

November 2, 2006

To: British Columbia Securities Commission  
Alberta Securities Commission  
TSX Venture Exchange

**Re: AMENDED Annual Financial Statements for the year ended June 30, 2006**

Dear Sirs/Madams,

The annual financial statements of Peer 1 Network Enterprises, Inc. for the year ended June 30, 2006 were amended on November 2, 2006 to correct a typo in the heading of the second table under note 21 on page 30 of the financial statements. In the initial version of the annual financial statements filed, reference was inadvertently made in the note to '2006' rather than '2005', being the comparable period.

Adjustments were also made to correct the roman numeral numbering under note 14 on page 22 of the financial statements. In the second set of bullet points the numbering continued to 'iv', 'v', 'vi' in the initial filed document instead of resetting to 'i'.

In addition to the above, the word "Continued" was removed from the first reference to the section 'Exhibit D' on the top of page 6 of the financial statements, and corrections were made to the formatting throughout the document to present paragraphs in a more uniform manner.

Yours truly,

**"Gary Sherlock"**

Gary Sherlock  
Chief Financial Officer  
PEER 1



NETWORK | CO-LOCATION | DEDICATED HOSTING

Consolidated Financial Statements  
For The Fiscal Years Ended June 30, 2006 and 2005



**PEER 1 NETWORK ENTERPRISES INC.**

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Cinnamon Jang Willoughby & Company

Chartered Accountants

*A Partnership of Incorporated Professionals*

To the Shareholders of Peer 1 Network Enterprises Inc.:

We have audited the consolidated balance sheet of Peer 1 Network Enterprises Inc. as at June 30, 2006 and 2005, and the consolidated statements of operations and deficit, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. 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 and the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform an audit to obtain reasonable assurance whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated 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 our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at June 30, 2006 and 2005, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Comments by Auditors for U.S. Readers on Canada - United States Reporting Differences

United States reporting standards of the Public Company Accounting Oversight Board (United States) for auditors require the addition of an explanatory paragraph (following the opinion paragraph) when the financial statements are affected by conditions and events that cast substantial doubt on the Company's ability to continue as a going concern, such as those described in Note 1 to the financial statements. Our report to the shareholders dated October 13, 2006 is expressed in accordance with Canadian reporting standards which do not permit reference to such conditions and events in the auditors' report when these are adequately disclosed in the financial statements.

"Cinnamon Jang Willoughby & Company"

Chartered Accountants

Burnaby, BC  
October 13, 2006

**PEER 1 NETWORK ENTERPRISES INC.**  
**Consolidated Balance Sheet**  
**June 30, 2006**  
(in thousands of United States dollars)

<b>Assets</b>	<b>2006</b>	<b>2005</b>
<b>Current:</b>		
Cash and cash equivalents	\$ 5,666	\$ 292
Restricted cash (Note 4)	505	500
Accounts receivable	5,242	2,442
Prepaid expenses	720	387
	<b>12,133</b>	3,621
Other assets (Note 6)	3,951	1,030
Property and equipment (Note 7)	24,520	10,196
Goodwill (Notes 8, 9)	1,715	590
Intangible Assets (Note 10)	5,964	4,120
	<b>\$48,283</b>	\$19,557
<b>Liabilities</b>		
<b>Current:</b>		
Accounts payable and accrued liabilities	\$10,039	\$ 4,593
Deferred revenue	3,749	1,139
Shareholder notes payable (Note 11)	-	2,250
Current portion of deferred lease inducements	84	49
Current portion of notes payable	3,664	10,992
Income taxes payable (Note 16)	402	-
	<b>17,938</b>	19,023
Deferred lease inducements (Note 12)	423	314
Notes payable (Note 13)	17,388	95
Long-term debt (Note 14)	8,087	-
	<b>43,836</b>	19,432
<b>Shareholders' Equity</b>		
Capital stock (Note 15)	14,327	7,828
Warrants (Note 15)	1,061	-
Equity component of convertible notes (Note 15)	-	326
Contributed surplus (Note 15)	778	502
Deficit, per Exhibit "B"	(11,708)	(8,520)
Cumulative translation adjustment	(11)	(11)
	<b>4,447</b>	125
	<b>\$48,283</b>	\$19,557

Nature of Operations and Future Operations (Note 1)  
Commitments (Note 20)  
Subsequent Events (Note 23)

Approved by the Directors:

"Scott Shaw"

"David Harrison"

**PEER 1 NETWORK ENTERPRISES INC.**  
**Consolidated Statement of Operations and Deficit**  
**For the Year Ended June 30, 2006**  
(in thousands of United States dollars, except per share amounts)

	2006	2005
Revenue	<b>\$60,726</b>	\$19,438
Cost of sales	<b>39,295</b>	11,889
Gross Profit	<b>21,431</b>	7,549
Operating expenses	<b>17,401</b>	7,225
Operating Income before other items	<b>4,030</b>	324
Other Items:		
Amortization of preferred share discount	<b>1,089</b>	-
Integration costs	<b>1,187</b>	318
Loss from investment accounted for on an equity basis	<b>13</b>	176
Loss on disposal of property plant & equipment	<b>61</b>	-
Foreign exchange loss (gain)	<b>305</b>	(121)
Interest expense – long term	<b>4,136</b>	1,956
Interest expense – short term	<b>37</b>	177
	<b>6,828</b>	2,506
Loss before income taxes	<b>2,798</b>	2,182
Income taxes (Note 16)	<b>390</b>	-
Net Loss	<b>3,188</b>	2,182
Deficit, beginning	<b>8,520</b>	6,069
Less: Adjustment for prior years' stock based compensation	<b>-</b>	269
Deficit, ending, to Exhibit "A"	<b>\$11,708</b>	\$ 8,520
Basic and diluted loss per share (Note 15)	<b>\$ 0.04</b>	\$ 0.04

**PEER 1 NETWORK ENTERPRISES INC.**  
**Consolidated Statement of Cash Flows**  
**For the Year Ended June 30, 2006**  
**(in thousands of United States dollars)**

	2006	2005
<b>Operating Activities:</b>		
Net Loss, per Exhibit "B"	\$ (3,188)	\$ (2,182)
Adjustments for -		
Amortization of preferred share discount	1,089	-
Foreign exchange translation adjustment	-	(44)
Amortization of property and equipment	7,072	1,815
Amortization of intangible assets	1,442	691
Increase in accrued interest and accretion of convertible debt	2,337	730
Settlement of loan renewal fee	400	-
Bad debt expense	859	374
Loss on disposal of property and equipment	61	-
Stock-based compensation and other	289	70
	<b>10,361</b>	<b>1,454</b>
Changes in non-cash working capital -		
Increase in accounts receivable	(3,658)	(1,070)
Increase in prepaid expenses	(333)	(137)
Increase in accounts payable and accrued liabilities	4,254	2,797
Increase in income taxes payable	402	-
Increase in deferred revenue	2,610	673
Cash flows from operating activities	<b>13,636</b>	<b>3,717</b>
<b>Investing Activities:</b>		
Increase in restricted cash	(5)	(401)
Investment in other assets	(2,921)	(381)
Acquisition of property and equipment	(20,572)	(8,357)
Acquisition of intangible assets	(2,998)	(4,139)
Acquisition of goodwill	(1,125)	(590)
Proceeds on disposition of equipment	16	-
Increase in deferred lease inducements	144	231
Cash flows (used in) investing activities	<b>(27,461)</b>	<b>(13,637)</b>
<b>Financing Activities:</b>		
Proceeds from shareholder notes payable	-	1,176
Proceeds from notes payable and long - term debt, net of repayments	18,890	7,231
Issuance of capital stock	309	1,106
Cash flows from financing activities	<b>19,199</b>	<b>9,513</b>
Increase (Decrease) in Cash and Equivalents	<b>5,374</b>	<b>(407)</b>
Cash and Equivalents, beginning	<b>292</b>	<b>699</b>
Cash and Equivalent, ending	<b>\$ 5,666</b>	<b>\$ 292</b>

Supplemental Disclosure of Cash Flow Information (Note 17)

**PEER 1 NETWORK ENTERPRISES INC.**  
**Notes to Consolidated Financial Statements**  
**June 30, 2006**  
**(tabular dollar amounts are presented in thousands of**  
**United States dollars, except number of shares and per share amounts)**

**1. Nature of Operations and Future Operations:**

Peer 1 Network Enterprises Inc. ("the Company") was incorporated under the laws of British Columbia. The Company provides high performance internet bandwidth, co-location facilities and dedicated servers to web-centric and enterprise customers across North America. Building on an internal network with built in redundancy, the company guarantees 100% uptime internet access for companies with mission-critical applications. The Company has established local offices and data centres throughout Canada and the USA, and also has established a point of presence in London, UK.

