PEER 1 NETWORK ENTERPRISES INC.

CONSOLIDATED FINANCIAL STATEMENTS

For the Year Ended June 30, 2004

HLB

Cinnamon Jang Willoughby & Company

Chartered Accountants
A Partnership of Incorporated Professionals

AUDITORS' REPORT

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, 2004 and the consolidated statements of operations and deficit, and cash flows for the year 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 audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the 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, 2004 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The consolidated financial statements as at June 30, 2003 and for the year then ended were audited by other auditors who expressed an opinion without reservation on those statements in their report dated October 31, 2003.

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

United States reporting standards for auditors require the addition of an explanatory 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. Although we conducted our audit in accordance with both Canadian generally accepted auditing standards and United States generally accepted auditing standards, our report to the shareholders dated August 18, 2004 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.

United States reporting standards also require the addition of an explanatory paragraph when the financial statements reflect a change in accounting policy, such as described in Note 2(f) for future income taxes. The adoption of this policy had no effect on the company's financial statements.

"Cinnamon Jang Willoughby & Company"

Chartered Accountants

Burnaby, BC
August 18, 2004

PEER 1 NETWORK ENTERPRISES INC.
Consolidated Balance Sheet
June 30, 2004

Assets	**2004**	2003
Current:		
Cash and cash equivalents	**$ 855,478**	$ 204,920
Accounts receivable	**2,139,565**	1,619,071
Prepaid expenses	**305,724**	228,401
	3,300,767	2,052,392
Restricted cash (Note 7(c))	**121,370**	445,987
Other assets (Note 4)	**794,804**	416,174
Property and equipment (Note 5)	**5,300,519**	3,579,724
	$9,517,460	$6,494,277
Liabilities		
Current:		
Accounts payable and accrued liabilities	**$2,201,583**	$2,562,021
Deferred revenue	**571,156**	308,759
Shareholder notes payable (Note 6)	**1,315,341**	486,854
Current portion of deferred lease inducements	**11,799**	17,700
Current portion of obligations under capital leases	**-**	127,850
Current portion of notes payable	**510,289**	111,473
	4,610,168	3,614,657
Deferred lease inducements	**150,432**	156,329
Obligations under capital leases	**-**	5,351
Notes payable (Note 7)	**3,319,312**	3,229,723
	8,079,912	7,006,060
Shareholders' Equity		
Capital stock (Note 8)	**9,914,432**	6,779,922
Warrants (Note 7)	**-**	156,506
Equity component of convertible notes (Note 7)	**435,638**	682,187
Contributed surplus	**220,355**	10,129
Deficit	**9,132,877**	8,140,527
	1,437,548	(511,783)
	$9,517,460	$6,494,277

Nature of Operations and Future Operations (Note 1)
Commitments (Note 13)

Approved by the Directors:

"Lance Tracey"

"Geoff Hampson"

- See accompanying notes -

PEER 1 NETWORK ENTERPRISES INC.
Consolidated Statement of Operations and Deficit
For the Year Ended June 30, 2004

	For the Year Ended June 30, 2004	For the Ten Months Ended June 30, 2003
Revenue	**$13,587,914**	$8,642,072
Cost of sales	**8,622,363**	6,462,465
Gross Profit	**4,965,551**	2,179,607
Operating expenses	**5,003,234**	4,334,149
Operating Loss	**37,683**	2,154,542
Gain on payables settlement (Note 11)	**-**	(479,359)
Interest expense on payables settlement (Note 11)	**-**	479,359
Interest expense	**952,823**	381,823
Foreign exchange (gain) loss	**1,844**	(107,805)
Loss before income taxes	**992,350**	2,428,560
Provision for income taxes (Note 9)	**-**	59,398
Net Loss	**992,350**	2,487,958
Deficit, beginning	**8,140,527**	5,652,569
Deficit, ending	**$ 9,132,877**	$8,140,527
Basic and diluted loss per share (Note 8)	**$ (0.02)**	$ (0.07)

- See accompanying notes -

PEER 1 NETWORK ENTERPRISES INC.
Consolidated Statement of Cash Flows
For the Year Ended June 30, 2004

