

IP Applications Corp.

Consolidated Financial Statements

December 31, 2008 and 2007
(in Canadian dollars)

April 28, 2009

PricewaterhouseCoopers LLP
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Auditors' Report

To the Shareholders of IP Applications Corp.

We have audited the consolidated balance sheets of **IP Applications Corp.** as at December 31, 2008 and 2007 and the consolidated statements of operations, comprehensive loss and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2008 and 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants

IP Applications Corp.

Consolidated Balance Sheets

As at December 31, 2008 and 2007

	2008	2007
Assets		
Current assets		
Cash	\$ 535,773	\$ 686,983
Restricted cash (note 3)	40,000	40,000
Accounts receivable	512,731	627,039
Prepaid expenses	52,398	79,365
	<hr/> 1,140,902	<hr/> 1,433,387
Property and equipment (note 4)	414,029	528,941
	<hr/> \$ 1,554,931	<hr/> \$ 1,962,328
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	636,281	787,584
Deferred revenue	46,220	-
Current portion of lease commitment (note 13)	-	55,026
Current portion of leasehold inducement (note 12)	29,935	29,935
Current portion of obligations under capital lease (note 6)	28,019	79,273
	<hr/> 740,455	<hr/> 951,818
Leasehold inducement (note 12)	178,363	208,298
Obligations under capital lease (note 6)	-	41,938
	<hr/> 918,818	<hr/> 1,202,054
Shareholders' Equity (Deficit)		
Share capital (note 7(b))	11,840,673	11,296,280
Warrants (note 7(c))	171,169	31,744
Contributed surplus (note 8)	2,461,625	2,315,955
Deficit	(13,837,354)	(12,883,705)
	<hr/> 636,113	<hr/> 760,274
	<hr/> \$ 1,554,931	<hr/> \$ 1,962,328
Nature of operations and going concern (note 1)		
Commitments (note 15)		

The accompanying notes are an integral part of these financial statements.

Approved by the Board of Directors

“Kelly Edmison” Director

“John Jacobson” Director

IP Applications Corp.

Consolidated Statements of Operations, Comprehensive Loss and Deficit
For the years ended December 31, 2008 and 2007

	2008	2007
Revenue	\$ 5,703,748	\$ 7,736,544
Direct costs	3,564,647	4,366,524
	<hr/> 2,139,101	<hr/> 3,370,020
Operating expenses		
Amortization of property and equipment	184,303	462,008
Foreign exchange (gain)/loss	(72,057)	111,831
General and administration	1,353,823	1,490,115
Interest on capital lease obligations	14,625	17,373
Sales and marketing	394,138	362,599
Stock-based compensation	113,926	165,614
Operations and development	1,105,525	1,416,154
	<hr/> 3,094,283	<hr/> 4,025,694
Loss before the following	(955,182)	(655,674)
Interest accretion on convertible debenture	-	(257,401)
Other income	1,533	3,050
	<hr/>	<hr/>
Net Loss and Comprehensive Loss for the year	(953,649)	(910,025)
Deficit - Beginning of year	(12,883,705)	(11,973,680)
Deficit - End of year	<hr/> \$ (13,837,354)	<hr/> \$ (12,883,705)
Loss per share – basic and diluted	<hr/> (0.03)	<hr/> (0.05)
Weighted average number of common shares used in the calculation of loss per share	<hr/> 33,388,169	<hr/> 17,659,876
Nature of operations and going concern (note 1)		

IP Applications Corp.

Consolidated Statements of Cash Flows

For the years ended December 31, 2008 and 2007

	2008	2007
Cash flows from operating activities		
Loss for the year	\$ (953,649)	\$ (910,025)
Items not affecting cash		
Accretion on convertible debenture	-	257,401
Amortization of property and equipment	184,303	462,008
Reduction of loss on lease commitment	(55,026)	(71,540)
Stock based compensation	113,926	165,614
Unrealized foreign exchange (gain)/loss	(205,315)	73,214
Leasehold inducement amortization	(29,935)	(29,935)
	<hr/>	<hr/>
	(945,696)	(53,263)
Net change in non-cash working capital items		
Accounts receivable	252,027	206,021
Prepaid expenses	26,967	17,673
Accounts payable and accrued liabilities	(196,943)	(511,849)
Deferred revenue	46,220	(42,201)
Convertible debenture interest	-	97,803
	<hr/>	<hr/>
	(817,425)	(285,816)
Cash flows from investing activities		
Restricted cash	-	(40,000)
Purchase of property and equipment	(69,391)	(4,917)
	<hr/>	<hr/>
	(69,391)	(44,917)
Cash flows from financing activities		
Payments under capital leases	(93,191)	(259,229)
Proceeds from exercise of warrants	-	40,000
Proceeds from private placements	775,000	1,232,590
Financing issuance costs	(59,438)	(44,744)
	<hr/>	<hr/>
	622,371	968,617
Foreign exchange impact on cash	113,235	(21,094)
	<hr/>	<hr/>
Increase / (decrease) in cash	(151,210)	616,790
Cash - Beginning of period	686,983	70,193
	<hr/>	<hr/>
Cash - End of period	\$ 535,773	\$ 686,983
	<hr/>	<hr/>
Supplemental disclosure of cash flow information		
Shares issued to convert debt	-	7,762,400
Interest received	1,533	3,050
Interest paid	3,914	30,263
	<hr/>	<hr/>

IP Applications Corp.