The Company, through the ServerBeach division, based in San Antonio, Texas, specializes in offering self-managed dedicated servers providing firewalls, SAN, security and support to augment the clients' applications and custom hosting solutions for clients with unique requirements. The corporate headquarters are in Vancouver.

To date, the Company has generated losses from operations and has a net working capital deficiency. These consolidated financial statements have been prepared on a going concern basis, which presumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future. The ability to do so is dependent upon its ability to obtain additional sources of financing and achieve future profitable operations, the outcome of which cannot be predicted at this time. These consolidated financial statements do not include any adjustments that might be necessary should the Company be unable to continue as a going concern.

**2. Significant Accounting Policies:**

a) Basis of Consolidated Financial Statements -

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Peer 1 Network Inc., Peer 1 Network (USA) Inc., Peer 1 Network (Seattle) Inc., Peer 1 Network (San Jose) Inc., Peer 1 Network (New York) Inc., Peer 1 Network (Nevada) GP, Inc., Peer 1 Network (Nevada) LP, Inc., ServerBeach Ltd., Data Center Technologies IP Inc., Peer 1 Dedicated Hosting Inc., Colobrokers.com Inc., 585065 B.C. Ltd., Peer 1 Network (Texas), LP and, Peer 1 Network (LA), Inc.

b) Cash and Cash Equivalents -

Cash and cash equivalents consist of cash and short-term deposits with maturities at the date of purchase of three months or less.

**PEER 1 NETWORK ENTERPRISES INC.**  
**Notes to Consolidated Financial Statements**  
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**2. Significant Accounting Policies: (Continued)**

c) Property and Equipment -

The following assets are recorded at cost. Amortization is provided on a declining balance basis at the following annual rates:

Co-location equipment	20%
Computer equipment	30%
Furniture and fixtures	20%
Network equipment	20%

Dedicated servers rented to customers as part of the dedicated server business unit are amortized straight line over their expected useful life, which varies from 24 to 36 months. Inventory of parts held for server assembly are classified in this component of property and equipment, and are not subject to amortization until the assets are put into use.

Amortization of leasehold improvements is provided on a straight-line basis over the terms of the respective leases.

When the net carrying amount of the property and equipment exceeds the estimated net recoverable amount, the asset is written down to its estimated fair value and a charge is recorded in the consolidated statement of operations.

d) Goodwill -

Goodwill is recorded at the amount originally recognized. See Notes 8 and 9. Goodwill is tested for impairment in value on an annual basis. Fair value is determined based on the present value of discounted cash flows. Following the impairment test at year-end, management has concluded that there has been no impairment in the value of goodwill.

e) Intangible assets –

Computer software comprising PC based software acquired for internal use is amortized at an annual rate of 100%. Computer software acquired as a component of revenue producing assets, or internal systems such as accounting or customer relations management systems is amortized over the expected useful life of the software. Amortization commences when the asset is put into service. Licences are recorded at cost. Amortization is provided on a straight-line basis over the term of the licences. The lease purchase option is not amortized.

f) Deferred Lease Inducements -

Lease inducements, including rent free periods, are deferred and accounted for as a reduction of rent expense over the term of the related leases on a straight-line basis.

**PEER 1 NETWORK ENTERPRISES INC.**  
**Notes to Consolidated Financial Statements**  
**June 30, 2006**  
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**2. Significant Accounting Policies: (Continued)**

g) Debt Instruments -

Where the Company issues debt instruments with detachable warrants or conversion options in connection with a debt instrument, the estimated fair market value of the warrants and conversion feature are credited to shareholders' equity. The reduced liability component of the debt is accreted by a charge to interest expense.

h) Future Income Taxes -

Income taxes are calculated using the liability method of tax allocation. Temporary differences arising from the difference between the tax basis of an asset or liability and its carrying amount on the balance sheet, and unutilized losses carried forward are used to calculate future income tax assets or liabilities. Future income tax assets or liabilities are calculated using tax rates anticipated to apply in the year that the temporary differences are expected to reverse. The carrying value of the future income tax asset is limited to the amount that is more likely than not to be realized. A valuation allowance is provided. See Note 16.

i) Financing Costs -

Costs directly identifiable with the raising of capital are charged against the related capital stock. Costs incurred to obtain debt financing are deferred and amortized by a charge to interest expense over the term of the related debt. Debt financing fees are amortized and included as part of interest expense. Financing costs expensed for 2006 are \$762,315 (\$624,421 in 2005).

j) Capitalization of Internally Developed Software -

Internally developed software is stated at cost less accumulated amortization and is amortized using the straight line method over its estimated useful life. Software assets are reviewed for impairment when events or circumstances indicate that the carrying value may not be recoverable over the remaining lives of the assets. Costs are capitalized during the software application development stage. Upgrades and enhancements are capitalized if they result in added functionality which enables the software to perform tasks it was previously incapable of performing.

Software maintenance, training, data conversion and business process reengineering costs are expensed in the period in which they are incurred.

k) Organizational Costs -

Organizational costs, direct or incremental costs directly related to acquisitions, are deferred and added to the cost of the purchase. Only costs that are directly related to proposed transactions, where completion is considered more likely than not, are deferred. Once the Company ceases to be engaged on a regular ongoing basis and it is not likely that activities will resume, the costs are expensed.

**PEER 1 NETWORK ENTERPRISES INC.**  
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**2. Significant Accounting Policies: (Continued)**

l) Foreign Currency Transactions -

Monetary assets and liabilities denominated in currencies other than the United States dollars are translated at the rate of exchange in effect at the end of the year. Revenue and expense items are translated at the rate of exchange in effect on the dates they occur. Exchange gains or losses are recognized immediately in the consolidated statement of operations.

The Company's non-US subsidiaries are managed as integrated operations and accordingly are accounted for under the temporal method. Under this method, monetary assets and liabilities are translated at the exchange rate in effect at the balance sheet date. Non-monetary assets and liabilities are translated at historical rates. Revenues and expenses are translated at average rates for the year. Exchange gains or losses arising from the translation are included in operations. See also Note 3.

m) Revenue Recognition -

The four sources of revenue are co-location, internet traffic, rental of dedicated servers and general services. General services include installation, IP monitoring, tape back-up, technical support, additional access cards, and DNS services. Co-location, internet traffic, rental of dedicated servers and general services revenue is recognized once an agreement is in place, the price is fixed or determinable, the service is provided and there is reasonable assurance of cash collection.

Revenue is earned through monthly charges at contractually agreed upon prices. Revenue is recognized ratably over the term of the contract as services are provided to the customer. One-time installation fees are deferred and recognized on a straight-line basis over the contractual period, which typically varies from six months to three years.

n) Stock-based Compensation -

The Company has a stock-based compensation plan for executives and other key employees. The stock-based compensation expense is recognized in accordance with CICA Handbook Section 3870 "Stock-Based Compensation and Other Stock-Based Payments". Beginning January 1, 2004, the Company changed its accounting policy related to employee stock options, and began to recognize compensation expense for stock or stock option grants to employees, based on the fair value of the stock or stock options issued. Consideration paid by employees on the purchase of shares under the employee share purchase plan and exercise of stock options is recorded as share capital..

**PEER 1 NETWORK ENTERPRISES INC.**  
**Notes to Consolidated Financial Statements**  
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**2. Significant Accounting Policies: (Continued)**

o) Earnings Per Share -

The diluted earnings per share is calculated based on the weighted-average number of common shares outstanding during the year, plus the effects of dilutive common share equivalents. This method requires that the dilutive effect of outstanding options issued should be calculated using the treasury stock method. This method assumes that all common share equivalents have been exercised at the beginning of the period (or at time of issuance, if later), and that the funds obtained thereby were used to purchase common shares of the Company at the average trading price of common shares during the period

p) 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 amounts reported in the financial statements and accompanying disclosures. Although these estimates are based on management's best knowledge of current events and actions the Company may undertake in the future, actual results may differ from these estimates.

q) Comparative Numbers –

The 2005 comparative figures have been reclassified, where applicable, in order to conform with the presentation used in the current year. Comparative figures have also been translated to US dollars. See Note 3.

r) Investments held with significant influence –

These consolidated financial statements include operating results for the incorporated joint venture Symmetric Broadband Inc., recorded on an equity basis.

For comparative purposes, Symmetric Broadband Inc. was included in the financial statements on a proportionate consolidation basis for the period to December 31, 2004.

**PEER 1 NETWORK ENTERPRISES INC.**  
**Notes to Consolidated Financial Statements**  
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**3. Functional And Reporting Currency Change:**

Effective October 1, 2005, the Company changed its functional currency to the U.S. dollar from the Canadian dollar in order to more accurately represent the currency of the economic environment in which it operates as a result of increasing U.S. dollar denominated revenues and expenditures. Concurrent with the change in its functional currency, the Company has adopted the U.S. Dollar as its reporting currency.

