

Consolidated financial statements of

Uniserve Communications Corporation

Six months ended November 30, 2009

(Unaudited)

NOTICE OF NO AUDITOR REVIEW OF INTERIM FINANCIAL STATEMENTS

The accompanying unaudited interim Consolidated 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 the standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

"Michael Schmidt"

Michael Schmidt, President and CEO

January 25, 2010

Uniserve Communications Corporation

Consolidated statements of operations, comprehensive income (loss) and deficit

	Three months ended Nov. 30,		Six months ended Nov. 30,	
	2009 (Unaudited)	2008 (Unaudited) As restated *	2009 (Unaudited)	2008 (Unaudited) As restated *
	\$	\$	\$	\$
Revenues	3,870,874	4,849,213	7,856,933	9,987,954
Cost of sales	1,920,448	2,472,063	3,954,247	5,189,258
Gross margin	1,950,426	2,377,150	3,902,686	4,798,696
Expenses				
Operations and service delivery costs	1,788,635	2,918,588	3,300,144	5,195,456
Amortization of property and equipment (Note 4)	128,773	288,792	250,742	448,973
Amortization of intangible assets (Note 5)	110,000	138,682	220,000	277,363
Amortization of deferred finance costs (Note 5)	1,734	-	3,467	-
Sales and marketing	65,989	68,172	113,439	176,185
Stock-based compensation	-	-	2,621	2,937
	2,095,131	3,414,234	3,890,413	6,100,914
Operating income (loss)	(144,705)	(1,037,084)	12,273	(1,302,218)
Other expense				
Interest and bank charges	(277,464)	(366,389)	(572,746)	(746,591)
Foreign exchange loss	(71,042)	(230,596)	(66,589)	(926,972)
Write-down of goodwill and intangible assets (Notes 5, 6)	-	(309,197)	-	(309,197)
Write-down of property and equipment (Note 4)	(19,966)	-	(19,966)	-
Accretion to face value of preferred shares (Note 8)	(79,798)	(79,798)	(159,596)	(159,596)
	(448,270)	(985,980)	(818,897)	(2,142,356)
Loss before income taxes from continuing operations	(592,975)	(2,023,064)	(806,624)	(3,444,574)
Income tax recovery (expense)				
Future	40,187	26,735	15,778	93,935
	40,187	26,735	15,778	93,935
Net loss and comprehensive loss for the period				
from continuing operations	(552,788)	(1,996,329)	(790,846)	(3,350,639)
Results from discontinued operations (Note 3)	-	5,919,255	-	5,313,528
Net income (loss) and comprehensive income (loss) for the period	(552,788)	3,922,926	(790,846)	1,962,889
Deficit, beginning of period	(19,744,843)	(21,375,077)	(19,506,785)	(19,415,040)
Deficit, end of period	(20,297,631)	(17,452,151)	(20,297,631)	(17,452,151)
Basic earnings per share				
Basic loss per share from continuing operations	(0.02)	(0.08)	(0.03)	(0.14)
Basic income (loss) per share	(0.02)	0.16	(0.03)	0.08
Diluted loss per share from continuing operations ⁽¹⁾	(0.02)	(0.08)	(0.03)	(0.14)
Diluted income (loss) per share ⁽¹⁾	(0.02)	0.13	(0.03)	0.06
Weighted average number of common shares outstanding - basic	24,630,865	24,630,865	24,630,865	24,588,242
Weighted average number of common shares outstanding - diluted ⁽¹⁾	-	31,368,568	-	31,375,626

⁽¹⁾ In the case of a loss, the diluted EPS will be anti-dilutive, therefore the basic and diluted EPS will be the same

* See Note 2(b)(i)

