

ALTERNET SYSTEMS INC  
Form 10-Q  
August 15, 2011

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

**FORM 10-Q**

Quarterly report pursuant section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended **June30, 2011**

Transition report pursuant section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number **000-31909**

**ALTERNET SYSTEMS INC.**

(Exact name of small business issuer as specified in its charter)

**Nevada**  
(State of Incorporation)

**88-047897**

(I.R.S. Employer Identification No.)

**2665 S. Bayshore Dr.  
Miami, Florida 33133**

**Tel: 786-265-1840**

(Address and telephone number of Registrant's principal executive offices and principal place of business)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable

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date.

| <u>Class</u>                                | <u>Outstanding at August 12, 2011</u> |
|---------------------------------------------|---------------------------------------|
| Common Stock, \$0.00001 par value per share | 67,978,599 shares                     |

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**PART 1 FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS.**

Our unaudited interim consolidated financial statements for the three month period ended June 30, 2011 form part of this quarterly report. They are stated in United States Dollars (US\$) and are prepared in accordance with United States generally accepted accounting principles.

**ALTERNET SYSTEMS INC.**

**(A Development Stage Company)**

**CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

**JUNE 30, 2011**

(Unaudited Prepared by Management)

CONSOLIDATED INTERIM BALANCE SHEETS

CONSOLIDATED INTERIM STATEMENTS OF OPERATIONS

CONSOLIDATED INTERIM STATEMENTS OF CASH FLOWS

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

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**ALTERNET SYSTEMS INC.**  
**CONSOLIDATED INTERIM BALANCE SHEETS**  
(Unaudited)

As at June 30, 2011 and December 31, 2010

|                                           | June 30,<br>2011    | (Audited)<br>December<br>31,<br>2010 |
|-------------------------------------------|---------------------|--------------------------------------|
| <b>ASSETS</b>                             |                     |                                      |
| <b>Current Assets</b>                     |                     |                                      |
| Cash                                      | \$ 206,824          | \$ 13,718                            |
| Accounts receivable                       | 630,532             | 856,339                              |
| Share subscriptions receivable            | 4,000               | 4,000                                |
| Prepays and deposits                      | 229,444             | 218,832                              |
|                                           | 1,070,800           | 1,092,889                            |
| <b>Fixed Assets (Note 3)</b>              | 109,369             | 2,544                                |
| <b>Intellectual property (Note 4)</b>     | 100,000             | -                                    |
| <b>TOTAL ASSETS</b>                       | <b>\$ 1,280,169</b> | <b>\$ 1,095,433</b>                  |
| <b>LIABILITIES</b>                        |                     |                                      |
| <b>Current Liabilities</b>                |                     |                                      |
| Accounts payable and accrued charges      | \$ 682,527          | \$ 1,003,828                         |
| Wages payable                             | 304,824             | 396,156                              |
| Accrued taxes                             | 316,513             | 224,324                              |
| Customer deposits (Note 2)                | 184,200             | 144,000                              |
| Deferred income (Note 2)                  | 189,833             | 142,312                              |
| Other loans payable (Note 5)              | 286,576             | 313,313                              |
| Due to related parties (Note 5 and 8)     | 153,906             | 133,181                              |
| Current portion of capital lease (Note 6) | 35,856              | -                                    |
|                                           | 2,154,235           | 2,357,114                            |
| <b>Capital lease (Note 6)</b>             | 36,987              | 0                                    |
| <b>TOTAL LIABILITIES</b>                  | <b>2,191,222</b>    | <b>2,357,114</b>                     |
| <b>STOCKHOLDERS' DEFICIENCY</b>           |                     |                                      |
| Capital Stock (Note 7)                    | 617                 | 483                                  |
| Additional paid-in capital                | 9,599,733           | 7,860,223                            |
| Private placement subscriptions           | 323,862             | 145,362                              |
| Obligation to issue shares                | 25,000              | 108,000                              |
| Deferred compensation (Note 9)            | (21,250)            | (79,832)                             |
| Deficit                                   | (10,430,794)        | (9,181,753)                          |
|                                           | (502,832)           | (1,147,517)                          |
| Non-controlling interest                  | (408,221)           | (114,164)                            |

|                                       |           |             |
|---------------------------------------|-----------|-------------|
| <b>TOTAL STOCKHOLDERS' DEFICIENCY</b> | (911,053) | (1,261,681) |
|---------------------------------------|-----------|-------------|

|                                                       |                     |                     |
|-------------------------------------------------------|---------------------|---------------------|
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIENCY</b> | <b>\$ 1,280,169</b> | <b>\$ 1,095,433</b> |
|-------------------------------------------------------|---------------------|---------------------|

The accompanying notes are an integral part of these financial statements

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**ALTERNET SYSTEMS INC.**  
**CONSOLIDATED INTERIM STATEMENTS OF OPERATIONS**

(Unaudited)

|                                                 | Three<br>months<br>ended<br>June 30,<br>2011 | Three<br>months<br>ended<br>June 30,<br>2010 | Six months<br>ended<br>June 30,<br>2011 | Six months<br>ended<br>June 30,<br>2010 |
|-------------------------------------------------|----------------------------------------------|----------------------------------------------|-----------------------------------------|-----------------------------------------|
| <b>REVENUE</b>                                  |                                              |                                              |                                         |                                         |
| Sales                                           | \$ 52,377                                    | 51,239                                       | \$ 76,844                               | \$ 97,604                               |
| <b>COST OF SALES</b>                            |                                              |                                              |                                         |                                         |
| Direct cost of sales                            | 23,155                                       | 15,872                                       | 50,648                                  | 33,364                                  |
| <b>GROSS PROFIT</b>                             | <b>29,222</b>                                | <b>35,367</b>                                | <b>26,196</b>                           | <b>64,240</b>                           |
| <b>OPERATING EXPENSES</b>                       |                                              |                                              |                                         |                                         |
| Bad debt                                        | -                                            | -                                            | 3,023                                   | -                                       |
| Bank charges and interest                       | 16,051                                       | 19,553                                       | 34,631                                  | 20,671                                  |
| Depreciation and amortization                   | 8,862                                        | 252                                          | 9,041                                   | 504                                     |
| Financing costs                                 | -                                            | 759,652                                      | -                                       | 905,009                                 |
| Interest on capital leases                      | 1,971                                        | -                                            | 1,971                                   | -                                       |
| Investor relations                              | 315                                          | 25,430                                       | 40,410                                  | 50,580                                  |
| Licenses, dues, and insurance                   | 2,732                                        | -                                            | 2,732                                   | 825                                     |
| Management and consulting                       | 192,813                                      | 89,216                                       | 333,730                                 | 191,248                                 |
| Marketing                                       | 3,500                                        | -                                            | 5,300                                   | -                                       |
| Office and general                              | 17,217                                       | 44,347                                       | 22,293                                  | 56,746                                  |
| Professional fees                               | 69,251                                       | 36,093                                       | 109,057                                 | 42,274                                  |
| Rent                                            | 18,683                                       | 11,130                                       | 36,306                                  | 14,266                                  |
| Salaries                                        | 324,029                                      | 47,800                                       | 569,930                                 | 78,467                                  |
| Telephone and utilities                         | 5,562                                        | 5,980                                        | 10,301                                  | 6,754                                   |
| Travel                                          | 46,270                                       | 27,063                                       | 83,279                                  | 58,169                                  |
| <b>TOTAL OPERATING EXPENSES</b>                 | <b>707,256</b>                               | <b>1,066,516</b>                             | <b>1,262,004</b>                        | <b>1,425,513</b>                        |
| <b>NET LOSS BEFORE OTHER ITEMS</b>              | <b>(678,034)</b>                             | <b>(1,031,149)</b>                           | <b>(1,235,808)</b>                      | <b>(1,361,273)</b>                      |
| <b>OTHER ITEMS</b>                              |                                              |                                              |                                         |                                         |
| Customer fees                                   | 70                                           | 58                                           | 166                                     | 250                                     |
| Other income/(expense)                          | 2,231                                        | -                                            | 2,231                                   | -                                       |
| Loss on disposal of assets                      | -                                            | -                                            | -                                       | (1,411)                                 |
| Gain (Loss) on debt settlement                  | (143,953)                                    | 254,172                                      | (143,953)                               | 169,172                                 |
| Increase (decrease) in derivative liability     | (49,411)                                     | 19,416                                       | (165,734)                               | 108,487                                 |
| <b>NET LOSS BEFORE NON-CONTROLLING INTEREST</b> | <b>\$ (869,097)</b>                          | <b>\$ (757,503)</b>                          | <b>\$ (1,543,098)</b>                   | <b>\$ (1,084,775)</b>                   |
| <b>NON-CONTROLLING INTEREST</b>                 | <b>(169,566)</b>                             | <b>(28,108)</b>                              | <b>(294,057)</b>                        | <b>(91,994)</b>                         |
|                                                 | <b>\$ (699,531)</b>                          | <b>\$ (729,395)</b>                          | <b>\$ (1,249,041)</b>                   | <b>\$ (992,781)</b>                     |

**NET LOSS ATTRIBUTABLE TO ALTERNET  
SYSTEMS INC. FOR THE PERIOD**

|                                               |    |                   |    |                   |    |                   |    |                   |
|-----------------------------------------------|----|-------------------|----|-------------------|----|-------------------|----|-------------------|
| <b>BASIC NET LOSS PER SHARE</b>               | \$ | (0.01)            | \$ | (0.03)            | \$ | (0.02)            | \$ | (0.04)            |
| <b>WEIGHTED COMMON SHARES<br/>OUTSTANDING</b> |    | <b>56,405,558</b> |    | <b>28,132,495</b> |    | <b>52,745,186</b> |    | <b>24,800,873</b> |