For comparative purposes, the results for the years ended June 30, 2006 and June 30, 2005 have been presented in US dollars. The consolidated financial statements of the Company for the comparative periods ended on or before June 30, 2005 which were based on the Canadian functional currency have been translated into the U.S. reporting currency using the current rate method as follows: assets and liabilities using the rate of exchange prevailing at the balance sheet date; shareholders' equity using the applicable historic rate; and revenue and expenses using a monthly average rate of exchange. Translation adjustments have been included as part of the cumulative translation adjustment.

For periods commencing July 1, 2005 monetary assets and liabilities denominated in foreign currencies are translated into U.S. dollars using exchange rates in effect at the balance sheet date. All other assets and liabilities are translated at the exchange rates prevailing at the dates the assets were acquired or liabilities incurred. Revenue and expense items are translated at the average exchange rate for the period. Foreign exchange gains and losses are included in the determination of the income for the period.

**4. Restricted Cash:**

The Company has issued letters of credit totaling \$505,000 (\$500,000 in 2005) to landlords and other vendors in the normal course of business in lieu of deposit requirements. The letters of credit have a term of one year, with annual renewal provisions. Certificates of deposit in the amount of \$505,000 have been pledged as security for the letters of credit, and are disclosed on the balance sheet as restricted cash.

**5. Investment in Symmetric:**

Symmetric provides voice services over the internet. As this is a more technically demanding service than those currently offered by the Company, it entered into an agreement with a joint venturer who would provide the required expertise.

In January 2005 the Company amended the agreement with the joint venturer. Under the terms of the revised agreement, the Company is no longer responsible for continuing to fund Symmetric's operations, with all current funding being made available by the other party to the agreement. As a result, the Company's ownership interest has declined from 50% at December 31, 2004 to 28% at June 30, 2005, and the basis of accounting was changed from proportionate consolidation to equity accounting during the June 30, 2005 fiscal year end.

After reflecting the Company's share of the losses incurred by Symmetric during 2006 on the equity basis, the net investment in Symmetric is \$Nil (\$11,517 in 2005). The investment was included as a component of Other Assets on the balance sheet. See also Note 6.

The Company has retained the right to increase its interest in Symmetric back to the 50% level by providing funding equivalent to twice the amount that would otherwise be required to match the contributions made by the other party to the agreement.

**PEER 1 NETWORK ENTERPRISES INC.**  
**Notes to Consolidated Financial Statements**  
**June 30, 2006**

(tabular dollar amounts are presented in thousands of  
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<b>6. Other Assets:</b>	<b>2006</b>	2005
Financing costs	<b>\$1,995</b>	\$ 70
Investment in Symmetric Broadband Inc. (Note 5)	-	11
Network installation fees	<b>14</b>	4
Organizational costs	-	287
Security deposits	<b>1,942</b>	658
	<b>\$3,951</b>	\$1,030

**7. Property and Equipment:**

**2006**

	<b>Cost</b>	<b>Accumulated Amortization</b>	<b>Net</b>
Co-location equipment	\$ 3,248	\$1,238	\$ 2,010
Computer equipment	720	257	463
Dedicated servers	14,431	5,485	8,946
Furniture and fixtures	178	63	115
Leasehold improvements	10,836	1,593	9,243
Network equipment	5,814	2,071	3,743
	\$35,227	\$10,707	\$24,520

**2005**

	<b>Cost</b>	<b>Accumulated Amortization</b>	<b>Net</b>
Co-location equipment	\$2,270	\$ 781	\$ 1,489
Computer equipment	393	177	216
Dedicated servers	3,175	704	2,471
Furniture and fixtures	118	40	78
Leasehold improvements	3,870	574	3,296
Network equipment	4,005	1,359	2,646
	\$13,831	\$3,635	\$10,196

There are no assets under capital lease in the current year (\$Nil in 2005).

Included in Computer equipment is \$191,516 relating to a system integration project. This has not yet been put into use and has therefore not incurred amortization during the year.

Included in dedicated servers is inventory of parts held for server assembly at a cost of \$544,160 (\$83,901 in 2005).

**PEER 1 NETWORK ENTERPRISES INC.**  
**Notes to Consolidated Financial Statements**  
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**(tabular dollar amounts are presented in thousands of**  
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**8. Acquisition of ServerBeach, Ltd.:**

On October 20, 2004, the Company, through its 100% owned subsidiary, P1 Acquisition, Ltd. ("P1") acquired all of the operating assets of San Antonio, Texas-based ServerBeach, Ltd. (AServerBeach@). Included in the operating assets were existing customer contracts, an exclusive use licence for technology that is essential to the ServerBeach business and over 4,200 dedicated servers. As part of the purchase of assets, the Company obtained rights to the Company name, was granted the authority to rename P1 Acquisition, Ltd. to ServerBeach, Ltd. on October 22, 2004, and now operates under that name. The asset purchase price was \$7,500,000 and a secured promissory note agreement. See Note 13(d).

The purchase price and related organizational costs were allocated in 2005 to the assets acquired based on their fair market value, with the excess recorded as goodwill, as follows:

Inventory	\$ 46
Tangible capital assets	2,357
Licences	4,727
Goodwill	590
	\$7,720

**9. Interland Inc. Asset Acquisition:**

On September 2, 2005 the company, through its wholly owned subsidiary, Peer 1 Dedicated Hosting, Inc., completed an asset acquisition pursuant to the asset purchase agreement dated August 31, 2005 with Interland, Inc. ("Interland"). The Interland Inc. Asset acquisition is being accounted for under the purchase method. The results of the acquisition are included in the consolidated company results from September 2, 2005. Pursuant to the agreement, Interland agreed to sell, and the Company agreed to purchase, all of the assets of Interland that are necessary for the daily operation of Interland's dedicated server business. The Company has also agreed to assume certain liabilities of Interland. In addition, Interland has granted to the Company a royalty-free non-exclusive license to the intellectual property owned by Interland and access to property licensed to Interland from third parties. The purchase price for the assets and the obligations of Interland was \$14,000,000 plus an adjustment of \$604,162 relating to a working capital adjustment due to the Company having assumed reduced net liabilities of Interland, plus legal and consulting costs of \$709,054, subject to adjustment in accordance with the asset purchase agreement. 20% of the purchase price prior to adjustment was placed in escrow as security for the obligations of Interland under the agreement. Peer 1 and Interland have also entered into an administrative services agreement dated as of August 31, 2005 which was amended December 31, 2005.

The purchase price and related organizational costs were allocated to the assets acquired based on the fair market value, with the excess recorded as goodwill, as follows:

**PEER 1 NETWORK ENTERPRISES INC.**  
**Notes to Consolidated Financial Statements**  
**June 30, 2006**  
**(tabular dollar amounts are presented in thousands of**  
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**9. Interland Inc. Asset Acquisition: (Continued)**

Accounts Receivable, net	\$ 457
Prepaid Expenses	538
Other Assets – deposits	289
Tangible Assets	12,610
Software	1,391
Lease purchase option	962
Goodwill	1,125
Deferred Revenue	(1,894)
Accounts Payable	(165)
	\$15,313

**10. Intangible Assets:**

<b>2006</b>	<b>Cost</b>	<b>Accumulated Amortization</b>	<b>Net</b>
Licences	\$4,727	\$1,576	\$3,151
Computer software	1,699	609	1,090
Internally developed software	761	-	761
Lease purchase option	962	-	962
	\$8,149	\$2,185	\$5,964

  

<b>2005</b>	<b>Cost</b>	<b>Accumulated Amortization</b>	<b>Net</b>
Licences	\$4,726	\$630	\$4,096
Computer software	137	113	24
	\$4,863	\$743	\$4,120

See also Notes 8 and 9.

Computer software totaling \$576,483 (\$119,544 in 2005) has been fully amortized and remains in service.

**11. Shareholder Notes Payable:**

The shareholder notes payables were unsecured, payable on demand and bore interest at prime plus 7%.

On August 31, 2005 the Company entered into agreements with the respective holders of the shareholder notes payable whereby the respective parties agreed that if and when an advance is made under the Fortress Credit Corp. Loan (Note 13(f)), the Company will repay the total amount owing under the shareholder notes in full by issuing to the Lender common shares of the Company at a price of CDN\$0.2775 per share.

**PEER 1 NETWORK ENTERPRISES INC.**  
**Notes to Consolidated Financial Statements**  
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**11. Shareholder Notes Payable: (Continued)**

On September 2, 2005 the shareholder notes were converted to 10,056,436 shares, at CDN\$0.2775. At June 30, 2006 the notes had been paid in full and accrued interest payable is \$Nil (\$185,320 in 2005).