Notes to Consolidated Financial Statements

For the year ended December 31, 2008 and 2007

1 Nature of operations and going concern

The Company

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 Company focuses on delivering billing, payments processing and technical support services for online businesses. Its on-demand billing and payments application delivers custom payment processing options and provides management software for customers’ subscribers from the point of sign-up to account closure.

Going Concern

While the accompanying consolidated financial statements are prepared on a going-concern basis, which contemplates the realization of assets and the settlement of liabilities in the normal course of business, there are material uncertainties and conditions that cast significant doubt about the validity of this assumption.

The Company has not yet realized profitable operations, has generated negative cash flows from operating activities and has an accumulated deficit of \$13,837,354 at December 31, 2008. The Company also continues to rely on external sources of debt and equity to fund operations.

The Company’s ability to continue as a going concern will depend on management’s ability to successfully execute its business plan and obtain additional financing until it achieves profitability and positive cash flows from operations.

The Company has historically provided subscription management and billing support to customers. In January 2008, the Company began assessing and developing the opportunity to expand its subscription management and billing business by enhancing and marketing these services to other emerging Software as a Service (“SaaS”) companies. In order to execute its SaaS-orientated development and marketing plans for 2009, the Company must seek additional forms of debt or equity financing, but cannot provide assurances that this will be successful.

These consolidated financial statements do not reflect adjustments to the carrying values of the assets and liabilities, reported revenues and expenses, and balance sheet classifications, that would be necessary if the company was unable to continue as a going concern. Such adjustments could be material.

IP Applications Corp.

Notes to Consolidated Financial Statements

For the year ended December 31, 2008 and 2007

2 Summary of significant accounting policies

a) Generally Accepted Accounting Principles

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”) and include the accounts of the Company and its wholly-owned subsidiary IP Applications Solutions Inc. All amounts are stated in Canadian dollars unless otherwise stated.

All material intercompany balances and transactions are eliminated upon consolidation.

b) Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Financial results as determined by actual events could differ from those estimates. Significant areas requiring the use of estimates and assumptions include the determination of future income taxes and the calculation of fair value for stock based compensation.

c) Reporting currency and foreign exchange currency translation

These consolidated financial statements are reported in Canadian dollars. Foreign currency transactions and balances are translated into Canadian dollars as follows:

- i) Revenues and expenses at average exchange rates for each period;
- ii) Monetary items at the rates of exchange prevailing at balance sheet dates;
- iii) Non-monetary items at the historical exchange rates; and,
- iv) Exchange gains and losses arising from translation are included in the determination of earnings for each year.

d) Cash and cash equivalents and restricted cash

Cash, cash equivalents and restricted cash consist of cash on deposit and highly liquid short-term interest bearing securities with maturities at the date of purchase of three months or less.

e) Short term investments

Investments with an original maturity of more than three months are considered short-term investments which are measured at fair value with changes in fair value recorded in the income statement. As at December 31, 2008 and 2007, the Company had no investments in interest bearing securities with original maturity terms greater than three months.

IP Applications Corp.

Notes to Consolidated Financial Statements

For the year ended December 31, 2008 and 2007

f) **Property and equipment**

Property and equipment are recorded at historical cost net of accumulated depreciation. Depreciation is calculated beginning on the date that the asset is available for use using the straight-line method over the following estimated useful economic lives of the assets:

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

g) **Impairment of long-lived assets**

The company reviews long-lived assets for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. The determination of any impairment would include a comparison of the undiscounted estimated future operating cash flows anticipated to be generated during the remaining life to the net carrying value of the asset. If any impairment exists, the carrying value is written down to the fair value of the asset.

h) **Leases**

Leases are classified as either capital or operating. Leases which transfer substantially all the benefits and risks of ownership are accounted for as a capital leases. All other leases are accounted for as operating leases wherein rental payments are expensed as incurred.

i) **Leasehold inducements**

Leasehold inducements received in connection with the leasing of premises are amortized on a straight-line basis over the initial term of the lease. Such amortization is recorded as a reduction of rent expense.

j) **Revenue recognition**

The Company earns revenue from the provision of services and solutions to ISP's and from the setup of customers on the Company's system.