Uniserve Communications Corporation

Consolidated balance sheets

	November 30, 2009 (Unaudited)	May 31, 2009 (Audited)
	\$	\$
Assets		
Current assets		
Cash	173,246	196,651
Accounts receivable	632,574	764,118
Inventory	157,386	204,337
Prepaid expenses	22,120	33,902
Amounts held in escrow (Notes 3, 12)	1,583,400	2,729,250
Future income tax asset	-	16,474
	2,568,726	3,944,732
Future income tax asset	273,939	237,877
Property and equipment (Note 4)	1,629,791	1,594,854
Intangible and other assets (Note 5)	1,861,740	1,621,792
Goodwill (Note 6)	4,312,884	4,312,884
	10,647,080	11,712,139
Liabilities and shareholders' deficit		
Current liabilities		
Bank indebtedness (Note 7)	87,571	122,345
Accounts payable and accrued liabilities	6,327,570	6,978,954
Accrued dividends payable (Note 8)	657,033	485,633
Deferred revenue	866,995	996,628
Obligations under capital leases	65,191	37,611
Future income tax liability	-	6,634
	8,004,360	8,627,805
Obligations under capital leases	195,013	18,442
Future income tax liability	10,444	-
Convertible preferred shares (Notes 8, 9(e))	3,405,037	3,245,441
	11,614,854	11,891,688
Shareholders' deficit		
Share capital (Note 9(a))	14,315,028	14,315,028
Other equity instruments (Note 9(e))	3,613,559	3,642,059
Contributed surplus (Note 9(a))	1,401,270	1,370,149
Deficit	(20,297,631)	(19,506,785)
	(967,774)	(179,549)
	10,647,080	11,712,139

Contingent liability and subsequent events (Note 12)

Approved by the directors

"Michael Schmidt"

Director

"Maurice Lees"

Director

Uniserve Communications Corporation

Consolidated statements of cash flows

	Three months ended Nov. 30,		Six months ended Nov. 30,	
	2009 (Unaudited)	2008 (Unaudited)	2009 (Unaudited)	2008 (Unaudited)
	\$	\$	\$	\$
		As restated *		As restated *
Operating activities				
Net income (loss) for the period	(552,788)	3,922,926	(790,846)	1,962,889
Results of discontinued operations	-	5,919,255	-	5,313,528
Net loss for the period from continuing operations	(552,788)	(1,996,329)	(790,846)	(3,350,639)
Items not involving cash				
Amortization of property and equipment	128,773	288,792	250,742	448,973
Amortization of intangible assets	110,000	138,682	220,000	277,363
Amortization of deferred finance costs	1,734	-	3,467	-
Write-down of goodwill and intangible assets	-	309,197	-	309,197
Write-down of property and equipment	19,966	-	19,966	-
Accretion of face value of preferred shares	79,798	79,798	159,596	159,597
Stock-based compensation	-	-	2,621	2,937
Unrealized loss (gain) on foreign exchange	101,934	(991,898)	93,734	(301,828)
Future income taxes expense (recovery)	(40,187)	(26,735)	(15,778)	(93,935)
Changes in non-cash operating working capital (Note 11)	(223,970)	(2,407,353)	(215,263)	(769,731)
Net cash used in continuing operating activities	(374,740)	(4,605,846)	(271,761)	(3,318,066)
Net cash used in discontinued operating activities	-	(305,702)	-	(220,111)
Net cash used in operating activities	(374,740)	(4,911,548)	(271,761)	(3,538,177)
Investing activities				
New product development	(249,795)	(210,028)	(463,415)	(451,553)
Purchase of property and equipment	(256,571)	(14,027)	(305,644)	(29,488)
Proceeds from funds held in escrow	1,052,189	-	1,052,189	-
Business disposition, net of cash	-	18,326,723	-	17,768,623
Net cash provided by continuing investing activities	545,823	18,102,668	283,130	17,287,582
Net cash used in discontinued investing activities	-	(99,149)	-	(253,241)
Net cash provided by investing activities	545,823	18,003,519	283,130	17,034,341
Financing activities				
Revolving line of credit	-	(1,340,000)	-	(1,410,000)
Repayment of short-term debt	(17,491)	(18,740)	(34,774)	(37,591)
Repayment of long-term debt	-	(9,930,000)	-	(9,930,000)
Repayments to related parties	-	(1,888,383)	-	(1,893,458)
Net cash used in continuing financing activities	(17,491)	(13,177,123)	(34,774)	(13,271,049)
Net cash used in discontinued financing activities	-	(53,935)	-	-
Net cash used in financing activities	(17,491)	(13,231,058)	(34,774)	(13,271,049)
Increase (decrease) in cash and cash equivalents	153,592	(139,087)	(23,405)	225,115
Cash, beginning of period	19,654	565,320	196,651	201,118
Cash, end of period	173,246	426,233	173,246	426,233
Cash related to:				
Continuing operations	173,246	426,233	173,246	426,233
Discontinued operations	-	-	-	-
	173,246	426,233	173,246	426,233