The accompanying notes are an integral part of these financial statements

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**ALTERNET SYSTEMS INC.**  
**CONSOLIDATED INTERIM STATEMENTS OF CASH FLOWS**

(Unaudited)

|                                                                | Six months<br>ended<br>June 30,<br>2011 | Six months<br>ended<br>June 30,<br>2010 |
|----------------------------------------------------------------|-----------------------------------------|-----------------------------------------|
| <b>OPERATING ACTIVITIES</b>                                    |                                         |                                         |
| Net Loss From Operations Attributable to Alternet Systems Inc. | \$ (1,249,041)                          | \$ (992,781)                            |
| Non-controlling interest                                       | (294,057)                               | (91,994)                                |
| Add: Items Not Affecting Cash                                  |                                         |                                         |
| Depreciation                                                   | 9,041                                   | 504                                     |
| Shares for services                                            | 310,500                                 | 19,500                                  |
| Reversal of shares for services                                | -                                       | (40,000)                                |
| Shares for debt                                                | 831,144                                 | 783,678                                 |
| Loss on disposal of assets                                     | -                                       | 1,411                                   |
| Deferred compensation                                          | 58,582                                  | (1,958)                                 |
| (Gain) Loss on debt settlement                                 | 143,953                                 | (169,172)                               |
| Value of debt for share conversion features                    | -                                       | 727,346                                 |
| Changes In Non-Cash Working Capital:                           |                                         |                                         |
| Accounts receivable                                            | 225,807                                 | 8,615                                   |
| Prepays and deposit                                            | (10,612)                                | (6,480)                                 |
| Accounts payable and accrued charges                           | (465,254)                               | (507,947)                               |
| Wages payable                                                  | (91,332)                                | -                                       |
| Accrued taxes                                                  | 92,189                                  | 52,849                                  |
| Customer deposits                                              | 40,200                                  | -                                       |
| Deferred income                                                | 47,521                                  | -                                       |
| Due to related parties                                         | 20,725                                  | (77,671)                                |
|                                                                | (330,634)                               | (294,100)                               |
| <b>INVESTING ACTIVITIES</b>                                    |                                         |                                         |
| Acquisition of fixed assets                                    | (115,866)                               | (371)                                   |
| Acquisition of intellectual property                           | (100,000)                               | -                                       |
|                                                                | (215,866)                               | (371)                                   |
| <b>FINANCING ACTIVITIES</b>                                    |                                         |                                         |
| Change in loans payable                                        | (26,737)                                | 211,364                                 |
| Change in capital leases                                       | 72,843                                  | -                                       |
| Derivative liability                                           | -                                       | 75,372                                  |
| Deferred financing costs                                       | -                                       | (6,196)                                 |
| Net proceeds on sale of common stock and subscriptions         | 693,500                                 | 15,000                                  |
|                                                                | 739,606                                 | 295,540                                 |
| <b>OTHER COMPREHENSIVE INCOME</b>                              | -                                       | (82)                                    |
| <b>NET CHANGE IN CASH DURING THE PERIOD</b>                    | 193,106                                 | 987                                     |



|                                  |                   |                  |
|----------------------------------|-------------------|------------------|
| <b>CASH, BEGINNING OF PERIOD</b> | 13,718            | 17,854           |
| <b>CASH, END OF PERIOD</b>       | <b>\$ 206,824</b> | <b>\$ 18,841</b> |

The accompanying notes are an integral part of these financial statements

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**ALTERNET SYSTEMS INC.**  
**CONSOLIDATED INTERIM STATEMENT OF STOCKHOLDERS EQUITY**

For the Period from May 16, 2002 (Inception) to June 30, 2011

|                                                                                                     | Shares           | Common<br>Stock | Additional<br>Paid in<br>Capital | Treasury<br>Shares | Treasury<br>Stock | Private<br>Placement<br>Subscriptions | Accumulated<br>Deficit | Deferred<br>Compensation | Other |
|-----------------------------------------------------------------------------------------------------|------------------|-----------------|----------------------------------|--------------------|-------------------|---------------------------------------|------------------------|--------------------------|-------|
| Balance<br>May 16,<br>2002                                                                          | -                | -               | -                                | -                  | -                 | -                                     | -                      | -                        | -     |
| Issuance of<br>common<br>stock for<br>cash at<br>\$0.223 per<br>share -<br>May 17,<br>2002          | 448,400          | 448             | 99,552                           | -                  | -                 | -                                     | -                      | -                        | -     |
| Issuance of<br>common<br>stock for<br>services at<br>\$0.223 per<br>share -<br>December<br>31, 2002 | 2,394,854        | 2,396           | 531,684                          | -                  | -                 | -                                     | -                      | -                        | -     |
| Issuance of<br>common<br>stock for<br>cash at<br>\$0.223 per<br>share -<br>December<br>31, 2002     | 156,776          | 157             | 34,805                           | -                  | -                 | -                                     | -                      | -                        | -     |
| Net Loss<br>for the year                                                                            | -                | -               | -                                | -                  | -                 | -                                     | (88,038)               | -                        | -     |
| <b>Balance<br/>December<br/>31, 2002</b>                                                            | <b>3,000,030</b> | <b>3,001</b>    | <b>666,041</b>                   | -                  | -                 | -                                     | <b>(88,038)</b>        | -                        | -     |
| Net Loss<br>for the year                                                                            | -                | -               | -                                | -                  | -                 | -                                     | (387,426)              | -                        | -     |
| <b>Balance<br/>December<br/>31, 2003</b>                                                            | <b>3,000,030</b> | <b>3,001</b>    | <b>666,041</b>                   | -                  | -                 | -                                     | <b>(475,464)</b>       | -                        | -     |
| Issuance of<br>common<br>stock for<br>cash at                                                       | 363,669          | 364             | 112,256                          | -                  | -                 | -                                     | -                      | -                        | -     |

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|                                                                              |         |     |         |           |           |   |   |   |   |   |
|------------------------------------------------------------------------------|---------|-----|---------|-----------|-----------|---|---|---|---|---|
| \$0.31 per share - April 30, 2004                                            |         |     |         |           |           |   |   |   |   |   |
| Issuance of common stock for services at \$0.31 per share - April 30, 2004   | 475,914 | 475 | 146,905 | -         | -         | - | - | - | - | - |
| Redemption of shares                                                         | -       | -   | -       | 1,615,445 | 360,260   | - | - | - | - | - |
| Issuance of common stock at \$0.42 per share                                 | -       | -   | 148,698 | (762,122) | (167,668) | - | - | - | - | - |
| Issuance of common stock for acquisition at \$0.50 per share - June 30, 2004 | -       | -   | 115,321 | (411,268) | (90,479)  | - | - | - | - | - |
| Issuance of common stock for services at \$0.50 per share - June 30, 2004    | -       | -   | 28,018  | (99,919)  | (21,982)  | - | - | - | - | - |
| Issuance of common stock for cash at \$0.60 per share - September 30, 2004   | 33,516  | 34  | 76,917  | (154,988) | (36,299)  | - | - | - | - | - |

The accompanying notes are an integral part of these financial statements

**ALTERNET SYSTEMS INC.**  
**CONSOLIDATED INTERIM STATEMENT OF STOCKHOLDERS EQUITY**

**For the Period from May 16, 2002 (Inception) to June 30, 2011**

|                                                                                                     | Shares  | Common<br>Stock | Additional<br>Paid in<br>Capital | Treasury<br>Shares | Treasury<br>Stock | Private<br>Placement<br>Subscriptions | Accumulated<br>Deficit | Deferred<br>Compensation | Ob<br>T<br>S |
|-----------------------------------------------------------------------------------------------------|---------|-----------------|----------------------------------|--------------------|-------------------|---------------------------------------|------------------------|--------------------------|--------------|
| Issuance of<br>common<br>stock for<br>Services at<br>\$0.60 per<br>share -<br>September<br>30, 2004 | 40,471  | 40              | 92,878                           | (187,148)          | (43,832)          | -                                     | -                      | -                        |              |
| Issuance of<br>common<br>stock for<br>cash at<br>\$0.50 per<br>share -<br>September<br>30, 2004     | 204,834 | 205             | 102,295                          | -                  | -                 | -                                     | -                      | -                        |              |
| Issuance of<br>common<br>stock for<br>services at<br>\$0.50 per<br>share -<br>September<br>30, 2004 | 644,600 | 644             | 321,856                          | -                  | -                 | -                                     | -                      | -                        |              |
| Issuance of<br>common<br>stock for<br>cash at<br>\$0.48 per<br>share -<br>October 1,<br>2004        | 413,956 | 414             | 199,586                          | -                  | -                 | -                                     | -                      | -                        |              |
| Issuance of<br>common<br>stock for<br>services at<br>\$0.48 per<br>share -<br>October 1,<br>2004    | 150,000 | 150             | 71,850                           | -                  | -                 | -                                     | -                      | -                        |              |
|                                                                                                     | -       | -               | -                                | -                  | -                 | -                                     | (1,619,425)            | -                        |              |