Revenues from the provision of services are recognized when the related service has been rendered, if persuasive evidence of an arrangement exists, the fee is fixed or determinable and collectability is reasonably assured.

Cash received in advance of the delivery of services is recorded as deferred revenue until the services are rendered and the revenue recognition criteria are fulfilled.

k) **Stock-based compensation**

The Company accounts for stock options using the fair value method calculated using the Black-Scholes

IP Applications Corp.

Notes to Consolidated Financial Statements

For the year ended December 31, 2008 and 2007

option pricing model. When options are granted, the compensation cost is measured at fair value at the date of grant and is expensed to operations over the award's vesting period. A corresponding increase in contributed surplus is recorded when stock options are expensed. When stock options are exercised, capital stock is credited by the sum of the consideration paid and the related portion previously recorded in contributed surplus. The effects of forfeitures are accounted for as they occur.

For options granted to non-employees, the fair value is measured when performance is complete, a performance commitment is made or the options are fully vested and non-forfeitable, whichever is earliest. The expense is recognized over the period in which the goods or services from the non-employees are received.

l) Income taxes

The Company follows the asset and liability method of accounting for income taxes. Under this method, future income taxes are recognized for the future income tax consequences attributable to differences between the financial statement carrying values and their respective income tax bases (temporary differences) and for the benefit of loss carry-forwards. Future tax assets and liabilities are measured using substantively enacted tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled. The effect on future income tax assets or liabilities of a change in tax rates is included in income in the period during which the change in rates is considered to be substantially enacted. Future income tax assets are evaluated and if realization is not considered to be more likely than not, a valuation allowance is provided.

m) Loss per share

Basic loss per share is computed by dividing the loss by the weighted average number of shares outstanding during the year. Diluted loss per share reflects the effect of all potentially dilutive common shares resulting from stock-based compensation awards, warrants and convertible debentures, unless the conversion or exercise of such shares would be anti-dilutive.

As at December 31, 2008, 2,117,100 warrants (2007 – 200,000) and 3,054,500 options (2007 – 3,133,500) were outstanding. These were excluded from the calculation diluted loss per share as their effects would be anti-dilutive.

n) Financial Instruments

On January 1, 2007, the Company adopted the recommendations included in the Canadian Institute of Chartered Accountants ("CICA") Handbook Sections 1530, "Comprehensive Income"; 3251, "Equity"; 3855, "Financial Instruments – Recognition and Measurement"; and 3861, "Financial Instruments – Disclosure and Presentation".

Section 1530 requires the presentation of comprehensive income and its components in a new financial statement. Comprehensive income is the change in a Company's net assets that results from transactions, events and circumstances from sources other than the Company's shareholders. Other comprehensive income refers to items recognized in comprehensive income that are excluded from net income calculated

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Notes to Consolidated Financial Statements

For the year ended December 31, 2008 and 2007

in accordance with GAAP. The adoption of this standard had no impact on the Company's financial statements for the period ended December 31, 2008.

Section 3251 requires that a company present separately the changes in and the balances of the following components of equity: retained earnings, accumulated other comprehensive income, contributed surplus, capital stock and reserves. Sections 3855 and 3861 establish the standards for the recognition, measurement, disclosure and presentation of financial assets, financial liabilities and non-financial derivatives. These standards prescribe when to recognize a financial instrument in the balance sheet and at what amount. On initial recognition, all financial instruments included in the scope of section 3855 are measured at fair value. Depending on their balance sheet classification, fair value or cost-based measures are used to measure financial instruments after initial recognition. Adoption of these standards had no material effect on the Company's financial statements.

The Company has made the following classifications for its financial instruments:

Cash, cash equivalents and restricted cash	Held for trading
Short-term investments	Held for trading
Accounts receivable	Loans and receivables
Accounts payable and accrued liabilities	Other financial liabilities
Derivative instruments	Held for trading

Subsequent to adoption, the following methods and assumptions are used to estimate the fair value of the company's financial instruments as at December 31, 2008:

- i) Cash and cash equivalents, restricted cash and short-term investments: The amounts reported on the balance sheet are measured at fair value with any resulting gains or losses recognized in net loss.
 - ii) Accounts receivable and other receivables: The amounts reported on the balance sheet are carried at amortized cost using the effective interest rate method, which is an approximation of fair value. Subsequent measurement of trade receivables is at amortized cost less an allowance for doubtful accounts as determined on a customer specific basis.
 - iii) Derivative instruments: The amounts represent the fair value of forward foreign exchange contracts. These amounts are measured at fair value with any resulting gains or losses recognized in net loss.
 - iv) Accounts payable and accrued liabilities: The amounts reported on the balance sheet are carried at amortized cost using the effective interest rate method, which is an approximation of fair value.
 - v) Long-term debt: The amount is carried at amortized cost using the effective interest rate method.
- o) Adoption of new accounting policies**

Capital Disclosures

Effective January 1, 2008, the Company adopted the CICA Handbook Section 1535, "Capital Disclosures," which requires disclosure of information that enables users of financial statements to

IP Applications Corp.

