

ORIGINAL 971318-TX

INTERNATIONAL TELCOM, LTD.  
DBA KALLBACK

FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 1995 AND 1994

WITH

INDEPENDENT AUDITORS' REPORT

ACK \_\_\_\_\_  
 AFA \_\_\_\_\_  
 APP \_\_\_\_\_  
 CAF \_\_\_\_\_  
 CML \_\_\_\_\_  
 CTR \_\_\_\_\_  
 EFG \_\_\_\_\_  
 JFS \_\_\_\_\_  
 JMI \_\_\_\_\_  
 JSC \_\_\_\_\_  
 RCH \_\_\_\_\_  
 RFI \_\_\_\_\_  
 WFS \_\_\_\_\_

KENNETH L. WALL & CO. P. C.  
 CERTIFIED PUBLIC ACCOUNTANTS  
 1801 WESTIN BUILDING  
 2001 SIXTH AVENUE  
 SEATTLE, WASHINGTON 98121

DOCUMENT NUMBER-DATE  
 10468 OCT 13 95  
 FPSC-RECORDS/REPORTING

INTERNATIONAL TELCOM, LTD.  
DBA KALLBACK

For the Years Ended December 31, 1995 and 1994

CONTENTS

	Page
Independent Auditors' Report	1
Financial Statements:	
Balance Sheets	2
Statements of Income	3
Statements of Stockholders' Deficit	4
Statements of Cash Flows	5
Notes of Financial Statements	6-13
Supplementary Information:	
Independent Auditors' Report on Supplementary Information	14
Statements of Direct Costs and Selling, General and Administrative Expenses	15

KENNETH L. WALL & CO., P.S.

CERTIFIED PUBLIC ACCOUNTANTS

1801 WESTIN BUILDING

2001 SIXTH AVENUE

SEATTLE, WASHINGTON 98121-2571

TELEPHONE (206) 441-1055

FAX (206) 441-1058

NEAL D. OTTMAR  
CALVIN L. OTT  
DAVID R. HUBASKO

June 19, 1996

INDEPENDENT AUDITORS' REPORT

To the Board of Directors  
International Telcom Ltd. dba Kallback  
Seattle, Washington

We have audited the accompanying balance sheets of International Telcom Ltd. dba Kallback (a corporation) as of December 31, 1995 and 1994, and the related statements of income, stockholders' deficit, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. 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 financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of International Telcom Ltd. dba Kallback as of December 31, 1995 and 1994, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

*Kenneth L. Wall & Co., P.S.*  
KENNETH L. WALL & CO., P.S.



INTERNATIONAL TELCOM, LTD.  
DBA KALLBACK

BALANCE SHEETS  
December 31, 1995 and 1994

ASSETS

	<u>1995</u>	<u>1994</u>
<b>CURRENT ASSETS</b>		
Cash and cash equivalents (Note 1)	\$ [REDACTED]	\$ [REDACTED]
Cash reserves (Note 1)		
Accounts receivable - trade, net of allowance for doubtful accounts of \$545,000 in 1995 and \$290,900 in 1994		
Accounts receivable - related parties (Note 12)		
Prepaid expenses		
Marketable securities (Notes 1 and 2)		
Notes receivable - related party (Note 3)		
Carrier deposits, current portion (Note 4)		
Income taxes refundable		
Deferred income taxes (Notes 1 and 10)		
<b>TOTAL CURRENT ASSETS</b>	<b>\$ [REDACTED]</b>	<b>\$ [REDACTED]</b>
<b>FIXED ASSETS (Note 1)</b>		
Furniture and fixtures	\$ [REDACTED]	\$ [REDACTED]
Office computers, equipment and software		
Telephone switching equipment		
Capitalized lease equipment (Notes 1 and 11)	\$ [REDACTED]	\$ [REDACTED]
Less accumulated depreciation and amortization	\$ [REDACTED]	\$ [REDACTED]
<b>OTHER ASSETS</b>		
Carrier deposits, net of current portion (Note 4)	\$ [REDACTED]	\$ [REDACTED]
Deferred income taxes (Notes 1 and 10)		
Intangible assets, net of amortization (Notes 1 and 5)	\$ [REDACTED]	\$ [REDACTED]
	\$ [REDACTED]	\$ [REDACTED]