Supplemental cash flow information (Note 11)

* See Note 2(b)(i)

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November 30, 2009 and 2008

1. Nature of operations and going concern

Uniserve Communications Corporation ("the Company") was incorporated on January 19, 1988 under the Company Act of British Columbia. The Company's principal business activity is the provision of Internet access and related communications services primarily in British Columbia, Alberta, Ontario and Quebec which represents a single operating segment.

Our consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities in the normal course of business. As at November 30, 2009, the Company has a working capital deficiency of \$5,435,634 (May 31, 2009 - deficiency of \$4,683,073). For the period ended November 30, 2009 the Company had negative cash flow from operations mostly due to one-time expenses associated with the closing of the Company's subsidiary's Montreal office and the outsourcing of its Montreal and Vancouver call centers. The Company incurred net losses due to interest expense, foreign exchange, amortization of customer lists and other intangible assets and accretion to face value of preferred shares.

Liquidity risk is the risk that we will not be able to meet our financial obligations as they become due. Accordingly, the Company's ability to continue as a going concern, which means that it can realize its assets and discharge its liabilities in the normal course of business, is dependent in part upon the Company's ability to continue to generate sufficient cash flow from operations and to obtain additional equity or debt financing in the near term to continue to meet its obligations as they come due.

2. Basis of Presentation and Accounting Policies:

(a) Basis of presentation:

The unaudited interim Consolidated Financial Statements include the accounts of Uniserve Communications Corp., and its subsidiaries (collectively the "Company"). The notes presented in these unaudited interim Consolidated Financial Statements include only significant events and transactions occurring since the Company's last fiscal year end and are not fully inclusive of all matters required to be disclosed in the Company's annual audited consolidated financial statements. As a result, these unaudited interim Consolidated Financial Statements should be read in conjunction with the Company's consolidated financial statements for the year ended May 31, 2009.

(b) Accounting Policies:

The unaudited interim Consolidated Financial Statements follow the same accounting policies and method of application as the most recent annual consolidated financial statements.

(i) *Adoption of new accounting policies*

Goodwill and Intangible Assets:

In February 2008, the CICA issued Handbook Section 3064 ("CICA 3064"), "Goodwill and Intangible Assets". CICA 3064 replaces Section 3062 "Goodwill and Intangible Assets", and Section 3450, "Research and Development Costs". It establishes standards for the recognition, measurement and disclosure of goodwill and intangible assets. The new Section also provides guidance for the treatment of preproduction and start-up costs and requires that these costs be expensed as incurred. This new standard is effective for the Company's interim and annual consolidated financial statements commencing June 1, 2008 and are to be adopted on a retrospective basis. The impact of adopting this accounting standard, on a retrospective basis, is an increase of \$1,100,893 in the net loss for fiscal 2008 and a decrease of \$1,059,964 in shareholders' equity at May 31, 2007, and a decrease in intangible and other assets of \$2,160,857 as at May 31, 2008. This change resulted in the net loss and

Uniserve Communications Corporation

Notes to consolidated financial statements

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comprehensive loss per share being \$0.04 and \$0.05 lower for fiscal 2008 and 2007 respectively.