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For the year ended December 31, 2008 and 2007

evaluate the Company's objectives, policies and processes for managing capital including disclosures of externally imposed capital requirements and the consequences for non-compliance. This standard relates only to disclosure and presentation and has had no impact on the Company's financial results. Refer to note 16 for additional disclosures related to capital management.

Financial Instrument Disclosures

Effective January 1, 2008, the Company adopted CICA Handbook Section 3862, "Financial Instruments – Disclosures" and section 3863, "Financial Instruments – Presentation." Collectively they 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. These new standards have been applied prospectively from the date of adoption. Refer to note 11 for additional disclosure related to financial instruments.

General Standards of Financial Statement Presentation

In June 2007, the CICA amended Handbook section 1400, "General Standards of Financial Statement Presentation", to include additional requirements to assess and disclose an entity's ability to continue as a going concern. Section 1400 is effective for interim and annual reporting periods beginning on or after January 1, 2008. The adoption of this standard has expanded the Company's going concern note disclosure without impacting the Company's operating results or financial position.

p) Recent Canadian GAAP announcements

CICA Handbook 1582, Business Combinations; 1601, Consolidated Financial Statements, and 1602, Non-controlling Interests.

In January 2008, the CICA issued Handbook Sections 1582, "Business Combinations"; 1601, "Consolidated Financial Statements" and 1602, "Non-Controlling Interests". These sections replace the former CICA Handbook Section 1581, "Business Combinations" and section 1600, "Consolidated Financial Statements" and establish a new section for accounting for a non-controlling interest in a subsidiary. These sections also provide the Canadian equivalent to IFRS 3, "Business Combinations" and IAS 27, "Consolidated and Separate Financial Statements".

Section 1582 is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011. Sections 1601 and 1602 apply to interim and annual consolidated financial statements relating to years beginning on or after January 1, 2011.

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Notes to Consolidated Financial Statements

For the year ended December 31, 2008 and 2007

3 Restricted cash

Restricted cash of \$40,000 (2007 - \$40,000) is pledged as collateral to a chartered bank for the provision of certain credit facilities. The banking arrangement to secure credit facilities aggregating to \$720,000 was signed in March 2007 with a Canadian chartered bank. The facilities consist of a \$320,000 standby Letter of Credit and a \$400,000 Line of Credit. During 2008, the standby Letter of Credit balance was reduced to \$160,000 and no funds were drawn against the Line of Credit as at December 31, 2008.

4 Property and equipment

	2008		
	Cost	Accumulated amortization	Net
Computer equipment	\$ 1,347,512	\$ 1,261,347	\$ 86,165
Office equipment	52,867	42,021	10,846
Computer software	129,034	126,540	2,494
Leasehold improvements	445,237	130,713	314,524
	<u>\$ 1,974,650</u>	<u>\$ 1,560,621</u>	<u>\$ 414,029</u>
	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 \$1,161,859 and accumulated amortization of \$1,115,614 (as at December 31, 2007 cost was \$1,153,023 and accumulated amortization was \$1,027,389). No new capital leases were entered into during the year ended December 31, 2008.

5 Convertible debenture

- During the year ended December 31, 2006, the Company completed a convertible debt financing totalling \$960,130 consisting of \$411,144 in cash and a roll-over of \$548,986 owing under the first tranche of debentures issued during the period ended December 31, 2005. The Company recorded the proceeds of the cash component between debt and equity based on their relative fair value of the debt and conversion option. The fair value of the debt component was \$183,951, and the fair value of the conversion option was \$227,193. This latter amount was booked to contributed surplus and was accreted on a straight line basis over the term of the debt. This debenture was due 18 months from the date of issue with an interest

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Notes to Consolidated Financial Statements

For the year ended December 31, 2008 and 2007

rate of 12% per annum. At the holders' option, the debentures were convertible into units consisting of one common share and one-sixth of a common share purchase warrant anytime after April 1, 2007. The conversion price was the lesser of: a) market price at the time of conversion (not less than \$0.25); b) \$0.40; or c) the price of a qualifying financing. Each investor had the right to either convert its debentures on the same terms and conditions as the qualifying financing or have its debentures repaid in full by the Company.

- b) Effective October 19, 2007 and in conjunction with a qualifying financing (see note 7 (b)(ii)), holders of the convertible debenture (see 5 (a) above) agreed to settle the principal and accrued interest of \$1,086,736 in exchange for 7,762,400 common shares of the Company at the deemed value of \$0.14 per share. As part of the debt conversion, the holders agreed to surrender all 1,350,000 common share purchase warrants held at that date.

