VOIP INC
Form 10KSB/A
October 27, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-KSB/A
(Amendment No. 2)

(Mark One)

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2005

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period ____________to____________

Commission file number 000-28985

VOIP, INC.
(Name of small business issuer in its charter)

Texas (State or other jurisdiction of incorporation or organization)	75-2785941 (I.R.S. Employer Identification No.)
151 South Wymore Rd, Suite 3000 Altamonte Springs, Florida (Address of principal executive offices)	32714 (Zip Code)

Issuer's telephone number, including area code: (407) 389-3232

Securities registered pursuant to Section 12(b) of the Act: None.

Securities registered pursuant to Section 12(g) of the Act: Common Stock, par value $0.001.

Check whether the issuer is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. o

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months (or for such shorter period that the issuer was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES x NO o

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained herein, and none will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. x

Indicate by a check mark whether the registrant is a shell company (as defined by Rule12b-2 of the Exchange Act).
YES o NOx

The issuer's revenues for its most recent fiscal year were $ 15,507,145.

The aggregate market value of the voting and non-voting common stock held by non-affiliates of the issuer, based on the average bid and asked price of such stock, was $90,522,977 at March 22, 2006. At March 22, 2006, the registrant had outstanding 68,838,766 shares of par value $.001 common stock.

DOCUMENTS INCORPORATED BY REFERENCE

None.

Transitional Small Business Disclosure Format (Check one): Yes o ; No x

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Explanatory Note

VoIP, Inc. (the "Company") is filing this Amendment No. 2 to its Annual Report on Form 10-KSB for the fiscal year ended December 31, 2005 (the "2005 10-KSB"), which was originally filed on April 17, 2006 and first amended on June 6, 2006. This Amendment No. 2 is being filed to include in the 2005 10-KSB the re-audited financial statements of WQN, Inc., which was acquired by the Company on October 5, 2005.

This Amendment does not reflect events occurring after the filing of the 2005 10-KSB, and does not update or modify the disclosures therein in any way other than as required to reflect the amendments described above.

ITEM 7. FINANCIAL STATEMENTS

The financial statements of the Company begin at Page F-1 hereof.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors
VoIP, Inc. and Subsidiaries
Ft. Lauderdale, Florida

We have audited the accompanying consolidated balance sheets of VoIP, Inc. and Subsidiaries ("the Company") as of December 31, 2005 and 2004, and the related consolidated statements of operations, stockholders' equity, 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 audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of VoIP, Inc. and Subsidiaries ("the Company") as of December 31, 2005 and 2004, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note K to the financial statements, the Company's dependence on outside financing, lack of sufficient working capital, and recurring losses raise substantial doubt about the Company's ability to continue as a going concern. Management's plans are described in Note K to the financial statements. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Berkovits, Lago & Company, LLP

Fort Lauderdale, Florida
April 12, 2006

VoIP, Inc.
Consolidated Balance Sheets

	December 31			
		2005		2004
ASSETS				
Current assets:				
Cash and cash equivalents	$	3,228,745	$	1,141,137
Accounts receivable, net of allowance of $177,489 and $136,795 respectively		1,320,062		166,239
Due from related parties		161,530		245,402
Inventory		797,074		324,185
Assets from discontinued operations less valuation allowance of $392,000 in 2005		-		412,419
Other current assets		936,520		-
Total current assets		6,443,931		2,289,382
Property and equipment, net		10,155,507		419,868
Goodwill and other intangible assets		39,441,372		6,923,854
Other assets		349,205		23,579
TOTAL ASSETS	$	56,390,015	$	9,656,683
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current liabilities:				
Accounts payable and accrued expenses	$	13,304,915	$	1,148,833
Loans payable		4,685,236		200,000
Convertible notes payable		3,399,798		-
Advances from investors		3,000,000		-
Due to related parties		1,572,894		560,000
Other current liabilities		956,004		103,030
Total current liabilities		26,918,847		2,011,863
Other liabilities		245,248		-
TOTAL LIABILITIES		27,164,095		2,011,863
Shareholders' equity:				
Common stock - $0.001 par value; 100,000,000 shares authorized; 61,523,397 and 24,258,982 shares issued and outstanding, respectively		61,523		24,259
Additional paid-in capital		63,964,497		14,107,328
Accumulated deficit		(34,800,100)		(6,486,768)
Total shareholders' equity		29,225,920		7,644,820

TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$	56,390,015	$	9,656,683

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

VoIP Inc.

Consolidated Statements of Operations

	Year Ended December 31 2005	2004
Revenues	$ 15,507,145	$ 1,828,193
Cost of sales	16,331,663	1,372,146
Gross profit (loss)	(824,518)	456,047
Operating expenses		
Compensation and related expenses	7,730,795	4,254,477
Commissions and fees to third parties	4,949,612	407,498
Professional and legal	1,868,263	430,432
Depreciation and amortization	3,140,401	82,832
General and administrative expenses	4,193,987	1,288,239
Impairment of goodwill	4,173,452	-
Loss from operations	(26,881,028)	(6,007,431)
Interest expense	1,638,489	-
Gain on sale of fixed assets	(206,184)	-
Net loss before discontinued operations	(28,313,333)	(6,007,431)
Income from discontinued operations, net of income taxes	-	145,311
Net loss	$ (28,313,333)	$ (5,862,120)
Basic and diluted loss per share:		
Loss before discontinued operations	$ (0.67)	$ (0.41)
Income from discontinued operations, net of income taxes	-	0.01
Net loss per share	$ (0.67)	$ (0.40)
Weighted average number of shares outstanding	42,022,906	14,597,312

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

VoIP, Inc.
Consolidated Statements of Cash Flows

	Year Ended December 31 2005	2004
Cash flows from operating activities:		
Continuing operations:		
Net loss	$ (28,313,333)	$ (6,007,431)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	3,140,401	82,832
Goodwill impairment	4,173,452	-
Amortization of debt discounts	416,175	-
Common shares issued for services	3,380,474	599,166
Options and warrants issued for services and compensation	2,181,350	3,320,763
Changes in operating assets and liabilities, net of assets & liabilities acquired:		
Accounts receivable	(17,368)	233,620
Due from related parties	83,872	(245,402)
Inventory	100,080	8,179
Other current assets	(582,685)	52,233
Accounts payable	(4,549,404)	(372,446)
Due to related parties	812,894	-
Other current liabilities	852,974	(335,696)
Net cash used in continuing operating activities	(18,321,118)	(2,664,182)
Discontinued operations:		
Income (loss) from discontinued operations	-	145,311
Changes in assets, liabilities, and net results	412,419	(408,000)
Net cash provided by (used in) discontinued operating activities	412,419	(262,689)
Net cash used in operating activities	(17,908,699)	(2,926,871)
Cash flows from investing activities:		
Cash from acquisitions	-	104,872
Purchase of property and equipment	(2,566,122)	(157,881)
Acquisition of Caerus and WQN (Note K)	(1,290,727)	-
Purchase of other assets	267,940	(71,100)
Net cash used in investing activities	(3,588,909)	(124,109)
Cash flows from financing activities:		
Proceeds from issuance of notes payable	9,616,104	560,000
Proceeds from sales of common stock	11,719,614	3,628,618
Issuance of stock for note conversions	2,465,286	-
Repayment of notes payable	(215,788)	-
Net cash provided by financing activities	23,585,216	4,188,618
Net increase in cash	2,087,608	1,137,638
Cash and cash equivalents at beginning of year	1,141,137	3,499

Cash and cash equivalents at end of year	$	3,228,745	$	1,141,137

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

VoIP, Inc.
Consolidated Statements of Changes in Shareholders' Equity
Years Ended December 31, 2005 and 2004

	Common Stock Shares	Common Stock Amount	Additional Paid- in Capital	Accumulated Deficit	Total
Balance as of December 31, 2003	1,730,939	$ 1,731	$ 731,208	$ (624,647)	$ 108,292
Common stock issued	12,500,000	12,500	-	-	12,500
Common stock issued to investors for cash received	5,520,566	5,521	3,610,598	-	3,616,119
Common stock issued for services	907,477	907	493,259	-	494,166
Common Stock issued for acquisition of DTNet Tech.	2,500,000	2,500	4,747,500	-	4,750,000
Common Stock issued for acquisition of VoipAmericas	1,000,000	1,000	1,099,000	-	1,100,000
Warrants issued to two company officers	-	-	3,320,763	-	3,320,763
Warrants issued for intellectual property	100,000	100	105,000	-	105,100
Loss for the year	-	-	-	(5,862,120)	(5,862,120)
Balance December 31, 2004	24,258,982	24,259	14,107,328	(6,486,767)	7,644,820
Common Stock issued for services	2,994,592	2,995	3,377,479	-	3,380,474
Common stock issued to investors for cash received	6,740,038	6,740	8,022,598	-	8,029,338
Common stock issued for cash received, pursuant to exercise of warrants	3,292,778	3,293	3,919,360	-	3,922,653
Common stock issued for debt conversions	4,054,536	4,054	2,461,232	-	2,465,286
Common Stock issued for acquisition of Caerus, Inc.	18,932,471	18,932	19,956,068	-	19,975,000
Options issued for acquisition of Caerus, Inc.	-	-	355,000	-	355,000
Common Stock issued for acquisition of WQN	1,250,000	1,250	1,298,250	-	1,299,500
Value of warrants issued for acquisition of WQN	-	-	5,200,000	-	5,200,000
Value of warrants and conversion features of debt issued	-	-	3,085,832	-	3,085,832
Stock compensation - amortization	-	-	242,101		242,101
Option and warrant compensation - amortization	-	-	1,939,249	-	1,939,249
Loss for the year	-	-	-	(28,313,333)	(28,313,333)
Balance December 31, 2005	61,523,397	$ 61,523	$ 63,964,497	$ (34,800,100)	$ 29,225,920

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

VoIP, Inc.
Notes to Consolidated Financial Statements

NOTE A - ORGANIZATION AND DESCRIPTION OF BUSINESS

VoIP, Inc. (the "Company") was incorporated on August 3, 1998 under its original name of Millennia Tea Masters under the laws of the State of Texas. In February 2004 the Company exchanged 12,500,000 shares for the common stock of two start-up telecommunication businesses, eGlobalphone, Inc. and VoIP Solutions, Inc. The Company changed its name to VoIP, Inc. in April 2004 and acquired VCS Technologies, Inc. d/b/a DT Net Technologies, a hardware supplier, and VoIP Americas, Inc., a VoIP related company, in June and September, respectively, of 2004. The Company decided to exit its former tea business in December 2004 and focus its efforts and resources in the Voice over Internet Protocol telecommunications industry. In May 2005 the Company acquired Caerus, Inc., a VoIP carrier and service provider. In October 2005 the Company purchased substantially all of the assets of WQN Inc.'s voice over internet protocol business.

