

IP Applications Corp.

Interim Consolidated Financial Statements
(Unaudited)

September 30, 2008

NOTICE OF NO AUDITOR REVIEW OF INTERIM FINANCIAL STATEMENTS

Under National Instrument 51-102, Part 4, subsection 4.3(3)(a), if an auditor has not performed a review of the interim financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The accompanying unaudited interim financial statements of the Company have been prepared by and are the responsibility of the Company's management.

The Company's independent auditor has not performed a review of these financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

IP Applications Corp.

Consolidated Balance Sheets

	2008 September 30 (Unaudited)	2007 December 31 (Audited)
Assets		
Current assets		
Cash	\$ 747,467	\$ 686,983
Restricted cash (note 4)	40,000	40,000
Accounts receivable	412,619	627,039
Prepaid expenses	88,205	79,365
	<hr/> 1,288,291	<hr/> 1,433,387
Property and equipment (note 5)	443,755	528,941
	<hr/> \$ 1,732,046	<hr/> \$ 1,962,328
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	\$ 612,964	\$ 787,584
Current portion of lease commitment (note 11)	-	55,026
Current portion of leasehold inducement (note 10)	29,935	29,935
Current portion of obligations under capital lease (note 6)	61,300	79,273
	<hr/> 704,199	<hr/> 951,818
Leasehold inducement (note 10)	185,846	208,298
Obligations under capital lease (note 6)	-	41,938
	<hr/> 890,045	<hr/> 1,202,054
Shareholders' Equity		
Capital stock (note 7(b))	11,771,023	11,296,280
Warrants (note 7(c))	240,819	31,744
Contributed surplus (note 8)	2,429,036	2,315,955
Deficit	(13,598,877)	(12,883,705)
	<hr/> 842,001	<hr/> 760,274
	<hr/> \$ 1,732,046	<hr/> \$ 1,962,328
Nature of operations and going concern (note 1)		
Subsequent events (note 12)		

Approved by the Board of Directors

"Kelly Edmison" Director

"John Jacobson" Director

IP Applications Corp.

Consolidated Statements of Operations, Comprehensive Loss and Deficit (Unaudited)

	Nine months ended September 30		Three months ended September 30	
	2008	2007	2008	2007
Revenue	\$ 4,329,615	\$ 5,903,741	\$ 1,329,436	\$ 1,878,429
Direct costs	2,686,103	3,268,474	787,739	1,043,286
	<u>1,643,512</u>	<u>2,635,267</u>	<u>541,697</u>	<u>835,143</u>
Operating expenses				
Amortization of property and equipment	136,988	350,891	46,242	106,999
Foreign exchange loss/(gain)	(15,908)	103,129	(10,633)	43,071
General and administration	1,013,612	1,093,885	318,412	338,179
Interest on capital lease obligations	11,913	10,510	3,605	1,725
Sales and marketing	281,125	296,805	108,515	81,189
Stock-based compensation	81,337	128,582	20,757	31,417
Operations and development	849,617	1,049,646	258,422	352,399
	<u>2,358,684</u>	<u>3,033,448</u>	<u>745,320</u>	<u>954,979</u>
Loss before the following	(715,172)	(398,181)	(203,623)	(119,836)
Interest accretion on convertible debenture	-	(231,831)	-	(77,277)
Net Loss and Comprehensive Loss for the period	(715,172)	(630,012)	(203,623)	(197,113)
Deficit - Beginning of period	(12,883,705)	(11,973,680)	(13,395,254)	(12,406,579)
Deficit - End of period	<u>\$ (13,598,877)</u>	<u>\$ (12,603,692)</u>	<u>\$ (13,598,877)</u>	<u>\$ (12,603,692)</u>
Loss per share - basic	(0.022)	(0.04)	(0.006)	(0.01)
Weighted average number of common shares used in the calculation of loss per share	32,633,274	15,146,550	34,393,347	15,176,184
Nature of operations and going concern (note 1)				

IP Applications Corp.