Balance – December 31, 2006	\$ 646,379
Interest expense	97,803
Accretion of interest	257,401
Fair value warrant component (note 7(c))	85,153
Debt converted to equity	<u>(1,086,736)</u>
Balance – December 31, 2007	<u>\$ -</u>

6 Obligations under capital lease

	2008	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.	-	52,263
Lease payable in monthly instalments of \$1,686 including interest at an imputed rate of 6.0% until March 1, 2008, secured by a charge over equipment	-	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>28,019</u>	<u>60,671</u>
Less: Current portion	<u>28,019</u> <u>(28,019)</u>	<u>121,211</u> <u>(79,273)</u>
	<u>\$ -</u>	<u>\$ 41,938</u>

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Notes to Consolidated Financial Statements

For the year ended December 31, 2008 and 2007

Future minimum lease payments for the respective fiscal years ended are as follows:

2009	30,920
2010	-
	<hr/>
	30,920
Less: Imputed interest	(2,901)
	<hr/>
	\$ 28,019
	<hr/>

7 Share capital

a) Authorized

100,030,000 common shares without par value

b) Issued

	Number of shares	Amount
Balance – December 31, 2006	15,086,624	\$ 8,965,825
Warrants exercised (note 7 (b) (i))	100,000	55,873
Private placement for cash (note 7 (b) (ii))	8,804,214	1,232,590
Convertible debenture settlement (note 5 (b))	7,762,400	1,086,736
Financing issuance costs	-	(44,744)
Balance – December 31, 2007	31,753,238	\$ 11,296,280
Private placement for cash (note 7 (b) (iii))	3,875,000	603,831
Financing issuance costs	-	(59,438)
Balance – December 31, 2008	35,628,238	\$ 11,840,673

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Notes to Consolidated Financial Statements

For the year ended December 31, 2008 and 2007

- i) On March 9, 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 entitles the holder to purchase an additional common share at a price of \$0.40 during the 24 month period from closing. On April 20, 2007, 100,000 warrants were exercised at a price of \$0.40 per share for total cash consideration of \$40,000. The fair value of the respective warrants exercised was \$15,873.

The fair value of the warrants originally issued was \$47,616 using the Black-Scholes valuation model with the assumptions noted below.

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

- ii) On October 19, 2007, the Company completed a non-brokered private placement for 8,804,214 common shares at \$0.14 per share for total gross proceeds for \$1,232,590.
- iii) 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 holding period which expired on November 30, 2008.

The fair value of the warrants issued was \$219,690 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

The value allocated to the warrants was determined by pro-rating the proceeds based on the relative fair values of the common shares and warrants. The pro-rated value apportioned to the warrants is \$171,169.

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Notes to Consolidated Financial Statements

For the year ended December 31, 2008 and 2007

c) Warrants

At December 31, 2008, the following share purchase warrants are outstanding:

Number of warrants outstanding and exercisable	Exercise price	Expiry Date
2,117,100	(note 7(b)(iii)) 0.25	July 29, 2010

	Number of warrants	Amount
Balance – December 31, 2006	4,855,149	\$ 851,142
Warrants exercised (note 7 (b) (i))	(100,000)	(15,873)
Warrants expired	(3,205,149)	(718,372)
Warrants expired upon debt settlement (note 5 (b))	(1,350,000)	(85,153)
Balance – December 31, 2007	200,000	\$ 31,744
Warrants expired	(200,000)	(31,744)
Warrants issued (note 7 (b) (iii))	2,117,100	171,169
Balance – December 31, 2008	2,117,100	\$ 171,169

d) Stock options

The Company's amended and restated fixed stock option plan dated August 22, 2005, (the "Old Plan") provided 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. Additionally, the Company repriced to \$0.18 per share, a total of 270,000 previously granted options originally exercisable at prices ranging from \$0.33 - \$0.55.

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. This grant of 587,000 options was subsequently approved at the Company's AGM on May 29, 2008.

There are 755,889 options available for future grant as at December 31, 2008.