	For the Year Ended June 30, 2004	For the Ten Months Ended June 30, 2003
Operating Activities:		
Net Loss	**$ (992,350)**	$(2,487,958)
Amortization	**867,601**	569,531
Gain on disposal of equipment	**(427)**	-
Write-off of future income tax asset	**-**	58,554
Settlement of consulting fees payable (Note 11)	**-**	(21,250)
Gain on payables settlement (Note 11)	**-**	(479,359)
Interest expense on payable settlement (Note 11)	**-**	479,359
Increase in accrued interest and accretion of convertible debt	**313,083**	382,033
Stock-based compensation and other	**-**	(1,980)
	187,907	(1,501,070)
Changes in non-cash working capital -		
Increase in accounts receivable	**(520,494)**	(200,433)
(Increase) Decrease in prepaid expenses	**(77,323)**	119,238
Decrease in accounts payable and accrued liabilities	**(360,438)**	(385,499)
Increase in deferred revenue	**262,397**	110,612
Cash flows (used in) operating activities	**(507,951)**	(1,857,152)
Investing Activities:		
(Increase) Decrease in restricted cash	**324,617**	(445,987)
Investment in other assets	**(378,630)**	(275,441)
Acquisition of property and equipment	**(2,590,488)**	(1,371,386)
Proceeds on disposition of equipment	**2,519**	-
Increase (Decrease) in deferred lease inducements	**(11,798)**	174,029
Cash flows (used in) investing activities	**(2,653,780)**	(1,918,785)
Financing Activities:		
Proceeds from shareholder notes payable	**705,789**	482,124
Repayment of obligations under capital leases	**(133,201)**	(408,806)
Proceeds from notes payable	**1,290,691**	1,994,847
Issuance of capital stock	**1,969,010**	1,869,449
Share issuance costs	**(20,000)**	(4,825)
Cash flows from financing activities	**3,812,289**	3,932,789
Increase in Cash and Equivalents	**650,558**	156,852
Cash and Equivalents, beginning	**204,920**	48,068
Cash and Equivalent, ending	**$ 855,478**	$ 204,920

Supplemental Disclosure of Cash Flow Information (Note 10)

- See accompanying notes -

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 bandwith and co-location facilities to web-centric and enterprise customers across North America. The company has established local offices and co-location facilities in Vancouver, Toronto, Montreal, New York, San Jose and Seattle, and also points of presence in Ashburn, Virginia and Chicago.

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., Colobrokers.com Inc., and 585065 B.C. Ltd.

These consolidated financial statements also include the company's share (50%) of the accounts of the incorporated joint venture, Symmetric Broadband Inc. (Symmetric) on the proportionate consolidation method.

B) Cash and Cash Equivalents -

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

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%
Computer software	100%
Furniture and fixtures	20%
Network equipment	20%

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

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2. Significant Accounting Policies: (Continued)

c) Property and Equipment (Continued) -

When the net carrying amount of the property and equipment exceeds 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) 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.

e) Debt Instruments -

Where the company issues warrants in connection with a debt instrument, the estimated fair market value of the warrants is credited to shareholders' equity. The reduced liability component of the debt is accreted by a charge to interest expense.

f) 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 liabilities or assets. Future income tax liabilities or assets 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.

g) 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.

h) Deferred Start-up Costs -

The company has recorded its share of start-up costs incurred by Symmetric. On the earlier of June 30, 2005 or Symmetric generating significant revenues, these costs will be amortized on a straight-line basis over three years. If it were to appear that the deferred costs could not be recovered, the unamortized balance would be immediately written-off.

i) Organizational Costs -

Organizational costs, direct or incremental costs directly related to acquisitions, are deferred and added to the cost of 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.

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2. Significant Accounting Policies: (Continued)

10. Foreign Currency Transactions -

Monetary assets and liabilities denominated in currencies other than the Canadian dollar 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 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.

k) Revenue Recognition -

The company has three sources of revenue: co-location, internet traffic, and general services. General services include installation, IP monitoring, tape back-up, technical support, additional access cards, and DNS services. Co-location, internet traffic 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.

12. Stock-based Compensation -

Effective July 1, 2002, the company adopted The Canadian Institute of Chartered Accountants (CICA) Handbook Section 3870, Stock-Based Compensation and Other Stock-Based Payments. The new recommendations are to be applied prospectively to all stock-based payments to employees and non-employees granted on or after July 1, 2002. The change in accounting policy did not result in any adjustment to the company's opening deficit balance.

The company accounts for all stock-based payments to employees and non-employees granted on or after July 1, 2002 using the fair value based method. Under the fair value method, stock-based payments to employees and non-employees are measured at the fair market value of the equity instrument issued.