The Company is an emerging global provider of advanced communications services utilizing Voice over Internet Protocol (VoIP) technology. Internet Protocol telephony is the real time transmission of voice communications in the form of digitized "packets" of information over the Internet or a private network, similar to the way in which e-mail and other data is transmitted. VoIP services are expected to allow consumers and businesses to communicate in the future at dramatically reduced costs compared to traditional telephony networks.

The Company owns its network and its technology and offers the ability to provide complete product and service solutions, including wholesale carrier services for call routing and termination, outsourced customer service and hardware fulfillment. The Company is a certified Competitive Local Exchange Carrier (CLEC) and Interexchange Carrier (IXC.) The Company provides a portfolio of advanced telecommunications technologies, enhanced service solutions, and broadband products to the VoIP industry. Current and targeted customers include RBOCs, CLECs, IXCs, wireless carriers, resellers, internet service providers, cable multiple system operators and other providers of telephony services.

The Company's operations consist of three segments, as follows: Telecommunication Services, Hardware Sales and Calling Cards.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Caerus, Inc., eGlobalphone, Inc., VoIP Solutions, Inc., DTNet Technologies, and VoIP Americas, Inc. from their respective dates of acquisition. All significant intercompany balances and transactions have been eliminated in consolidation.

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 amounts of assets and liabilities; disclosure of contingent assets and liabilities at the date of the financial statements; and the reported amounts of revenues and expenses. Actual results could differ from those estimates.

Cash and cash equivalents

For purposes of reporting cash flows, the Company considers all cash on hand, in banks, including amounts in book overdraft positions, certificates of deposit and other highly liquid debt instruments with a maturity of three months or less at the date of purchase to be cash and cash equivalents. Cash overdraft positions may occur from time to time due to the timing of making bank deposits and releasing checks, in accordance with the Company's cash management policies.

Accounts Receivable

Accounts receivable are stated at the amount management expects to collect from outstanding balances. Management provides for probable uncollectible amounts based on its assessment of the current status of the individual receivables and after using reasonable collection efforts. As of December 31, 2005 and 2004 the balance of the allowance for uncollectible accounts amounted to $177,489 and $136,795 respectively.

Inventory

Inventory consists of finished goods and is valued at the lower of cost or market using the first-in, first-out method.

Convertible Debt

Convertible debt with beneficial conversion features, whereby the conversion feature is “in the money” are accounted for in accordance with guidance supplied by Emerging Issues Task Force (“EITF”) No. 98-5 "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios" and EITF No. 00-27 "Application of Issue 98-5 to Certain Convertible Instruments." The relative fair value of the warrants and the Beneficial Conversion Feature has been recorded as a discount against the debt and is amortized over the term of the debt.

Income Taxes

The Company follows Statement of Financial Accounting Standards No. 109 “Accounting for Income Taxes” (“SFAS No. 109”). Under the asset and liability method of SFAS No. 109, deferred tax assets and liabilities are recognized for the future tax consequences attributed to differences between the financial statements carrying amounts of existing assets and liabilities and their respective tax base. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Under SFAS No. 109, the effect on deferred tax assets and liabilities of a change in tax rates is recognized in the results of operations in the period that includes the enactment date. If it is more likely than not that some portion of a deferred tax asset will not be realized, a valuation allowance is recognized

Earnings (Loss) Per Share

Basic earnings (loss) per share is computed by dividing the net income (loss) for the year by the weighted-average number of shares of common stock outstanding. The calculation of fully diluted earnings per share assumes the dilutive effect of all potential outstanding common shares attributable to outstanding options, warrants, and convertible notes. Potential outstanding shares are not included in the computation of fully diluted loss per share as their effect is anti-dilutive.

Fair Value of Financial Instruments

The carrying amount of cash, accounts receivable, accounts payable and notes payable, as applicable, approximates fair value due to the short term nature of these items and/or the current interest rates payable in relation to current market conditions.

Revenue Recognition

Revenues are primarily derived from fees charged to terminate voice services over the Company’s network and from monthly recurring charges associated with internet services and from sales of hardware product and calling cards.

Variable revenue is earned based on the number of minutes during a call and is recognized upon completion of a call. Revenue for each customer is calculated from information received through the Company’s network switches. The Company tracks the information received from the switch and analyzes the call detail records and applies the respective revenue rate for each call.

Fixed revenue is earned from monthly recurring services provided to customers that are fixed and recurring in nature, and are connected for a specified period of time. Revenue recognition commences after the provisioning, testing, and acceptance of the service by the customer. Revenues are recognized as the services are provided and continue until the expiration of the contract or until cancellation of the service by the customer.

Revenues from hardware product sales and calling cards are recognized when persuasive evidence of an arrangement exists, delivery to the customer has occurred, the sales price is fixed and determinable, and collectibility of the related receivable is considered probable.

Property, Plant, and Equipment

Property, plant, and equipment are stated at cost. Depreciation is provided over the estimated useful lives of the related assets using the straight line method. The useful life of assets ranges from three to five years. The leasehold improvements are amortized over the life of the related leases.

Business Combinations

The Company accounts for business combinations in accordance with Statement of Financial Accounting Standard No. 141, "Business Combinations" (SFAS No. 141). SFAS No. 141 requires that the purchase method of accounting be used for all business combinations. SFAS No. 141 requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead be tested for impairment at least annually by comparing carrying value to the respective fair value in accordance with the provisions of Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" (SFAS No. 142). This pronouncement also requires that the intangible assets with estimated useful lives be amortized over their respective estimated useful lives.

Impairment of Long-Lived Assets

VoIP, Inc. reviews the recoverability of its long-lived assets, such as plant, equipment and intangibles when events or changes in circumstances occur that indicate that the carrying value of the asset group may not be recoverable. The assessment of possible impairment is based on the Company's ability to recover the carrying value of the asset or asset group from the expected future pre-tax cash flows (undiscounted and without interest charges) of the related operations. If these cash flows are less than the carrying value of such asset, an impairment loss is recognized for the difference between estimated fair value and carrying value. The measurement of impairment requires management to estimate future cash flows and the fair value of long-lived assets.

Goodwill and Other Intangible Assets

In accordance with Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets," the Company tests its goodwill and intangible assets for impairment at least annually by comparing the fair values of these assets to their carrying values, and the Company may be required to record impairment charges for these assets if in the future their carrying values exceed their fair values. During the year ended December 31, 2005 the Company recorded an impairment charge of $4,173,452 relating to goodwill recorded as a result of a prior acquisition. The Company may be required to record additional impairment charges in the future.

Stock Based Compensation

The Company applies the fair value method of Statement of Financial Accounting Standards No. 123R, "Accounting for Stock Based Compensation" ("SFAS No. 123R") in accounting for its stock options. This standard states that compensation cost is measured at the grant date based on the value of the award and is recognized over the service period, which is usually the vesting period. The fair value for each option granted is estimated on the date of the grant using the Black-Scholes option pricing model. The fair value of all vested options granted has been charged to salaries, wages, and benefits in accordance with SFAS No. 123.

Reclassifications

Certain reclassifications have been made to the 2004 financial statements to conform to the 2005 presentation.

Recent Accounting Pronouncements

In November 2004, the Financial Accounting Standards Board (“FASB”) issued Statement No. 151, "Inventory Costs - an amendment of ARB No. 43, Chapter 4." Statement No. 151 requires that abnormal amounts of costs, including idle facility expense, freight, handling costs and spoilage, should be recognized as current period charges. The provisions of this Statement are effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company does not expect the adoption of this Statement to have a material impact on its financial statements.

In December 2004, FASB issued Statement No. 153, "Exchanges of Nonmonetary Assets - an amendment of Accounting Principles Board ("APB") Opinion No. 29." Statement No. 153 amends APB Opinion No. 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have a commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. The provisions of this Statement are effective for nonmonetary exchanges occurring in fiscal periods beginning after June 15, 2005. The Company does not expect the adoption of this Statement to have a material impact on its financial statements.

In May 2005, FASB issued SFAS No. 154, Accounting Changes and Error Corrections or SFAS 154, which supersedes APB Opinion No. 20, Accounting Changes and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements. SFAS 154 changes the requirements for the accounting for and reporting of changes in accounting principle. The statement requires the retroactive application to prior periods' financial statements of changes in accounting principles, unless it is impracticable to determine either the period specific effects or the cumulative effect of the change. SFAS 154 does not change the guidance for reporting the correction of an error in previously issued financial statements or the change in an accounting estimate. SFAS 154 is effective for accounting changes and corrections or errors made in fiscal years beginning after December 15, 2005. We do not expect the adoption of SFAS 154 to have a material impact on our consolidated results of operations or financial condition.