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

LIABILITIES AND STOCKHOLDERS' DEFICIT

	1995	1994
<b>CURRENT LIABILITIES</b>		
Accounts payable - trade	\$	\$
Accounts payable - related party (Note 12)		
Accrued liabilities		
Payroll and payroll taxes		
Business taxes		
Deferred carrier credits, current portion (Note 6)		
Notes payable - related party (Note 7)		
Capital lease obligations, current portion (Notes 1 and 11)		
Security deposits - current portion (Note 8)		
Security deposit, related party (Notes 8 and 12)		
<b>TOTAL CURRENT LIABILITIES</b>	\$	\$
 <b>OTHER LIABILITIES</b>		
Capital lease obligations, net of current portion (Notes 1 and 11)	\$	\$
Deferred carrier credits, net of current portion (Note 6)		
Security deposits, net of current portion (Note 8)		
	\$	\$
 <b>COMMITMENTS AND CONTINGENCIES (Note 11)</b>		
 <b>STOCKHOLDERS' DEFICIT</b>		
Common stock, \$10 par, 100 shares authorized, issued and outstanding	\$	\$
Capital in excess of par		
Retained deficit		
	\$	\$
	\$	\$

INTERNATIONAL TELCOM, LTD.  
DBA KALLBACK

: STATEMENTS OF INCOME  
For the Years Ended December 31, 1995 and 1994

	<u>1995</u>	<u>1994</u>
REVENUES	\$ [REDACTED]	\$ [REDACTED]
DIRECT COSTS OF REVENUE	[REDACTED]	[REDACTED]
Gross Operating Profit	\$ [REDACTED]	\$ [REDACTED]
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	[REDACTED]	[REDACTED]
Operating Income (Loss)	\$ [REDACTED]	\$ [REDACTED]
OTHER INCOME (EXPENSES)		
Interest income	[REDACTED]	[REDACTED]
Investment income (losses) (Note 2)	[REDACTED]	[REDACTED]
Miscellaneous income	[REDACTED]	[REDACTED]
Interest expense	[REDACTED]	[REDACTED]
	\$ [REDACTED]	\$ [REDACTED]
INCOME (LOSS) BEFORE INCOME TAX BENEFITS	\$ [REDACTED]	\$ [REDACTED]
BENEFIT OF INCOME TAXES (Note 10)	[REDACTED]	[REDACTED]
NET INCOME (LOSS)	\$ [REDACTED]	\$ [REDACTED]

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

INTERNATIONAL TELCOM, LTD.  
DBA KALLBACK

STATEMENTS OF STOCKHOLDERS' DEFICIT  
For the Years Ended December 31, 1995 and 1994

	<u>Shares Issued</u>	<u>Common Stock</u>	<u>Capital in Excess of Par</u>	<u>Retained Deficit</u>
BALANCE, December 31, 1993	██████████	\$ ██████████	\$ ██████████	\$ ██████████
Net Income	—	—	—	██████████
BALANCE, December 31, 1994	██████████	\$ ██████████	\$ ██████████	\$ ██████████
Net Loss	—	—	—	██████████
BALANCE, December 31, 1995	██████████	\$ ██████████	\$ ██████████	\$ ██████████