**12. Deferred Lease Inducements:**

	<b>2006</b>	2005
Deferred lease inducements	\$507	\$363
Less: Current portion	84	49
	\$423	\$314

**13. Notes Payable:**

	Principal and Interest	Unamortized Accretion	<b>2006 Total</b>	2005 Total
<b>Secured Loans -</b>				
a) Sutton Group Financial Services Limited	\$ -	\$ -	\$ -	\$ 756
b) Sutton Group Financial Services Limited	-	-	-	930
c) Polygon Financial, Inc.	-	-	-	399
d) Polygon Financial Investments Inc.	-	-	-	8,000
e) Code Capital Limited	-	-	-	265
f) Fortress Credit Corp.	21,507	455	21,052	-
g) Polygon Financial Investments Inc.	-	-	-	-
	21,507	455	21,052	10,350
<b>Unsecured Loans -</b>				
h) ACACIA Management Services Inc.	-	-	-	87
i) Cyber Pacific Holdings Limited	-	-	-	550
j) Code Marketing Limited	-	-	-	100
	-	-	-	737
	\$21,507	\$455	21,052	11,087
Less: Current portion			3,664	10,992
			<u>\$ 17,388</u>	<u>\$ 95</u>

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**13. Notes Payable: (Continued)**

a) Sutton Group Financial Services Limited - (Continued)

On July 1, 2003, the Company amended the terms of a convertible, secured 10% note dated May 10, 2002 held by a significant shareholder, Sutton Group Financial Services Limited. The amended note accelerated the maturity date from January 2008 to July 2006. It also reduced the share price at which the outstanding principal and interest could be converted to common shares of the Company, from a range of CDN\$0.45 to CDN\$0.65 during the term of the note to CDN\$0.32 until September 30, 2005, and CDN\$0.352 thereafter. The terms of the note were further amended on August 31, 2005.

As consideration for the acceptance of the terms as amended July 1, 2003, the Company issued warrants to purchase 2,502,900 common shares at CDN\$0.32 per share until October 22, 2005. The warrants were exercised in March 2004. The shares of Peer 1 Network Inc., the Canadian operating subsidiary, were registered under a pledge agreement to secure the note. On August 31, 2005 the Company amended the note by entering into an agreement with Sutton Group Financial Services Limited whereby the parties agreed that if and when an advance is made under the Fortress Credit Corp. Loan (Note 13(f)), the Company will repay the total amount owing under the note in full by issuing the Lender common shares at a price of CDN\$0.2775 per share. On September 2, 2005 the debt was converted to 3,585,328 shares at CDN\$0.2775 per share.

b) Sutton Group Financial Services Limited -

An unsecured, demand promissory note bearing interest at prime plus 7% was issued to a significant shareholder of the Company, Sutton Group Financial Services Limited, in September 2002 and the terms of the note were amended effective July 1, 2003. The amended terms provided that the principal and interest accrued at prime plus 7% would be due June 30, 2006 and that the note could have been converted to common shares of the Company at CDN\$0.32 per share until June 30, 2005, and thereafter at CDN\$0.352 per share.

The Company had also agreed that the holders could have exchanged the amended note to the Company for shares in the capital of Peer 1 Network Enterprises Inc. Prior to September 30, 2005, the number of shares issued were based on CDN\$0.32 per share, thereafter, CDN\$0.352 per share. The terms of the note were further amended on August 31, 2005.

As partial consideration for agreeing to renegotiate the terms of the existing debt as per the amendment dated July 1, 2003, the creditors were granted warrants to purchase 3,013,821 common shares at CDN\$0.32 per share expiring on October 22, 2005. The warrants were exercised in March 2004.

The Company had pledged the assets of Peer 1 Network Enterprises Inc. as security for the loan, subject to the security interest of the Code Capital Limited loan (Note 13(e)), and a postponement agreement. Code Capital Limited is a Company owned by a shareholder and director of the Company.

On August 31, 2005 the Company entered into an agreement with Sutton Group Financial Services Limited (the "Lender") whereby the parties agreed that if and when an advance is made under the Fortress Loan, the Lender would assign the Indebtedness to the Company in exchange for common shares of the Company at a price of CDN\$0.2775 per share. On September 2, 2005 the debt was converted to 4,565,328 shares at CDN\$0.2775 per share.

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**13 Notes Payable: (Continued)**

c) Polygon Financial, Inc. -

Under an April 4, 2003 line of credit agreement with Polygon Financial, Inc., a lender controlled by a director of the Company, the lender advanced \$900,000, the full amount of the agreement, in four draws.

Interest was charged at 10% per annum compounded monthly (increasing to 15% in the event of default). Principal and interest were payable in quarterly installments commencing October 31, 2003 and ending on January 31, 2008. The unused portion of the facility bore a standby fee of 7.5%.

The aggregate principal amount under the line of credit could have been converted into common shares at the option of the lender. During the first two years of the line of credit, the conversion price was CDN\$0.32 per share. The conversion price was to be increased by 10% per year thereafter. If the conversion resulted in the lender holding more than 20% of the issued common shares, shareholder approval was to be obtained. On August 31, 2005 the conversion price was amended to CDN\$0.2775 per share.

In connection with the April 4, 2003 line of credit agreement, the Company issued to the lender, a non-transferable share purchase warrant entitling it to purchase up to 4,145,906 common shares at CDN\$0.32 per share, for two years. The warrants, issued in lieu of additional interest and fees, expired on July 24, 2005.

The assets of Peer 1 Network (USA) Inc. had been pledged as security for the facility.

On August 31, 2005 the Company entered into an agreement with Polygon Financial, Inc., whereby the parties agreed that if and when an advance is made under the Fortress Credit Corp Loan (Note 13(f)), the Lender will assign the total amount owing under the promissory note – the “Indebtedness” to the Company in exchange for common shares of the Company at a price of CDN\$0.2775 per share and that the Company will then forgive the Indebtedness. On September 2, 2005 the debt of CDN\$728,049 was converted to 2,623,600 shares at CDN\$0.2775 per share.

d) Polygon Financial Investments Inc. -

On October 18, 2004 a senior secured promissory note agreement was entered into with Polygon Financial Investments Inc., a Company owned by a shareholder and a director of the Company, in the amount of \$7,500,000. Under the terms of the note, interest accrued at a rate of 6% per annum, compounded monthly, from the date of issue to December 31, 2004 at which time the accrued interest was payable. The interest rate then increased to 15% per annum, compounded monthly, with accrued interest payable monthly commencing January 31, 2005.

A \$500,000 transaction fee was charged as additional compensation for the making of the loan. On April 1, 2005 the agreement was amended to add the \$500,000 fee to the principal amount of the note. The transaction fee has been charged to income over the term of the note.

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**13. Notes Payable: (Continued)**

d) Polygon Financial Investments Inc. – (Continued)

The maturity date of the note was June 30, 2005, with provisions for extension at the discretion of the borrower. The note extension periods varied from three to six months, with renewal fees equivalent to 2.5% of the outstanding principal for each three month period. The Company exercised a six month renewal option, and extended the maturity date of the note to December 31, 2005. The transaction fee associated with the renewal was \$400,000, which was settled on July 1, 2005 by issuing 1,538,625 shares at CDN\$0.32 per share.

The shares of ServerBeach GP Inc., ServerBeach LP Inc., ServerBeach Ltd., and Data Centre Technologies IP Inc. had been pledged as security for the note.

On September 2, 2005 the note was repaid.

e) Code Capital Limited -

In October 2003, a promissory note agreement was entered into with Code Capital Limited, a Company owned by a shareholder and a director of the Company, in the amount of CDN\$500,000. Under the terms of the note, interest accrued at a rate of prime plus 4%. Principal and interest were payable in 60 equal installments of CDN\$10,359 commencing October 15, 2003.

Under the agreement, the Company issued 500,000 warrants to purchase 500,000 common shares at CDN\$0.28 per share if exercised before November 6, 2005. The warrants were exercised on October 14, 2005.

The loan had first security over the assets of the Company, except for the security interest in the shares of Peer 1 Network (USA) Inc., a wholly-owned subsidiary of the Company.

On August 31, 2005 the Company entered into an agreement with Code Capital Limited whereby the parties agreed that if and when an advance is made under the Fortress Credit Corp. Loan (Note 13 f), the Company will repay the total amount owing under the promissory note in full by issuing to the Lender common shares of the Company at a price of CDN\$0.2775 per share.

On September 2, 2005 the note was converted to 1,254,176 shares, at CDN\$0.2775.

f) Fortress Credit Corp.-

In connection with the Interland acquisition, the Company entered into a Loan and Security Agreement (the "LSA") dated September 2, 2005 by and among Peer 1 (USA), Inc. and each of its subsidiaries that are signatories thereto as borrowers (the "Borrowers"), the Company and each of its subsidiaries that are signatories thereto as guarantors (the "Guarantors"), and Fortress Credit Corp. ("Fortress") as the lender, arranger and administrative agent.