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

	2008		2007	
	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	100,000	0.17	1,498,000	0.19
Expired	(64,000)	0.55	-	-
Forfeited	(115,000)	0.27	(294,400)	0.40
Closing balance	3,054,500	\$ 0.30	3,133,500	\$ 0.31

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 two and a 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 twelve months ended December 31, 2008 have been determined using the Black-Scholes option pricing formulae with the following factors and are being recognized as an expense over the two year vesting period:

Expected dividend yield	0%
Stock price volatility	98.3%
Risk-free interest rate	3.3%
Expected life of options	2 years
Fair value of the options granted	\$9,110

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Notes to Consolidated Financial Statements

For the year ended December 31, 2008 and 2007

At December 31, 2008, the following stock options are outstanding:

Number of stock options outstanding	Exercise price	Expiry date	Number of stock options exercisable
74,000	0.55	February 27, 2009	74,000
150,000	0.55	May 27, 2009	150,000
100,000	0.17	February 20, 2010	54,167
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	150,000
<u>1,278,000</u>	0.18	November 29, 2012	<u>865,000</u>
<u>3,054,500</u>			<u>2,595,667</u>

8 Contributed surplus

	2008	2007
Opening balance	\$ 2,315,955	\$ 1,431,968
Stock-based compensation	113,926	165,614
Warrants expired (note 7 (b)(i))	<u>31,744</u>	<u>718,373</u>
Closing balance	<u>\$ 2,461,625</u>	<u>\$ 2,315,955</u>

IP Applications Corp.

Notes to Consolidated Financial Statements

For the year ended December 31, 2008 and 2007

9 Income taxes

The Company's provision for income taxes differs from the amounts computed by applying the combined Canadian federal and provincial income tax rates to the loss as a result of the following:

	2008	2007
Statutory rates	26%	27%
	\$	\$
Income tax recovery computed at statutory rates	253,073	245,707
Permanent differences		
Accretion on convertible debenture	-	(69,498)
Other	(1,328)	(1,067)
Stock-based compensation	(30,187)	(44,716)
	(31,515)	(115,281)
Book to tax differences	21,141	415,179
Change in valuation allowance	(75,969)	(186,528)
Change in tax rate	(55,354)	(357,971)
Non-capital losses expired unused	(111,376)	(1,106)
Provision for income taxes	-	-

IP Applications Corp.

Notes to Consolidated Financial Statements

For the year ended December 31, 2008 and 2007

The tax effects of temporary timing differences that give rise to significant components of the future tax assets and future tax liabilities are as follows:

	2008	2007
Statutory rates	26%	27%
	\$	\$
Future tax assets		
Non-capital loss carry-forwards	2,396,267	2,336,539
Other	668,336	636,345
Total gross future income tax assets	3,064,603	2,972,884
Less: Valuation allowance	(3,064,603)	(2,972,884)
Net future income tax assets	-	-

In assessing the realizability of future tax assets, management considers whether it is more likely than not that some portion or all of the future tax assets will be realized. The ultimate realization of future tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. As management believes there is sufficient uncertainty regarding the realization of future tax assets, a full valuation allowance has been provided.

At December 31, 2008, the Company has non-capital losses of approximately of \$9,038,988, which may be carried forward to apply against future years' income for Canadian income tax purposes, subject to final determination by taxation authorities expiring as follows:

	\$
2009	1,289,819
2010	761,939
2014	1,388,419
2015	2,825,831
2026	1,612,716
2027	354,791
2028	805,473
	<u>9,038,988</u>

IP Applications Corp.

Notes to Consolidated Financial Statements

For the year ended December 31, 2008 and 2007

10 Related party transactions

Pender Growth Fund (VCC) (“PGF”) , a shareholder owning 39% of the shares of the Company, participated in the private placement of shares completed in July 2008 (see note 7 (b)(iii)). PGF acquired 1,250,000 shares of the Company at a price of \$0.20 per share, the same price offered to independent investors. A Director of the Company is a Director and the Chairman of PGF.

11 Financial instruments

The Company, through its financial assets and liabilities, is exposed to various risks related to changes in foreign exchange rates, collection of accounts receivable, settlement of liabilities and management of cash and cash equivalents.

Market Risk

The following table summarizes the carrying values of the Company’s financial instruments in US dollars as at December 31, 2008 and 2007:

	2008	2007
Cash	\$ 81,790	\$ 331,382
Accounts receivable	303,729	479,007
Accounts payable	(208,135)	(220,347)
Net identifiable assets and liabilities	<u>\$ 177,384</u>	<u>\$ 590,042</u>

a) Interest rate risk

The only financial instruments at present which expose the Company to interest rate risk are its cash, cash equivalents and restricted cash. The Company’s objectives of managing its cash and cash equivalents are to ensure sufficient funds are maintained on hand at all times to meet operating requirements and to place amounts in excess of operating requirements in short-term deposits with the Company’s banks to earn interest. When placing amounts of cash, cash equivalents and restricted cash in short-term deposits, the Company only uses high quality commercial banks, utilizes low risk instruments and ensures that access to the amounts placed can be obtained on short notice.

The Company has access to credit facilities consisting of a \$400,000 demand revolving loan and a \$160,000 Standby Letter of Credit. Should the revolving loan be utilized, interest is paid at the Bank’s prime rate + 1.25% per annum.

IP Applications Corp.