Consolidated Statements of Cashflows (Unaudited)

	Nine months ended September 30		Three months ended September 30	
	2008	2007	2008	2007
Cash flows from operating activities				
Loss for the period	\$ (715,172)	\$ (630,012)	\$ (203,623)	\$ (197,113)
Items not affecting cash				
Accretion on convertible debenture	-	231,831	-	77,277
Amortization of property and equipment	136,988	350,891	46,242	106,999
Reduction of lease commitment	(55,026)	(53,198)	(18,342)	(17,733)
Stock based compensation	81,337	128,582	20,757	31,417
Leasehold inducement amortization	(22,452)	(22,451)	(7,485)	(7,484)
	(574,325)	5,643	(162,451)	(6,637)
Changes in non-cash working capital items				
Accounts receivable	214,420	100,848	45,657	(98,079)
Prepaid expenses	(8,840)	16,909	(13,771)	12,807
Accounts payable and accrued liabilities	(174,620)	(496,653)	8,700	(120,329)
Deferred revenue	-	(42,201)	-	(9,376)
	(543,365)	(415,454)	(121,865)	(221,614)
Cash flows from investing activities				
(Increase)/Release in restricted cash	-	(40,000)	-	-
Purchase of property and equipment	(51,802)	(473)	(1,150)	(473)
	(51,802)	(40,473)	(1,150)	(473)
Cash flows from financing activities				
Payments under capital leases	(59,911)	(221,174)	(18,218)	(67,612)
Proceeds from exercise of warrants	-	40,000	-	-
Proceeds from private placements	775,000	-	775,000	-
Proceeds demand loan	-	250,000	-	250,000
Convertible debenture interest	-	95,964	-	31,851
Capital raising costs	(59,438)	-	(56,438)	-
	655,651	164,790	700,344	214,239
Increase / (Decrease) in cash	60,484	(291,137)	577,329	(7,848)
Cash/(Bank Indebtedness) - Beginning of period	686,983	70,193	170,138	(213,096)
Cash/(Bank Indebtedness) - End of period	\$ 747,467	\$ (220,944)	\$ 747,467	\$ (220,944)

IP Applications Corp.

Notes to Consolidated Financial Statements (Unaudited)

For the nine months ended September 30, 2008

1 Nature of operations and going concern

IP Applications Corp. (the “Company”) incorporated under the laws of British Columbia, provides outsourced Internet applications and solutions to Internet service providers (ISP), telecommunications companies or other corporate clients either to resell these applications to their customers and end users or for their own internal corporate use.

The accompanying consolidated financial statements are prepared on a going-concern basis, which assumes the realization of assets and the settlement of liabilities in the normal course of business. Certain conditions cast substantial doubt on this assumption. The Company has a history of recurring losses. The Company’s current level of working capital and revenues are not considered sufficient to solely fund operations. The Company has traditionally financed its operations through equity and debt financing. External financings will be required by the Company to advance its operations and pursue other potential business opportunities.

The ability of the Company to continue as a going concern and meet its commitments and ongoing operating expenses will depend upon eventually generating profitable operations and upon raising further funds in the future either through debt or equity financings. There is no assurance that the Company will be successful in achieving these goals.

The consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or to the amounts and classification of liabilities that might be necessary should the entity not continue as a going concern. These adjustments could be material.

2 Basis of presentation

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”) and include the accounts of IP Applications Corp. and its wholly owned subsidiary, IP Applications Solutions Inc. All intercompany balances and transactions are eliminated.

The accounting policies applied to the presentation of these financial statements are consistent with those applied to the previous audited annual financial statements.

3 Significant accounting policies

Adoption of new accounting standards

On January 1, 2007, the Company adopted four new accounting standards issued by the Canadian Institute of Chartered Accountants (“CICA”); Section 3855, “Financial instruments - recognition and measurement”, Section 3861, “Financial instruments - disclosure and presentation”, Section 3251, “Equity” and Section 1530, “Comprehensive income”. These standards were adopted on a prospective basis and as such, prior periods have not been restated.

IP Applications Corp.

Notes to Consolidated Financial Statements (Unaudited)

For the nine months ended September 30, 2008

Financial instruments

CICA Handbook Sections 3855, 3861 and 3251 require among other things, that all financial assets, except those classified as held to maturity and derivative financial instruments, must be measured at fair value. All financial liabilities must be measured at fair value when they are classified as held for trading; otherwise, they are measured at amortized cost and establish how gains and losses are to be recognized and presented. For the period ended September 30, 2008, the adoption of these policies had no material impact.