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

INTERNATIONAL TELCOM, LTD.  
DBA KALLBACK

STATEMENTS OF CASH FLOWS  
For the Years Ended December 31, 1995 and 1994

	1995	1994
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income (loss)	\$ [REDACTED]	\$ [REDACTED]
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	[REDACTED]	[REDACTED]
Intangible assets	[REDACTED]	[REDACTED]
Provision for bad debts	[REDACTED]	[REDACTED]
Investment income (losses)	[REDACTED]	[REDACTED]
Increase in deferred income tax assets	[REDACTED]	[REDACTED]
Increase in deferred carrier credits	[REDACTED]	[REDACTED]
Changes in operating assets and liabilities:		
Decrease in cash reserves	[REDACTED]	[REDACTED]
Increase in accounts receivable	[REDACTED]	[REDACTED]
Increase in federal income taxes refundable	[REDACTED]	[REDACTED]
Increase in prepaid expenses	[REDACTED]	[REDACTED]
Increase in carrier deposits	[REDACTED]	[REDACTED]
Increase in accounts payable	[REDACTED]	[REDACTED]
Increase (decrease) in accrued liabilities	[REDACTED]	[REDACTED]
Increase in security deposits	[REDACTED]	[REDACTED]
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	\$ [REDACTED]	\$ [REDACTED]
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchases of fixed assets	\$ [REDACTED]	\$ [REDACTED]
Purchases of marketable securities	[REDACTED]	[REDACTED]
Proceeds from sale of marketable securities	[REDACTED]	[REDACTED]
Issuance of notes receivable - related party	[REDACTED]	[REDACTED]
Proceeds from repayment on notes receivable - related party	[REDACTED]	[REDACTED]
<b>NET CASH USED BY INVESTING ACTIVITIES</b>	\$ [REDACTED]	\$ [REDACTED]
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Payments on notes payable - related party	\$ [REDACTED]	\$ [REDACTED]
Payments on capital lease obligations	[REDACTED]	[REDACTED]
<b>NET CASH USED BY FINANCING ACTIVITIES</b>	\$ [REDACTED]	\$ [REDACTED]
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	\$ [REDACTED]	\$ [REDACTED]
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEARS</b>	[REDACTED]	[REDACTED]
<b>CASH AND CASH EQUIVALENTS AT END OF YEARS</b>	[REDACTED]	\$ [REDACTED]

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



(BLANK PAGE)

INTERNATIONAL TELCOM, LTD.  
DBA KALLBACK

NOTES TO FINANCIAL STATEMENTS  
For the Years Ended December 31, 1995 and 1994

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Company was incorporated on January 12, 1993 in the State of Washington. The Company provides "phone call re-origination" services to domestic and international customers. The Company uses fiber optic networks of major international telephone companies to provide customers with low cost international phone lines and innovative telecommunication services.

Cash and Cash Equivalents - The Company considers all short-term investments with a maturity at date of purchase of three months or less to be cash equivalents. . .

Cash Reserves - The Company's banks require a separate reserve account for processing credit card transactions. Credit card charge backs are applied against those reserves.

Marketable Securities - The Company's investment in trading securities are recorded at their fair value and consist of debt and equity securities. Fair value is based on quoted market price. Unrealized gains or losses for trading securities are included in the Company's net earnings.

Leases - Leases which meet certain criteria are classified as capital leases, and assets and liabilities are recorded as amounts equal to the lesser of the present value of the minimum lease payments or the fair value of the leased properties at the beginning of the respective lease terms. Such assets are depreciated using accelerated methods over the related economic lives. Leases which do not meet such criteria are classified as operating leases and related rentals are charged to expense as incurred.

Fixed Assets and Related Depreciation and Amortization - Fixed assets are stated at cost. Depreciation and amortization are computed using accelerated methods applied over the estimated lives of the related assets. Maintenance and repairs which do not improve or extend the life of the respective assets are expensed currently.

The estimated lives of the principal asset classifications including capitalized leases are as follows: Furniture and fixtures, seven years; Office computers, equipment and purchased software, five years; Telephone and telephone switching equipment, five years.

Impairment of Long-Lived Assets - In 1995, the Financial Accounting Standards Board issued Statement No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of", which requires impairment losses to be recorded on long-lived assets used in operations when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amounts. Statement 121 also addresses the accounting for long-lived assets that are expected to be sold. The Company adopted Statement 121 as of January 1, 1995, which did not have a material effect on the Company's consolidated financial position or results of operations.

Intangible Assets - Intangible assets, including start up and organizational costs, are amortized using the straight line method for a period of sixty months.

Advertising - Costs incurred for producing and communicating advertising are expensed as incurred. Total advertising costs were \$ [redacted] and \$ [redacted] for 1995 and 1994, respectively.