Notes to Consolidated Financial Statements

For the year ended December 31, 2008 and 2007

b) Foreign Exchange risk

The Company is exposed to foreign exchange risk on its cash balances, accounts receivable and payable balances and derivative instruments which are denominated in foreign currencies.

As the Company generates revenues primarily in US dollars and incurs expenditures in Canadian and US dollars, it is exposed to risk from changes in foreign currency rates. The Company monitors forecasted cash flows in foreign currencies and attempts to mitigate the risk by modifying the nature of the cash held or by entering into forward foreign exchange contracts with a Canadian chartered bank as hedges against the sales and purchases denominated in foreign currencies. The Company has not adopted hedge accounting and forward foreign exchange contracts are only entered into for purposes of managing foreign exchange risk and not for speculative purposes. As at December 31, 2008, the Company had entered into forward foreign exchange derivative contracts to convert a total of \$260,000 US dollars to Canadian dollars from January 1 to March 31, 2009. The Company is obligated to convert US dollars at foreign exchange rates ranging from 1.2110 to 1.2482 Canadian dollars.

The Company also has the ability to reduce currency risk by structuring natural hedges which match the inflow and outflow of foreign currency. This objective is being pursued by outsourcing future US dollar expenditures to more closely match the inflow of US dollars from sales revenue.

The Company has completed a sensitivity analysis to estimate the impact on net loss for the period. The following table compares the Company's financial instruments at actual translated values versus an increase or decrease of 10% in the foreign exchange rate utilized at December 31, 2008.

	US dollars at December 31, 2008	Translation at December 31, 2008	Translation increase 10%	Translation decrease 10%
Cash	\$ 81,790	\$ 100,160	\$ 10,016	\$ (10,016)
Accounts receivable	303,729	368,401	36,840	(36,840)
Accounts Payable	<u>(208,315)</u>	<u>(254,882)</u>	<u>(25,488)</u>	<u>25,488</u>
Total value	<u>\$ 177,384</u>	<u>\$ 213,679</u>	<u>\$ 21,368</u>	<u>\$ (21,368)</u>

Credit Risk

Credit risk is the risk that the Company will incur a loss due to the failure by one of its customers or other parties to meet their contractual obligations. Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents and accounts receivable.

The Company's cash and cash equivalents consist of deposit investments that are highly liquid and held only with a Canadian chartered bank. They are not considered a material credit risk for the Company.

IP Applications Corp.

Notes to Consolidated Financial Statements

For the year ended December 31, 2008 and 2007

Credit risk with respect to accounts receivable is considered to be limited due to the fact a significant majority of our revenues derive from long-standing customers and the Company has experienced only nominal credit losses/bad debts over the past two fiscal periods (2008 - \$23,714; 2007 - \$24,732). Of the total accounts receivable balance of \$512,731 as at December 31, 2008, 37% relates to 2 customers (note 14). Though the Company does not presently believe that there is significant credit risk arising from any of the Company's individual customers, there is however, a concentration of credit risk. If any one of our ten key customers is unable to settle amounts due, the impact on the Company could be significant.

The Company is subject to a concentration of credit risk and concentration of sales as it earns revenues from a limited number of customers. The following table summarizes the extent to which the Company's receivables are concentrated with a limited number of customers:

	Number of customers	Related amount \$
Accounts receivable		
December 31, 2008	2	189,664
December 31, 2007	3	316,308

Financial assets past due

The following table provides information regarding the aging of accounts receivable balances as at December 31:

	2008	2007
Not past due	\$ 417,877	\$ 499,578
Past due 1-30 days	102,021	95,285
Past due 31-60 days	10,358	24,165
Past due 61-90 days	4,607	409
Over 91 days past due	24	7,602
Less: Allowance for doubtful accounts	(22,156)	-
Total accounts receivable	<u>\$ 512,731</u>	<u>\$ 627,039</u>

The Company reviews financial assets past due on an ongoing basis with the objective of identifying potential matters which could delay the collection of funds at an early stage. Once items are identified as being past due, contact is made with the respective company to determine the reason for delay in payment and to establish an agreement to rectify the breach in contractual terms. At December 31, 2008 the Company had a provision for doubtful accounts of \$22,156 which was made against receivables in excess of at least 60 days past due and where collection efforts to-date have been unsuccessful. The Company is not aware of any other information suggesting that the collectability of current amounts is impaired.

IP Applications Corp.

Notes to Consolidated Financial Statements

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Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its obligations as they fall due. The Company's objective to managing liquidity risk is to ensure that it has sufficient liquidity available to meet its liabilities when due. The following are the contractual maturities of financial liabilities as at December 31, 2008:

Financial liabilities	Contractual cash outflows	0 to 12 months	12 to 24 months	Subsequent months
Bank debt	\$ -	\$ -	\$ -	\$ -
Accounts payable and accrued liabilities	636,281	636,281	-	-
Premise lease (note 15)	3,330,768	470,844	456,371	2,403,553
Obligations under capital lease	28,019	28,019	-	-
Total value	<u>\$ 3,995,068</u>	<u>\$ 1,135,144</u>	<u>\$ 456,371</u>	<u>\$ 2,403,553</u>

It is the Company's intention to meet these obligations through the collection of accounts receivable, and the receipt of future payments on amounts not yet invoiced, as well as from cash and cash equivalents. In addition, the Company has an available line of credit of \$400,000 at December 31, 2008.