Comprehensive income

Under CICA Handbook Section 1530, comprehensive income is the change in the Company's net assets that results from transactions, events and circumstances from sources other than the Company's shareholders and includes items that would not normally be included in the statement of operations such as unrealized gains or losses on available-for-sale investments. For the period ended September 30, 2008, the Company did not have other comprehensive income or loss, therefore comprehensive loss for the period was equal to the loss for the period and accumulated other comprehensive income is nil.

Recent Canadian GAAP announcements

CICA Handbook Section 1535, Capital Disclosures

In December, 2006, the CICA issued Handbook Section 1535, Capital Disclosures. The new standard requires disclosure of qualitative and quantitative information that enables users of financial statements to evaluate the company's objectives, policies and processes for managing capital. These recommendations are effective for the company's interim and annual reporting periods beginning after October 1, 2007. The company has not evaluated the impact of this standard on the company's consolidated financial statements.

CICA Handbook Section 3862, Financial Instruments - Disclosures and Section 3863, Financial Instruments – Presentation

In December 2006, the CICA issued Handbook Sections 3862, Financial Instruments - Disclosures, and 3863, Financial Instruments - Presentation, which will replace Section 3861, Financial Instruments - Disclosure and Presentation. The new disclosure standard increases the emphasis on the risks associated with both recognized and unrecognized financial instruments and how those risks are managed. The new presentation standard carries forward the former presentation requirements and is effective for the company's interim and annual reporting periods beginning after October 1, 2007. The company has not evaluated the impact of this standard on the company's consolidated financial statements.

International Financial Reporting Standards

In January 2006, the CICA AcSB adopted a strategic plan for the direction of accounting standards in Canada. As part of that plan, accounting standards in Canada for public companies are expected to converge with IFRS by the end of 2011. The impact of the transition to IFRS on the company's consolidated financial statements has not yet been determined.

IP Applications Corp.

Notes to Consolidated Financial Statements (Unaudited)

For the nine months ended September 30, 2008

Property and equipment

Property and equipment are amortized on a straight-line basis at the following rates per annum:

Computer equipment	3 years
Office equipment	5 years
Computer software	2 years
Leasehold improvements	straight line over the remaining term of the lease

4 Restricted cash

Restricted cash of \$40,000 (2007 - \$40,000) was pledged as collateral in March 2007 to a chartered bank for the provision of certain credit facilities.

5 Property and equipment

	September 30, 2008		
	Cost	Accumulated amortization	Net
Computer equipment	\$ 1,329,924	\$ 1,229,932	\$ 99,992
Office equipment	52,867	39,121	13,746
Computer software	129,033	124,830	4,203
Leasehold improvements	445,237	119,423	325,814
	<u>\$ 1,957,061</u>	<u>\$ 1,513,306</u>	<u>\$ 443,755</u>

	December 31, 2007		
	Cost	Accumulated amortization	Net
Computer equipment	\$ 1,300,886	\$ 1,141,261	\$ 159,625
Office equipment	52,867	29,390	23,477
Computer software	124,758	120,038	4,720
Leasehold improvements	426,748	85,629	341,119
	<u>\$ 1,905,259</u>	<u>\$ 1,376,318</u>	<u>\$ 528,941</u>

Included in property and equipment are assets financed by capital leases with a cost of \$1,158,005 and accumulated amortization of \$1,093,484 (as at December 31, 2007 cost was \$1,153,023 and accumulated amortization \$1,027,389).

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Notes to Consolidated Financial Statements (Unaudited)

For the nine months ended September 30, 2008

6 Obligations under capital lease

	September 30 2008	December 31 2007
Lease payable in monthly instalments of \$3,286 including interest at an imputed rate of 3.9% until December 1, 2008, secured by a charge over equipment.	23,984	52,263
Lease payable in monthly instalments of \$1,686 including interest at an imputed rate of 6.0% until March 1, 2008. The Company exercised the purchase buyout option in April 2008.	-	8,277
Lease payable in monthly instalments of \$3,865 including interest at an imputed rate of 14.0% until August 1, 2009, secured by a charge over equipment.	<u>37,316</u>	<u>60,671</u>
Less: Current portion	<u>61,300</u> <u>(61,300)</u>	<u>121,211</u> <u>(79,273)</u>
	<u>\$ -</u>	<u>\$ 41,938</u>

Future minimum lease payments for the respective period ends based on the fiscal year-end are as follows:

2008	\$ 35,777
2009	<u>30,920</u>
	66,697
Less: Imputed interest	<u>(5,397)</u>
	<u>\$ 61,300</u>

IP Applications Corp.