INTERNATIONAL TELCOM, LTD.  
DBA KALLBACK

NOTES TO FINANCIAL STATEMENTS - Continued  
For the Years Ended December 31, 1995 and 1994

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

Income Taxes - Deferred income taxes are determined based on differences between financial reporting and tax basis of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

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

Fair Value of Financial Instruments - The carrying amount of cash and cash equivalents, cash reserves, accounts receivable, marketable securities, accounts payable, accrued liabilities, deferred carrier credits and capital lease obligations are reasonable estimates of their fair value. The fair values of other financial instruments are stated in Note 9.

Concentrations of Credit Risk - Financial instruments which potentially subject the Company to credit risk consist principally of cash investments and accounts receivable. Cash is invested in low risk liquid instruments with high quality financial institutions. The Company has not incurred losses related to cash investments. Customers of the Company who are located outside of the United States account for a substantial portion of trade receivables. Concentrations of credit risk with respect to receivables are limited due to the large number of customers comprising the Company's customer base and their dispersion across different business and geographic areas. The Company has also minimized its credit risk with accounts receivable by performing credit evaluations of customers, establishing credit limits, and for certain customers requiring security deposits on account.

Business Concentration - For the year ended December 31, 1995, the Company purchased carrier service from three suppliers representing 52% of total carrier services purchased. The Company has other available sources of carrier services, that could be used to replace current suppliers without severely impacting operations.

Reclassification - Certain reclassifications have been made to prior year financial statements to conform to the current format.

NOTE 2 - MARKETABLE SECURITIES

The Company's investments in equity securities have been classified as trading securities and are reported at their fair value of \$ [redacted] and \$ [redacted] as of December 31, 1995 and 1994, respectively. Unrealized gains and losses are included in net earnings.

NOTE 3 - NOTES RECEIVABLE - RELATED PARTY

Notes receivable from related party consist of 5% demand notes due from the shareholder of the Company in the amount of \$ [redacted] and \$ [redacted] as of December 31, 1995 and 1994, respectively.

INTERNATIONAL TELCOM, LTD.  
DBA KALLBACK

NOTES TO FINANCIAL STATEMENTS - Continued  
For the Years Ended December 31, 1995 and 1994

NOTE 4 - CARRIER DEPOSITS

Carrier deposits consist of amounts deposited with the Company's various providers of telephone communication services. The deposits are required by the carriers to secure amounts due for telephone communication services provided. As of December 31, 1995 and 1994, the Company's carrier deposits amounted to [REDACTED] and \$ [REDACTED] respectively.

NOTE 5 - INTANGIBLE ASSETS

Intangible assets consist of the following at December 31, 1995 and 1994:

	1995	1994
Name rights	\$ [REDACTED]	\$ [REDACTED]
Start up costs	[REDACTED]	[REDACTED]
Organizational costs	[REDACTED]	[REDACTED]
Total	\$ [REDACTED]	\$ [REDACTED]
Less amortization	[REDACTED]	[REDACTED]
	\$ [REDACTED]	\$ [REDACTED]

NOTE 6 - DEFERRED CARRIER CREDITS

Deferred carrier credits include sign up and usage bonuses received under a carrier agreement. The deferred credits are amortized over the remaining 21 months of the agreement.

NOTE 7 - NOTES PAYABLE - RELATED PARTY

Notes in the amount of \$ [REDACTED] are payable to a relative of a shareholder of the Company. The notes are due on demand, bear interest at a rate of 12%, and are secured by the Company's accounts receivable. Interest expense for the notes amounted to \$ [REDACTED] for 1995 and 1994.

NOTE 8 - SECURITY DEPOSITS

The Company requires a security deposit from certain customers before an account is opened. These deposits are used as security for telephone charges incurred by the customer. The security deposit is applied to a bill upon cancellation of services. Upon cancellation of services, the security deposit is first applied to any unpaid bills on the account and the remainder is refunded to the customer.

Although security deposits are payable on demand, only a portion were actually refunded in 1995 and 1994. The Company has estimated the current portion of security deposits to be \$ [REDACTED] and \$ [REDACTED] as of December 31, 1995 and 1994, respectively. These amounts have been classified as current liabilities with the remaining balance of \$ [REDACTED] and \$ [REDACTED] as of December 31, 1995 and 1994, respectively, classified as long-term liabilities.