No compensation expense is recorded for the stock-based compensation. Consideration paid by employees on the exercise of stock options is recorded as capital stock. A description of the stock-based compensation plan and the pro forma effect on the accounting for stock options granted to employees under the fair value method are disclosed in Note 8.

13. 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.

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2. Significant Accounting Policies: (Continued)

14. Comparative Figures -

The 2003 comparative figures have been reclassified, where applicable, in order to conform with the presentation used in the current year.

3. Investment in Symmetric:

Symmetric will provide voice services over the internet. This is a more technically demanding service than those currently offered by the company. Accordingly, the company has joined with a joint venturer who will provide the required expertise. Symmetric has not started operations.

The company's proportionate interest (50%) in Symmetric's assets and liabilities include:

Cash	$157,645
Lease deposits	17,699
Computer equipment	1,282
Deferred start-up costs	42,184
	$218,810

Accounts payable	$ 11,598
Shareholders' equity	207,212
	$218,810

The company has entered into lease agreements on behalf of Symmetric expiring in May, 2006. The lease payments are US $4,300 monthly.

Accounts receivable includes $2,793 due from the other joint venture member.

4. Other Assets:

	2004	2003
Deferred financing costs	**$123,953**	$ 43,409
Deferred start-up costs - Joint Venture (see also Note 3)	**42,184**	-
Network installation fees	**13,974**	12,145
Organizational costs	**163,150**	-
Security deposits	**451,543**	360,620
	$794,804	$416,174

5. Property and Equipment:

June 30, 2004

	Cost	Accumulated Amortization	Net
Co-location equipment	$2,152,455	$ 603,996	$1,548,459
Computer equipment	308,310	137,611	170,699
Computer software	124,323	97,324	26,999
Furniture and fixtures	93,050	34,353	58,697
Leasehold improvements	2,080,683	377,482	1,703,201
Network equipment	2,970,958	1,178,494	1,792,464
	$7,729,779	$2,429,260	$5,300,519

June 30, 2003

	Cost	Accumulated Amortization	Net
Co-location equipment	$1,387,259	$ 302,407	$1,084,852
Computer equipment	229,504	90,747	138,757
Computer software	90,128	69,346	20,782
Furniture and fixtures	73,888	22,738	51,150
Leasehold improvements	1,264,004	236,991	1,027,013
Network equipment	2,096,601	839,431	1,257,170
	$5,141,384	$1,561,660	$3,579,724

Software totalling $90,100 (2003 - $69,346) has been fully amortized and remains in service.

Included within network equipment are assets under capital lease with a net book value of $54,423 (2003 - $668,511).

6. Shareholder Notes Payable:

The shareholder notes payable are unsecured, payable on demand and bear interest at prime plus 7%. At June 30, 2004, accrued interest payable is $130,821 (2003 - $8,123).

7. Notes Payable:

	Principal and Interest	Unamortized Accretion	**2004 Total**	2003 Total
Secured Loans -				
a) Sutton Group Financial Services Limited	$ 885,035	$104,526	**$ 780,509**	$ 655,589
b) Sutton Group Financial Services Limited	1,111,981	205,781	**906,200**	993,223
c) Polygon Financial, Inc.	1,164,446	462,680	**701,766**	241,245
d) Code Capital Limited	444,881	36,638	**408,243**	-
	3,606,343	809,625	**2,796,718**	1,890,057
Unsecured Loans -				
e) ACACIA Management Services Inc.	409,965	10,670	**399,295**	757,190
f) Cyber Pacific Holdings Limited	657,130	121,325	**535,805**	586,949
g) Code Marketing Limited	119,794	22,011	**97,783**	107,000
	$1,186,889	$154,006	**1,032,883**	1,451,139
			3,829,601	3,341,196
Less: Current portion			**510,289**	111,473
			$3,319,312	$3,229,723

a) Sutton Group Financial Services Limited -

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 accelerates the maturity date from January 2008 to July 2006. It also reduces the share price at which the outstanding principal and interest may be converted to common shares of the company, from a range of $0.45 to $0.65 during the term of the note to $0.32 until September 30, 2005, and $0.352 thereafter.

As consideration for the acceptance of the amended terms, the company issued warrants to purchase 2,502,900 common shares at $0.32 per share until October 22, 2005. The warrants were exercised in March 2004.

The fair value of the warrants (2004 - $226,977; 2003 - $Nil) and of the conversion feature (2004 - $32,965; 2003 - $248,597) have been credited to shareholders' equity.