|                                                                                           |                  |              |                  |          |          |          |                    |          |          |
|-------------------------------------------------------------------------------------------|------------------|--------------|------------------|----------|----------|----------|--------------------|----------|----------|
| Net Loss<br>for the year                                                                  |                  |              |                  |          |          |          |                    |          |          |
| <b>Balance</b>                                                                            |                  |              |                  |          |          |          |                    |          |          |
| <b>December</b>                                                                           |                  |              |                  |          |          |          |                    |          |          |
| <b>31, 2004</b>                                                                           | <b>5,326,990</b> | <b>5,327</b> | <b>2,082,621</b> | <b>-</b> | <b>-</b> | <b>-</b> | <b>(2,094,889)</b> | <b>-</b> | <b>-</b> |
| Issuance of<br>common<br>stock for<br>cash at<br>\$0.48 per<br>share -<br>June            |                  |              |                  |          |          |          |                    |          |          |
| 30, 2005                                                                                  | 357,477          | 357          | 172,304          | -        | -        | -        | -                  | -        | -        |
| Issuance of<br>common<br>stock for<br>services at<br>\$0.48 per<br>share -<br>June 30,    |                  |              |                  |          |          |          |                    |          |          |
| 2005                                                                                      | 1,137,880        | 1,138        | 548,201          | -        | -        | -        | -                  | -        | -        |
| Issuance of<br>common<br>stock for<br>acquisition<br>at \$0.48<br>per share<br>- June 30, |                  |              |                  |          |          |          |                    |          |          |
| 2005                                                                                      | 425,961          | 426          | 205,374          | -        | -        | -        | -                  | -        | -        |
| Net Loss<br>for the year                                                                  | -                | -            | -                | -        | -        | -        | (837,842)          | -        | -        |
| <b>Balance</b>                                                                            |                  |              |                  |          |          |          |                    |          |          |
| <b>December</b>                                                                           |                  |              |                  |          |          |          |                    |          |          |
| <b>31, 2005</b>                                                                           | <b>7,248,308</b> | <b>7,248</b> | <b>3,008,500</b> | <b>-</b> | <b>-</b> | <b>-</b> | <b>(2,932,731)</b> | <b>-</b> | <b>-</b> |

The accompanying notes are an integral part of these financial statements

**ALTERNET SYSTEMS INC.**  
**CONSOLIDATED INTERIM STATEMENT OF STOCKHOLDERS EQUITY**

**For the Period from May 16, 2002 (Inception) to June 30, 2011**

|                                                                           | Shares           | Common<br>Stock | Additional<br>Paid in<br>Capital | Treasury<br>Shares | Treasury<br>Stock | Private<br>Placement<br>Subscriptions | Accumulated<br>Deficit | Deferred<br>Compensation |
|---------------------------------------------------------------------------|------------------|-----------------|----------------------------------|--------------------|-------------------|---------------------------------------|------------------------|--------------------------|
| Issuance of common stock for cash at \$0.48 per share - June 30, 2006     | 594,585          | 595             | 286,676                          | -                  | -                 | -                                     | -                      | -                        |
| Issuance of common stock for services at \$0.48 per share - June 30, 2006 | 781,818          | 782             | 376,947                          | -                  | -                 | -                                     | -                      | -                        |
| Issuance of common stock for services at \$0.35 per share - June 30, 2006 | 425,961          | 426             | 146,574                          | -                  | -                 | -                                     | -                      | -                        |
| Net Loss for the year                                                     | -                | -               | -                                | -                  | -                 | -                                     | (553,314)              | -                        |
| <b>Balance December 31, 2006</b>                                          | <b>9,050,672</b> | <b>9,051</b>    | <b>3,818,697</b>                 | <b>-</b>           | <b>-</b>          | <b>-</b>                              | <b>(3,486,045)</b>     | <b>-</b>                 |
| Net Loss for the year                                                     | -                | -               | -                                | -                  | -                 | -                                     | (320,322)              | -                        |
| Balance December 31, 2007                                                 | 9,050,672        | 9,051           | 3,818,697                        | -                  | -                 | -                                     | (3,806,367)            | -                        |
| Alternet Systems Inc. balance before reverse acquisition                  | 6,278,146        | 63              | 5,136,702                        | -                  | -                 | 231,487                               | (5,540,778)            | (29,677)                 |
| Issued to effect reverse acquisition                                      | 4,000,000        | 40              | 21,791                           | -                  | -                 | -                                     | -                      | -                        |
| Reverse acquisition recapitalization                                      | (9,050,672)      | (9,051)         | (5,552,854)                      | -                  | -                 | -                                     | 5,540,778              | -                        |

adjustment

**Balance**

**December 31,**

**2007**      **10,278,146**      **103**      **3,424,336**      **-**      **-**      **231,487**      **(3,806,367)**      **(29,677)**

Stock-based  
compensation  
at  
\$0.025 per  
share - January  
2,  
2008

4,500,000      45      112,455      -      -      -      -

Stock-based  
compensation  
at  
\$0.025 per  
share - January  
15,  
2008

750,000      7      18,743      -      -      -      -

Stock-based  
compensation  
at  
\$0.025 per  
share - January  
23,  
2008

75,000      1      1,874      -      -      -      -

The accompanying notes are an integral part of these financial statements

**ALTERNET SYSTEMS INC.**  
**CONSOLIDATED INTERIM STATEMENT OF STOCKHOLDERS EQUITY**

**For the Period from May 16, 2002 (Inception) to June 30, 2011**

|                                                                                                   | Shares    | Common<br>Stock | Additional<br>Paid in<br>Capital | Treasury<br>Shares | Treasury<br>Stock | Private<br>Placement<br>Subscriptions | Accumulated<br>Deficit | Deferred<br>Compensation | Obliga-<br>To Sh |
|---------------------------------------------------------------------------------------------------|-----------|-----------------|----------------------------------|--------------------|-------------------|---------------------------------------|------------------------|--------------------------|------------------|
| Issuance<br>of<br>common<br>stock for<br>services at<br>\$0.30 per<br>share -<br>May 23,<br>2008  | 23,542    | -               | 7,063                            | -                  | -                 | -                                     | -                      | -                        | -                |
| Issuance<br>of<br>common<br>stock for<br>services at<br>\$0.51 per<br>share -<br>May 23,<br>2008  | 150,000   | 2               | 76,498                           | -                  | -                 | -                                     | -                      | -                        | -                |
| Issuance<br>of<br>common<br>stock for<br>services at<br>\$0.50 per<br>share -<br>June 6,<br>2008  | 100,000   | 1               | 49,999                           | -                  | -                 | -                                     | -                      | -                        | -                |
| Issuance<br>of<br>common<br>stock for<br>services at<br>\$0.42 per<br>share -<br>June 26,<br>2008 | 1,500,000 | 15              | 629,985                          | -                  | -                 | -                                     | -                      | -                        | -                |
| Issuance<br>of<br>common<br>stock for<br>debenture                                                | 277,778   | 3               | 99,997                           | -                  | -                 | -                                     | -                      | -                        | -                |



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|                                                                                                            |         |   |         |   |   |           |   |   |   |
|------------------------------------------------------------------------------------------------------------|---------|---|---------|---|---|-----------|---|---|---|
| note at<br>\$0.36 per<br>share -<br>July 16,<br>2008                                                       |         |   |         |   |   |           |   |   |   |
| Issuance<br>of<br>common<br>stock for<br>debenture<br>note at<br>\$0.21 per<br>share -<br>July 16,<br>2008 | 48,443  | - | 10,000  | - | - | -         | - | - | - |
| Issuance<br>of<br>common<br>stock for<br>debenture<br>note at<br>\$0.35 per<br>share -<br>July 16,<br>2008 | 57,143  | 1 | 19,999  | - | - | -         | - | - | - |
| Issuance<br>of<br>common<br>stock for<br>cash at<br>\$0.35 per<br>share -<br>July<br>16, 2008              | 670,000 | 7 | 234,493 | - | - | (234,500) | - | - | - |
| Issuance<br>of<br>common<br>stock for<br>services at<br>\$0.42 per<br>share -<br>July 16,<br>2008          | 500,000 | 5 | 209,995 | - | - | -         | - | - | - |
| Issuance<br>of<br>common<br>stock for<br>services at<br>\$0.42 per<br>share -<br>August 6,                 | 310,000 | 3 | 130,197 | - | - | -         | - | - | - |

2008

The accompanying notes are an integral part of these financial statements

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**ALTERNET SYSTEMS INC.**  
**CONSOLIDATED INTERIM STATEMENT OF STOCKHOLDERS EQUITY**

**For the Period from May 16, 2002 (Inception) to June 30, 2011**

|                                                                                | Shares  | Common<br>Stock | Additional<br>Paid in<br>Capital | Treasury<br>Shares | Treasury<br>Stock | Private<br>Placement<br>Subscriptions | Accumulated<br>Deficit | Deferred<br>Compensation |
|--------------------------------------------------------------------------------|---------|-----------------|----------------------------------|--------------------|-------------------|---------------------------------------|------------------------|--------------------------|
| Issuance of common stock for cash at \$0.35 per share - August 7, 2008         | 14,100  | -               | 4,930                            | -                  | -                 | (4,930)                               | -                      | -                        |
| Issuance of common stock for cash at \$0.35 per share - August 11, 2008        | 241,158 | 2               | 84,403                           | -                  | -                 | (84,405)                              | -                      | -                        |
| Issuance of common stock for cash at \$0.35 per share - August 13, 2008        | 44,960  | -               | 15,735                           | -                  | -                 | (15,735)                              | -                      | -                        |
| Issuance of common stock for services at \$0.41 per share - September 16, 2008 | 200,000 | 2               | 81,998                           | -                  | -                 | -                                     | -                      | -                        |
| Private placement subscriptions received                                       | -       | -               | -                                | -                  | -                 | 333,498                               | -                      | -                        |
| Foreign exchange translation adjustment                                        | -       | -               | -                                | -                  | -                 | -                                     | -                      | -                        |
| Increase in derivative liability                                               | -       | -               | -                                | -                  | -                 | -                                     | -                      | -                        |
|                                                                                | -       | -               | -                                | -                  | -                 | -                                     | -                      | -                        |