INTERNATIONAL TELCOM, LTD.  
DBA KALLBACK

NOTES TO FINANCIAL STATEMENTS - Continued  
For the Years Ended December 31, 1995 and 1994

NOTE 9 - FINANCIAL INSTRUMENTS

The estimated fair value of financial instruments has been determined based on available market information and appropriate evaluation methodologies. However, considerable judgement is required in interpreting market data and maturities of the financial instruments to develop estimates of fair value. Accordingly, the estimates presented herein are not necessarily an indicator of the amounts the Company might realize in a current market exchange. At December 31, 1995 and 1994, the carrying amount and estimated fair value of such financial instruments are as follows:

	1995		1994	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Assets (liabilities)				
Notes receivable	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]	[REDACTED]
Carrier deposits	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Notes payable	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Security deposits	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

The estimated fair value of the above financial instruments is based on the present value of estimated future cash flows using a discount rate commensurate with the risks involved.

NOTE 10 - INCOME TAXES

Income taxes (benefits) for the years ended December 31, 1995 and 1994 consisted of the following:

	1995	1994
Current	\$ [REDACTED]	\$ [REDACTED]
Deferred benefits	\$ [REDACTED]	\$ [REDACTED]

The effective rate, as computed on income (loss) before income taxes, differs from the statutory U.S. income tax rate for the years ended December 31 1995 and 1994 due to the following:

	1995	1994
Income taxes (benefits) at statutory rate of 34%	\$ [REDACTED]	\$ [REDACTED]
Utilization of unused net operating loss carryforward	[REDACTED]	[REDACTED]
Decrease in beginning of year valuation allowance for deferred tax assets	[REDACTED]	[REDACTED]
Other, net	[REDACTED]	[REDACTED]
Benefit of income taxes benefits	\$ [REDACTED]	\$ [REDACTED]

INTERNATIONAL TELCOM, LTD.  
DBA KALLBACK

NOTES TO FINANCIAL STATEMENTS - Continued  
For the Years Ended December 31, 1995 and 1994

NOTE 10 - INCOME TAXES, continued

Deferred income taxes are recorded based upon differences between financial reporting basis and tax basis of the Company's assets and liabilities and available net operating loss and tax credit carryforwards. At December 31, 1995 and 1994, deferred tax assets are recorded as follows:

	1995	1994
Deferred Tax Assets:		
Net operating loss carryforward	\$ [REDACTED]	\$ [REDACTED]
Alternative Minimum Tax credits	[REDACTED]	[REDACTED]
Allowance for doubtful accounts	[REDACTED]	[REDACTED]
Unrealized loss on investments	[REDACTED]	[REDACTED]
	\$ [REDACTED]	\$ [REDACTED]
Less current portion	[REDACTED]	[REDACTED]
Deferred tax assets, long-term portion	\$ [REDACTED]	\$ [REDACTED]

The Company has recorded a deferred tax assets of \$ [REDACTED] reflecting the benefit of \$ [REDACTED] in net operating loss carryforwards, which expire in 2008. Realization of the tax benefits is dependent on generating sufficient taxable income prior to expiration of the loss carryforwards. Although realization is not assured, management believes it is more likely than not that all of the deferred tax asset will be realized. The amount of the deferred tax asset considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carryforward period are reduced.

NOTE 11 - COMMITMENTS AND CONTINGENCIES

Leases:

All non-cancelable leases have been categorized as capital or operating leases. The Company has leases for buildings and equipment. The leases are generally renewable and under most leasing arrangements, the Company pays the property taxes, insurance, maintenance and expenses related to the leased property. Total rental expense under all operating leases was [REDACTED] and [REDACTED] for the years ended December 31, 1995 and 1994, respectively.