The shares of Peer 1 Network Inc., the company's Canadian operating subsidiary, have been registered under a pledge agreement to secure the note.

b) Sutton Group Financial Services Limited -

The company issued an unsecured, demand promissory note bearing interest at prime plus 7% to a significant shareholder of the company, Sutton Group Financial Services Limited, in September 2002 and amended the terms of the note effective July 1, 2003. The amended terms provide that the principal and interest accrued at prime plus 7% are due June 30, 2006. The note may be converted to common shares of the company at $0.32 per share until June 30, 2005, and thereafter at $0.352 per share.

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7. Notes Payable: (Continued)

b) Sutton Group Financial Services Limited (Continued) -

The company has also agreed that the holders may put the amended note to the company in exchange for shares in the capital of Peer 1 Network Enterprises Inc. Prior to September 30, 2005, the number of shares issued will be based on $0.32 per share, thereafter, $0.352 per share.

As partial consideration for agreeing to renegotiate the terms of the existing debt, the creditors were granted warrants to purchase 3,013,821 common shares at a price of $0.32 per share expiring on October 22, 2005. The warrants were exercised in March 2004.

The fair value of the warrants (2004 - $267,123; 2003 - $Nil) and the conversion feature (2004 - $41,549; 2003 - $Nil) have been credited to shareholders' equity.

The company has 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 7(d)), and a postponement agreement. Code Capital Limited is a company owned by a shareholder and director of the company.

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 US $900,000, the full amount of the agreement, in four draws (2003 - US $388,090). Until the funds are spent on purposes specified in the agreement, expanding operations of and providing working capital for one of the company's US subsidiaries, they are reported as "Restricted Cash" on the balance sheet.

Interest is charged at 10% per annum compounded monthly (increasing to 15% in the event of default). Principal and interest are payable in quarterly instalments 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 may be converted into common shares of the company at the option of the lender. During the first two years of the line of credit, the conversion price is $0.32 per share. The conversion price increases by 10% per year thereafter. If the conversion results in the lender holding more than 20% of the issued common shares, shareholder approval must be obtained.

In connection with the 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 a price of $0.32 per share, for two years. The warrants were issued in lieu of additional interest and fees.

The fair value of warrants issued (2004 - $156,506; 2003 - $156,506) and of the conversion feature associated with advances (2004 - $332,755; 2003 - $92,869) have been credited to shareholders' equity.

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

d) Code Capital Limited -

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

Under the agreement, the company issued 500,000 warrants to purchase 500,000 common shares at a price of $0.28 per share for two years.

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7. Notes Payable: (Continued)

d) Code Capital Limited (Continued) -

The fair value of the warrants issued (2004 - $42,481; 2003 - $Nil) has been credited to shareholders' equity.

The loan has 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.

e) ACACIA Management Services Inc. -

The company entered into a convertible note agreement with ACACIA Management Services Inc., and amended the terms of the agreement effective July 1, 2003. The loan bears interest at 10%. As amended, $500,000 may be converted to common shares of the company at $0.38 per share. Upon conversion, the balance of the loan is repayable without interest in quarterly payments of $75,000.

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

The fair value of the conversion feature (2004 - $Nil; 2003 - $340,731) has been credited to shareholders' equity.

f) Cyber Pacific Holdings Limited -

The company issued an unsecured, demand promissory note bearing interest at prime plus 7% 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 provide that the note may be converted to common shares of the company at $0.32 per share until June 30, 2005 and at $0.352 until June 30, 2006, when the note is to be repaid.

In consideration of the amendment, the company issued 1,834,215 warrants to purchase common shares of the company at a price of $0.32 per share if exercised before October 23, 2005.

The fair value of the warrants (2004 - $157,857; 2003 - $Nil) and the conversion feature (2004 - $24,130; 2003 - $Nil) have been credited to shareholders' equity.

g) Code Marketing Limited -

The company issued an unsecured, demand promissory note without interest 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 may be converted to common shares at a price of $0.32 per share until June 30, 2005 and $0.352 per share thereafter. If the note is not converted by June 30, 2006, the principal plus all accrued and unpaid interest, calculated at prime plus 7%, is payable immediately.

In consideration for the lender's acceptance of the amendments, the company issued 334,375 share purchase warrants. The warrants entitle the lender to purchase common shares at a price of $0.32 per share if exercised before October 22, 2005. The warrants were exercised in March 2004.