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|                                                                                             |                   |            |                  |          |          |                |                    |                  |
|---------------------------------------------------------------------------------------------|-------------------|------------|------------------|----------|----------|----------------|--------------------|------------------|
| Obligation to issue shares per consulting agreement Services provided per term of contracts | -                 | -          | -                | -        | -        | -              | -                  | (842,466)        |
| Net loss for the year                                                                       | -                 | -          | -                | -        | -        | -              | (1,983,957)        | -                |
| <b>Balance December 31, 2008</b>                                                            | <b>19,740,270</b> | <b>197</b> | <b>5,212,700</b> | <b>-</b> | <b>-</b> | <b>225,415</b> | <b>(5,790,324)</b> | <b>(872,143)</b> |
| Issuance of common stock for cash at \$0.08 per share - April 9, 2009                       | 312,500           | 3          | 24,997           | -        | -        | (25,000)       | -                  | -                |
| Issuance of common stock for services at \$0.10 per share - May 5, 2009                     | 200,000           | 2          | 19,998           | -        | -        | -              | -                  | -                |
| Private placement subscriptions received                                                    | -                 | -          | -                | -        | -        | 25,000         | -                  | -                |

The accompanying notes are an integral part of these financial statements

**ALTERNET SYSTEMS INC.**  
**CONSOLIDATED INTERIM STATEMENT OF STOCKHOLDERS EQUITY**

For the Period from May 16, 2002 (Inception) to June 30, 2011

|                                                              | Shares            | Common<br>Stock | Additional<br>Paid in<br>Capital | Treasury<br>Shares | Treasury<br>Stock | Private<br>Placement<br>Subscriptions | Accumulated<br>Deficit | Deferred<br>Compensation |
|--------------------------------------------------------------|-------------------|-----------------|----------------------------------|--------------------|-------------------|---------------------------------------|------------------------|--------------------------|
| Foreign exchange translation adjustment                      | -                 | -               | -                                | -                  | -                 | -                                     | -                      | -                        |
| Increase (decrease) in derivative liability                  | -                 | -               | -                                | -                  | -                 | -                                     | -                      | -                        |
| Services provided per term of contracts                      | -                 | -               | -                                | -                  | -                 | -                                     | -                      | 226,962                  |
| Reversal of obligation to issue shares                       | -                 | -               | -                                | -                  | -                 | -                                     | -                      | -                        |
| Obligation to issue shares per consulting agreement          | -                 | -               | -                                | -                  | -                 | -                                     | -                      | -                        |
| Obligation to issue shares per debt settlement agreement     | -                 | -               | -                                | -                  | -                 | -                                     | -                      | -                        |
| Subsidiary shares issued to non-controlling interest         | -                 | -               | -                                | -                  | -                 | -                                     | -                      | -                        |
| Net loss for the year                                        | -                 | -               | -                                | -                  | -                 | -                                     | (779,420)              | -                        |
| <b>Balance December 31, 2009</b>                             | <b>20,252,770</b> | <b>202</b>      | <b>5,257,695</b>                 | <b>-</b>           | <b>-</b>          | <b>225,415</b>                        | <b>(6,569,744)</b>     | <b>(645,181)</b>         |
| Issuance of common stock for services at \$0.065 per share - |                   |                 |                                  |                    |                   |                                       |                        |                          |
| Jan 5, 2010                                                  | 250,000           | 2               | 16,248                           | -                  | -                 | -                                     | -                      | -                        |
| Issuance of common stock                                     | 414,554           | 4               | 26,942                           | -                  | -                 | -                                     | -                      | -                        |

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|                                                                                          |           |    |        |   |   |   |   |   |   |
|------------------------------------------------------------------------------------------|-----------|----|--------|---|---|---|---|---|---|
| for<br>debt at \$0.065<br>per share - Jan<br>5, 2010                                     |           |    |        |   |   |   |   |   |   |
| Issuance of<br>common stock<br>for<br>debt at \$0.10<br>per share - Feb<br>18, 2010      | 1,000,000 | 10 | 99,990 | - | - | - | - | - | - |
| Issuance of<br>common stock<br>for<br>debt at \$0.13<br>per share -<br>April<br>19, 2010 | 500,000   | 5  | 64,995 | - | - | - | - | - | - |
| Issuance of<br>common stock<br>for<br>debt at \$0.06<br>per share - May<br>5, 2010       | 800,000   | 8  | 49,592 | - | - | - | - | - | - |

The accompanying notes are an integral part of these financial statements

**ALTERNET SYSTEMS INC.**  
**CONSOLIDATED INTERIM STATEMENT OF STOCKHOLDERS EQUITY**

**For the Period from May 16, 2002 (Inception) to June 30, 2011**

|                                                                       | Shares    | Common<br>Stock | Additional<br>Paid in<br>Capital | Treasury<br>Shares | Treasury<br>Stock | Private<br>Placement<br>Subscriptions | Accumulated<br>Deficit | Deferred<br>Compensation | Obliga-<br>tions to<br>Share-<br>holders |
|-----------------------------------------------------------------------|-----------|-----------------|----------------------------------|--------------------|-------------------|---------------------------------------|------------------------|--------------------------|------------------------------------------|
| Issuance of common stock for debt at \$0.06 per share - May 11, 2010  | 769,231   | 8               | 46,146                           | -                  | -                 | -                                     | -                      | -                        | -                                        |
| Issuance of common stock for debt at \$0.045 per share - May 12, 2010 | 800,000   | 8               | 35,992                           | -                  | -                 | -                                     | -                      | -                        | -                                        |
| Issuance of common stock for debt at \$0.05 per share - May 19, 2010  | 611,077   | 6               | 30,548                           | -                  | -                 | -                                     | -                      | -                        | -                                        |
| Issuance of common stock for debt at \$0.04 per share - May 20, 2010  | 1,600,000 | 16              | 63,984                           | -                  | -                 | -                                     | -                      | -                        | -                                        |
| Issuance of common stock for debt at \$0.05 per share - May 21, 2010  | 3,266,667 | 33              | 163,300                          | -                  | -                 | -                                     | -                      | -                        | -                                        |
|                                                                       | 923,680   | 9               | 27,701                           | -                  | -                 | -                                     | -                      | -                        | -                                        |

Issuance of  
common  
stock for  
debt at  
\$0.03 per  
share -  
June  
1, 2010

Issuance of  
common  
stock for  
debt at  
\$0.03 per  
share -  
June  
17, 2010

Issuance of  
common  
stock for  
debt at  
\$0.04 per  
share -  
July  
22, 2010

Issuance of  
common  
stock for  
services at  
\$0.085 per  
share -  
July  
October 5,  
2010

Issuance of  
common  
stock for  
debt at  
\$0.14 per  
share -  
November  
23, 2010

|           |    |         |   |   |   |   |   |   |
|-----------|----|---------|---|---|---|---|---|---|
| 7,076,297 | 71 | 212,218 | - | - | - | - | - | - |
| 3,331,604 | 34 | 133,231 | - | - | - | - | - | - |
| 3,150,000 | 32 | 267,718 | - | - | - | - | - | - |
| 1,258,604 | 13 | 176,192 | - | - | - | - | - | - |

The accompanying notes are an integral part of these financial statements



**ALTERNET SYSTEMS INC.**  
**CONSOLIDATED INTERIM STATEMENT OF STOCKHOLDERS EQUITY**

**For the Period from May 16, 2002 (Inception) to June 30, 2011**

|                                                                               | Shares  | Common<br>Stock | Additional<br>Paid in<br>Capital | Treasury<br>Shares | Treasury<br>Stock | Private<br>Placement<br>Subscriptions | Accumulated<br>Deficit | Deferred<br>Compensation |
|-------------------------------------------------------------------------------|---------|-----------------|----------------------------------|--------------------|-------------------|---------------------------------------|------------------------|--------------------------|
| Issuance of common stock for debt at \$0.14 per share - November 30, 2010     | 521,801 | 5               | 73,047                           | -                  | -                 | -                                     | -                      | -                        |
| Issuance of common stock for debt at \$0.13 per share - December 22, 2010     | 559,672 | 6               | 72,751                           | -                  | -                 | -                                     | -                      | -                        |
| Issuance of common stock for services at \$0.13 per share - December 22, 2010 | 500,000 | 5               | 64,995                           | -                  | -                 | -                                     | -                      | -                        |
| Share subscriptions issued                                                    | 633,691 | 6               | 95,047                           | -                  | -                 | (95,053)                              | -                      | -                        |
| Private placement subscriptions received                                      | -       | -               | -                                | -                  | -                 | 15,000                                | -                      | -                        |
| Value of debt for share conversion features                                   | -       | -               | 881,891                          | -                  | -                 | -                                     | -                      | -                        |
| Services provided per term of contracts                                       | -       | -               | -                                | -                  | -                 | -                                     | -                      | 749,849                  |
| Obligation to issue shares per consulting agreement                           | -       | -               | -                                | -                  | -                 | -                                     | -                      | (184,500)                |