NOTE C - BUSINESS SEGMENT INFORMATION

The Company has three reportable segments: telecommunication services, hardware sales, and calling cards. The telecommunications services segment terminates wholesale and retail, local and long distance calls placed on our network. Such termination is either on our network or through other telecommunication providers. This segment is also in the early stages of implementing wholesale VOIP services. The hardware sales segment supplies broadband components and VOIP hardware to broadband service providers. The calling card segment sells prepaid telephone calling cards that we purchase from other carriers through a network of private distributors located primarily in southern California.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. Information about operations by business segment, as of and for the years ended December 31, 2005 and 2004, is as follows:

2005		Telecommunication Services		Hardware Sales		Calling Cards		Corporate and Eliminations		Consolidated
Revenues	$	8,198,587	$	2,376,329	$	4,932,229	$	-	$	15,507,145
Interest expense	$	560,351	$	-	$	-	$	1,078,138	$	1,638,489
Depreciation and amortization	$	2,916,380	$	161,047	$	-	$	62,974	$	3,140,401
Net income (loss)	$	(9,247,515)	$	(4,674,514)	$	6,348	$	(14,397,652)	$	(28,313,333)
Capital expenditures	$	2,403,902	$	13,572	$	-	$	148,648	$	2,566,122
Identifiable assets	$	11,979,115	$	562,576	$	1,448,236	$	2,958,716	$	16,948,643
Goodwill	$	23,306,341	$	1,037,101	$	-	$	-	$	24,343,442
Other intangible assets, net	$	14,792,930	$	-	$	-	$	305,000	$	15,097,930
2004										
Revenues	$	649,230	$	1,178,963	$	-	$	-	$	1,828,193
Interest expense	$	-	$	-	$	-	$	-	$	-
Depreciation and amortization	$	55,221	$	19,164	$	-	$	8,447	$	82,832
Net income (loss)	$	(385,067)	$	(775,199)	$	-	$	(4,701,853)	$	(5,862,120)
Capital expenditures	$	39,931	$	15,427	$	-	$	102,523	$	157,881
Identifiable assets	$	414,042	$	891,020	$	-	$	1,427,768	$	2,732,831
Goodwill	$	1,408,301	$	5,210,553	$	-	$	-	$	6,618,854
Other intangible assets, net	$	-	$	-	$	-	$	305,000	$	305,000

NOTE D - PROPERTY AND EQUIPMENT, NET

As of December 31, 2005 and 2004, property and equipment consists of the following:

		2005		2004
Equipment	$	9,381,372	$	519,810
Furniture & Fixtures		216,402		56,748
Software		1,667,864		-
Vehicles		15,269		4,769
Leasehold improvements		248,952		4,562
Total		11,529,859		585,889
Less accumulated depreciation		(1,374,352)		(166,021)
Total	$	10,155,507	$	419,868

Depreciation expense for 2005 and 2004 amounted to $1,208,331 and $82,832 respectively.

NOTE E - GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill, by segment:	2005	2004
Telecommunications services	$ 23,306,341	$ 1,408,301
Hardware sales	1,037,101	5,210,553
Calling cards	-	-
Corporate and other	-	-
Subtotal, goodwill	24,343,442	6,618,854

Other intangible assets:

	Useful Life (Years)		
Technology	4.0	$ 6,000,000	$ -
Customer relationships	5.0 - 6.0	8,325,000	-
Trade names	9.0	1,300,000	-
Non-compete agreement	1.0	500,000	-
Other intangible assets	Indefinite	600,000	305,000
Subtotal		16,725,000	305,000
Accumulated amortization		(1,627,070)	-
Other intangible assets, net		15,097,930	305,000
Total goodwill and other intangible assets		$ 39,441,372	$ 6,923,854

In accordance with SFAS No. 142 the Company performs an evaluation of the fair values of our operating segments at least annually. During this evaluation for 2005 the Company determined, based upon market conditions, projected discounted cash flows, and other factors, that the carrying value of our hardware sales operating segment exceeded its fair value at December 31, 2005. Accordingly the Company recorded an impairment charge of $4,173,452 in our 2005 statement of operations and reduced goodwill for this segment by that amount.

NOTE F - ACCOUNTS PAYABLES AND ACCRUED EXPENSES

As of December 31, 2005 and 2004 accounts payables and accrued expenses consisted of the following:

	2005	2004
Accounts payable-trade	$ 11,155,401	$ 912,674
Accrued expenses	2,149,514	233,711
Other	-	2,448
Total	$ 13,304,915	$ 1,148,833

See Note S for a discussion of litigation with two vendors, certain amounts for which are included in accounts payable - trade.

NOTE G - LOANS PAYABLE

As of December 31, 2005 loans payable consisted of a loan payable to a lending institution. These borrowings are repayable over a three-year period and bear interest at 12.5% per annum. Additional borrowings under this facility are contingent upon, among other things, the Company raising certain levels of additional equity financing. Interest paid

under this debt facility during the year ended December 31, 2005, was $399,551.

This loan agreement contains customary covenants and restrictions and provides the lender the right to a perfected first-priority, secured interest in all of the Company's assets, as well as rights to preferred stock warrants. The Company was in violation of certain requirements of this debt facility at December 31, 2005, and, while the lending institution has not declared the loan in default, the full amount of the note at December 31, 2005 has been classified as current.

As of December 31, 2004, loans payable consisted of a revolving line of credit at prime plus 1.0% and a promissory note bearing interest at 7.5%. These loans were collateralized by receivables, inventory and equipment, and both these loans were fully paid in January 2005.

NOTE H - CONVERTIBLE NOTES PAYABLE

As of December 31, 2005, convertible notes payable consisted of the following:

Payable to WQN, Inc.	$	3,700,000
Payable to accredited investors		1,496,804
Subtotal, principal		5,196,804
Less discount		(1,797,006)
Total	$	3,399,798

During 2005, the Company issued and sold $3,085,832 principal amount of convertible notes to accredited investors at a discount, receiving net proceeds of $2,520,320. These notes are immediately convertible at the option of the note holders into 3,857,290 shares of common stock. These note holders also received five-year warrants to purchase 3,857,290 shares of common stock for prices ranging from $1.38 to $1.65 per share. These notes are secured by a subordinated lien on the Company's assets, and the notes bear interest at an effective rate of approximately 20%. Half of these notes are repayable beginning in October 2005, and the other half beginning in January 2006 (3 months following their respective issuances), in 21 equal monthly principal payments, plus interest, until the notes are either repaid or converted.

The fair market value of the conversion feature and the warrants, calculated using the Black-Scholes pricing model, was $3,085,832, which was recognized as a debt discount and an addition to paid-in capital. Interest expense at the dates of issuance was recognized for the difference between the principal value of the notes and their related net proceeds (original issue discount). The debt discount is being amortized to interest expense over the notes' 24-month contact terms.

The Black-Scholes pricing calculations were made using volatilities at either one-year or three-year, monthly or weekly, trailing measures, as appropriate, and risk-free rates as determined by the nearest maturity Treasury yield as of respective valuation dates.

No interest was paid under these debt facilities during the year ended December 31, 2005.

NOTE I - ADVANCE FROM INVESTORS

The unsecured advance of $3,000,000 at December 31, 2005 represents funds deposited with the Company in anticipation of the issuance of convertible notes payable, which were issued in January 2006, (see NOTE S). The advance is not interest bearing, and is unsecured.

NOTE J - ACQUISITIONS

On May 31, 2005 the Company acquired 100 percent of Caerus, Inc. and its wholly owned subsidiaries Volo Communications, Inc., Caerus Networks, Inc., and Caerus Billing, Inc. in exchange for approximately 16.9 million of the Company's common shares (plus 2.0 million escrowed shares).

The goodwill, intangible assets and property recorded for the acquisition of Caerus, Inc. (Caerus) represent the fair market value of liabilities as of the date of acquisition, plus approximately $18.3 million which represents the value of the Company's common stock and options issued pursuant to the acquisition.

On October 5, 2005 the Company acquired substantially all of the operating assets and liabilities of WQN, Inc., for a total purchase price of $9.8 million. The acquisition was financed with the issuance of $3.2 million of convertible debt, 1.3 million shares of the Company's common stock, and 5.0 million warrants to purchase the Company's common stock at $0.001 per share.

Condensed balance sheets of the Caerus and WQN acquisitions, reflecting the net fair value amounts assigned to each major asset and liability, as of their respective acquisition dates are as follows:

		Caerus, Inc.		**WQN, Inc.**
Current assets	$	617,000	$	3,775,000
Property and equipment, net		7,869,000		508,000
Other assets		131,000		463,000
Accounts payable and other current liabilities		(14,674,000)		(2,031,000)
Note payable		(4,832,000)		-
Net liabilities assumed		(10,889,000)		2,715,000
Goodwill		17,778,000		4,120,000
Intangible assets - other		13,800,000		2,925,000
Intangible assets		31,578,000		7,045,000
Net fair value assets acquired	$	20,689,000	$	9,760,000

NOTE K - LIQUIDITY AND CAPITAL RESOURCES

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplates continuation of the Company as a going concern.

The Company has incurred operating losses and negative cash flows from operations since inception of its business in 2004 and has been dependent on issuances of debt and equity instruments to fund its operations and capital expenditures.

At December 31, 2005 the Company's contractual obligations for debt, leases and capital expenditures totaled approximately $11.5 million. Included in this amount is approximately $4.7 million due on a loan from a lending institution. The Company was not in compliance with certain covenants under the loan agreement for this debt.

In January and February, 2006, the Company issued and sold $11,959,666 principal amount of Convertible Notes to nine accredited investors, for net proceeds of $9,879,400 (at a 12.121% original issue discount) in a private placement. The investors also received five-year warrants to purchase a total of 4,537,053 shares for an exercise price of $1.46 per share, and one-year warrants to purchase 4,537,053 shares for an exercise price of $1.59 per share.