The fair value of the warrants (2004 - $28,777; 2003 - $Nil) and the conversion feature in (2004 - $4,239; 2003 - $Nil) have been credited to shareholders' equity.

8. Capital Stock:

Authorized -
100,000,000 Common shares without par value

Issued and Fully Paid -

	Number of Shares	Amount
Balance, August 31, 2002	31,627,639	$4,927,407
Return of shares to Treasury	(5,500)	(1,980)
Shares issued pursuant to a private placement	5,312,343	1,859,320
Share issuance costs	-	(4,825)
Balance, June 30, 2003	36,934,482	6,779,922
Conversion option exercised	1,315,789	276,315
Warrants exercised	6,115,096	2,878,195
Share issuance costs	-	(20,000)
Balance, June 30, 2004	44,365,367	$9,914,432

Private Placement -

On February 18, 2003, the company completed a private placement of 5,312,343 units at $0.35 per unit for gross proceeds of $1,859,320. Each unit consists of one common share and one non-transferable share purchase warrant entitling the holder to purchase an additional common share for two years, at a price of $0.39 per share.

Shares Held in Escrow -

As at June 30, 2004, 16,231,275 (2003 - 18,458,925) shares of the company are subject to an escrow agreement and may not be transferred, assigned or otherwise dealt with without regulatory approval.

Warrants Outstanding -

At June 30, 2004, the company has the following non-transferable share purchase warrants outstanding:

Exercise Price	June 30, 2003	Issued	Exercised	**June 30, 2004**	Expiry Date
0.72	4,305,416	-	-	**4,305,416**	July 24, 2004
0.45	400,000	-	-	**400,000**	July 24, 2004
0.39	5,312,343	-	174,000	**5,138,343**	February 18, 2005
0.32	4,145,906	-	-	**4,145,906**	April 4, 2005
0.32	-	7,775,311	5,941,096	**1,834,215**	October 22, 2005
0.28	-	500,000	-	**500,000**	November 6, 2005
	14,163,665	8,275,311	6,115,096	**16,323,880**	

8. Capital Stock: (Continued)

Stock Options -

	June 30, 2004		June 30, 2003	
	Shares	**Weighted Average Exercise Price**	Shares	Weighted Average Exercise Price
Outstanding, beginning	2,644,250	$0.45	2,680,250	$ 0.45
Granted	858,000	0.38	415,000	0.436
Exercised	-	-	-	-
Expired	(74,000)	0.40	(200,000)	0.45
Forfeited	-	-	(251,000)	0.45
Outstanding, ending	3,428,250	0.45	2,644,250	0.45
Options exercisable at year-end	3,028,250		1,322,125	0.45

The following table summarizes stock options outstanding and exercisable at June 30, 2004:

Options Outstanding				Options Exercisable	
Range of Exercise Prices	Number Outstanding at June 30, 2004	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable at June 30, 2004	Weighted Average Exercise Price
$0.32 - $0.48	3,428,250	3.5	$0.45	3,028,250	$0.45

Under the stock option plan, the company may grant options to its directors, consultants, and employees for up to 1,138,487 (2003 - 3,693,448) shares of common stock. The exercise price of each option equals the market price of the stock on the date of the grant. Of the options granted, 50% vest on stock exchange approval with the remaining 50% vesting 12 months from stock exchange approval.

The pro forma of stock options granted to employees based on the fair value of the stock options at the grant dates would have increased the loss and loss per share to the pro forma amounts indicated below:

	2004	2003
Loss - as reported	**$ (992,350)**	$(2,487,958)
Loss - pro forma	**(1,107,910)**	(2,589,079)
Loss per common share - as reported	**(0.02)**	(0.07)
Loss per common share - pro forma	**(0.03)**	(0.07)

8. Capital Stock: (Continued)

Stock Options (Continued) -

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:

	2004	2003
Dividend yield	-	-
Expected volatility	75%	75%
Risk-free interest rate	3.0%	4.75%
Expected average option term	5 years	5 years

The weighted average fair value of the options granted to employees during the year was $0.29 (2003 - $0.21) per option.

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 and warrants as at June 30, 2004 and June 30, 2003 would have had an anti-dilutive effect on the loss per share.