3. Discontinued operations

On October 7, 2008, the Company completed the sale of its wholly owned subsidiary, Parasun to IBBS, for cash consideration of US\$20,000,000 in exchange for all of the issued and outstanding shares of Parasun. Of the purchase price, US\$2,500,000 is to be held in escrow for a period of 1 year to satisfy any indemnification claims for any deficiencies in the representations and warranties and for any taxes owing up to the date of sale, see note 12.

During the period ending November 30, 2009, US\$1,000,000 was released from escrow. The remaining balance US\$1,500,000 (CDN\$1,583,400 as at November 30, 2009) was extended to March 31, 2010.

In conjunction with the sale, the subordinated debt of US\$10,000,000 including an early payment fee of US\$400,000 plus the accrued interest was repaid. Amounts due to related parties totaling \$1,893,458 and the revolving line of credit balance of \$1,500,000 were also repaid.

The following is a summary of the consideration received and the book value of the assets and liabilities of Parasun. The sale resulted in a gain on disposition of \$7,373,356 before income taxes. The Company has sufficient tax losses available to fully offset this gain; therefore no income tax expense has been recorded for the sale transaction.

	May 31, 2009 USD	May 31, 2009 CDN
	\$	\$
Consideration received		
Cash	17,500,000	19,533,500
Amounts held in escrow	2,500,000	2,790,500
Management contract termination fee	500,000	558,100
Purchase price adjustment	(350,000)	(390,670)
Working capital deficiency	(254,434)	(284,000)
Transaction costs		(997,756)
		<u>21,209,674</u>
Assets		
Cash		505,547
Non-cash current assets		2,777,262
Equipment		1,132,755
Other assets		46,780
Intellectual property		3,027,688
Customer list		4,238,763
Goodwill		5,597,810
		<u>17,326,605</u>
Liabilities		
Accounts payable and accrued liabilities		1,488,957
Deferred revenue		99,820
Due to former shareholders		440,652
Future tax liability		1,460,858
		<u>3,490,287</u>
Net book value		<u>13,836,318</u>
Gain on disposition		<u>7,373,356</u>

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Notes to consolidated financial statements

November 30, 2009 and 2008

3. Discontinued operations (continued)

For the periods ended November 30, 2009 and November 30, 2008, the financial results associated with the discontinued operations of Parasun were as follows:

	Three months ended Nov. 30,		Six months ended Nov. 30,	
	2009	2008	2009	2008
	\$	\$	\$	\$
Revenues	-	910,035	-	3,485,106
Gross margin	-	696,093	-	2,617,731
Expenses	-	779,265	-	2,838,787
Operating loss	-	(83,172)	-	(221,056)
Other expense	-	(2,268,824)	-	(2,646,667)
Gain on sales of Parasun	-	8,301,251	-	8,301,251
Income before income taxes	-	5,949,255	-	5,433,528
Income tax expense	-	(30,000)	-	(120,000)
Net income and comprehensive income for the period	-	5,919,255	-	5,313,528

4. Property and equipment

	November 30, 2009			
	Cost	Accumulated amortization	Write-down	Net book value
	\$	\$	\$	\$
Equipment	9,082,794	7,707,206	-	1,375,588
Software	776,906	522,703	-	254,203
Leasehold improvements	342,478	322,512	19,966	-
	10,202,178	8,552,421	19,966	1,629,791

	May 31, 2009			
	Cost	Accumulated amortization	Write-down	Net book value
	\$	\$	\$	\$
Equipment	8,778,090	7,457,150	41,318	1,279,622
Software	775,965	482,917	-	293,048
Leasehold improvements	342,478	320,294	-	22,184
	9,896,533	8,260,361	41,318	1,594,854

The cost of property under capital leases, equipment and software aggregated \$260,204 as at November 30, 2009 (May 31, 2009 - \$56,053). The cost of property under capital leases associated with related parties aggregated \$197,244 as at November 30, 2009 (May 31, 2009 - \$nil), see note 10(c).

Amortization charged to continuing operations, which includes amortization associated with property under capital leases, was \$250,742 and \$448,973 for the periods ended November 30, 2009 and 2008, respectively.