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|                                             |                   |            |                  |          |          |                |                    |                 |
|---------------------------------------------|-------------------|------------|------------------|----------|----------|----------------|--------------------|-----------------|
| Reversal of obligation to issue shares      | -                 | -          | -                | -        | -        | -              | -                  | -               |
| Foreign exchange translation adjustment     | -                 | -          | -                | -        | -        | -              | -                  | -               |
| Increase (decrease) in derivative liability | -                 | -          | -                | -        | -        | -              | -                  | -               |
| Non-controlling interest                    | -                 | -          | -                | -        | -        | -              | -                  | -               |
| Net loss for the year                       | -                 | -          | -                | -        | -        | -              | (2,446,347)        | -               |
| <b>Balance December 31, 2010</b>            | <b>48,219,648</b> | <b>483</b> | <b>7,860,223</b> | <b>-</b> | <b>-</b> | <b>145,362</b> | <b>(9,016,091)</b> | <b>(79,832)</b> |

The accompanying notes are an integral part of these financial statements

**ALTERNET SYSTEMS INC.**  
**CONSOLIDATED INTERIM STATEMENT OF STOCKHOLDERS EQUITY**

**For the Period from May 16, 2002 (Inception) to June 30, 2011**

|                                                                                                       | Shares    | Common<br>Stock | Additional<br>Paid in<br>Capital | Treasury<br>Shares | Treasury<br>Stock | Private<br>Placement<br>Subscriptions | Accumulated<br>Deficit | Deferred<br>Compensation | Oblig<br>To I<br>Sha |
|-------------------------------------------------------------------------------------------------------|-----------|-----------------|----------------------------------|--------------------|-------------------|---------------------------------------|------------------------|--------------------------|----------------------|
| Issuance<br>of<br>common<br>stock for<br>debt at<br>\$0.155<br>per share<br>-<br>February<br>25, 2011 | 1,220,363 | 12              | 189,144                          | -                  | -                 | -                                     | -                      | -                        | -                    |
| Issuance<br>of<br>common<br>stock for<br>debt at<br>\$0.13 per<br>share -<br>April<br>12, 2011        | 2,214,276 | 22              | 287,834                          | -                  | -                 | -                                     | -                      | -                        | -                    |
| Issuance<br>of<br>common<br>stock for<br>debt at<br>\$0.13 per<br>share -<br>April<br>19, 2011        | 1,498,000 | 15              | 194,726                          | -                  | -                 | -                                     | -                      | -                        | -                    |
| Issuance<br>of<br>common<br>stock for<br>services<br>at \$0.13<br>per share<br>-<br>April 19,<br>2011 | 250,000   | 3               | 32,497                           | -                  | -                 | -                                     | -                      | -                        | -                    |
| Issuance<br>of<br>common                                                                              | 444,079   | 4               | 57,726                           | -                  | -                 | -                                     | -                      | -                        | -                    |

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|                                                                            |           |    |         |   |   |   |   |   |      |
|----------------------------------------------------------------------------|-----------|----|---------|---|---|---|---|---|------|
| stock for debt at \$0.13 per share - April 21, 2011                        |           |    |         |   |   |   |   |   |      |
| Issuance of common stock for services at \$0.13 per share - April 21, 2011 | 600,000   | 6  | 77,994  | - | - | - | - | - | (7)  |
| Issuance of common stock for services at \$0.12 per share - May 3, 2011    | 1,500,000 | 15 | 179,985 | - | - | - | - | - | (12) |
| Issuance of common stock for debt at \$0.10 per share - May 13, 2011       | 1,016,613 | 10 | 101,651 | - | - | - | - | - |      |
| Issuance of common stock for services at \$0.12 per share - June 7, 2011   | 400,000   | 4  | 47,996  | - | - | - | - | - |      |
| Issuance of common stock for services at \$0.11                            | 250,000   | 3  | 27,497  | - | - | - | - | - |      |

per share

-

June 8,  
2011

The accompanying notes are an integral part of these financial statements

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**ALTERNET SYSTEMS INC.**  
**CONSOLIDATED INTERIM STATEMENT OF STOCKHOLDERS EQUITY**

**For the Period from May 16, 2002 (Inception) to June 30, 2011**

|                                                                           | Shares    | Common<br>Stock | Additional<br>Paid in<br>Capital | Treasury<br>Shares | Treasury<br>Stock | Private<br>Placement<br>Subscriptions | Accumulated<br>Deficit | Deferred<br>Compensation |
|---------------------------------------------------------------------------|-----------|-----------------|----------------------------------|--------------------|-------------------|---------------------------------------|------------------------|--------------------------|
| Issuance of common stock for cash at \$0.10 per share - June 15, 2011     | 3,333,333 | 33              | 499,967                          | -                  | -                 | -                                     | -                      | -                        |
| Issuance of common stock for services at \$0.11 per share - June 21, 2011 | 250,000   | 2               | 27,498                           | -                  | -                 | -                                     | -                      | -                        |
| Share subscriptions issued                                                | 500,000   | 5               | 14,995                           | -                  | -                 | (15,000)                              | -                      | -                        |
| Private placement subscriptions received                                  | -         | -               | -                                | -                  | -                 | 193,500                               | -                      | -                        |
| Services provided per term of contracts                                   | -         | -               | -                                | -                  | -                 | -                                     | -                      | 71,082                   |
| Obligation to issue shares per consulting agreements                      | -         | -               | -                                | -                  | -                 | -                                     | -                      | (12,500)                 |
| Obligation to issue shares per employment agreement                       | -         | -               | -                                | -                  | -                 | -                                     | -                      | -                        |
| Obligation to issue shares per consulting agreement                       | -         | -               | -                                | -                  | -                 | -                                     | -                      | -                        |
| Increase (decrease) in derivative liability                               | -         | -               | -                                | -                  | -                 | -                                     | -                      | -                        |

Non-controlling  
interest

|                              |                   |            |                  |          |          |                |                     |                     |
|------------------------------|-------------------|------------|------------------|----------|----------|----------------|---------------------|---------------------|
| Net loss for the year        | -                 | -          | -                | -        | -        | -              | (1,083,307)         | -                   |
| <b>Balance June 30, 2011</b> | <b>61,696,312</b> | <b>617</b> | <b>9,599,733</b> | <b>-</b> | <b>-</b> | <b>323,862</b> | <b>(10,099,398)</b> | <b>(21,250,000)</b> |

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**ALTERNET SYSTEMS INC.  
NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

**June 30, 2011 and December 31, 2010**

**NOTE 1 NATURE OF OPERATIONS AND BASIS OF PRESENTATION**

Alternet Systems Inc. ( Alternet or the Company ) is focused on the mobile phone value added services marketplace which encompasses Mobile Commerce and Mobile Security in North and South America. The Company also provides Voice over IP services, primarily in Latin America.

The Company was incorporated on June 26, 2000 in the State of Nevada as North Pacific Capital Corp. and was organized for the purpose of creating a corporate vehicle to locate and acquire an operating business. On December 19, 2001, the Company changed its name to Schoolweb Systems Inc. and on May 14, 2002 the Company changed its name to Alternet Systems Inc. ( Alternet or the Company ). On November 6, 2000, the Company filed a Form 10SB registration statement with the United States Securities and Exchange Commission ( SEC ) and as a result is subject to the regulations governing reporting issuers in the United States. On March 14, 2003, the Company was listed for quotation on the Over-the-Counter Bulletin Board.

By agreement entered into December 31, 2007, Alternet issued 4,000,000 shares of restricted common stock to the shareholders of TekVoice Communications, Inc., a Company incorporated on May 17, 2002 in the State of Florida, in exchange for all of the issued and outstanding shares of TekVoice Communications, Inc.

The acquisition resulted in the former shareholders of TekVoice Communications, Inc. acquiring 38.92% of the then outstanding shares of the Company and has been accounted for as a reverse merger with TekVoice Communications, Inc., the legal subsidiary, being treated as the accounting parent and Alternet, the legal parent, being treated as the accounting subsidiary. Accordingly, the consolidated results of operations of the Company include those of TekVoice Communications, Inc. for all periods shown and those of Alternet since the date of the reverse acquisition.

In July 2009, the Company purchased 51% of the outstanding shares of Alternet Transactions Systems, Inc. ( ATS ), a company incorporated in the State of Florida on July 29, 2009, for \$5,100. ATS is doing business as Utiba Americas.

In September 2009, the Company purchased 60% of the outstanding shares of International Mobile Security, Inc. ( IMS ), a company incorporated in the State of Florida on September 17, 2009, for \$6,000.

In January 2010, AI Systems Group (Canada) Inc. was dissolved. All transactions incurred from January 1, 2010 to January 11, 2010 have been included in these interim financial statements.

In February 2011, the Company purchased 100% of the outstanding shares of Megatecnica, S.A., a company incorporated in Panama.

The consolidated interim financial statements have been prepared on the basis of a going concern, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. At June 30, 2011 the Company had a working capital deficiency of \$1,120,422. The Company's continued operations are dependent on the successful implementation of its business plan, its ability to obtain additional financing as needed, continued support from creditors, settling its outstanding debts and ultimately attaining profitable operations.

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**ALTERNET SYSTEMS INC.  
NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

**June 30, 2011 and December 31, 2010**

**NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The consolidated interim financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America.