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**13. Notes Payable: (Continued)**

f) Fortress Credit Corp.- (Continued)

Pursuant to the LSA, Fortress agreed to make three loan facilities available to the Borrowers after they have met the terms of the contract, a term loan which was advanced on September 2, 2005 in the amount of \$24,000,000; a term loan (the "Incremental Term Loan") of up to \$4,000,000 (less if certain cash flow criteria specified in the LSA are not satisfied) and a revolving loan (the "Revolving Facility") of up to \$7,000,000 until September 2, 2008 and \$10,000,000 thereafter until September 2, 2010 if the maturity date is extended by the Company for two years in accordance with the terms of the LSA.

The interest rate on borrowings under the LSA is LIBOR plus 6.5% per annum, subject to adjustment in certain specified circumstances. The amounts borrowed must be repaid in monthly installments of \$288,000, commencing on October 1, 2005. A portion of the net proceeds received by any of the Borrowers from the sale of assets or the issuance of equity securities must be used to prepay the loan. The maturity date of the loan is September 1, 2008, though the Company may extend the maturity date for two years by giving notice of such extension at least 90 days before September 1, 2008.

The Company has pledged 100% of the shares of Peer 1 Network Enterprises Inc and its subsidiaries Peer 1 Network Inc. (and its subsidiaries), and Peer1 Network (USA) Inc. (and its subsidiaries) as security for the loan with Fortress Credit Corp.

In connection with the LSA, the Company issued warrants entitling the holders to acquire 2,306,571 common shares at \$0.23 per share for a period of five years.

g) Polygon Financial Investments Inc.

On July 18, 2005 the Company closed a \$2,000,000 loan, the proceeds of which were used to build a data centre in Los Angeles and to complete the build out of the new facility in Toronto. The lenders are companies which are controlled by directors of the Company.

The loan bears interest at 10% per annum, compounded monthly, plus contingent interest in certain circumstances equal to 50% of the aggregate operating profit generated from the new locations during the period ending June 30, 2010. Interest only is payable monthly effective July 31, 2005 and blended payments of principal and interest are payable effective July 31, 2006. The loan matures on June 30, 2008.

At the option of the lender, the loan was convertible into common shares at CDN\$0.40 per share if exercised by July 18, 2007 and CDN\$0.46 per share if exercised thereafter. The loan was convertible only until 90 days after the lender received any payment of contingent interest. As further consideration for the loan, the Company issued 3,100,000 warrants to the lenders, pro rata to their respective percentage of the loan. Each warrant entitles the holder to purchase one common share of the Company at CDN\$0.40 per share until July 18, 2007.

The loan is secured by the assets of the new Los Angeles and Toronto facilities. On September 2, 2005 the note was repaid.

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**13. Notes Payable: (Continued)**

h) ACACIA Management Services Inc. -

An unsecured, convertible note agreement was entered into with ACACIA Management Services Inc., and amended the terms of the agreement effective July 1, 2003. The loan bore interest at 10%. As amended, CDN\$500,000 could be converted to common shares of the Company at CDN\$0.38 per share. Upon conversion, the balance of the loan was repayable without interest in quarterly payments of CDN\$75,000.

The lender exercised its right to convert debt of CDN\$500,000 and received 1,315,789 common shares of the Company on November 6, 2003.

The loan was repaid in January 2006.

i) Cyber Pacific Holdings Limited -

An unsecured, demand promissory note bearing interest at prime plus 7% was issued to a lender, Cyber Pacific Holdings Limited, whose director is also a shareholder of the Company, in November 2002 and amended the terms of the note effective July 1, 2003. The amendments provided that the note could be converted to common shares of the Company at CDN\$0.32 per share until June 30, 2005 and at CDN\$0.352 until June 30, 2006, when the note was to be repaid. The terms of the note were further amended on August 31, 2005.

In consideration of the amendment effective July 1, 2003, the Company issued 1,834,215 warrants to purchase common shares of the Company at CDN\$0.32 per share if exercised before October 23, 2005. The warrants were not exercised and expired.

On August 31, 2005 the Company entered into an agreement with Cyber Pacific Holdings Limited whereby the parties agreed that if and when an advance is made under the Fortress Credit Corp. Loan (Note 13(f)), the Company will repay the total amount owing under the promissory note in full by issuing to the Lender common shares of the Company at a price of CDN\$0.2775 per share. On September 2, 2005 the note was converted to 2,697,897 shares, at CDN\$0.2775.

j) Code Marketing Limited -

An unsecured, demand promissory note without interest was issued to a lender, Code Marketing Limited, controlled by a shareholder and director of the Company in May 2002 and amended the note effective July 1, 2003. Under the amended terms, the note could be converted to common shares at CDN\$0.32 per share until June 30, 2005 and CDN\$0.352 per share thereafter. If the note was not converted by June 30, 2006, the principal plus all accrued and unpaid interest, calculated at prime plus 7%, would be payable immediately. The terms of the note were further amended on August 31, 2005.

In consideration for the lender's acceptance of the amendments effective July 1, 2003, the Company issued 334,375 share purchase warrants. The warrants entitled the lender to purchase common shares at CDN\$0.32 per share if exercised before October 22, 2005. The warrants were exercised in March 2004.

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**13. Notes Payable: (Continued)**

j) Code Marketing Limited – (Continued)

On August 31, 2005 the Company entered into an agreement with Code Marketing Limited whereby the parties agreed that if and when an advance was made under the Fortress Credit Corp Loan (Note 13(f)), the Company would repay the total amount owing under the promissory note in full by issuing to the Lender common shares of the Company at a price of CDN\$0.2775 per share. On September 2, 2005 the note was converted to 491,823 shares, at CDN\$0.2775.

**14. Long Term Debt**

a) Preferred Shares Series A -

On September 2, 2005 7,000 preferred shares with a par value of \$1,000 per share were issued for cash proceeds of \$7,000,000. The preferred shares are classified as long term debt as they are redeemable by the holders at \$2,000 per share anytime after four years. The \$14,000,000 redemption amount has been reduced by a discount on issuance of \$7,000,000 and is being amortized using the effective interest method over a period of four years.

The Company and its subsidiary, Peer 1 Network (USA Inc.) ("Peer 1 USA"), entered into a Series A preferred stock Purchase Agreement (the "SPA") dated September 2, 2005 with several investors (the "Investors") pursuant to which Peer 1 USA has issued 7,000 shares of Series A preferred stock in its capital at \$1,000 per share, for aggregate proceeds of \$7,000,000.

The Series A preferred stock carries one vote per share and a cumulative annual dividend of 8%. In the event of any liquidation, dissolution or winding up of Peer 1 USA, the holders of the Series A preferred stock are entitled to receive, in preference to any distribution of the assets of Peer 1 USA, an amount per share equal to the liquidation value for each share of Series A preferred stock. The liquidation value of a share of Series A preferred stock is:

- (i) for the period beginning on September 2, 2005 (the "Closing Date") through but excluding the second anniversary of the Closing Date, \$1,000 per share;
- (ii) for the period beginning on such second anniversary through but excluding the third anniversary of the Closing Date, \$1,500 per share; and
- (iii) for the period beginning on the third anniversary of the Closing Date and thereafter, \$2,000 per share, subject in each case to adjustments in certain circumstances.

At any time after the fourth anniversary of the Closing Date and provided that the amounts borrowed under the LSA have been repaid and the LSA has been terminated, any holder of shares of Series A preferred stock may cause Peer 1 USA to redeem any or all of its outstanding shares of Series A preferred stock at \$2,000 per share.

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**14. Long Term Debt: (Continued)**

a) Preferred Shares Series A (Continued) -

In connection with the SPA, the Company and Peer 1 USA entered into an Investors' Rights Agreement (the "IRA") dated September 2, 2005 with the Investors. In addition to providing the Investors with rights to register their shares of Series A preferred stock in the United States in certain circumstances, the IRA contains rights of put and call as follows:

- (i) any Investor may require the Company to purchase for \$2,000 per share any or all of its shares of Series A preferred stock at any time after the fourth anniversary of the Closing Date, upon a liquidation, dissolution or winding up of the Company or upon a change of control.
- (ii) at any time after the fourth anniversary of the Closing Date, the Company may require the Investors to sell all of their shares of Series A preferred stock to the Company at \$2,000 per share.
- (iii) any investor may at any time require the Company to purchase any or all of its shares of Series A preferred stock in exchange for the number of common shares in the capital of the Company determined by dividing \$1,000 per share of Series A preferred stock plus cumulative but unpaid dividends being exchanged by \$0.2291, subject to adjustment in certain specified circumstances.

