segment profit is used to measure performance, as management believes that such information is the most relevant in evaluating the results of certain segments relative to other entities that operate within the same industry.

The Company serves a large and unrelated customer base and no single customer contributed 10% or more to the Company's revenue for both 2013 and 2012.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

18. Operating segments (continued):

(b) Segment assets and liabilities:

	2013	2012
Segment assets:		
Retail	\$ 2,546,146	\$ 2,320,672
Wholesale	174,754	283,030
Total segment assets	\$ 2,720,900	\$ 2,603,702
Segment liabilities:		
Retail	\$ 1,338,132	\$ 1,289,774
Wholesale	92,640	151,813
Total segment liabilities	\$ 1,430,772	\$ 1,441,587

For the purposes of monitoring segment performance and allocating resources between segments, assets used jointly by reportable segments are allocated on the basis of the revenue earned by individual reportable segments, and liabilities for which reportable segments are jointly liable are allocated in proportion to segment assets.

19. Acquisition transaction costs:

During fiscal 2013, the Company incurred transaction costs of \$149,030 (2012 - nil) with regard to acquisition related activities which have been expensed in the consolidated statement of operations.

20. Subsequent events:

On February 28, 2014, the Company completed the acquisition of a combination of shares and assets of G3 Telecom Corp. and its group of affiliated companies ("G3 Telecom").

In accordance with the terms of the Agreement the Company acquired G3 Telecom's wireless telecommunications licences for Huntsville, Ont., and Dawson Creek, B.C., as well as its telecommunications businesses in the U.S. and the Philippines. G3 Telecom is a facilities-based reseller of telecommunication services in Canada, and is registered with the Canadian Radio-television Telecommunications Commission (CRTC) and the Federal Communications Commission (FCC) in the United States.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

20. Subsequent events (continued):

The aggregate purchase price of the acquisition was \$4.3 million, payable \$2.0 million in cash on the date of closing, \$1.5 million over 24 months from the date of closing by way of a secured promissory note with interest at 5% per annum and the issuance of 8,000,000 common shares of the Company at a deemed value of \$0.10 per common share. The Agreement provides for a price reduction of \$1.0 million should Industry Canada not approve the transfer consents of two wireless spectrum licences to the Company's control within 90 days from the date of closing. This reduction will be offset against the \$1.5 million outstanding secured promissory note over 24 months after closing. The Agreement also provides for the cancellation of 5,000,000 common shares issued to the vendors in the event that the FCC fails to approve the transfer consents of G3 Telecom's U.S. subsidiary to the Company's control within 90 days from closing.

The acquisition will be accounted for using the acquisition method under IFRS 3, Business Combinations, with the results of operations included in the consolidated financial statements from the date of the acquisition. The purchase price of \$4.3 million is subject to working capital adjustments that have not yet been finalized.

Due to the complexity and timing of the acquisition, the Company is in the process of determining the estimated fair value of the net assets acquired as part of the acquisition. The amounts determined on a provisional basis generally relate to net asset assessments and measurement of the assumed liabilities.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

20. Subsequent events (continued):

The impact of acquisition accounting applied on a provisional basis in connection with the acquisition of G3 Telecom is as follows:

Assets acquired:	
Cash	\$ 825,000
Property and equipment	985,000
Acquired intangible assets:	
Wireless spectrum licenses	1,000,000
Customer lists	670,000
FCC licenses	50,000
Trademarks	750,000
	<hr/> 4,280,000
Liabilities assumed:	
Deferred revenue	745,000
Deferred income taxes	350,000
	<hr/> 1,095,000
Goodwill	1,115,000
Total consideration	<hr/> \$ 4,300,000

The goodwill to be recognized in connection with this acquisition is primarily attributable to the synergies with the Company's existing business and other intangibles that do not qualify for separate recognition including assembled workforce.

In connection with the transaction, the Company completed a concurrent private placement of \$3.0 million of unsecured, five-year debentures. The debentures will mature five years from the date of closing of the offering and will bear interest at a rate of 10% per annum, payable semi-annually in cash on June 30 and December 31 in each year, commencing on June 30, 2014, with the final payment due on the maturity date. Each debenture was priced at a 2% discount, namely at \$980 per \$1,000 of the principal amount thereof. On and after June 30, 2016, and at any time prior to the maturity date, the debentures are redeemable at the option of the Company at a price equal to \$1,000 per debenture plus accrued and unpaid interest thereon up to but excluding the date of redemption. The Company engaged Jones, Gable & Company Ltd. ("Jones Gable") to act as finder in connection with the offering and paid Jones Gable a \$195,000 fee equal to 6.5% of the gross proceeds raised from the sale of the debentures. The debentures issued pursuant to the offering will be subject to a statutory four-month-and-one-day hold period.

TELEHOP COMMUNICATIONS INC.

Notes to Consolidated Financial Statements (continued)

Years ended December 31, 2013 and 2012

21. Comparative figures:

Certain 2012 comparative balances have been reclassified in order to reflect current year consolidated statements of financial position classification.