9. Income Taxes:

The company has non-capital losses of approximately $7,037,355 (2003 - $4,875,494) which may be carried forward to apply against future years' income for tax purposes. These losses expire as follows:

2007	$ 724,178
2008	3,849,862
2009	301,454
2010	2,161,861

Significant components of the future tax assets are shown below:

	2004	2003
Future Tax Assets -		
Non-capital loss carry-forwards	**$ 2,090,197**	$ 2,319,889
Property and equipment	**162,661**	50,193
Financing costs	**122,665**	279,273
Other	**(178,944)**	206,466
Total future tax assets	**2,196,579**	2,855,821
Valuation allowance	**(2,196,579)**	(2,855,821)
	$ -	$ -

9. Income Taxes: (Continued)

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:

	2004	2003
Basic blended federal and provincial tax at statutory income tax rates	**$ 62,144**	$ (672,474)
Change in valuation allowance	**(224,142)**	992,107
Non-deductible interest	**108,963**	(42,348)
Non-deductible financing fee	**-**	(165,201)
Other permanent differences	**53,035**	(52,686)
	$ **-**	$ 59,398

10. Supplemental Disclosure of Cash Flow Information:

a) Supplemental Disclosure -

	For the Year Ended June 30, 2004	For the Ten Months Ended June 30, 2003
Interest	**$271,250**	$27,402

b) Non-cash Transactions -

i) Issuance of 8,275,311(2003 - 4,145,906) bonus warrants with a fair value of $723,575 (2003 - $156,506) as additional consideration for promissory note.

ii) Conversion of $500,000 of debt into 1,315,789 shares.

11. 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 the company's management, directors, and principal shareholders.

11. Related Party Balances and Transactions: (Continued)

At June 30, amounts due to and from related parties were as follows:

	For the Year Ended June 30, 2004	For the Ten Months Ended June 30, 2003
Transactions During the Year -		
Revenue earned	**$360,627**	$233,982
Consulting fees paid	**-**	45,963
Interest expensed	**876,676**	208,069

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.

	2004	2003
Balances at Year-End -		
Accounts receivable from related companies	**$264,767**	$ -
Accounts payable to a related party	**2,996**	-

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

Also see Notes 3, 6, 7 and 8 for details of additional related party transactions and balances.

Payables Settlement -

During the prior year, the company entered into a series of arrangements with certain critical suppliers and Caliber Management Ltd. (Caliber), whereby the suppliers agreed to an assignment of certain trade liabilities due from the company to Caliber and settlement of such liabilities for amounts less than their carrying values. Caliber is owned by a director who is also a shareholder. Funding for the settlement of the accounts payable was provided to Caliber on an unsecured basis by another shareholder of the company (the Investor). Caliber paid $478,844 to the suppliers in settlement of $958,203 of the company's obligations. On February 14, 2003, the company paid the Investor $958,203. The Investor paid Caliber $1 in fees related to these arrangements.

On February 18, 2003, the company completed a private placement of units as described in Note 8. The company issued 5,312,343 units for aggregate proceeds of $1,859,320. As part of the private placement, a company related to the Investor purchased 328,600 units for aggregate proceeds of $115,010 and parties related to Caliber purchased 1,000,000 units for aggregate proceeds of $350,000.

Due to the involvement of the related parties and management in these arrangements, the statement of operations reports a gain on settlement of accounts payable amounting to $479,359 related to the difference between the settlement amount and the carrying value of the trade liabilities. In addition, interest expense has been charged for the same amount of $479,359 representing the cost of funds used to make the settlements.

12. 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 value of notes payable and loan payable are stated at amounts that approximate their fair value.

b) Foreign Currency Risk -

The company has accounts receivable and accounts payable denominated in US 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.

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. The company also requires a deposit at the onset for installation charges.

13. Commitments:

a) Premises Leases -

The company has entered into agreements to lease premises which expire in 2011, 2012 and 2013. The future minimum lease payments for the next five years are as follows:

2005	$1,855,782
2006	1,892,924
2007	1,935,483
2008	1,972,525
2009	1,872,117

b) Services Agreements -

The company has entered into a series of agreements to obtain bandwith, backbone, peering, local loop/cross connect and points of presence services. Minimum lease payments for the next five years under the contracts are as follows:

	2005	2006	2007	2008	2009
Bandwith	$ 766,890	$ -	$ -	$ -	$ -
Backbone	1,239,671	28,110	-	-	-
Peering	126,898	-	-	-	-
Local loop/cross connect	346,031	97,920	64,320	23,048	17,688
Points of presence	166,196	29,698	-	-	-
	$2,645,686	$155,728	$64,320	$23,048	$17,688