Notes to Consolidated Financial Statements (Unaudited)

For the nine months ended September 30, 2008

7 Share capital

a) Authorized

100,030,000 common shares without par value

b) Issued

	Number of shares	Amount
Balance – December 31, 2007	31,753,238	\$ 11,296,280
Private placement for cash (note 7 (b)(i))	3,875,000	534,181
Capital raising costs	-	(59,438)
Balance – September 30, 2008	35,628,238	\$ 11,771,023

- i) In July 2008, the Company completed a non-brokered private placement for 3,875,000 units at \$0.20 per unit for gross proceeds of \$775,000. Each unit consisted of one common share and one-half common share purchase warrant. Each whole warrant entitles the holder to purchase an additional common share at a price of \$0.25 during the 24 month period from closing. Additionally, a finder's fee of \$35,920 and 179,600 warrants were paid and issued in connection with the offering. All securities issued were subject to a four-month hold expiring on November 30, 2008.

The fair value of the warrants issued was \$240,819 using the Black-Scholes valuation model with the assumptions noted below.

Expected dividend yield	0%
Stock price volatility	108.01%
Risk-free interest rate	3.11%
Expected life of warrants	2 years

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Notes to Consolidated Financial Statements (Unaudited)

For the nine months ended September 30, 2008

c) Warrants

Balance - December 31, 2007	\$ 31,744
Warrants expired (note 7 (c) (i))	(31,744)
Warrants issued (note 7 (b) (i))	<u>240,819</u>
Balance – September 30, 2008	<u>\$ 240,819</u>

- i) During the year ended December 31, 2006, the Company completed a non-brokered private placement for 300,000 units at \$0.33 per unit for gross proceeds of \$100,000. Each unit consists of one common share and one warrant. Each warrant entitled the holder to purchase an additional common share at a price of \$0.40 during the 24 month period from closing. The fair value of the warrants issued was \$47,616 and was estimated on the issuance date using the Black-Scholes valuation model.

On April 20, 2007, 100,000 warrants were exercised at a price of \$0.40 per share, for a total of \$40,000. The fair value of the respective warrants exercised was \$15,872 using the Black-Scholes valuation model with the assumptions noted below. The remaining 200,000 warrants expired as of March 31, 2008.

Expected dividend yield	0%
Stock price volatility	92.62%
Risk-free interest rate	4.10%
Expected life of warrants	2 years

d) Stock options

The Company's amended and restated fixed stock option plan dated August 22, 2005, (the "Old Plan") provides that the maximum number of common shares of the Company reserved for issuance under the Old Plan shall not exceed 2,624,935 common shares. On November 29, 2007, the Company granted 761,000 options under the Old Plan at an exercise price of \$0.18 per share thereby leaving 78,435 available for grant under the Old Plan.

Subsequently, on November 29, 2007, the Company adopted the 2008 Stock Option Plan (the "New Plan") to increase the maximum number of common shares reserved for issuance under the New Plan to 3,810,389 common shares and to grant an additional 587,000 options at an exercise price of \$0.18 per share. An additional 100,000 options at an exercise price of \$0.165 per share were granted on March 1, 2008. The New Plan was subject to shareholder approval at the Company's AGM in May 2008 and accordingly, the 687,000 options were not exercisable until such time as the adoption was approved. The New Plan was approved at the May 2008 AGM. There are 751,889 options in total available for future grant as at September 30, 2008.