Leases with terms in excess of capital leases have been capitalized and the related assets are included in the following table for the years ended December 31, 1995 and 1994:

	1995	1994
Equipment	\$ [REDACTED]	\$ [REDACTED]
Less accumulated amortization	[REDACTED]	[REDACTED]
Net assets recorded under capital leases	\$ [REDACTED]	\$ [REDACTED]

INTERNATIONAL TELCOM, LTD.  
DBA KALLBACK

NOTES TO FINANCIAL STATEMENTS - Continued  
For the Years Ended December 31, 1995 and 1994

NOTE 11 - COMMITMENTS AND CONTINGENCIES, continued

As of December 31, 1995, future minimum payments under long-term capital leases and other non-cancelable operating leases with initial or remaining terms in excess of one year are as follows:

	<u>Capital Leases</u>	<u>Operating Leases</u>
1996	\$ [REDACTED]	\$ [REDACTED]
1997	\$ [REDACTED]	\$ [REDACTED]
1998	\$ [REDACTED]	\$ [REDACTED]
Total minimum lease payments	\$ [REDACTED]	\$ [REDACTED]
Less amount representing interest	\$ [REDACTED]	\$ [REDACTED]
Present value of net minimum lease payments	\$ [REDACTED]	\$ [REDACTED]
Less current installments payable	\$ [REDACTED]	\$ [REDACTED]
Capital lease obligation, long-term portion	\$ [REDACTED]	\$ [REDACTED]

Included in these amounts are \$ [REDACTED] of capital lease commitments to an entity controlled by a relative of the shareholder of the Company. The present value of minimum lease payments shown are calculated based on interest rates, with a weighted average of approximately 8.0%, as determined to be applicable at the inception of the leases. Interest expense on the outstanding leases were \$ [REDACTED] and \$ [REDACTED] in 1995 and 1994, respectively.

Purchase Commitments:

The Company has purchase agreements with various carriers of telephone communication services subject to quality and performance. These purchase commitments at current prices, are approximately \$ [REDACTED] for 1996 and \$ [REDACTED] for 1997. The Company does not expect the purchase commitments to exceed its usage in any of the years.

Contingencies:

In 1994, the Company purchased long distance services from Marathon Communications, Inc., an entity controlled by a relative of the shareholder of the Company, which purchased such services from Sprint Communications Company, L.P. In September 1994, Kallback joined with Marathon Communications, Inc. to bring suit against Sprint alleging, among other things, that Sprint overcharged Kallback and Marathon Communications, Inc. for long distance services. Sprint has counter claimed against Marathon alleging it is owed significant amounts for unpaid charges. The litigation is in the stages of discovery and it is not possible to predict the outcome of this litigation with any certainty. However, Kallback believes its claims against Sprint are valid, and Sprint's fees are grossly inflated. Kallback intends to vigorously prosecute its own claims and assist Marathon in its defense against the claims brought by Sprint.

INTERNATIONAL TELCOM, LTD.  
DBA KALLBACK

NOTES TO FINANCIAL STATEMENTS - Continued  
For the Years Ended December 31, 1995 and 1994

NOTE 11 - COMMITMENTS AND CONTINGENCIES, continued

Contingencies, continued

The Company is subject to other legal proceedings and claims which arose in the ordinary course of business. Management believes the amount of liability with respect to the actions will not materially affect the financial position of the Company.

On March 27, 1996, the Federal Communications Commission (FCC) granted the Company special temporary authority to provide resale telecommunication services between the United States and various international points. The temporary period runs from March 27, 1996 through September 23, 1996. The Company must comply with certain terms and conditions for the special temporary authority to remain in place. The Company may be subject to monitoring by the FCC who could revoke the special temporary authorization if it determines that the Company is not in compliance with the conditions of the authorization. However, the FCC affords carriers an opportunity to explain the circumstances of any violation before revoking an authorization. The Company may also apply for an extension of the authorization. The Company has filed an application under Section 214 of the Communications Act of 1934, as amended. The application is in process and the special temporary authority was granted without prejudice to unfavorable action on the application. Management believes that its application will be granted.

The Company may be the subject of sanctions by the FCC if it is determined to have provided common carrier service without first having obtained Section 214 authorization. Such sanctions could include monetary forfeitures and/or the denial of the pending application. Alleged violations upon which the forfeitures are based may not have occurred more than one year prior to the date of issuance of a notice of apparent liability. If the FCC denies the Company's application, it would become necessary for the Company to discontinue the provision of international common carrier service. If the application is denied there would be several reconsideration and appellate remedies available to the Company.

NOTE 12 - RELATED PARTY TRANSACTIONS

The shareholder of the Company and relatives of the shareholder have ownership interests in other companies and partnerships which have not been consolidated with the Company's financial statements.