Of the convertible notes approximately $7.6 million are secured by a subordinated lien on our assets, and of all these notes bear interest at an effective rate of 20%, are payable over two years beginning 90 to 180 days after closing in cash or at the option of the Company in registered common stock at the lesser of $1.40 per share or 85% of the weighted average price of the stock on the OTCBB. The holders may at their election convert all or part of the notes into shares of common stock at the conversion rate of $1.32 per share.

The subscription agreements for the sale of these convertible notes contain provisions that could impact the Company's future capital raising efforts and its capital structure, including:

· In February 2006, the Company filed a registration statement to register 200% of the shares issuable upon conversion of these notes and all of the shares issuable upon exercise of the warrants (the "Notes Registration Statement"). If the Notes Registration Statement is not declared effective by late April 2006, the Company is liable for liquidated damages each month at a rate of 1.5% of the outstanding note principal until the Registration Statement is declared effective.

· Unless consent is obtained from the note holders, the Company may not file any new registration statements or amend any existing registrations until the sooner of (i) 60 days following the effective date of the Note Registration Statement or (ii) all the notes have been converted into shares and such shares and the warrant shares have been sold by the note holders.

· Until the Notes Registration Statement has been effective for 365 days the note holders must be given the right of first refusal to purchase any proposed sale of the Company's common stock or debt obligations.

· Unless we consent is obtained from the note holders for so long as 20% or more of the note principal, warrants or common stock issued or issuable for the notes remains outstanding, the Company may not issue any new shares of common stock, convertible securities or warrants at a price per share, conversion price per share or exercise price per share that is lower than those prices in effect for the notes and warrants without issuing the note holders sufficient additional shares or warrants at prices such that their warrant exercise price or per share price on average is equal to that for the proposed securities to be issued.

The Company will need to continue to raise additional debt or equity capital to provide the funds necessary to restructure or repay its $4.7 million loan, meet its other contractual commitments, and continue its operations. The Company is actively seeking to raise this additional capital but may not be successful in obtaining further debt or equity financing. The accompanying financial statements do not include any adjustments relating to the recoverability and classification of asset amounts or the amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern.

The Company's authorized shares of stock consist of 100,000,000 shares of common stock. As of April 2006, 68,838,766 common shares issued and outstanding, and there are approximately 45 million additional shares that may become outstanding upon the exercise or conversion of outstanding stock options, warrants and convertible securities. A proxy statement has been filed in connection with annual meeting of shareholders at which a proposal will be submitted to increase the authorized shares of capital stock to 250,000,000 shares of common stock and 25,000,000 shares of "blank check" preferred stock. If such proposal is not approved, the Company will be unable to satisfy the contractual obligations it has undertaken to issue future shares of common stock.

NOTE L - STOCK BASED COMPENSATION

A total of 4,000,000 shares of common stock have been reserved for issuance under the Company's 2004 Employee Stock Option Plan. The activity in this 2004 Option Plan for the year ended December 31, 2005 is as follows:

	Number	Exercise Price Range	Wtd. Avg. Exercise Price
Options outstanding at December 31, 2004	3,650,000	$ 0.85 - $1.56	$ 1.14
Options returned to the plan due to employee terminations	(528,438)	$ 0.85 - $1.10	$ 0.95
Options granted	625,000	$ 1.01 - $1.53	$ 1.37
Options outstanding at December 31, 2005	3,746,562	$ 0.85 - $1.56	$ 1.21

In addition to options issued under the 2004 option plan, the Company granted 800,000 options during 2005 to two executive officers at an exercise price of $1.56, all of which remain outstanding at December 31, 2005

The Company recorded compensation expense of $894,333 and $1,103,309 for the years ended December 31, 2005 and 2004 respectively in connection with stock options granted. As of December 31, 2005, approximately $1,994,000 in total compensation cost related to nonvested options remains to be expensed in future periods.

During the years ended December 31, 2005 and 2004, the Company issued to employees and a financial services firm warrants to purchase 3,300,000 and 4,800,000 shares, respectively, of common stock for prices ranging from $0.93 to $1.07 per share. During year ended December 31, 2005 the Company issued 2,025,630 shares of common stock in exchange for related warrants. The Company recognized $1,044,917 and $2,217,600 in 2005 and 2004, respectively, in expense in connection with the issuance of these warrants.

On December 7, 2005, the Company's Board of Directors approved, subject to shareholder approval, the Company's 2006 Equity Incentive Plan (the "2006 Plan"). The 2006 Plan provides that key employees, consultants and non-employee directors of the Company or an affiliate may be granted: (1) options to acquire shares of the Company's common stock, (2) shares of restricted common stock, (3) stock appreciation rights, (4) performance-based awards, (5) "Dividend Equivalents", and (6) other stock-based awards. The Company is seeking shareholder approval at its 2006 shareholders' meeting for the future issuance of options under the 2006 Plan to allow its participants to acquire up to 10,000,000 shares of our common stock.

NOTE M - WARRANTS

A summary of the Company's warrants as of December, 31 2005 and 2004 is presented below:

	2005			2004		
	Warrants		Weighted average exercise price	Warrants		Weighted average exercise price
Warrants outstanding at beginning or year	4,800,000	$	1.06	-	$	-
Granted to company officers	2,450,000	$	1.51	4,400,000	$	1.00
Granted to a third party	850,000	$	1.60	400,000	$	1.75
Expired	-	$	-	-	$	-
Exercised	(4,400,000)	$	1.00	-	$	-
Warrants outstanding at end of year	3,700,000	$	1.55	4,800,000	$	1.06

The value of warrants was estimated using the Black-Scholes option pricing model. (See Note I for Black-Scholes pricing assumptions).

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NOTE N - COMMITMENTS

The Company is obligated under non-cancelable operating leases for its office facilities and two apartments used by its employees. Future minimum lease payments under the Company's non-cancelable operating leases as of December 31, 2005 are as follows:

Year ending Dec 31		
2006	$	386,846
2007		320,848
Total	$	707,694

During the years ended December 31, 2005 and 2004, $285,993 and $41,957, respectively, were charged to operations for rent expense related to these operating leases.

NOTE O - RELATED PARTY TRANSACTIONS

As of December 31, 2005 and 2004 the amount due from (to) related parties consisted of the following:

		2005		2004
DTNet, Inc. (1)	$	-	$	134,317
DTNet International (1)		-		119,974
WQN, Inc.		161,530		-
Mozart Communication		-		21,794
Com Laser		-		5,850
Other		-		(36,533)
Total	$	161,530	$	245,402

(1) The above entities are related to a shareholder of the Company. These advances are unsecured, due upon demand and non-interest bearing. However, $250,000 of these amounts was written off as uncollectible in 2005.

In December 2004 the Company issued a $560,000 note payable to a shareholder, bearing interest at 3.75%, with an original maturity date of December 2005. In January 2005 the Company added another note payable for $1,040,000 to the same shareholder under similar terms. At December 31, 2005 and 2004, the outstanding balance of these notes was $1,572,894 and $560,000, respectively. The notes are currently due on demand.

Interest paid under these notes was $50,613 during the year ended December 31, 2005.

NOTE P - INCOME TAXES

The components of the Company's consolidated income tax provision are as follows:

	Year ended December 31,			
		2005		2004
Current benefit	$	7,479,000	$	2,040,000
Deferred benefit		1,051,000		-
Subtotal	$	8,530,000	$	2,040,000
Less valuation allowances		(8,530,000)		(2,040,000)
Net	$	-	$	-

The reconciliation of the income tax provision at the statutory rate to the reported income tax expense is as follows:

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	Year ended December 31,	
	2005	2004
Computed at statutory rate	34%	34%
Value of options and warrants expensed, not deductible for tax purposes	(4%)	-
Valuation allowance	(30%)	(34%)
Total	-	-

At December 31, 2005 the Company's net deferred tax assets consisted of the following:

Net operating loss carryforwards	$ 9,519,000
Excess of goodwill impairment charge over tax basis amortization	773,000
Amortization of intangible assets	278,000
Subtotal	10,570,000
Less valuation allowances	(10,570,000)
Total	$ -

The Company's net operating loss carryforwards for federal income tax purposes were approximately $28 million as of December 31, 2005. These carryforwards expire in 2018 ($6,000,000) and 2019 ($22,000,000).

NOTE Q - DISCONTINUED OPERATIONS

In December 2004, the Company decided to exit the tea business and sold its entire tea inventory, therefore, those transactions have been presented as discontinued operations for the year ended December 31, 2004.

Assets, liabilities, and results of the discontinued tea operations of the Millennia Tea Master division for 2004 are as follows:

Assets from discontinued operations:	
Cash	$ 4,419
Notes receivable from purchaser of tea (non-interest bearing due in four equal installments through December 31, 2005)	408,000
Tea inventory at net realizable value	-
Other assets	-
Total	$ 412,419
Liabilities from discontinued operations:	
Due to related parties	$ -
Total	$ -
Results from discontinued operations:	
Revenues	$ 408,613
Cost of sales	263,302
Gross Profit	145,311
Other expenses	-
Income (loss) from discontinued operations	$ 145,311

NOTE R - LEGAL PROCEEDINGS

MCI

On April 8, 2005, Volo Communications, Inc. ("Volo") (a wholly-owned subsidiary of Caerus) filed suit against MCI WorldCom Network Services, Inc. d/b/a UUNET ("MCI WorldCom"). Volo alleges that MCI WorldCom engaged in a pattern and practice of over-billing Volo for the telecommunications services it provided pursuant to the parties' Services Agreement, and that MCI WorldCom refused to negotiate such overcharges in good faith. Volo also seeks damages arising out of MCI WorldCom's fraudulent practice of submitting false bills by, among other things, re-routing long distance calls over local trunks to avoid access charges, and then billing Volo for access charges that were never incurred.