Pursuant to the IRA, the Company has granted to each Investor a right of first offer with respect to future sales by the Company of any of its shares or securities convertible into or exchangeable or exercisable for any shares in the capital of the Company.

The Company, Peer 1 USA, the Investors and certain shareholders of the Company have entered into a Shareholder Agreement dated September 2, 2005 (the "Shareholder Agreement"). Pursuant to the Shareholder Agreement, the Company has agreed to seek shareholder approval to increase its authorized share capital and cause its management to take all necessary actions so that a nominee of Celerity Partners SBIC, L.P. is a member of the Board of Directors of the Company.

Celerity Partners SBIC, L.P., of Menlo Park, California, acquired \$4,090,000 and insiders of the Company acquired \$2,660,000 of the Series A preferred stock.

At June 30, 2006 cumulative preference share dividends in the amount of \$461,808 are undeclared and unpaid. These dividends are not payable if the preferred shares are redeemed for cash.

**15. Capital Stock:**

- a) Authorized -
  - Unlimited Common shares without par value
  - Unlimited Preferred shares without par value

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**15. Capital Stock: (Continued)**

On December 21, 2005 a resolution was passed altering the notice of articles to change the authorized share capital to an unlimited number of shares for the Common and Preferred shares.

b) Issued and Fully Paid -

	Number of Shares	Amount
Balance, June 30, 2004	44,365,367	\$ 6,720,939
Private placement	4,750,000	1,105,753
Warrants exercised	4,000	1,183
Balance, June 30, 2005	49,119,367	7,827,875
Debt for equity conversion	25,274,588	5,825,390
Share issuance costs	-	(49,861)
Stock options exercised	60,000	34,937
Settlement of loan renewal fee	1,538,625	400,000
Warrants exercised	500,000	156,039
Private placement	833,333	132,456
Balance, June 30, 2006	77,325,913	\$14,326,836

**Debt for Equity Conversion**

On September 2, 2005, the Company converted approximately CDN\$7,013,698 of its aggregate indebtedness into 25,274,588 common shares of the Company, at CDN\$0.2775 per share.

**Settlement of Loan Renewal Fee**

On July 1, 2005, the Company and Polygon Financial Investments Inc., settled a \$400,000 transaction fee associated with the renewal of a senior promissory note agreement by issuing 1,538,625 shares at CDN\$0.32 per share.

**Private Placement -**

The Company completed a private placement on January 30, 2006 for 833,333 units, each unit consisting of one common share and one share purchase warrant at a price of CDN\$0.30 per unit. Proceeds attributable to the common shares shown above were \$132,456.

**Shares Held in Escrow -**

Shares in the amount of 9,207,001 (13,082,925 in 2005) are subject to an escrow agreement and may not be transferred, assigned or otherwise dealt with without regulatory approval.

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**15. Capital Stock: (Continued)**

**Warrants –**

The following non-transferable share purchase warrants are outstanding:

Exercise Price	2005	Issued	Expired/ Exercised	2006	Expiry Date
CDN\$0.32	1,834,215	-	1,834,215		October 23, 2005
CDN\$0.28	500,000	-	500,000		November 6, 2005
CDN\$0.40	-	3,100,000	-	3,100,000	July 18, 2007
\$0.23	-	2,306,571	-	2,306,571	September 2, 2010
CDN\$0.40	-	833,333	-	833,333	January 31, 2011
	2,334,215	6,239,904	2,334,215	6,239,904	

**Contributed Surplus –**

Balance, June 30, 2004	\$ 163
Adjustment for prior years stock based compensation	269
Stock based compensation	70
Balance, June 30, 2005	502
Stock options exercised	(13)
Stock based compensation	289
Balance, June 30, 2006	\$ 778

**Stock Options -**

	2006		2005	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning	3,647,250	\$0.34	3,428,250	\$0.35
Granted	1,515,000	0.49	452,000	0.29
Exercised	60,000	0.36	-	-
Expired	77,500	0.32	-	-
Forfeited	-	-	(233,000)	0.32
Outstanding, ending	5,024,750	\$0.41	3,647,250	\$0.34
Options exercisable, ending	4,540,583	\$0.39	3,647,250	\$0.34

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**15. Capital Stock: (Continued)**

**Stock Options - (Continued)**

The following table summarizes stock options outstanding and exercisable:

	<b>Range of Exercise Prices</b>	<b>Number Outstanding 2006</b>	<b>Weighted Average Remaining Contractual Life</b>	<b>Weighted Average Exercise Price</b>
Outstanding, ending	0.21 – 0.67	5,024,750	2.47 Years	\$0.41
Options exercisable, ending	0.21 – 0.67	4,540,583	2.22 Years	\$0.39

During the fiscal year ended June 30, 2006, directors and officers of the Company were granted aggregate 1,465,000 options with exercise prices with a range of \$0.35 - \$0.67 expiring between July 29, 2010 and May 30, 2011.

Under the stock option plan, the Company may grant options to its directors, consultants, and employees for up to 7,732,591 (4,911,937 in 2005) shares of common stock. The exercise price of each option equals the market price of the stock on the date of the grant. These options vest on varying terms from the date granted to equally over 18 months.

The fair value of each option is estimated as at the date of grant using the Black-Scholes Option Pricing Model with the following weighted average assumptions:

	<b>2006</b>	<b>2005</b>
Dividend yield	-	-
Expected volatility	75%	75%
Risk-free interest rate	4.5 %	3.0 %
Expected average option term	5 years	5 years

The weighted average fair value of the options granted to employees during the year was \$0.28 (\$0.17 in 2005) per option. The 2006 stock based compensation expense is \$289,000.

**Loss Per Share**

Loss per share is based on the weighted average number of common shares outstanding during the year. The exercise of outstanding stock options, warrants and preferred shares as at June 30, 2006 and June 30, 2005 would have had an anti-dilutive effect on the loss per share.

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**16. Income Taxes:**

Accumulated non-capital losses of approximately \$7,114,114 (\$9,667,325 in 2005) are available to be carried forward to apply against future years' income for tax purposes. These losses expire as follows:

2010	\$ 354
2011	569
2012	775
2025	2,008
2026	3,408

For Canadian tax purposes losses can be carried forward for seven years, whereas, for US tax purposes losses can generally be carried forward for twenty years.

Significant components of the future tax assets are shown below:

	<b>2006</b>	2005
Future Tax Assets -		
Non-capital losses carried forward	<b>\$ 2,446</b>	\$ 3,394
Amortization expensed in excess of capital allowances	<b>1,533</b>	(1,099)
Financing costs	<b>127</b>	82
Other	<b>405</b>	143
Total future tax assets	<b>4,511</b>	2,520
Valuation allowance	<b>(4,511)</b>	(2,520)
	<b>\$ -</b>	\$ -

Management believes there is sufficient uncertainty regarding the realization of future tax assets such that a full valuation allowance has been provided.

Income taxes vary from the amount that would be computed by applying the combined statutory income tax rate for the following reasons:

	<b>2006</b>	2005
Expected tax	<b>\$ (971)</b>	\$ (718)
Losses from previous years applied against this years profits	<b>(1,564)</b>	-
Non-capital losses carried forward	<b>1,193</b>	1,687
Depreciation in excess of capital allowances	<b>1,236</b>	(1,231)
Amortization of goodwill	<b>(102)</b>	(153)
Other temporary differences	<b>(267)</b>	272
Non-deductible finance expenses	<b>227</b>	106
Amortization of preferred share discount	<b>380</b>	-
Stock based compensation	<b>101</b>	25
Other permanent differences	<b>41</b>	12
US state tax	<b>116</b>	-
	<b>\$ 390</b>	\$ -

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**17. Supplemental Disclosure of Cash Flow Information:**

	<b>2006</b>	2005
a) Supplemental Disclosure -		
Interest	<b>\$ 1,836</b>	\$ 102
b) Non-cash Transactions -		
i) On September 2, 2005, there was an issuance of 2,306,571 warrants with a fair value of \$630,215 as additional consideration for a note payable. The unamortized accretion is \$455,161. See Note 13(f).		
ii) On July 18, 2005, there was an issuance of 3,100,000 warrants with a fair value of \$382,923 as additional consideration for a note payable. See Note 13(g).		
iii) On September 2, 2005, there was a conversion of CDN\$7,013,698 into 25,274,588 common shares. See Note 15(b).		
iv) On July 1, 2005, there was a conversion of a \$400,000 loan renewal fee into 1,538,625 common shares. See Note 15(b).		

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**18. Related Party Balances and Transactions:**

The Company has entered into a number of related party transactions with companies either owned or subject to significant influence by management, directors, and principal shareholders.