14. Segmented Information:

The company operates within a single operating segment. The operations of the company have been grouped according to the respective geographical region:

June 30, 2004

	British Columbia	Ontario	Quebec	US	Totals
Revenue	$5,690,265	$3,059,480	$3,143,746	$1,694,423	$13,587,914
Property and equipment	2,312,191	731,232	679,602	1,577,494	5,300,519
Amortization	364,517	131,750	138,731	232,603	867,601

June 30, 2003

	British Columbia	Ontario	Quebec	US	Totals
Revenue	$4,037,561	$2,158,329	$1,987,250	$458,932	$8,642,072
Property and equipment	1,572,226	482,217	584,604	940,677	3,579,724
Amortization	250,140	76,720	93,010	149,661	569,531

15. 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 -

	2004	2003
Net Loss - Canadian GAAP	**$ 992,350**	$2,487,959
Add: Deferred charges	**42,184**	-
Debt conversion charges	**62,228**	43,409
Stock based compensation	**115,560**	101,121
Unrealized foreign exchange	**(70,659)**	13,396
Accretion interest charge on convertible debt	**(326,322)**	(103,153)
Net Loss - US GAAP	**815,341**	2,542,732
Unrealized foreign exchange	**70,659**	(13,396)
Comprehensive Loss - US GAAP	**$ 886,000**	$2,529,336

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

Statement of Operations (Continued) -

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 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.

Employee Stock Options -

Effective July 1, 2003, the company began to account 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.

Non-employee Stock Option -

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, 2004. 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

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

The company's interest on its 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.

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

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 No. 128 as follows:

	2004	2003
Weighted Average Number of Shares Outstanding -		
Canadian	**39,365,775**	33,937,552
Less: Escrow shares	**16,231,275**	18,458,925
US GAAP	**23,134,500**	15,478,627
Basic loss per share under US GAAP	**$(0.04)**	$(0.16)

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.

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

Balance Sheet

Assets	**2004**	2003
Canadian GAAP	**$9,517,460**	$6,494,277
Effect of deferred charges and debt conversion costs	**(147,821)**	(43,409)
US GAAP	**$9,369,639**	$6,450,868

Liabilities		
Canadian GAAP	**$8,079,912**	$7,006,060
Effect of equity portion of convertible debentures	**6,163**	579,034
US GAAP	**$8,086,075**	$7,585,094

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

Balance Sheet (Continued)

Shareholders' Equity

Deficit - Canadian GAAP	**$ 9,132,877**	$ 8,140,527
Add: Effect of deferred charges and debt conversion costs	**104,412**	43,409
Stock based compensation	**115,560**	101,121
Accretion interest charge on convertible debt	**(326,322)**	(103,153)
Cumulative effect of prior years' adjustments:		
Deferred charges and debt conversion costs	**43,409**	-
Stock based compensation	**740,693**	639,572
Accretion interest charge on convertible debt	**(103,153)**	-
Deficit - US GAAP	**9,707,476**	8,821,476
Capital - Canadian GAAP	**10,570,425**	7,628,744
Less: Equity component of convertible debt	**(435,638)**	(682,187)
Stock based compensation	**856,253**	740,693
Capital - US GAAP	**10,991,040**	7,687,250
Shareholders' Equity (Deficiency) - US GAAP	**$ 1,283,564**	$(1,134,226)

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 (Note 7).

Recent Accounting Pronouncements:

Revenue Recognition -

In 1999, SAB No. 101 "Revenue Recognition in Financial Statements" was issued. SAB No. 101 provides guidance on recognition, presentation and disclosure of revenue in financial statements filed with the SEC. Although SAB No. 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 No. 101 as amended by SAB No. 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 financial statements.

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

Derivative Instruments -

In June 1998, FASB issued SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities" which established accounting and reporting standards for derivative instruments and hedging activities. It requires an entity to measure all derivatives at fair market value and to recognize them on the balance sheet as an asset or liability depending on the entity's rights or obligations under the applicable derivative contract.

In June 1999, FASB issued SFAS No. 138 "Accounting for Derivative Instruments and Hedging Activities" which amends the accounting and reporting standards of SFAS No. 133 for certain derivative instruments and hedging activities. The company's adoption of this statement, for US GAAP purposes, which requires the accounting recognition of derivatives at fair value, did not have a significant effect on the company's financial position or results of operations.