On April 4, 2005, MCI WorldCom declared Volo in default of its obligations under the Services Agreement, claiming that Volo owes a past due amount of $8,365,980, and threatening to terminate all services to Volo within 5 days. By this action Volo alleges claims for (1) breach of contract; (2) fraud in the inducement; (3) primary estoppel; and (4) deceptive and unfair trade practices. Volo also seeks a declaratory judgment that (1) MCI WorldCom is in breach of the Services Agreement; (2) $8,365,980 billed by MCI WorldCom is not "due and payable" under that agreement; and (3) MCI WorldCom's default letter to Volo is in violation of the Services Agreement. Volo seeks direct, indirect and punitive damages in an amount to be determined at trial.

On May 26, 2005, MCI WorldCom filed an Answer, Affirmative Defenses, Counterclaim and Third-Party Complaint naming Caerus as a third-party defendant. MCI WorldCom asserts a breach of contract claim against Volo, a breach of guarantee claim against Caerus, and a claim for unjust enrichment against both parties, seeking an amount to be determined at trial. On July 11, 2005, Volo and Caerus answered the counterclaim and third-party complaint, and filed a third-party counterclaim against MCI WorldCom for declaratory judgment, fraud in the inducement, and breach of implied duty of good faith and fair dealing. Volo and Caerus seek direct, indirect and punitive damages in an amount to be determined at trial.

On August 1, 2005, MCI WorldCom moved to strike most of Volo's and Caerus' affirmative defenses and demand for attorney's fees, and to dismiss Caerus' counterclaims. On October 6, 2005, the Court denied the motions in part, granted them in part with leave to amend, and deferred ruling on the motions in part. On October 13, 2005, Volo and Caerus filed amended affirmative defenses, and Caerus filed amended counterclaims.

Discovery is in progress. MCI WorldCom has served requests for documents and for admissions and interrogatories on Volo and Caerus, to which Volo and Caerus have responded. Document production is ongoing. Volo has served document requests and interrogatories on MCI WorldCom. Volo has also initiated third party discovery. The Court on March 9, 2006 granted in part and denied in part motions to compel disclosures brought by Volo and MCI WorldCom. A pretrial conference is set for May 2, 2006. The Court has not issued a scheduling order or set a trial date. The Company is currently unable to assess the likelihood of a favorable or unfavorable outcome for this litigation.

Netrake

The Company and its subsidiaries Caerus and Volo are involved in pending disputes with Netrake Communications (“Netrake”) arising from an equipment purchase contract under which Volo agreed to purchase approximately $2,000,000 worth in Netrake telephonic equipment and software. The Company has paid approximately $200,000 on the contract but has withheld further payments due to dissatisfaction with the performance of the equipment. In arbitration pending in Dallas, Texas, Netrake has brought claim against the Company and its subsidiaries for (1) breach of contract in the amount of $1.8 million plus interest, (2) business disparagement, (3) misappropriation of trade secrets, (4) tortuous interference with prospective business relations and (5) conversion. Netrake also seeks to recover its attorneys’ fees. Within this same arbitration Volo and Caerus seek damages against Netrake for breach of

contract and breach of warranty claiming that the Netrake product did not perform in accordance with agreed upon specifications and warranties.

Volo and Caerus have initiated litigation in Broward County, Florida claiming damages and recession against Netrake for alleged fraudulent misrepresentations, negligent misrepresentations, violation of Florida's Deceptive and Unfair Trade Practices Act and seeking declaratory relief. Netrake claims all of these claims fall within the arbitration clause of the equipment purchase contract, and has removed the action to arbitrate in Dallas.

The Company is presently unable to determine what impact, if any, this arbitration and litigation will have on its financial condition or results of operations.

VOIP, INC. AND SUBSIDIARIES
UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL STATEMENTS

The Following unaudited pro forma condensed combined financial statements are derived from and should be read in conjunction with the historical consolidated financial statements and related notes of VOIP, INC. ("VOIP" or the "Company"), CAERUS, INC. ("CAERUS"), and WQN, Inc. ("WQN").

On June 1, 2005, the Company, and Caerus announced the closing of the merger of Volo Acquisition Corp., a wholly-owned subsidiary of the Company with and into Caerus, with Caerus as the surviving corporation (the "Merger"). The Merger was completed pursuant to an Agreement and Plan of Merger (the "Merger Agreement'), executed on May 31, 2005.

On October 6, 2005, the Company purchased substantially all of the assets of WQN, Inc. relating to WQN's "Voice over Internet Protocol" business. Such assets consist of WQN's properties and infrastructure for its services platform for both retail and wholesale voice over internet business.

The unaudited pro forma condensed combined statements of operation for the year ended December 31, 2005 assumes that the mergers of Caerus, WQN and the Company were consummated at the beginning of the respective periods.

The unaudited pro forma condensed combined statements of operations has been prepared based on currently available information and assumptions that are deemed appropriate by the Company's management. The pro forma information is for informational purposes only and is not intended to be indicative of the actual consolidated results that would have been reported had the transactions occurred on the dates indicated, nor does the information represent a forecast of the consolidated financial position at any future date or the combined financial results of the Company, Caerus and WQN for any future period.

VoIP, Inc
Proforma Condensed Combined Statement of Operations (Unaudited)
Year Ended December 31, 2005

	VoIP, Inc	Caerus, Inc	WQN, Inc	Adjustments	Consolidated
Revenues	$ 3,277,323	$ 11,307,620	$ 31,790,296	$ -	$ 46,375,239
Cost of sales	2,754,073	14,814,907	30,397,628	-	47,966,608
Gross profit	523,250	(3,507,287)	1,392,668	-	(1,591,369)
Operating expenses	19,393,232	6,558,373	5,024,616	3,968,437	34,944,658
Loss from operations	(18,869,982)	(10,065,660)	(3,631,948)	(3,968,437)	(36,536,027)
Interest expense	1,078,138	786,390	-	643,200	2,507,728
Gain on sale of fixed assets	(206,184)	-	(148,236)	-	(354,420)
Provision for income taxes	-	-	-	-	-
Net loss before discontinued operations	(19,741,936)	(10,852,050)	(3,483,712)	(4,611,637)	($38,689,335)
Income from discontinued operations, net of income taxes	-	-	-	-	-
Net Loss	$ (19,741,936)	$ (10,852,050)	$ (3,483,712)	$ (4,611,637)	$ (38,689,335)
Basic and diluted loss per share:					$ (0.79)
Weighted average number of shares outstanding					48,870,602

The accompanying notes are an integral part of this pro forma condensed combined statement of operations.

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VOIP, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL STATEMENTS

(1) VoIP, INC. Basis of Presentation

Historical financial information for VoIP, Inc. for the year ended December 31, 2005 has been derived from VoIP, Inc.'s historical statements.

(2) Caerus, Inc. Basis of Presentation

Historical financial information for Caerus, Inc. for the year ended December 31, 2005 has been derived from Caerus, Inc.'s historical statements.

(3) Historical financial information for WQN, Inc. for the year ended December 31, 2005 has been derived from WQN, Inc.'s historical financial statements.

(4) VoIP, Inc. and Caerus, Inc. Merger

On June 1, 2005, the Company and Caerus, Inc. announced the closing of the merger of Volo Acquisition Corp., a wholly-owned subsidiary of the Company with and into Caerus, Inc. with Caerus, Inc. as the surviving corporation (the "Merger"). The Merger was completed pursuant to an Agreement and Plan of Merger (the "Merger Agreement'), executed on May 31, 2005 by the conversion of all Caerus, Inc. capital stock into 16,434,470 shares of common stock, par value $0.001, of the Company.

(5) On October 6, 2005, the Company purchased substantially all of the assets of WQN, Inc. relating to WQN's "Voice over Internet Protocol" business. Such assets consist of WQN's properties and infrastructure for its services platform for both retail and wholesale voice over internet business.

(6) Pro Forma Statements of Operations Adjustments

Adjustments to the pro forma Statements of Operations represent amortization of intangible assets and interest expense related to convertible debt recorded in connection with the acquisitions.

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors
Caerus, Inc.
Altamonte Springs, Florida

We have audited the accompanying consolidated balance sheets of Caerus, Inc. as of December 31, 2004 and 2003, and the related consolidated statements of operations, changes in stockholders' equity (deficit), and cash flows for the year ended December 31, 2004 and for period May 15, 2002 (date of inception) through December 31, 2003. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about 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. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Caerus, Inc. as of December 31, 2004 and 2003, and the results of its operations and cash flows for the year ended December 31, 2004 and for the period May 15, 2002 (date of inception) through December 31, 2003 in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming the Company will continue as a going concern. As discussed in Note 1 to the consolidated financial statements, the Company has incurred significant losses and negative cash flows from operations, has a working capital deficit, and has significant unresolved litigation as discussed in Note 8 to the financial statements. These matters, among other things, raise substantial doubt about the Company's ability to continue as a going concern. Management's plans related to these matters are also discussed in Note 1. These financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Moore Stephens Lovelace, P.A.
Certified Public Accountants

Orlando, Florida
July 25, 2005

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CAERUS, INC.
CONSOLIDATED BALANCESHEETS
December 31, 2004 and 2003

ASSETS

	2004	2003
CURRENT ASSETS		
Cash and cash equivalents	$ 19,414	$ 25,078
Restricted cash	60,224	196
Accounts receivable	2,098,598	358,522
Note receivable - related party	-	179,974
Supplies, deposits and prepaid expenses	70,999	350,199
TOTAL CURRENT ASSETS	2,249,235	913,969
PROPERTY AND EQUIPMENT		
Telecommunications equipment and computers	6,390,973	732,205
Furniture and fixtures	61,960	21,624
Leasehold improvements	163,808	146,358
Purchased and developed software	473,228	598,243
	7,089,969	1,498,430
Less accumulated depreciation and amortization	(824,580)	(183,408)
NET PROPERTY AND EQUIPMENT	6,265,389	1,315,022
OTHER ASSETS		
Deferred loan origination costs, net	285,075	-
Lease deposit and other	28,959	65,000
TOTAL ASSETS	$ 8,828,658	$ 2,293,991

LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)

	2004	2003
CURRENT LIABILITIES		
Accounts payable and accrued expenses	$ 7,137,293	$ 452,094
Note payable	6,006,899	-
Convertible notes payable - related party	1,830,000	1,050,000
Deferred revenue and customer deposits	38,750	60,576
TOTAL CURRENT LIABILITIES	15,012,942	1,562,670
STOCKHOLDERS' EQUITY (DEFICIT)		
Common stock - $.01 par value; 50,000,000 shares authorized; 14,940,508 and 11,948,367 shares issued and outstanding, respectively	149,405	119,484
Preferred stock - $.01 par value; 25,000,000 shares authorized; -0- shares issued and outstanding	-	-
Additional paid-in capital	4,618,253	2,952,184
Accumulated deficit	(10,951,942)	(2,340,347)
TOTAL SHAREHOLDERS' EQUITY (DEFICIT)	(6,184,284)	731,321

TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)	$	8,828,658	$	2,293,991

The accompanying notes are an integral part of the consolidated financial statements.