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5. Intangible and other assets

	Nov. 30, 2009			
	Cost	Accumulated amortization	Write-down	Net book value
	\$	\$		\$
Customer lists	15,971,161	15,457,828	-	513,333
Deferred finance costs	424,139	406,805	-	17,334
Product development costs	1,331,073	-	-	1,331,073
	17,726,373	15,864,633	-	1,861,740

	May 31, 2009			
	Cost	Accumulated amortization	Write-down	Net book value
	\$	\$		\$
Customer lists	15,971,161	15,135,879	101,949	733,333
Deferred finance costs	424,139	403,338	-	20,801
Product development costs	867,658	-	-	867,658
	17,262,958	15,539,217	101,949	1,621,792

During the period ended November 30, 2009 product development costs of \$463,415 related to Kinzin, a social networking site being developed by the Company, were capitalized. The total capitalized product development costs relating to Kinzin as of November 30, 2009 were \$1,331,073 (May 31, 2009 - \$867,658).

6. Goodwill

	Discontinued Operations	Continuing Operations
	\$	\$
Balance, May 31, 2008	5,597,810	4,622,081
Disposition of Parasun	(5,597,810)	-
Write-down - KBT	-	(309,197)
Balance, May 31, 2009 and November 30, 2009	-	4,312,884

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7. Bank indebtedness

	Nov. 30, 2009	May 31, 2009
	\$	\$
Bank demand loan bearing interest at prime plus 3% repayable in monthly blended payments of \$6,250; secured by a general security agreement over assets of KBT	87,571	122,345
	87,571	122,345

8. Convertible preferred shares

	Nov. 30, 2009	May 31, 2009
	\$	\$
Series A Convertible Preferred Shares, \$4,285,000 (May 31, 2009 - \$4,285,000) redeemable at the option of the holder on or after May 24, 2012, 8% cumulative dividends, net of unamortized discount of \$879,963 (May 31, 2009 - \$1,039,559 (Notes 9(a)(ii), 12)	3,405,037	3,245,441
	3,405,037	3,245,441

The Convertible Preferred Shares, Series A are convertible to common shares at \$0.75 in year one, \$0.80 in year two, \$0.90 in year three, \$1.05 in year four and \$1.25 in year five and carry a cumulative dividend rate of 8%. The Company can, at its option, force conversion, if, at any time during the term, the common shares of the Company trade at 200% of the conversion price then in effect for a period of 30 days. The preferred shares are redeemable at the option of the holder on or after the fifth anniversary of the date of issue. As the Company may be required to redeem the preferred shares for cash, they have been classified as long-term debt with the value of the conversion right included in other equity instruments.

On issue the amount allocated to long-term liability was \$2,701,441 and \$1,583,559 was allocated to the conversion right, see Notes 9(a)(ii) and 9(e). The carrying value of the amount allocated to long-term liability is being accreted to the face value of the preferred shares over a five year period.

As at November 30, 2009 the dividends on the Series A Convertible Preferred Shares are in arrears in the amount of \$657,033 (May 31, 2009 - \$485,633).

Subsequent to the balance sheet date, 30,000 Series A Convertible Preferred Shares with a face value of \$300,000 were redeemed for a cash payment of \$150,000. In addition, these preferred shareholders relinquished their rights to cumulative dividends of \$44,000, of which \$42,000 is accrued as at November 30, 2009, see notes 9(a)(ii), 12.

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Notes to consolidated financial statements

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9. Share capital

(a) *Authorized and issued and contributed surplus*

The authorized share capital of the Company consists of an unlimited number of common shares and an unlimited number of Convertible Preferred Shares. As at November 30, 2009, 428,500 (May 31, 2009 – 428,500) Preferred Shares, Series A are outstanding.