**Principles of Consolidation**

The consolidated interim financial statements include the accounts of the following companies:

- Alternet Systems Inc.
- AI Systems Group, Inc., a wholly owned subsidiary of Alternet
- AI Systems Group (Canada), Inc., a wholly owned subsidiary of AI Systems Group, Inc
- Tekvoice Communications, Inc., a wholly owned subsidiary of Alternet
- Alternet Transactions Systems, Inc., a subsidiary of Alternet
- International Mobile Security, Inc, a subsidiary of Alternet
- Megatecnica, S.A., a wholly owned subsidiary of International Mobile Security, Inc.

The minority interests of ATS, IMS, and IMS's wholly owned subsidiary Megatecnica, S.A., have been deducted from earnings and equity. All significant intercompany transactions and account balances have been eliminated.

**Use of Estimates and Assumptions**

Preparation of the Company's financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

**Cash and Cash Equivalents**

The Company considers all liquid investments, with an original maturity of three months or less when purchased, to be cash equivalents.

**Equipment**

Fixed assets are recorded at cost and depreciated at the following rates:

- |                                 |   |                             |
|---------------------------------|---|-----------------------------|
| Computer equipment and software | - | 30% declining balance basis |
| Equipment                       | - | 20% declining balance basis |

**Impairment of Long Lived Assets**

Management monitors the recoverability of long-lived assets based on estimates using factors such as current market value, future asset utilization, and future undiscounted cash flows expected to result from its investment or use of the related assets. The Company's policy is to record any impairment loss in the period when it is determined that the carrying amount of the asset may not be recoverable. Any impairment loss is calculated as the excess of the carrying value over estimated realizable value.

**Intellectual Property** The Company accounts for its intellectual property in accordance with the Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* (SFAS 142). Under the provisions of SFAS 142, intangible assets deemed to have an indefinite life are not amortized but are subject to impairment tests at each reporting date. The Company assesses the impairment of intangible assets on a quarterly basis or whenever events or changes in circumstances indicate that the fair value is less than its carrying value. If the carrying amount of

the intangible asset exceeds its fair value, the intangible asset is considered impaired and the second step of the test is performed to determine the amount of impairment loss, if any.

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**ALTERNET SYSTEMS INC.  
NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

**June 30, 2011 and December 31, 2010**

**NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Revenue Recognition**

The Company derives its revenues from the sale of licenses of software, implementation services, support services, and telecommunication services. Revenues are recognized when title transfers or services are rendered.

- a) Revenue from the sale of licenses is recognized when the title of the license transfers to the customer
- b) Revenue from implementation services performed is recognized upon completion of the service.
- c) Revenue from support services is recognized as earned.
- d) Revenue from telecommunications services are recognized when billed, which occurs at the end of the month the services are provided.

The Company invoices 100% of the implementation services and requires customers to pay a non-refundable deposit prior to any services being performed. The Company recognizes the customer deposit as unearned revenue until either completion of the implementation or upon the contract being cancelled at which time the revenue is recognized. The uncollected portion of the implementation invoice is recorded as customer deposits until collection has occurred, completion of the implementation services, or upon the contract being cancelled.

The Company invoices support services at the beginning of the term and recognizes the revenue over the term of the agreement.

**Foreign Currency Translation**

The financial statements are presented in United States dollars. In accordance with Statement of Financial Accounting Standards No. 52, Foreign Currency Translation, foreign denominated monetary assets and liabilities are translated to their United States dollar equivalents using foreign exchange rates which prevailed at the balance sheet date. Revenue and expenses are translated at average rates of exchange during the year. Related translation adjustments are reported as a separate component of stockholders' deficit, whereas gains or losses resulting from foreign currency transactions are included in the results of operations.

**Fair Value of Financial Instruments**

In accordance with the requirements of SFAS No. 107, the Company has determined the estimated fair value of financial instruments using available market information and appropriate valuation methodologies. The fair value of financial instruments classified as current assets or liabilities approximate carrying value due to the short-term maturity of the instruments.

**Income Taxes**

The Company accounts for income taxes under a method which requires the Company to recognize deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in the Company's financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statements carrying amounts and tax basis of assets and liabilities using enacted tax rates. The Company presently prepares its tax returns on the cash basis and financial statement on the accrual basis. No deferred tax assets or liabilities have been recognized at this time, since the Company has shown losses for both tax and financial reporting.

**Stock-Based Compensation**

Prior to January 1, 2006, the Company accounted for stock-based awards under the recognition and measurement

provisions of Accounting Principles Board Opinion ( APB ) No. 25, *Accounting for Stock Issued to Employees* using the intrinsic value method of accounting, under which compensation expense was only recognized if the exercise price of the Company's employee stock options was less than the market price of the underlying common stock on the date of grant. Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS No. 123R *Share Based Payments*, using the modified prospective transition method. Under that transition method, compensation cost is recognized for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, and compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123R.

All transactions in which goods or services are the consideration received for the issuance of equity instruments are accounted for based on the fair value of the consideration received or the fair value of the equity instrument issued, whichever is more reliably measurable. Equity instruments issued to employees and the cost of the services received as consideration are measured and recognized based on the fair value of the equity instruments issued.

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**ALTERNET SYSTEMS INC.  
NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

**June 30, 2011 and December 31, 2010**

**NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Loss per Share**

The Company computes net earnings (loss) per share in accordance with SFAS No. 128, Earnings per Share. SFAS No. 128 requires presentation of both basic and diluted earnings per share (EPS) on the face of the statement of operations. Basic EPS is computed by dividing net loss available to common shareholders (numerator) by the weighted average number of common shares outstanding (denominator) during the period. Diluted EPS gives effect to all dilutive potential common shares outstanding during the period including warrants using the treasury stock method. Diluted EPS excludes all dilutive potential common shares if their effect is anti-dilutive. As the Company has net losses, no common equivalent shares have been included in the computation of diluted net loss per share as the effect would be anti-dilutive.

**Risk Management**

The Company is exposed to credit risk through accounts receivable and therefore, the Company maintains adequate provisions for potential credit losses.

The Company's functional currency is the United States dollar. The Company operates in foreign jurisdictions, giving rise to exposure to market risks from changes in foreign currency rates. The financial risk is the risk to the Company's operations that arises from fluctuations in foreign exchange rates and the degree of volatility of these rates. Currently, the Company does not use derivative instruments to reduce its exposure to foreign currency risk.

**Recent Accounting Pronouncements**

In January 2010, the FASB issued ASU 2010-01, *Accounting for Distributions to Shareholders with Components of Stock and Cash (Accounting for Distributions to Shareholders with Components of Stock and Cash Topic 505)*, which is effective for financial statements issued for interim and annual periods ending after December 15, 2009. This update identifies how companies should be reporting distributions to shareholders that offers them the ability to elect to receive the distribution in cash or an equivalent number of shares. It was determined that all distributions of shares relating to these payments should be recorded as new share issuances. This standard did not affect the Company's reported financial position or results of operations.

In January 2010, the FASB issued ASU 2010-02, *Accounting and Reporting for Decreases in Ownership of a Subsidiary (Consolidation Topic 810)*, which replaces SFAS No. 160 and is effective for financial statements issued for interim and annual periods ending after December 15, 2009. This update establishes the accounting and reporting guidance for non-controlling interest and changes in ownership interests of a subsidiary. This standard did not affect the Company's reported financial position or results of operations.

In January 2010, the FASB issued ASU 2010-06, *Improving Disclosures about Fair Value Measurements (Fair Value Measurements and Disclosures Topic 820)*, which replaces SFAS No. 157 and is effective for financial statements issued for interim and annual periods ending after December 15, 2009 except for the disclosures about purchases, sales, issuances, and settlements in the roll forward activity in Level 3 fair value measurements which are effective for financial statements issued for fiscal years ending after December 15, 2010 and interim periods commencing December 16, 2009. This update identifies new disclosure requirements relating to fair value measurements. This standard did not affect the Company's reported financial position or results of operations.

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In February 2010, the FASB issued ASU 2010-09, *Amendments to Certain Recognition and Disclosure Requirements (Subsequent Event Topic 855)*, which is effective for financial statements issued for interim and annual periods ending after June 15, 2010. This update addresses both the interaction of the requirements of Topic 855 with the SEC's reporting requirements and the intended breadth of the reissuance disclosure provision related to subsequent events. This standard is not expected to have a significant effect on the Company's reported financial position or results of operations.

In March 2010, the FASB issued ASU 2010-11, *Scope Exception Related to Embedded Credit Derivatives (Derivatives and Hedging Topic 815)*, which is effective for financial statements issued at the beginning of the entity's first fiscal quarter beginning after June 15, 2010. This update provides amendments to Subtopic 815-15, Derivatives and Hedging - Embedded Derivatives, such as clarification of the scope exception for embedded credit derivative features related to the transfer of credit risk in the form of subordination of one financial instrument to another and whether those derivatives are subject to potential bifurcation. This standard did not have a significant effect on the Company's reported financial position or results of operations.

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**ALTERNET SYSTEMS INC.  
NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

**June 30, 2011 and December 31, 2010**

**NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Recent Accounting Pronouncements (continued)**

In April 2010, the FASB issued ASU 2010-13, *Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Currency of the Market in Which the Underlying Equity Security Trades (Compensation Stock Compensation Topic 718)*, which is effective for financial statements issued for interim and annual periods beginning on or after December 15, 2010. This update addresses the classification of an employee share-based payment award with an exercise price denominated in a currency that differs from the functional currency of the employer entity or payroll currency of the employee. This standard did not have an effect on the Company's reported financial position or results of operations.