CAERUS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
For The Year Ended December 31, 2004, and
The Period May 15, 2002 (Date of Inception) Through December 31, 2003

	2004	2002-2003 (Development Stage)
SALES	$ 14,379,365	$ 1,191,287
COST OF SALES		
Network and termination costs	15,103,149	900,681
Testing and sales concessions	662,052	-
TOTAL COST OF SALES	15,765,201	900,681
GROSS PROFIT (LOSS)	(1,385,836)	290,606
OPERATING EXPENSES		
Equipment and computer expenses	603,189	97,068
Office expenses	228,108	206,215
Labor-related expenses	2,973,070	1,214,240
Professional fees	814,243	400,872
Marketing	217,835	16,689
Litigation settlement	326,205	-
Rent, utilities and security	246,545	355,481
Taxes and licenses	55,527	25,390
Travel, lodging and entertainment	163,555	90,928
Depreciation and amortization	641,172	183,409
Asset impairment charge	299,122	-
TOTAL EXPENSES	6,568,571	2,590,292
LOSS FROM OPERATIONS	(7,954,407)	(2,299,686)
OTHER EXPENSES		
Interest expense, net	(657,238)	(19,654)
Other expense, net	50	(21,007)
NET LOSS	$ (8,611,595)	$ (2,340,347)

The accompanying notes are an integral part of the consolidated financial statements.

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CAERUS, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (DEFICIT)
For The Year Ended December 31, 2004, and
The Period May 15, 2002 (Date of Inception) Through December 31, 2003

	Common Stock $.01 Par Value				
	Shares	Amount	Additional Paid-In Capital	Accumulated Deficit	Total Stockholders' Equity (Deficit)
BALANCE - MAY 15, 2002	-	$ -	$ -	$ -	$ -
ISSUANCE OF FOUNDER STOCK	5,400,000	54,000	-	-	54,000
SALE OF COMMON STOCK	6,186,592	61,866	2,721,909	-	2,783,775
ISSUANCE OF COMMON STOCK FOR SERVICES	150,000	1,500	81,750	-	83,250
ISSUANCE OF COMMON STOCK FOR PROPERTY AND EQUIPMENT	211,775	2,118	148,525	-	150,643
NET LOSS	-	-	-	(2,340,347)	(2,340,347)
BALANCE - DECEMBER 31, 2003	11,948,367	119,484	2,952,184	(2,340,347)	731,321
ISSUANCE OF COMMON STOCK	712,071	7,121	273,139	-	280,260
ISSUANCE OF COMMON STOCK FOR DEBT	2,280,070	22,800	1,097,200	-	1,120,000
ISSUANCE OF STOCK WARRANTS IN CONNECTION WITH SECURED NOTE PAYABLE	-	-	218,813	-	218,813
EMPLOYEE STOCK OPTIONS -					

COMPENSATION EXPENSE RECOGNIZED	-		-		76,917		-	76,917
NET LOSS	-		-		-		(8,611,595)	(8,611,595)
BALANCE - DECEMBER 31, 2004	14,940,508	$	149,405	$	4,618,253	$	(10,951,942)	$ (6,184,284)

The accompanying notes are an integral part of the consolidated financial statements.

CAERUS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
For The Year Ended December 31, 2004, and
The Period May 15, 2002 (Date of Inception) Through December 31, 2003

	2004	2002-2003 (Development Stage)
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	$ (8,611,595)	$ (2,340,347)
Adjustments to reconcile net loss to net cash used in operating activities:		
Litigation settlement	326,205	-
Depreciation and amortization	641,172	183,408
Asset impairment charge	299,122	-
Amortization of deferred loan fees	56,613	-
Stock issued to Founder	-	54,000
Stock issued for services	-	83,250
Expense related to employee stock options	76,917	-
Forgiveness of related-party loan	415,323	-
Changes in:		
Restricted cash	(60,028)	(196)
Accounts receivable	(2,066,281)	(358,522)
Supplies, deposits and prepaid expenses	279,200	(415,199)
Other assets	36,041	-
Accounts payable and accrued expenses	6,685,199	452,094
Deferred revenue	(21,826)	60,576
NET CASH USED IN OPERATING ACTIVITIES	(1,943,938)	(2,280,936)
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to property and equipment	(5,890,661)	(1,347,787)
Additions to related-party loan	(235,349)	(179,974)
NET CASH USED IN INVESTING ACTIVITIES	(6,126,010)	(1,527,761)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from borrowings	8,900,000	1,050,000
Repayment of note payable	(993,101)	-
Proceeds from issuance of common stock	280,260	2,783,775
Payments for loan origination costs	(122,875)	-
NET CASH PROVIDED BY FINANCING ACTIVITIES	8,064,284	3,833,775
NET CHANGE IN CASH	(5,664)	25,078
CASH AND CASH EQUIVALENTS - BEGINNING OF PERIOD	25,078	-

CASH AND CASH EQUIVALENTS - END OF PERIOD	$	19,414	$	25,078

The accompanying notes are an integral part of the consolidated financial statements.

Caerus, Inc. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For The Year Ended December 31, 2004 and For The Period May 15, 2002 (Date of Inception) Through December 31, 2003

NOTE 1 - DESCRIPTION OF BUSINESS

Caerus, Inc. and subsidiaries (collectively referred to as the "Company") were incorporated on May 15, 2002 and are wholesale providers of advanced telecommunications technologies and services to carriers and service providers, including Inter Exchange Carriers ("IXCs"), Competitive Local Exchange Carriers ("CLECs"), Internet Service Providers, Cable Operators and Enhanced Voice and Data Service Providers. Through its wholesale-only model, the Company has positioned itself as a "carrier's carrier" and offers protocol-agnostic packet switched technologies to address the gap between traditional communications and "next generation" platforms.

During the period May 15, 2002 (date of inception) to December 31, 2003, the Company was in the process of developing its resources, enhancing its proprietary technology, building a nationwide network with five physical interconnection points (cities), working with potential customers on testing its network, and attracting key engineering professionals; accordingly, the Company was considered to be a development stage enterprise. In January 2004, the Company became fully operational and management determined that the Company was no longer in a development stage.

The Company offers a comprehensive suite of Internet Protocol ("IP")-based broadband packet voice services, IP and Time Division Multiplexing ("TDM") origination/termination services, IP PBX-hosted services, and unified messaging services that include enhanced voice and data solutions. The suite of services is complemented by a Service Creation Environment that enables the Company to develop custom applications and features "on the fly" for its customers.

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated.

The Company has incurred significant losses and negative cash flows from operations since its inception. Additionally, the Company has a working capital deficit of $12,763,707 and an accumulated deficit of $10,951,942 at December 31, 2004. Management continues to undertake steps as part of a plan to attempt to improve liquidity and operating results with the goal of sustaining Company operations. These steps include seeking (a) to increase high-margin sales; and

(b) to control overhead costs and operating expenses. Management plans, in this regard, to continue the implementation of a stabilized and fully operational network, adding recurring-revenue customers, attracting an experienced management team capable of building a profitable company, and securing funding to meet current obligations.

There can be no assurance that the Company can successfully accomplish these steps. Accordingly, the Company's ability to continue as a going concern is uncertain and dependent upon continuing to achieve improved operating results and cash flows or obtaining additional financing. These consolidated financial statements do not include any adjustments to the amounts and classification of assets and liabilities that might be necessary should the Company be unable to continue in business.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Cash and Cash Equivalents

For financial presentation purposes, the Company considers short-term, highly liquid investments with original maturities of three months or less to be cash equivalents.

Restricted Cash and Letters of Credit

Certain cash is restricted to support standby letters of credit which, in turn, support operating license bonds required by several states' regulatory agencies. These standby letters of credit are generally in force for one year with automatic one-year extensions. Maximum draws available to the beneficiary as of December 31, 2004 were $60,000. If the Company was required to obtain replacement standby letters of credit as of December 31, 2004 for those currently outstanding, it is the Company's opinion that the replacement costs would not significantly vary from the present fee structure.

Accounts Receivable

Accounts receivable result from the sale of the Company's services, net of estimated allowances. The Company estimates an allowance for doubtful accounts based on a specific-identification basis. The Company had no allowance for doubtful accounts as of December 31, 2004 and 2003.

Property and Equipment

Property and equipment are recorded at cost. Depreciation and amortization are calculated on a straight-line basis over the assets' useful lives, which range from three to ten years. Leasehold improvements are amortized over the estimated useful lives of the improvements, or the term of the lease, if shorter. Maintenance and repairs are expensed as incurred, while renewals and betterments are capitalized. Upon the sale or other disposition of property, the cost and related accumulated depreciation are removed from the accounts, and any gain or loss is recognized in operations.