Common no par value shares outstanding are as follows:

	Number of shares	Share Capital Amount \$	Contributed Surplus \$
Balance, May 31, 2008	24,430,865	14,247,905	1,282,803
Private placement (i)	200,000	67,123	(67,123)
Expiry of warrants	-	-	150,500
Stock-based compensation expense	-	-	3,969
Balance, May 31, 2009	24,630,865	14,315,028	1,370,149
Stock-based compensation expense	-	-	2,621
Expiry of warrants	-	-	28,500
Balance, November 30, 2009	24,630,865	14,315,028	1,401,270

(i) On July 9, 2008, the Company issued an additional 200,000 units via a private placement. Each unit consisted of one common share at \$0.35 and one half share purchase warrant for total proceeds of \$70,000. Warrants are exercisable until July 9, 2010 at an exercise price of \$0.45. On issue the amount allocated to share capital was \$67,123 and \$2,877 was allocated to the warrant. The value assigned to the warrants of \$0.0288 per share was determined using the Black Scholes option pricing formula with the following assumptions: risk free interest rate – 3.25%; annual dividends – nil; expected life – 23 months; expected stock price volatility – 40%.

(ii) As the Company may be required to redeem the preferred shares for cash, they have been classified as long-term liabilities, see Note 8, with the par value of the conversion right included in other equity instruments, see Note 9(e). On issue the amount allocated to long-term liabilities was \$2,701,441 and \$1,583,559 was allocated to the conversion right. The carrying value of the amount allocated to long-term liabilities is being accreted to the face value of the preferred shares over a five year period. Subsequent to the balance sheet date, 30,000 Series A Convertible Preferred Shares with a face value of \$300,000 were redeemed for a cash payment of \$150,000, see Notes 8, 12.

(b) *Escrow*

As at November 30, 2009, 192,624 (May 31, 2009 - 192,624) shares are held in trust and are subject to arbitration proceedings.

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Notes to consolidated financial statements

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9. Share capital (continued)

(c) Share purchase warrants

The following share purchase warrants were outstanding as of November 30, 2009:

Issue date	Expiry date	Number of warrants	Exercise price \$
May 24, 2007	May 24, 2012	3,500,000	0.70
April 24, 2008	April 24, 2010	753,251	0.45
July 9, 2008	July 9, 2010	100,000	0.45
		<u>4,353,251</u>	

(d) Share purchase options

Pursuant to the policies of the TSX Venture Exchange, the Company may grant incentive stock options to its officers, directors and employees. TSX Venture Exchange policies permit the Company's directors to grant incentive stock options of the purchase of shares of the Company to persons in consideration for services. Stock options must be non-transferable and the aggregate number of shares that may be reserved for issuance pursuant to stock options may not exceed 10% of the issued shares of the Company at the time of granting and may not exceed 5% to any individual. The exercise price of stock options and vesting period is determined by the Board of Directors of the Company at the time of grant and may not be less than the average closing price of the Company's shares on the ten trading days immediately preceding the day on which the option is granted and publicly announced. Options have a maximum term of five years and terminate 90 days following the termination of the optionee's employment, except in the case of retirement, death, or disability, in which case they terminate one year after the event.

Stock option activity is summarized as follows:

	Shares available for grant	Options outstanding	
		Number of optioned common shares	Weighted average exercise price \$
Balance, May 31, 2008	650,587	1,792,500	0.51
Options forfeited	755,000	(755,000)	0.53
Additional shares available for grant	20,000	-	-
Balance, May 31, 2009	1,425,587	1,037,500	0.50
Options forfeited	25,000	(25,000)	0.50
Balance, November 30, 2009	1,450,587	1,012,500	0.50

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9. Share capital (continued)

(d) *Share purchase options (continued)*

The following table summarizes information about stock options outstanding and exercisable as at November 30, 2009:

Exercise price	Options outstanding		Options exercisable	
	Number of common shares issuable	Remaining contractual life (years)	Number of common shares issuable	Remaining contractual life (years)
\$0.50	1,012,500	1.94	990,000	1.94

(e) *Other equity instruments*

	Nov. 30, 2009	May 31, 2009
	\$	\$
Conversion rights on Series A preferred shares (Note 9(a)(ii))	1,583,559	1,583,559
Warrants (i)	2,030,000	2,030,000
Warrants (ii)	-	28,500
	3,613,559	3,642,059

(i) During the year ended May 31, 2007 as part of the US\$10,000,000 subordinated debt financing arrangements, the Company issued a total of 3,500,000 warrants. On issue, the Company allocated \$2,030,000 of the proceeds received to the warrants issued based on their fair value with the remaining amounts allocated to the subordinated debt. During the year ended May 31, 2009 the subordinated debt was repaid in conjunction with the sale of Parasun, see note 3.