The significant transactions with related parties are as follows:

	<b>2006</b>	2005
<hr/>		
Transactions During the Year -		
Revenue earned	<b>\$ 169</b>	\$ 87
Interest expensed	<b>322</b>	1,205
Other expenses	<b>365</b>	60

These transactions are in the normal course of operations and are measured at their exchange amounts, which is the amount of consideration established and agreed to by the related parties. Included in other expenses is \$139 (\$69,643 in 2005) in accounts receivable that has been written off.

	<b>2006</b>	2005
<hr/>		
Balances at Year-End -		
Accounts receivable from related companies	<b>\$59</b>	\$50
Accounts payable to a related party	<b>26</b>	(4)

The balances are payable on demand and have arisen from the sale of products and provision of services referred to above.

Also see Notes 6, 13, 14 and 16 for details of additional related party transactions and balances.

**19. Financial Instruments:**

a) Fair Values -

Cash and cash equivalents, restricted cash, accounts receivable, accounts payable and accrued liabilities, deferred revenue, and shareholder notes payable are stated at amounts approximating fair value due to their short-term nature. The fair values of notes payable and long-term debt are stated at amounts that approximate their fair value.

b) Foreign Currency Risk -

The Company has accounts receivable and accounts payable denominated in Canadian dollars. The carrying value of these items may change due to fluctuations in foreign exchange rates. The Company currently does not enter into hedging transactions.

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**19. Financial Instruments: (Continued)**

c) Credit Risk -

The accounts receivable are subject to credit risk as several customers operate in a volatile segment of the economy. The Company mitigates this risk through receipt and review of credit applications, diligent collection procedures and encouraging customers to pay via credit cards or pre-authorized payment. A deposit at the onset for installation charges is also required.

d) Interest Rate Risk -

The Company is exposed to interest rate risk as the notes payable bear interest based on an interest rate of Libor plus 6.5%

e) Liquidity Risk -

The Company is subject to significant liability risk on its accounts payable and notes payable.

**20. Commitments:**

a) Premises Leases -

The Company has entered into agreements to lease premises which expire between 2010 and 2017. The future minimum lease payments for the next five years are as follows:

2007	\$5,277
2008	5,409
2009	5,448
2010	5,109
2011	4,943

b) Services Agreements -

The Company has entered into a series of agreements to obtain bandwidth, backbone, peering, local loop/cross connect and points of presence services. These agreements expire between 2007 and 2010. Minimum lease payments for the next three years under the contracts are as follows:

	2007	2008	2009
Bandwidth	\$1,155	\$ -	\$ -
Backbone	1,198	273	-
Peering	81	-	-
Local loop/cross connect	658	427	268
Points of presence	250	26	11
	<b>\$3,342</b>	<b>\$726</b>	<b>\$279</b>

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**21. Segmented Information:**

The reporting segments are as follows:

	Co-location & Bandwidth	Dedicated Servers	<b>2006 Total</b>
Revenue	\$18,391	\$42,335	<b>\$60,726</b>
Income (Loss)	(3,219)	31	<b>(3,188)</b>
Amortization of property & equipment	1,562	5,510	<b>7,072</b>
Amortization of intangible assets	48	1,394	<b>1,442</b>
Total Assets	19,734	28,549	<b>48,283</b>
	Co-location & Bandwidth	Dedicated Servers	<b>2005 Total</b>
Revenue	\$13,627	\$5,811	<b>\$19,438</b>
Income (Loss)	(1,285)	(897)	<b>(2,182)</b>
Amortization of property & equipment	1,159	656	<b>1,815</b>
Amortization of intangible assets	37	654	<b>691</b>
Total Assets	11,375	8,182	<b>19,557</b>

Geographic segment information is shown on the basis of the geographic location of the permanent establishment that derived the results. The geographic segments in operation are as follows:

<b>2006</b>	Canada	US	<b>Total</b>
Revenue	\$14,160	\$46,566	<b>\$60,726</b>
Property and equipment	5,479	19,041	<b>24,520</b>
Goodwill	-	1,715	<b>1,715</b>
Intangible assets	51	5,913	<b>5,964</b>
Amortization of property and equipment	1,075	5,997	<b>7,072</b>
Amortization of intangible assets	48	1,394	<b>1,442</b>
<b>2005</b>	Canada	US	<b>Total</b>
Revenue	\$11,152	\$8,286	<b>\$19,438</b>
Property and equipment	4,254	5,942	<b>10,196</b>
Goodwill	-	590	<b>590</b>
Intangible Assets	23	4,097	<b>4,120</b>
Amortization of property and equipment	817	998	<b>1,815</b>
Amortization of intangible assets	37	654	<b>691</b>

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**22. Differences Between Canadian and United States  
Generally Accepted Accounting Principles:**

These financial statements are expressed in Canadian dollars and are prepared in accordance with Canadian GAAP which conform, in all material respects, with US GAAP except as described below:

Statement of Operations -	2006	2005
Net Loss - Canadian GAAP	<b>\$3,188</b>	\$2,182
Add: Deferred charges	<b>(126)</b>	48
Debt conversion charges	-	102
Unrealized foreign exchange	<b>10</b>	(220)
Accretion interest charge on convertible debt	<b>(1,089)</b>	(101)
Net Loss - US GAAP	<b>1,983</b>	2,011
Unrealized foreign exchange	<b>(10)</b>	220
Comprehensive Loss - US GAAP	<b>\$1,973</b>	\$2,231

The Company has deferred certain costs associated with developing a new business venture. These costs have been expensed for US reporting.

During the year, the Company negotiated various debt instruments. The costs associated with this restructuring have been expensed for US reporting purposes.

In accordance with APB No. 16, internal and indirect costs associated with merger and acquisition activities have been expensed as incurred. Incremental fees such as finders' fees and consulting fees have been capitalized.

Unrealized foreign exchange gains have been added back to the Net Loss and become a component of the Company's comprehensive income.

The interest on convertible debt includes an accretion charge to reflect the increase in the equity component of the convertible debt. Under US GAAP APB No. 14 "Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants", no portion of the security should be attributable to the conversion feature, so the accretion charge should be added back to Net Loss.

**Employee Stock Options -**

The Company accounts for all its employee stock options with the fair value method "FAS 123". Under this method, compensation cost is measured at the grant date based on the fair value of the options granted. FAS 123 requires that the option be valued using a fair value option pricing model.

The Company adopted the fair value method for Canadian purposes effective January 1, 2004. As a result there is no adjustment to net income for 2005, but there is an adjustment to share capital and deficit to reflect the different dates of adoption.

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**22. Differences Between Canadian and United States**  
**Generally Accepted Accounting Principles: (Continued)**

**Non-employee Stock Options -**

The Company accounts for its non-employee stock options with the fair value method "FAS 123". Under this method, compensation cost is measured at the grant date based on the fair value of the options granted. FAS 123 requires that the option be valued using the Black-Scholes Option Pricing Model.

The Company has granted employee and non-employee stock options at various times during the year ended June 30, 2005. At the dates of grant the options were valued using the Black-Scholes Option Pricing Model with the following assumptions:

Volatility factor of market	75%
Price of Company shares	\$0.45
Risk-free interest rate	3%
Weighted average exercise price	\$0.45
Term	5 years

**Share Purchase Warrants -**

Under FAS 133 as amended by FAS 149 and 150, beneficial detachable warrants issued as a component of debt have been reclassified as equity. As Canadian GAAP conforms to US GAAP, this has no material impact on the Company.

**Net Loss Per Share -**

On February 1997, SFAS No. 128 "Earnings per Share" was issued. SFAS 128 redefines earnings per share under US GAAP and replaces primary earnings per share with basic earnings per share. The net loss per share, as reported, is different from basic loss per share prescribed by SFAS 128 as follows:

	<b>2006</b>	<b>2005</b>
Weighted Average Number of Shares Outstanding –		
Canadian	<b>77,325,913</b>	45,722,660
Less: Escrow shares	<b>9,207,001</b>	13,082,925
US GAAP	<b>68,118,912</b>	32,639,735
Basic loss per share under US GAAP	<b>\$(0.03)</b>	\$(0.06)

**Application of US GAAP -**

In June 1997, FASB issued SFAS No. 130 "Reporting Comprehensive Income", which was effective for fiscal years beginning after December 15, 1997. The Company has determined that comprehensive income consists of its net loss and foreign currency translation adjustments, and is shown net of tax in the statement of changes in shareholders' equity.