In April 2010, the FASB issued ASU 2010-17, *Milestone Method of Revenue Recognition (Revenue Recognition Milestone Method Topic 605)*, which is effective on a prospective basis for milestones achieved in fiscal years, and interim periods within those years, beginning on or after June 15, 2010. This update provides guidance on defining a milestone and determining when it may be appropriate to apply the milestone method of revenue recognition for research and development transactions. This standard did not have an effect on the Company's reported financial position or results of operations.

In April 2010, the FASB issued ASU 2010-18, *Effect of a Loan Modification When the Loan Is Part of a Pool That Is Accounted for as a Single Asset (Receivables Topic 310)*, which is effective on a prospective basis for modifications of loans accounted for within pools occurring in the first interim or annual period ending on or after July 15, 2010. This update provides guidance on accounting for acquired loans that have evidence of credit deterioration upon acquisition. This standard did not have an effect on the Company's reported financial position or results of operations.

In July 2010, the FASB issued ASU 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses (Receivables Topic 310)*, which for public entities, the disclosures as of the end of a reporting period are effective in financial statements issued for interim and annual periods ending on or after December 15, 2010 and for disclosures about activities that occur during a period are effective for interim and annual periods beginning on or after December 15, 2010. This update provides guidance on increasing transparency about an entity's allowance for credit losses and the credit quality of its financing receivables. This standard did not have an effect on the Company's reported financial position or results of operations.

In December 2010, the FASB issued ASU 2010-28, *When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts (Intangibles Goodwill and Other Topic 350)*, which is effective for financial statements issued for interim and annual periods beginning on or after December 15, 2011. This update modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. This standard is not expected to have an effect on the Company's reported financial position or results of operations.

In December 2010, the FASB issued ASU 2010-29, *Disclosure of Supplementary Pro Forma Information for Business Combinations (Business Combinations Topic 850)*, which is effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. This update provides guidance on the pro forma revenue and earnings disclosure requirements for business combinations. This standard did not have an effect on the Company's reported financial position or results of operations.

In January 2011, the FASB issued ASU 2011-01, *Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20 (Receivables Topic 310)*, which is effective upon issuance. This update defers the effective date of the disclosures required under ASU 2010-20 to be concurrent with the effective date of the guidance for determining what constitutes a troubled debt restructuring as presented in proposed ASU update: *Receivables (Topic 310) Clarifications to Accounting for Troubled Debt Restructurings by Creditors*. This standard did not have an effect on the Company's reported financial position or results of operations.

In April 2011, the FASB issued ASU 2011-03, *Reconsideration of Effective Control for Repurchase Agreements (Transfers and Service Pricing Topic 860)*, which is effective for financial statements issued for interim and annual periods beginning on or after December 15, 2011. This update provides on the accounting for repurchase agreements (repos) and other agreements that entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. This standard is not expected to have an effect on the Company's reported financial position or results of operations.

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**ALTERNET SYSTEMS INC.**  
**NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

**June 30, 2011 and December 31, 2010**

**NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Recent Accounting Pronouncements (continued)**

In May 2011, the FASB issued ASU 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFS (Fair Value Measurement Topic 820)*, which is effective for financial statements issued for interim and annual periods beginning on or after December 15, 2011. This update explains how to measure fair value. This standard is not expected to have an effect on the Company's reported financial position or results of operations.

In June 2011, the FASB issued ASU 2011-05, *Presentation of Comprehensive Income (Comprehensive Income Topic 220)*, which is effective for financial statements issued for interim and annual periods beginning on or after December 15, 2011. This update provides guidance on improving the comparability, consistency, and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. This standard is not expected to have an effect on the Company's reported financial position or results of operations.

**NOTE 3 FIXED ASSETS**

|                                  | <b>June 30, 2011</b> |                             |                |
|----------------------------------|----------------------|-----------------------------|----------------|
|                                  | Cost                 | Accumulated<br>Amortization | Net Book Value |
| Computer equipment               | \$ 319,221           | \$ 317,930                  | \$ 1,291       |
| Computer equipment capital lease | 115,866              | 8,682                       | 107,184        |
| Computer software                | 72,560               | 72,083                      | 477            |
| Equipment                        | 10,576               | 10,159                      | 417            |
|                                  | \$ 518,223           | \$ 408,854                  | \$ 109,369     |

|                    | <b>December 31, 2010</b> |                             |                |
|--------------------|--------------------------|-----------------------------|----------------|
|                    | Cost                     | Accumulated<br>Amortization | Net Book Value |
| Computer equipment | \$ 319,221               | \$ 317,702                  | \$ 1,519       |
| Computer software  | 72,560                   | 71,999                      | 561            |
| Equipment          | 10,576                   | 10,112                      | 464            |
|                    | \$ 402,357               | \$ 399,813                  | \$ 2,544       |

**NOTE 4 INTELLECTUAL PROPERTY**

On January 25, 2011, the Company signed a Copyright Agreement with a supplier for various intellectual property. As at June 30, 2011, the Company has \$68,900 included in accounts payable and accrued charges relating to this agreement.

**ALTERNET SYSTEMS INC.  
NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

**June 30, 2011 and December 31, 2010**

**NOTE 5 CONVERTIBLE DEBENTURE NOTES AND OTHER LOANS**

**Convertible Debentures**

On February 4, 2008, the Company issued a note payable in the amount of \$50,000. The note carries interest at the rate of 8% per quarter and is due on May 4, 2008. If the note is not repaid on maturity or in any other event of default, the holder is entitled to convert all or any portion of the original principal face value of the note into shares of common stock of the Company at a conversion value equal to 50% of the average market price of the Company's stock for the 30 days prior to the date of conversion. As at June 30, 2011, \$136,252 (December 31, 2010 - \$122,360) of principal and accrued interest on this note was included in Other loans payable. Subsequent to the period, the creditor converted the balance of the loan into 2,265,207 common shares of the Company resulting in a full repayment of the loan.

On January 8, 2009, the Company issued a note payable in the amount of \$48,464. The note carries interest at the rate of 10% per annum and is due on January 8, 2010. If the note is not repaid on maturity or in any other event of default, the holder is entitled to convert all or any portion of the original principal face value of the note into shares of common stock of the Company at a conversion value equal to 50% of the average market price of the Company's stock for the 30 days prior to the date of conversion. As the loan had not been repaid by the maturity date, the loan was extended and interest continued to accrue. On April 22, 2010 the Company signed a Debt Settlement Agreement with the creditor whereby the creditor agreed to receive shares in lieu of payment of the outstanding balance. Under the terms of the Debt Settlement Agreement, the creditor is entitled to receive common stock of the Company at a conversion value equal to 50% of the average daily low price of the Company's stock for the 20 days prior to the date of conversion. The holder may not hold more than 4.99% of the outstanding common stock of the Company at any point in time. During the year ended December 31, 2010, the creditor converted \$55,141 of debt into 2,542,782 common shares of the Company resulting in a full repayment of the loan.

On January 8, 2009, the Company issued a note payable in the amount of \$48,517. The note carries interest at the rate of 10% per annum and is due on January 8, 2010. If the note is not repaid on maturity or in any other event of default, the holder is entitled to convert all or any portion of the original principal face value of the note into shares of common stock of the Company at a conversion value equal to 50% of the average market price of the Company's stock for the 30 days prior to the date of conversion. As the loan had not been repaid by the maturity date, the loan was extended and interest continued to accrue. On April 22, 2010 the Company signed a Debt Settlement Agreement with the creditor whereby the creditor agreed to receive shares in lieu of payment of the outstanding balance. Under the terms of the Debt Settlement Agreement, the creditor is entitled to receive common stock of the Company at a conversion value equal to 50% of the average daily low price of the Company's stock for the 20 days prior to the date of conversion. The holder may not hold more than 4.99% of the outstanding common stock of the Company at any point in time. During the year ended December 31, 2010, the creditor converted \$55,066 of debt into 1,180,846 common shares of the Company resulting in a full repayment of the loan.

On January 8, 2009, the Company issued a note payable in the amount of \$42,085. The note carries interest at the rate of 10% per annum and is due on January 8, 2010. If the note is not repaid on maturity or in any other event of default, the holder is entitled to convert all or any portion of the original principal face value of the note into shares of common stock of the Company at a conversion value equal to 50% of the average market price of the Company's stock for the 30 days prior to the date of conversion. On September 15, 2009, the balance outstanding on the note payable was agreed to be settled prior to the conversion date and as such the corresponding derivative liability was written off.

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On December 18, 2009, the Company issued a note payable in the amount of \$100,000. The note carries interest at the rate of 12% per annum and is due on March 18, 2010. If the note is not repaid on maturity or in any other event of default, the holder is entitled to convert all or any portion of the original principal face value of the note into shares of common stock of the Company at a conversion value equal to 80% of the lowest daily low price of the Company's stock for the 30 trading days immediately preceding and including the date of conversion. During the year ended December 31, 2010, the creditor converted \$50,640 of debt into 3,331,604 common shares of the company. During the period ended June 30, 2011, the creditor converted \$61,500 of debt into 853,163 common shares of the Company resulting in a full repayment of the loan.