(ii) During the year ended May 31, 2007, in consideration for the issue of certain interim financing, the Company issued warrants with a fair value of \$28,500. During the period ended August 31, 2009 these warrants expired and the previously record warrant value was charged to contributed surplus.

10. Related party transactions

- (a) On October 7, 2008, the \$1,000,000, the \$650,000 and the \$400,000 loans payable to a director and shareholder of the Company, plus accrued interest amounts of \$190,493, \$151,141, \$43,938 respectively, were paid in conjunction with the sale of Parasun to IBBS, see note 3.
- (b) One of the Company's subsidiaries entered into a lease agreement for office premises, commencing June 1, 2008 with a private company controlled by a director and shareholder.
- (c) One of the Company's subsidiaries entered into three capital lease agreements during the period ended November 30, 2009 with two private companies, both controlled by a director and shareholder. The cost of property under capital leases aggregated \$197,244 as at November 30, 2009, see note 4.

Related party transactions are in the normal course of operations and are recorded at amounts established and agreed between the related parties.

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November 30, 2009 and 2008

11. Statements of cash flows

(i) Changes in non-cash balance related to operations are as follows:

	Three Months Ended Nov. 30,		Six Months Ended Nov. 30,	
	2009	2008	2009	2008
	\$	\$	\$	\$
Accounts receivable	66,937	(13,100)	132,336	(13,857)
Inventory	50,314	(56,052)	46,950	(53,154)
Prepaid expenses	14,993	48,035	11,782	65,402
Accounts payable and accrued liabilities	(402,262)	(2,412,602)	(447,233)	(631,340)
Accrued dividends payable	85,700	85,700	171,400	171,400
Deferred revenue	(39,504)	(49,509)	(129,633)	(138,020)
Income taxes payable	-	(41,045)	-	(186,822)
Effect of foreign exchange rate changes on cash	(148)	31,220	(865)	16,660
	(223,970)	(2,407,353)	(215,263)	(769,731)

(ii) Supplemental information:

	Nov. 30, 2009	Nov. 30, 2008
	\$	\$
Interest paid	18,327	512,607
Non-cash financing and investing transactions Obligations under capital leases	260,204	-

12. Contingent liability and subsequent events

As a result of the sale of Parasun there was a total of US\$2,500,000 to be held in escrow for a period of 1 year to satisfy any indemnification claims for any deficiencies in the representations and warranties and for any taxes owing up to the date of sale, see note 3.

During the period ending November 30, 2009, US\$1,000,000 was released from escrow. The remaining balance US\$1,500,000 (CDN\$1,583,400 as at November 30, 2009) was extended to March 31, 2010. As at November 30, 2009 the Company has estimated the contingent liability to be US\$350,000 (CDN\$390,760 as at November 30, 2009) and has recorded this amount in the statement of operations. In the event that the amounts held in escrow are not sufficient to cover all claims, the Company would be potentially liable for amounts in excess of the funds held in escrow.

Subsequent to the balance sheet date, 30,000 Series A Convertible Preferred Shares with a face value of \$300,000 were redeemed for a cash payment of \$150,000. In addition, these preferred shareholders relinquished their rights to cumulative dividends of \$44,000, of which \$42,000 is accrued as at November 30, 2009, see notes 8, 9(a)(ii).

Subsequent to the balance sheet date, the Company announced the spin-off of the Kinzin Business unit into a subsidiary company, Kinzin International Inc., ("Kinzin"). The new structure will allow for Kinzin to operate independently and to facilitate its own funding through a private capital raise and IPO.