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Notes to Consolidated Financial Statements (Unaudited)

For the nine months ended September 30, 2008

Stock option transactions for the nine months ended September 30, 2008 and the year ended December 31, 2007 are summarized as follows:

	<u>September 30, 2008</u>		<u>December 31, 2007</u>	
	Number outstanding	Weighted average exercise price	Number outstanding	Weighted average exercise price
Opening balance	3,133,500	\$ 0.31	1,929,900	\$ 0.41
Granted	-	-	911,000	0.19
Granted – subject to shareholder approval	100,000	\$ 0.165	587,000	0.19
Expired	(60,000)	\$ 0.55	-	-
Forfeited	(115,000)	\$ 0.27	(294,400)	0.40
Closing balance	<u>3,058,500</u>	<u>\$ 0.30</u>	<u>3,133,500</u>	<u>\$ 0.31</u>

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Notes to Consolidated Financial Statements (Unaudited)

For the nine months ended September 30, 2008

The fair values of the options granted during the twelve months ended December 31, 2007 have been determined using the Black-Scholes option pricing formulae with the following factors and are being recognized as an expense over the one and half year vesting period:

Expected dividend yield	0%
Stock price volatility	99.9% - 103.8%
Risk-free interest rate	3.7% - 4.1%
Expected life of options	3 years
Fair value of the options granted	\$181,250

The fair values of the options granted during the nine months ended September 30, 2008 have been determined using the Black-Scholes option pricing formulae with the following factors and are being recognized as an expense over the one and half year vesting period:

Expected dividend yield	0%
Stock price volatility	98.30%
Risk-free interest rate	3.3%
Expected life of options	2 years
Fair value of the options granted	\$9,110

At September 30, 2008, the following stock options are outstanding:

Number of stock options outstanding	Exercise price	Expiry date	Number of stock options exercisable
4,000	\$ 0.55	November 15, 2008	4,000
74,000	0.55	February 27, 2009	74,000
150,000	0.55	May 27, 2009	150,000
43,800	0.18	May 2, 2010	43,800
205,000	0.55	May 2, 2010	205,000
29,200	0.18	September 22, 2010	29,200
12,500	0.55	September 22, 2010	12,500
127,000	0.18	February 28, 2011	127,000
785,000	0.33	February 28, 2011	785,000
75,000	0.34	April 20, 2011	75,000
25,000	0.34	April 20, 2011	25,000
150,000	0.28	April 30, 2012	84,375
1,278,000	0.18	November 29, 2012	705,250
100,000	0.165	February 20, 2010	41,667
<hr/>			<hr/>
3,058,500			2,361,792

IP Applications Corp.

Notes to Consolidated Financial Statements (Unaudited)
For the nine months ended September 30, 2008

8 Contributed surplus

	September 30 2008	December 31 2007
Opening balance	\$ 2,315,955	\$ 1,431,968
Stock-based compensation	81,337	165,614
Warrants expired	31,744	718,373
	<hr/>	<hr/>
Closing balance	<u>\$ 2,429,036</u>	<u>\$ 2,315,955</u>

9 Financial instruments

Fair values

The fair values of the Company's cash, accounts receivable, restricted cash, accounts payable and accrued liabilities approximate their carrying amounts because of the immediate or short-term maturity of these financial instruments.

Interest and foreign exchange rate risk

The Company is required to make certain payments in US dollars and has not entered into forward currency contracts or other financial derivatives in relation to this currency risk. To mitigate exchange risk, the Company maintains US dollar bank accounts for all US dollar sales and payments.

10 Leasehold inducements

	September 30 2008	December 31 2007
Opening balance	\$ 238,233	\$ 268,168
Amortization	(22,452)	(29,935)
	<hr/>	<hr/>
	215,781	238,233
Less: Current portion	(29,935)	(29,935)
	<hr/>	<hr/>
	<u>\$ 185,846</u>	<u>\$ 208,298</u>

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Notes to Consolidated Financial Statements (Unaudited)

For the nine months ended September 30, 2008

During the period ended December 31, 2005, the Company entered into a lease agreement for new office premises. In connection with the lease, the Company received lease inducements of \$299,350 relating to leasehold improvements. These inducements are being amortized over the initial ten year term of the lease.

11 Loss on lease commitment

	September 30 2008	December 31 2007
Opening balance	\$ 55,026	\$ 126,566
Reduction	(55,026)	(71,540)
	<hr/>	<hr/>
	\$ -	\$ 55,026
	<hr/>	<hr/>

During the period ended December 31, 2006, the Company entered into a sublease agreement for its former office space in New Westminster. The Company recorded a loss of \$209,687 representing the difference to be paid to the landlord and received from the subtenant during the period of January 1, 2006 to the expiration of both lease and sublease agreements on September 30, 2008.