The Company manages the liquidity needs through regular assessment of its short-term requirements through cash management procedures and through weekly and monthly cash flow forecasts. A longer annual forecast model is maintained to project operating results and financing requirements. This is regularly updated for changes in our operating environment and planned initiatives that may materially change forecast results from time to time. Management reviews and assesses these monitoring and forecast tools on a regular basis to plan the timing of future financing initiatives and suitability of various financing options and operating initiatives available to the Company.

The Company will need additional financing to meet its future growth plan objectives and maintain sufficient capital to meet its liquidity requirements. The Company's ability to obtain additional financing will depend on the successful implementation of its business plan, and its ability to raise capital in the financial markets under the current economic conditions.

IP Applications Corp.

Notes to Consolidated Financial Statements

For the year ended December 31, 2008 and 2007

12 Leasehold inducements

	2008	2007
Opening balance	\$ 238,233	\$ 268,168
Amortization	(29,935)	(29,935)
	<hr/>	<hr/>
Less: Current portion	208,298	238,233
	(29,935)	(29,935)
	<hr/>	<hr/>
	\$ 178,363	\$ 208,298
	<hr/>	<hr/>

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.

13 Loss on lease commitment

	2008	2007
Opening balance	\$ 55,026	\$ 126,566
Reduction	(55,026)	(71,540)
	<hr/>	<hr/>
Less: Current portion	-	55,026
	-	(55,026)
	<hr/>	<hr/>
	\$ -	\$ -
	<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.

IP Applications Corp.

Notes to Consolidated Financial Statements

For the year ended December 31, 2008 and 2007

14 Segmented information

During the years ended December 31, 2008 and 2007, the Company operated within a single operating segment, being the provision of Internet services and solutions. The following is a breakdown of revenue by geographic area by customer location:

	2008	2007
Revenue		
Canada	\$ 1,124,717	\$ 1,306,500
United States	4,579,031	6,430,044
	<u>\$ 5,703,748</u>	<u>\$ 7,736,544</u>

All of the Company's employees and assets are located in Canada.

The following table summarizes the extent to which the Company's sales are concentrated (>10% of total consolidated revenues per customer) with a limited number of customers:

	Number of customers	Related amount
Revenue		
Twelve month period ended December 31, 2008	3	\$ 2,740,276
Twelve month period ended December 31, 2007	4	\$ 4,894,518

15 Commitments

The Company has operating leases for office premises. The future minimum lease payments are summarized as follows:

2009	\$ 470,844
2010	456,371
2011	482,594
2012	483,313
2013	488,801
Thereafter	<u>948,845</u>
	<u>\$ 3,330,768</u>

Lease payments have a fixed base rent component and a variable component consisting of operating costs. The variable component has increased and hence subsequent years' payments have increased.

IP Applications Corp.

Notes to Consolidated Financial Statements

For the year ended December 31, 2008 and 2007

16 Capital Disclosures

The Company considers its shareholder equity components, cash and cash equivalents, and, if applicable, debenture debt as capital.

	December 31, 2008	December 31, 2007
Shareholder Equity	\$ 636,113	\$ 760,274
Cash and cash equivalents	\$ 575,773	\$ 726,983
Restricted cash	\$ 40,000	\$ 40,000

The Company manages its capital structure in order to ensure sufficient resources are available to meet day to day operating requirements; to allow it to enhance existing product offerings as well as develop new ones; to have the financial ability to expand the size of its operations by taking on new customers; and to maintain its ability to continue as a going concern in order to provide long term returns for shareholders and benefits for other stakeholders.

In managing its capital structure, the Company takes into consideration: changes in the Company's operating performance; changes in economic conditions; growth of its business and related infrastructure; estimated penetration of target markets; and the upfront costs of taking on new customers.

The Company's Officers and senior management take full responsibility for managing the Company's capital and do so through weekly meetings and regular review of financial information. The Company's Board of Directors are responsible for overseeing this process.

Methods used by the Company to manage its capital include the issuance of new share capital and debenture debt, which has historically been completed through private placements primarily with institutional investors. Additionally, the Company has access to a line of credit with a Canadian chartered bank should short-term circumstances warrant its use.

The Company is not subject to externally imposed capital requirements and there has been no change with respect to the overall capital risk management strategy during the period ended December 31, 2008.