The Company leases land and buildings on a month-to-month basis from an entity controlled by the shareholder of the Company. Total rental expense under the lease amounted to \$ [redacted] in 1995 and 1994, respectively.

The Company purchased equipment and electronic supplies in the amount of \$ [redacted] in 1995 and 1994, respectively, from entities controlled by relatives of the shareholder of the Company.

The Company purchased telephone services from an entity controlled by a relative of the shareholder of the Company in the amount of \$ [redacted] for 1994. The Company owed \$ [redacted] for services provided under the agreement at December 31, 1995 and 1994.



INTERNATIONAL TELCOM, LTD.  
DBA KALLBACK

NOTES TO FINANCIAL STATEMENTS - Continued  
For the Years Ended December 31, 1995 and 1994

NOTE 12 - RELATED PARTY TRANSACTIONS, continued

The Company purchased advertising services from an entity controlled by the shareholder of the Company in the amount of \$ [REDACTED] for 1994.

The Company earned revenues from telephone services provided to entities controlled by relatives of the shareholder of the Company. Gross revenues amounted to \$ [REDACTED] and \$ [REDACTED] for 1995 and 1994, respectively. Accounts receivable from related parties amounted to \$ [REDACTED] and \$ [REDACTED] for 1995 and 1994, respectively. Security deposits payable to related parties amounted to \$ [REDACTED] as of December 31, 1995 and 1994.

NOTE 13 - SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

Cash paid for interest and income taxes were as follows:

	<u>1995</u>	<u>1994</u>
Interest	\$ [REDACTED]	\$ [REDACTED]
Income taxes		

For 1994, the Company incurred obligations in the amount of \$ [REDACTED] in connection with lease agreements to acquire equipment.

## KENNETH L. WALL &amp; CO., P.S.

CERTIFIED PUBLIC ACCOUNTANTS

1801 WESTIN BUILDING

2001 SIXTH AVENUE

SEATTLE, WASHINGTON 98121-2571

TELEPHONE (206) 441-1058

FAX (206) 441-1058

NEAL D. OTTMAR  
CALVIN L. OTT  
DAVID R. HILBASS

June 19, 1996

INDEPENDENT AUDITORS' REPORT ON  
SUPPLEMENTARY INFORMATIONTo the Board of Directors  
International Telcom Ltd. dba Kallback  
Seattle, Washington

Our report on our audits of the basic financial statements of International Telcom Ltd. dba Kallback for December 31, 1995 and 1994 appears on page 1. The audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information for the years ended December 31, 1995 and 1994, contained in page 15, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

*Kenneth L. Wall & Co., P.S.*  
KENNETH L. WALL & CO., P.S.

INTERNATIONAL TELCOM, LTD.  
DBA KALLBACK

STATEMENTS OF DIRECT COSTS AND SELLING, GENERAL  
AND ADMINISTRATIVE EXPENSES  
For the Years Ended December 31, 1995 and 1994

	<u>1995</u>	<u>1994</u>
<b>DIRECT COSTS OF REVENUE</b>		
Carrier expense	\$ [REDACTED]	\$ [REDACTED]
Agent commissions	[REDACTED]	[REDACTED]
Bank credit card discounts	[REDACTED]	[REDACTED]
Dialers	\$ [REDACTED]	\$ [REDACTED]
<b>SELLING, GENERAL AND ADMINISTRATIVE EXPENSES</b>		
Payroll	\$ [REDACTED]	\$ [REDACTED]
Payroll taxes	[REDACTED]	[REDACTED]
Employee benefits	[REDACTED]	[REDACTED]
Employee training	[REDACTED]	[REDACTED]
Employee recruiting	[REDACTED]	[REDACTED]
Contract labor	[REDACTED]	[REDACTED]
Consulting fees	[REDACTED]	[REDACTED]
Professional fees	[REDACTED]	[REDACTED]
Advertising	[REDACTED]	[REDACTED]
Promotion and trade shows	[REDACTED]	[REDACTED]
Vehicle expense	[REDACTED]	[REDACTED]
Electronic supplies	[REDACTED]	[REDACTED]
Office supplies and expense	[REDACTED]	[REDACTED]
Insurance	[REDACTED]	[REDACTED]
License and permits	[REDACTED]	[REDACTED]
Dues and subscriptions	[REDACTED]	[REDACTED]
Bad debt expense	[REDACTED]	[REDACTED]
Bank charges	[REDACTED]	[REDACTED]
Contributions	[REDACTED]	[REDACTED]
Miscellaneous	[REDACTED]	[REDACTED]
Depreciation and amortization	[REDACTED]	[REDACTED]
Postage	[REDACTED]	[REDACTED]
Printing	[REDACTED]	[REDACTED]
Repairs and maintenance	[REDACTED]	[REDACTED]
Rent	[REDACTED]	[REDACTED]
Telephones	[REDACTED]	[REDACTED]
Utilities	[REDACTED]	[REDACTED]
Travel and entertainment	\$ [REDACTED]	\$ [REDACTED]