Under the Statement of Position ("SOP") 98-1, "Accounting for the Cost of Computer Software Developed or Obtained for Internal Use," the Company expenses computer software costs related to internal-use software that is incurred in the preliminary project stage. When the capitalization criteria of SOP 98-1 have been met, costs of developing or obtaining internal-use computer software are capitalized. The Company capitalized approximately $772,350 of costs incurred for internally developed software during the period from inception through December 31, 2004. Amortization of internal-use software over a 5-year estimated useful life commenced upon the software being placed in service beginning January 1, 2004. Amortization of internal-use software for the periods ended December 31, 2004 and 2003 was approximately $77,000 and $-0-, respectively. During 2004, the Company suspended a number of software development projects and, accordingly, recognized a related asset impairment charge of $299,122 in 2004.

Deposits

Deposits consist primarily of an equipment deposit, a refundable office lease deposit and various other deposits outstanding with service providers.

Deferred Revenue

Deferred revenue represents fees for services that have not yet met the criteria to be recognized as revenue.

Revenue Recognition

Revenue is recognized when earned. Revenue related to long distance, carrier access service and certain other usage-driven charges are billed monthly in arrears, and the associated revenues are recognized during the month of service.

Income Taxes

The Company utilizes the asset and liability method of accounting for income taxes. Under this method, deferred income taxes are recorded to reflect the tax consequences in future years of differences between the tax basis of assets and liabilities and their financially reported amounts at each year-end, based on enacted laws and statutory rates applicable to the periods in which differences are expected to affect taxable income. As of December 31, 2004, the Company had a deferred tax asset of approximately $3,000,000, the components of which consisted primarily of the Company's net losses, fixed asset depreciation and stock-based compensation. Also at December 31, 2004, the Company had a net operating loss carryforward of approximately $11,000,000 for federal income tax purposes that will begin to expire in 2022, and that is subject to significant limitations based upon the occurrence of certain changes in ownership of the Company.

A valuation allowance is provided against the future benefits of deferred tax assets if it is determined that it is more likely than not that the future tax benefits associated with the deferred tax asset will not be realized. Due to recurring losses since inception and the resultant uncertainty of the realization of the tax loss carryforward, the Company has established a 100% valuation allowance against the carryforward benefit. Accordingly, no provision/benefit for income taxes has been included in these consolidated financial statements.

Concentration of Credit Risk

Financial instruments that may subject the Company to concentrations of credit risk consist principally of cash and cash equivalents and accounts receivable. The Company has investment policies and procedures that are reviewed periodically to minimize credit risk.

One customer represented approximately 98% and 90% of the Company's accounts receivable as of December 31, 2004 and 2003, respectively, and approximately 91% and 95% of the Company's revenues for the year ended December 31, 2004 and for the period May 15, 2002 (date of inception) through December 31, 2003, respectively. The loss of this customer would have a significant adverse affect on the Company's operations.

Concentration of Supplier Risk

One supplier represented approximately 86% of the Company's accounts payable as of December 31, 2004, and approximately 94% of the Company's cost of sales for the year ended December 31, 2004 (see Note 8).

Stock-based Compensation

The Company uses the fair value method of Statement of Financial Accounting Standards No. 123R, "Accounting for Stock Based Compensation" in accounting for its stock options. This standard states that compensation cost is measured at the grant date based on the value of the award and is recognized over the service period, which is usually the vesting period. The fair value for each option granted is estimated on the date of the grant using the minimum value method.

Estimates

The preparation of these consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant management estimates affect the carrying value of, among other things, internal-use software, cost of goods sold (see Note 7), the estimating of the fair value of the Company's common stock (see Note 3), and the evaluation of existing disputes and claims (see Notes 7 and 8).

Reclassifications

Certain reclassifications have been made to the 2003 financial statements to conform to the 2004 presentation.

NOTE 3 - CONVERTIBLE NOTES PAYABLE - RELATED PARTY

During 2003, the Company issued two one-year convertible notes to a stockholder of the Company, $1,050,000 and $70,000 of which were funded in the periods ended December 31, 2003 and 2004, respectively. These notes accrued interest at 12% per annum, with all interest and principal due in September and December 2004. These notes, which had certain anti-dilution provisions and which were collateralized by substantially all of the assets of the Company,

were converted into common stock in May 2004 (see Note 6) and the convertible notes were cancelled and the principal amount was satisfied in full.

The Company determined the conversion rates based upon its evaluation of the Company's common stock on the issuance dates. The Company's evaluations were based upon, among other things, peer company valuations, industry and market conditions, the Company's current financial position, terms and conditions of funding available to the Company at the time of issuance, etc.

During 2004, the Company issued two one-year convertible notes to a stockholder of the Company, totaling $1,830,000. These notes accrue interest at 12% per annum, with monthly principal and interest payments originally scheduled through August and November 2004. Restrictive covenants pertaining to the note payable discussed in Note 4 to these financial statements precluded payment of scheduled principal and interest on these notes; therefore, these notes are currently due. However, the same covenants preclude payment until the note described in Note 4 to these financial statements is paid in full. These one-year notes are collateralized by substantially all of the assets of the Company (see Note 8).

Interest expense incurred with respect to these notes during the year ended December 31, 2004 and the period May 15, 2002 (date of inception) through December 31, 2003, was $122,223 and $19,653, respectively.

Interest payments made with respect to these notes during the year ended December 31, 2004 and the period May 15, 2002 (date of inception) through December 31, 2003, were $42,560 and $-0-, respectively.

NOTE 4 - NOTE PAYABLE

In June 2004, the Company secured a $15,000,000 debt facility and drew down the first $7,000,000 traunch primarily for the purpose of funding network equipment purchases. These borrowings are repayable over a three-year period and bear interest at 12.5% per annum. Additional borrowings under this facility are contingent upon, among other things, the Company raising certain levels of additional equity financing. The loan agreement contains customary covenants and restrictions and provides the lender the right to a perfected first-priority, secured interest in all of the Company's assets, as well as rights to preferred stock warrants (see Notes 6 and 8).

Interest paid under this debt facility during the year ended December 31, 2004, was $484,867.

The Company is currently in violation of several of the restrictive covenants in this debt facility. Under its provisions, the lender has the right to call the related note payable due. Accordingly, the full amount of the note at December 31, 2004 has been classified as current.

NOTE 5 - NOTE RECEIVABLE - RELATED PARTY

During the period May 15, 2002 (date of inception) through December 31, 2004, the Company advanced $415,323 to an officer of the Company. In 2005, these advances were characterized as compensation and were forgiven; accordingly, their carrying value was reduced to zero at December 31, 2004. In addition, the Company agreed to pay the related federal income tax withholding of approximately $104,000 on behalf of the related party, which was accrued at December 31, 2004.

NOTE 6 - STOCKHOLDERS' EQUITY

In June 2002, the Company increased its authorized shares to 100,000 shares of $0.01 par value common stock. In July 2002, the Company increased its authorized shares to 3,000,000 shares of $0.01 par value common stock and approved a 2-for-1 common stock split. In October 2002, the Company increased its authorized shares to 6,000,000 shares of $0.01 par value common stock. In July 2003, the Company approved an additional 3-for-1 common stock split and an increase in the authorized shares of common stock to 18,000,000. The Articles of Amendment for this amendment were not filed with the state of Delaware until 2004. The accompanying consolidated financial statements

and related notes present all of these amendments as if they were affected for all periods presented.

In 2002, 5,400,000 shares of common stock were issued to the founder of the Company. These shares were recorded at their par value.

In 2002, the Company issued 150,000 shares of its common stock for legal services provided to the Company, which were recorded at their estimated fair value of $83,250.

During the period May 15, 2002 (date of inception) through December 31, 2003, the Company issued 5,965,957 shares of its common stock and received net proceeds of $2,783,775. Offering costs related to these sales consisted of the issuance of an additional 220,635 shares of the Company's common stock.

During the period May 15, 2002 (date of inception) through December 31, 2003, the Company issued 211,775 shares of its common stock in consideration for leasehold improvements and equipment, of which 190,211 of the shares were issued to the founder of the Company. These shares were recorded at their estimated fair value of $150,643.

In May 2004, $1,120,000 of convertible notes payable to a shareholder were converted into 2,280,070 shares of common stock.

In May and August 2004, the Company issued 500,000 and 212,071 shares of its common stock for cash of $100,000 and $180,260, respectively.

In May 2004, the Company authorized the issuance of up to 25,000,000 shares of $.01 par value preferred stock, the terms of which will be decided upon by the Company's Board of Directors.

In August 2004, the Company approved increasing the authorized common stock to 50,000,000 shares. However, the related state filing has yet to be effected.

Rights to Convert to Preferred Stock

At December 31, 2004, related parties held 12,989,445 shares of common stock that had the right to be converted into preferred shares; however, as of December 31, 2004, no shares of preferred stock had been issued by the Company (see Note 8).

Stock Options

During October 2004, the Board approved the Company's 2004 Stock Option Plan (the "Plan"), whereby 4,000,000 shares of the Company's common stock were reserved for issuance under the Plan to selected directors, officers, employees and consultants of the Company. As of December 31, 2004, options to purchase 2,164,969 shares of common stock for $0.85 per share were issued and outstanding under the Plan. These options expire ten years from the date of issuance. They vest from 36 to 48 months of employment following the date of option issuance. These options had an estimated fair value of $330,599 at the date of grant, using the minimum-value method with the following assumptions:

Expected life (in years)	10.0
Risk-free interest rate	2.0%
Dividend yeild	0.0%

Related 2004 compensation expense was $76,917, determined by amortizing the options' estimated fair value at grant date over their vesting period. The weighted average remaining contractual life of the options outstanding at December 31, 2004 was 9.8 years (see Note 8). The Company had no stock options outstanding at December 31, 2003.