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**22. Differences Between Canadian and United States  
Generally Accepted Accounting Principles: (Continued)**

**Application of US GAAP - (Continued)**

The application of US GAAP would have the following effects on the balance sheet items as reported under Canadian GAAP:

**Balance Sheet**

Assets	2006	2005
Canadian GAAP	<b>\$48,283</b>	\$19,557
Effect of deferred charges and debt conversion costs	(47)	(138)
US GAAP	\$48,236	\$19,419

**Liabilities**

Canadian GAAP	<b>\$43,836</b>	\$19,432
Effect of equity portion of convertible debentures	(8,087)	148
US GAAP	\$35,749	\$19,580

**Shareholders' Deficiency**

Deficit - Canadian GAAP	<b>\$11,708</b>	\$ 8,520
Add: Effect of deferred charges and debt conversion costs	(126)	48
Stock based compensation	-	-
Accretion interest charge on convertible debt	(1,087)	(102)
Cumulative effect of prior years' adjustments:		
Deferred charges and debt conversion costs	174	115
Stock based compensation	422	422
Accretion interest charge on convertible debt	(101)	(101)
Deficit - US GAAP		<b>10,990</b>
8,902		
Capital - Canadian GAAP	<b>16,155</b>	8,645
Add: Stock based compensation	422	422
Equity component of convertible debt	6,899	(326)
Capital - US GAAP	23,476	8,741
Shareholders' Equity (Deficiency) – US GAAP	\$12,486	\$ (161)

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**22. Differences Between Canadian and United States**  
**Generally Accepted Accounting Principles: (Continued)**

**Convertible Promissory Debentures -**

Under US GAAP, in accordance with APB No. 14 "Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants", no portion of the proceeds from the issuance of convertible debt securities should be accounted for as attributable to the conversion feature. Canadian GAAP requires the separate presentation of the liability and equity component of the convertible debentures. See Note 15.

**Recent Accounting Pronouncements:**

a) Revenue Recognition -

In 1999, SAB No. 101 "Revenue Recognition in Financial Statements" was issued. SAB 101 provides guidance on recognition, presentation and disclosure of revenue in financial statements filed with the SEC. Although SAB 101 does not change any of the accounting profession's existing rules on revenue recognition, it draws upon existing rules and explains how the SEC staff applies those rules, by analogy, to other transactions that existing rules do not address.

SAB 101 as amended by SAB 101B becomes effective for the fourth fiscal quarter of fiscal years commencing after December 15, 1999. The Company has determined that SAB 101 does not have a material effect on its consolidated financial statements.

b) Derivative Instruments and Hedging Activities -

On April 30, 2003 the FASB issued Statement No. 149, Amendment of Statement No. 133 on "Derivative Instruments and Hedging Activities". Statement 149 is intended to result in more consistent reporting of contracts as either freestanding derivative instruments subject to Statement 133 in its entirety, or as hybrid instruments with debt host contracts and embedded derivative features. In addition, Statement 149 clarifies the definition of a derivative by providing guidance on the meaning of initial net investments related to derivatives. Statement 149 is effective for contracts entered into or modified after June 30, 2003. The adoption of Statement 149 did not have any effect on the Company's consolidated financial position, results of operations or cash flows.

c) Certain Financial Instruments with Characteristics of both Liabilities and Equity -

On May 15, 2003 the FASB issued Statement No. 150, "Accounting For Certain Financial Instruments with Characteristics of both Liabilities and Equity". Statement 150 establishes standards for classifying and measuring as liabilities certain financial instruments that embody obligations of the issuer and have characteristics of both liabilities and equity. Statement 150 represents a significant change in practice in the accounting for a number of financial instruments, including mandatory redeemable equity instruments and certain equity derivatives that frequently are used in connection with share repurchase programs. Statement 150 is effective for all financial instruments created or modified after May 31, 2003 and to other instruments as of September 1, 2003. The adoption of Statement 150 on July 1, 2003 did not have any impact on its consolidated financial position, results of operations or cash flows.

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**22. Differences Between Canadian and United States**  
**Generally Accepted Accounting Principles: (Continued)**

**Recent Accounting Pronouncements: (Continued)**

d) Accounting for Stock-Based Compensation -

In 2004, FASB issued a revision of FASB Statement No. 123, "Accounting for Stock-Based Compensation". This Statement supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and its related implementation guidance. This revised pronouncement requires that all stock options and warrants be accounted for using the Fair Value Method. This pronouncement will impact on the Company as a charge of \$526,620 increasing the deficit, offset by an equal credit to capital.

e) Consolidation of Variable Interest Entities -

FIN 46(R), "Consolidation of Variable Interest Entities", applies at different dates to different types of enterprises and entities, and special provisions apply to enterprises that have fully or partially applied Interpretation 46 prior to issuance of Interpretation 46(R). Application of Interpretation 46 or Interpretation 46(R) is required in financial statements of public entities that have interests in variable interest entities or potential variable interest entities commonly referred to as special-purpose entities for periods ending after December 15, 2003. Application by public entities (other than small business issuers) for all other types of entities is required in financial statements for periods ending after March 15, 2004. Application by small business issuers to entities other than special-purpose entities and by non-public entities is required at various dates in 2004 and 2005. There is no impact on the Company's consolidated financial statements.

f) Inventory Pricing -

In 2004, FASB issued Statement No. 151, an amendment of ARB No. 43, "Inventory Pricing," to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). Paragraph 5 of ARB 43, Chapter 4, previously stated that "under some circumstances, items such as idle facility expense, excessive spoilage, double freight, and rehandling costs may be so abnormal as to require treatment as current period charges." This Statement requires that those items be recognized as current-period charges regardless of whether they meet the criterion of "so abnormal." In addition, this Statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The adoption of Statement 151 did not have any impact on the company's consolidated financial position, results of operations or cash flows.

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**22. Differences Between Canadian and United States**  
**Generally Accepted Accounting Principles: (Continued)**

**Recent Accounting Pronouncements: (Continued)**

g) Exchange of Non-Monetary Assets -

In December 2004, the FASB issued SFAS Statement No. 153, "Exchanges of Non-monetary Assets". The statement is an amendment of APB Opinion No. 29 to eliminate the exception for non-monetary exchanges of similar productive assets and replaces it with a general exception for exchanges of non-monetary assets that do not have commercial substance. The Company believes that the adoption of this standard will have no material impact on its consolidated financial statements.

h) Accounting

In March 2005, FASB issued interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations—an interpretation of FASB Statement No. 143". This Interpretation clarifies that the term *conditional asset retirement obligation* as used in FASB Statement No. 143, *Accounting for Asset Retirement Obligations*, refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Thus, the timing and (or) method of settlement may be conditional on a future event. Accordingly, an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. The fair value of a liability for the conditional asset retirement obligation should be recognized when incurred—generally upon acquisition, construction, or development and (or) through the normal operation of the asset. Uncertainty about the timing and (or) method of settlement of a conditional asset retirement obligation should be factored into the measurement of the liability when sufficient information exists. Statement 143 acknowledges that in some cases, sufficient information may not be available to reasonably estimate the fair value of an asset retirement obligation. This Interpretation also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. There is no impact to the company's consolidated financial position, results of operations or cash flows.

i) Accounting Changes and Error Corrections -

In May 2005, FASB issued SFAS Statement No. 154 "Accounting Changes and Error Corrections" requiring retrospective application to prior periods' financial statements of a change in an accounting policy. The Company believes that the adoption of this standard will have no material impact on its consolidated financial statements.

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**23. Subsequent Events:**

**a) Stock Option Plan**

On September 6th, 2006 the Company announced that its Board of Directors had approved the adoption of a 2006 Combined Incentive and Nonqualified Stock Option Plan ("New Plan") to replace the Company's 2002 Incentive Stock Option Plan.

Under the new plan 15,468,382 common shares have been reserved for the issuance of options. This number of shares represents 20% of the Company's outstanding share capital as at September 6th, 2006. The previous plan had a reserve of 10% of the outstanding share capital from time to time.

The new plan is subject to shareholder and TSX Venture Exchange approval. Approval is required on or before February 28, 2007 or the New Plan will terminate.

On September 6th, 2006 the Company's Board of Directors granted options to certain non-director officers of the Company to acquire 2,973,100 shares. These options are exercisable at a price of \$0.63 per share, and have a term of five years, expiring on September 6th, 2011.

The options vest, subject to adjustment in certain circumstances, as to one third on September 6th, 2007 and two thirds monthly in equal amounts over the 24 months ending September 6th, 2009.

In addition, 828,000 of the options granted, included in the above total, are exercisable only after all requisite approvals of the new plan have been obtained.

**b) Sale and Leaseback of Data Centre**

On August 9, 2006 the Company exercised its option to purchase its leased Data Centre property located at 2300 NW Place, Miami, Florida.

The gross purchase price was \$4,617,266 and was subject to closing adjustments.

On September 26, 2006 the Company subsequently entered into a sale and leaseback arrangement for this property. The gross sale price was \$5,600,000. The Company leased the premises back from the purchaser for an initial term of 10 years with the option to renew for a further two 5 year periods.

After adjustments, the Company recorded a deferred gain of \$788,135 on this transaction.