## INTERNATIONAL TELCOM, LTD

## BALANCE SHEET

as of December 31, 1996

Preliminary - Unaudited - For Management Review Only

	Dec. 31, 1996
<b>ASSETS</b>	
<b>CURRENT ASSETS</b>	
Cash and cash equivalents	██████████
Cash reserves	██████████
Accounts receivable - trade, net of allowance for doubtful accounts of (1996&1995 - ██████████)(1994 - ██████████)	██████████
Accounts receivable - related parties	██████████
Prepaid expenses	██████████
Marketable securities	██████████
Notes receivable - related party	██████████
Carrier Deposits - Current Portion	██████████
Income Taxes - Refundable	██████████
Deferred income taxes	██████████
Inventory	██████████
<b>TOTAL CURRENT ASSETS</b>	██████████
<b>FIXED ASSETS</b>	
Furniture & Fixtures	██████████
Office Computers, Equip, & Software	██████████
Telephone Switching Equipment	██████████
Automobile	██████████
Capitalized lease equipment	██████████
Less accumulated depreciation	██████████
<b>OTHER ASSETS</b>	
Carrier deposits	██████████
Deferred income taxes	██████████
Intangible assets, net of amortization	██████████
<b>TOTAL ASSETS</b>	██████████

## INTERNATIONAL TELCOM, LTD

## BALANCE SHEET

as of December 31, 1996

Preliminary - Unaudited - For Management Review Only

LIABILITIES AND STOCKHOLDERS' EQUITY	Dec. 31, 1996
<b>CURRENT LIABILITIES</b>	
Accounts payable - trade	██████████
Accounts payable - related party	██████████
Accounts payable employee W/H	██████████
Accrued payroll expense	██████████
Excise tax payable	██████████
Capital lease - current portion	██████████
Deferred carrier credits-current portion	██████████
Security deposits - current portion	██████████
Security deposits - related party	██████████
Note payable - related party	██████████
<b>TOTAL CURRENT LIABILITIES</b>	<u>██████████</u>
<b>OTHER LIABILITIES</b>	
Notes Payable - Long Term	██████████
Notes Payable - Shareholder	██████████
Capital lease obligations	██████████
Deferred carrier credits	██████████
Security deposits	██████████
	<u>██████████</u>
<b>STOCKHOLDERS' EQUITY</b>	
Common Stock	██████████
Capital in excess of par	██████████
Retained deficit - prior	██████████
Retained earnings - current	██████████
	<u>██████████</u>
<b>TOTAL LIABILITIES &amp; STOCKHOLDERS EQUITY</b>	<u>██████████</u>

International Telcom, Ltd.

Income Statement for the 12 Months Ended December 31, 1996

Unaudited - For Management Use Only

	Preliminary Year Ended 1996
Net Sales	██████████
Cost of Sales	██████████
Gross Margin	----- ██████████
General & Admin Expenses	██████████
Operating Income <Loss>	----- ██████████
Other Income & Expenses	
Miscellaneous Income	
Investment Losses & Gains	
Interest Expense	
Interest Income	██████████
Officer Bonus	██████████
Income <Loss> Before Taxes	----- ██████████
Provision For Inc Tax Benefit & Taxes	██████████
Net Income <Loss>	----- ██████████ -----