Stock Warrants

In 2004, the Company granted a series of warrants to purchase shares of preferred stock, the specific terms of which had yet to be determined, at an exercise price of $0.85 per share, in conjunction with the long-term note payable issuance (see Note 4). These warrants expire at the earlier of ten years from their issuance date, or five years after a potential initial public securities offering. At the warrant holder's election, these warrants may be exercised on a non-cash basis whereby the warrant holder uses the surplus of the preferred stock's then-fair market value per share over the $0.85 exercise price as payment for the preferred stock purchased under these warrants.

These warrants had estimated fair values totaling $218,813 at their grant dates, recognized as additional paid-in capital and deferred loan origination costs. Additional information pertaining to these warrants issued and outstanding at December 31, 2004 is as follows:

Date Granted	Shares
June, 2004	1,235,294
August 2004	766,020
October, 2004	383,010
Total Issued and Outstanding	2,384,324

Also in conjunction with the long-term note payable issuance (see Note 4), the Company granted warrants to purchase up to $1.0 million of common or preferred stock that may be issued in conjunction with any future securities offering of at least $5.0 million, upon the same price and conditions as afforded to third-party investors in said potential securities offering.

In August 2004, the Company issued warrants to purchase 150,000 shares of common stock to a former employee whose employment was terminated in June 2004. Such warrants are exercisable at $0.85 per share, and expire on June 26, 2006. The Company had no stock warrants outstanding at December 31, 2003.

NOTE 7 - OTHER COMMITMENTS AND CONTINGENCIES

Operating Leases

In August 2002, the Company entered into an operating lease for office space, which expires in February 2008. Approximate minimum future lease payments due under this operating lease, are as follows:

Year Ending December 31,	Amount
2005	$ 196,000
2006	$ 202,000
2007	$ 208,000
2008	$ 35,000

During the year ended December 31, 2004 and the period May 15, 2002 (date of inception) through December 31, 2003, $172,700 and $234,000, respectively, were charged to operations for rent expense related to this operating lease.

Legal and Regulatory Proceedings

The Company's 100%-owned subsidiary, Volo Communications, Inc., settled its breach of contract dispute related to a 2003 "take or pay" sales contract with the Company. In connection with this settlement, the Company wrote off its previously recorded account receivable of $326,205 in 2004.

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Vendor Dispute

Certain transport and termination costs incurred by the Company are recorded at vendor invoice amount less any amounts that have been formally disputed, for which the Company expects to receive a credit. Disputed amounts are based upon management's detailed review of vendor call records and contract provisions; accordingly, the recorded transport and termination costs represent management's estimates of what is ultimately due and payable. During the year ended December 31, 2004, and the period May 15, 2002 (date of inception) through December 31, 2003, $4,500,000 and $2,500,000, respectively, of one vendor's charges were formally disputed. As of December 31, 2004, approximately $4,759,000 remained in dispute and are, therefore, not included in the accompanying financial statements (see Note 8). Differences between the disputed amounts and final settlements, if any, are reported in operations in the year of settlement.

Other

Telecommunications industry revenues are subject to statutory and regulatory changes, interpretations of contracts, etc., all of which could materially affect our revenues. Generally, our customers have sixty days from the invoice date to dispute any billed charges. Management reviews all billings for compliance with applicable rules, regulations and contract terms and believes that it is in compliance therewith; accordingly, no allowance has been recorded in the accompanying financial statements for potential disputed charges.

NOTE 8 - SUBSEQUENT EVENTS

Capital Stock Transactions

In February 2005, the Company issued 511,750 shares of Series B preferred stock for $818,800 cash. In May 2005, 7,289,445 shares of common stock were converted into 5,944,669 shares of Series A preferred stock. Both Series A and Series B preferred stock are convertible into common stock, and they carry voting rights equal to the equivalent number of common shares into which they are convertible. Also, both Series A and Series B preferred stock contain equal and ratable dividend and liquidation preferences over common stock.

Litigation

On April 8, 2005, Volo Communications, Inc. (“Volo”) (a wholly-owned subsidiary of Caerus, Inc.) filed suit against MCI Worldcom Network Services, Inc. d/b/a UUNET (“MCI”). Volo alleges that MCI engaged in a pattern and practice of over-billing Volo for the telecommunications services it provided pursuant to the parties’ Services Agreement, and that MCI refused to negotiate such overcharges in good faith. Volo also seeks damages arising out of MCI’s alleged fraudulent practice of submitting false bills by, among other things, re-routing long distance calls over local trunks to avoid access charges, and then billing Volo for access charges that were never incurred. On April 4, 2005, MCI declared Volo in default of its obligations under the Services Agreement, claiming that Volo owes a past due amount of $8,365,980 through March, 2005, and threatening to terminate all services to Volo within 5 days. On April 12, 2005, MCI terminated all services to Volo. By these actions, Volo alleges claims for (1) breach of contract; (2) fraud in the inducement; (3) primary estoppel; and (4) deceptive and unfair trade practices. Volo also seeks a declaratory judgment that (1) MCI is in breach of the Services Agreement; (2) $8,365,980 billed by MCI is not “due and payable” under that agreement; and (3) MCI’s default letter to Volo is in violation of the Services Agreement. Volo seeks direct, indirect and punitive damages in an amount to be determined at trial.

On May 26, 2005, MCI filed an Answer, Affirmative Defenses, Counterclaim and Third-Party Complaint naming Caerus, Inc. as a third-party defendant. MCI asserts a breach of contract claim against Volo, a breach of guarantee claim against Caerus, Inc., and a claim for unjust enrichment against both parties, seeking an amount to be determined at trial. On July 11, 2005, Volo and Caerus, Inc. answered the counterclaim and third-party complaint, and filed a

third-party counterclaim against MCI for declaratory judgment, fraud in the inducement, and breach of implied duty of good faith and fair dealing. Volo and Caerus, Inc. seek damages in an amount to be determined at trial. MCI has filed a motion to strike certain of Caerus' affirmative defenses and a motion to dismiss Caerus' counterclaims. Discovery should commence shortly. While management is optimistic about the outcome of this litigation, it is currently unable to assess the ultimate likelihood of a favorable or unfavorable outcome; accordingly, no related provision or liability has been made in the accompanying financial statements.

Merger

On May 31, 2005, the Company consummated an Agreement and Plan of Merger ("Merger Agreement") with VoIP, Inc. ("VoIP") (OTCBB:VOII.OB), whereby 100% of Caerus, Inc.'s common and preferred stock, stock options and warrants were exchanged for the common stock of a wholly-owned subsidiary of VoIP. The VoIP subsidiary's name was then changed to Caerus, Inc. Also in conjunction with this merger, the holder of the $1,830,000 notes payable at December 31, 2004 referred to in Note 3 agreed to exchange those notes plus accrued interest for an equivalent number of shares of VoIP common stock valued at $1.23 per share.

Report of Independent Registered Public Accounting Firm

Board of Directors
WQN, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of WQN, Inc. (a Delaware corporation) formerly known as WorldQuest Networks, Inc. and subsidiaries as of December 31, 2004 and 2003, and the related consolidated statements of operations, changes in stockholders' equity, 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 audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of WQN, Inc. and subsidiaries as of December 31, 2004 and 2003, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As more fully discussed in Note 20 to the financial statements, the Company sold substantially all of its operating assets and liabilities to an unrelated third-party.

/s/ Berkovits, Lago and Company, LLP

Fort Lauderdale, Florida
October 16, 2006

WQN, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	December 31, 2004	December 31, 2003
ASSETS		
Current assets:		
Cash and cash equivalents	$ 9,942,280	$ 17,931,820
Investment in partnership	2,944,243	—
Accounts receivable, net of allowances of $25,000 in 2004 and 2003	689,885	553,251
Notes receivable	2,408,679	—
Prepaid expenses and other current assets	806,068	557,577
Total current assets	16,791,155	19,042,648
Property and equipment, net	597,522	1,039,783
Note receivable	204,167	—
Other assets, net	972,794	101,192
Total assets	$ 18,565,638	$ 20,183,623
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 1,630,088	$ 1,108,152
Accrued expenses	457,459	471,746
Deferred revenue	444,988	254,121
Promissory note	300,000	—
Total current liabilities	2,832,535	1,834,019
Promissory note	—	300,000
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, par value $0.01 per share:		
Authorized shares—10,000,000; none issued and outstanding	—	—
Common stock, par value $.01 per share:		
Authorized shares—50,000,000; issued and outstanding shares — 6,830,062 at December 31, 2004 and — 6,386,199 at December 31, 2003	68,301	63,862
Additional capital	43,180,859	41,994,594
Accumulated deficit	(27,516,057)	(24,008,852)
Total stockholders' equity	15,733,103	18,049,604
Total liabilities and stockholders' equity	$ 18,565,638	$ 20,183,623

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

WQN, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	Year ended December 31, 2004		2003	
Retail telephony revenue	$	9,036,354	$	9,152,320
Wholesale telephony revenue and other		6,227,452		206,572
Total revenue		15,263,806		9,358,892
Cost of revenue		13,536,886		7,008,908
Gross profit		1,726,920		2,349,984
Operating expenses:				
Selling, general and administrative		3,901,045		4,517,784
Merger expenses		1,311,945		—
Depreciation and amortization		796,426		921,900
Total operating expenses		6,009,416		5,439,684
Operating loss		(4,282,496)		(3,089,700)
Interest income, net		287,709		202,187
Loss from partnership investment		(55,757)		—
Loss from continuing operations		(4,050,544)		(2,887,513)
Income (loss) from discontinued operations		543,339		(457,879)
Net loss	$	(3,507,205)	$	(3,345,392)
Income (loss) per share - basic and diluted:				
Continuing operations	$	(0.61)	$	(0.45)
Discontinued operations		0.08		(0.07)
Income (loss) per share	$	(0.53)	$	(0.52)
Weighted-average common shares outstanding - basic and diluted		6,642,005		6,386,199

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

WQN, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

Common Stock	Additional Capital	Accumulated Deficit	Total