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**ALTERNET SYSTEMS INC.  
NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

**June 30, 2011 and December 31, 2010**

**NOTE 5 CONVERTIBLE DEBENTURE NOTES AND OTHER LOANS (continued)**

**Convertible Debentures (continued)**

On December 18, 2009, the Company entered into a Debt Settlement agreement whereby a creditor agreed to receive shares in lieu of payment of a \$152,916 promissory note. The holder is entitled to receive common stock of the Company at a conversion value equal to 50% of the lowest closing price of the Company's stock for the 10 days prior to the date of conversion. The holder may not hold more than 4.99% of the outstanding common stock of the Company at any point in time. During the year ended December 31, 2010, the creditor converted \$113,750 of debt into 4,457,699 common shares of the company. During the period ended June 30, 2011, the creditor converted \$72,833 of debt into 1,220,363 common shares of the company resulting in a full repayment of the loan.

On March 8, 2010, the Company issued a note payable in the amount of \$25,000. The note carries interest at the rate of 12% per annum and is due on April 8, 2010. If the note is not repaid on maturity or in any other event of default, the holder is entitled to convert all or any portion of the original principal face value of the note into shares of common stock of the Company at a conversion value equal to 50% of the lowest closing price of the Company's stock for the 10 trading days immediately preceding and including the date of conversion. As at June 30, 2011, \$18,800 (December 31, 2010 - \$27,292) of principal and accrued interest on this note was included in Other loans payable.

On April 14, 2010, the Company issued a note payable in the amount of \$15,000. The note carries interest at the rate of 10% per annum and is due on May 18, 2010. If the note is not repaid on maturity or in any other event of default, the holder is entitled to convert all or any portion of the original principal face value of the note into shares of common stock of the Company at a conversion value equal to 50% of the lowest closing price of the Company's stock for the 10 trading days immediately preceding and including the date of conversion. As at June 30, 2011, \$17,215 (December 31, 2010 - \$16,310) of principal and accrued interest on this note was included in Other loans payable.

On April 22, 2010, the Company entered into a Debt Settlement agreement whereby a creditor agreed to receive shares in lieu of payment of a \$50,000 promissory note plus accrued interest calculated at 10% per annum. The creditor is entitled to receive common stock of the Company at a conversion value equal to 50% of the average daily low price of the Company's stock for the 20 days prior to the date of conversion. The holder may not hold more than 4.99% of the outstanding common stock of the Company at any point in time. During the year ended December 31, 2010, the creditor converted \$51,874 of debt into 1,703,169 common shares of the company resulting in a full repayment of the loan.

On April 30, 2010, the Company issued a note payable in the amount of \$100,000. The note carries interest at the rate of 10% per annum and is due on July 30, 2010. If the note is not repaid on maturity or in any other event of default, the holder is entitled to convert all or any portion of the original principal face value of the note into shares of common stock of the Company at a conversion value equal to 50% of the lowest daily low price of the Company's stock for the 10 trading days immediately preceding and including the date of conversion. As at June 30, 2011, \$111,862 (December 31, 2010 - \$106,833) of principal and accrued interest on this note was included in Other loans payable.

On June 1, 2010, the Company entered into a Debt Settlement agreement whereby a creditor agreed to receive shares in lieu of payment of a \$32,000 debt. The creditor is entitled to receive common stock of the Company at a conversion value equal to 50% of the lowest daily low price of the Company's stock for the 20 days prior to the date of

conversion. The holder may not hold more than 4.99% of the outstanding common stock of the Company at any point in time. During the year ended December 31, 2010, the creditor converted \$32,000 of debt into 1,258,604 common shares of the company resulting in a full repayment of the loan.

The Company accounts for debt with embedded conversion features and warrant issues in accordance with EITF 98-5: Accounting for convertible securities with beneficial conversion features or contingency adjustable conversion and EITF No. 00-27: Application of issue No 98-5 to certain convertible instruments. Conversion features determined to be beneficial to the holder are valued at fair value and recorded to additional paid in capital. The Company determines the fair value to be ascribed to the detachable warrants issued with the convertible debentures utilizing the *Black-Scholes* method. Any discount derived from determining the fair value to the debenture conversion features and warrants is amortized to financing cost over the life of the debenture. The unamortized costs if any, upon the conversion of the warrants is expensed to financing cost on a pro rata basis over the life of the warrant.

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**ALTERNET SYSTEMS INC.  
NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

**June 30, 2011 and December 31, 2010**

**NOTE 5 CONVERTIBLE DEBENTURE NOTES AND OTHER LOANS (continued)**

**Convertible Debentures (continued)**

Debt issued with the variable conversion features are considered to be embedded derivatives and are accountable in accordance with FASB 161; Accounting for Derivative Instruments and Hedging Activities. The fair value of the embedded derivative is recorded to derivative liability. This liability is required to be marked each reporting period. The resulting discount on the debt is amortized to interest expense over the life of the related debt.

**Other Loans**

On October 22, 2007, the Company signed a Promissory Note whereby the Company will repay a creditor \$20,000 plus interest at 8% per annum on November 22, 2007. On March 7, 2011, the Company signed a Debt Settlement Agreement with the creditor to convert the outstanding balance into shares of the Company. During the period ended June 30, 2011, the creditor converted \$27,000 of debt into 444,079 common shares of the company resulting in a full repayment of the loan.

On September 15, 2010, the Company signed a Promissory Note whereby the Company will repay a creditor \$20,000 plus interest at 10% per annum on October 15, 2010. The loan was repaid in full on November 5, 2010.

On September 17, 2010, the Company signed a Promissory Note whereby the Company will repay a creditor \$3,000 plus interest at 10% per annum on October 31, 2010. If the Promissory Note is not repaid by the maturity date, a \$50 penalty will be assessed for each month the loan is outstanding after the maturity date. The loan was repaid in full on November 5, 2010.

On January 25, 2011, the Company signed a Promissory Note whereby the Company will repay a director \$20,000 plus interest at 10% per annum on April 25, 2011. On April 25, 2011, the Company signed a new Promissory Note with the creditor which capitalized the unpaid principal and interest of \$20,500 under the previous Promissory Note and extended the maturity date to July 25, 2011. As at June 30, 2011, \$20,865 of principal and accrued interest on this note was included in Due to related parties.

On February 9, 2011, the Company signed a Promissory Note whereby the Company will repay a director \$5,000 plus interest at 10% per annum on May 9, 2011. On May 10, 2011, the Company signed a new Promissory Note with the creditor which capitalized the unpaid principal and interest of \$5,125 under the previous Promissory Note and extended the maturity date to August 8, 2011. As at June 30, 2011, \$5,197 of principal and accrued interest on this note was included in Due to related parties.

On February 11, 2011, the Company signed a Promissory Note whereby the Company will repay a director \$8,988 plus interest at 10% per annum on May 11, 2011. On May 12, 2011, the Company signed a new Promissory Note with the creditor which capitalized the unpaid principal and interest of \$9,213 under the previous Promissory Note and extended the maturity date to August 10, 2011. As at June 30, 2011, \$9,341 of principal and accrued interest on this note was included in Due to related parties.

On March 2, 2011, the Company signed a Promissory Note whereby the Company will repay a director \$100,000 plus interest at 10% per quarter on June 2, 2011. As at June 30, 2011, \$105,683 of principal and accrued interest on this

note was included in Due to related parties.

**NOTE 6 CAPITAL LEASE**

On April 27, 2011, the Company signed a Lease Agreement with a creditor to lease various computer equipment. The lease requires 24 monthly payments of \$3,620 including implicit interest of 14.99% and expires on May 1, 2013.

The remaining required principal payments over the next three fiscal years are as follows:

|      |        |
|------|--------|
| 2011 | \$     |
|      | 17,712 |
| 2012 | 37,692 |
| 2013 | 17,439 |

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**ALTERNET SYSTEMS INC.**  
**NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

**June 30, 2011 and December 31, 2010**

**NOTE 7 CAPITAL STOCK**

The Company is authorized to issue up to 100,000,000 shares of the Company's common stock with a par value of \$0.00001. As at December 31, 2010, 47,159,976 shares of common stock were issued and outstanding.

Effective January 29, 2008, the Company adopted a Retainer Stock Plan for Professional and Consultants (the 2008 Professional/Consultant Stock Compensation Plan) for the purpose of providing the Company with the means to compensate, in the form of common stock of the Company, eligible consultants that have previously rendered services or that will render services during the term of this 2008 Professional/Consultant Stock Compensation Plan. A total of 6,000,000 common shares may be awarded under this plan. The Company filed a Registration Statement on Form S-8 to register the underlying shares included in the 2008 Plan. To date, 5,998,542 common shares valued at \$431,631 relating to services provided have been awarded, leaving a balance of 1,458 shares which may be awarded under this plan.

The Company is obligated to issue 250,000 (December 31, 2010 - 600,000) common shares valued at \$25,000 (December 31, 2010 - \$108,500) as at June 30, 2011 in accordance with a consulting incentive. During year ended December 31, 2010, a liability to issue 200,000 shares valued at \$40,000 owed to one consultant was reversed to consulting fees as the consultant had not performed the services in accordance with the contract.

During the year ended December 31, 2010, the Company issued 250,000 common shares valued at \$16,250 for services rendered during the year ended December 31, 2009, 3,650,000 common shares valued at \$332,750 for services rendered during the year ended December 31, 2010, 23,433,187 common shares valued at \$1,276,865 for debt settlement and convertible debenture agreements, and 633,691 common shares valued at \$95,053 for share subscriptions previously received.

During the six months ended June 30, 2011, the Company issued 500,000 common shares valued at \$15,000 for share subscriptions received in prior years, 3,333,333 common shares valued at \$500,000 for subscriptions received during the period, 6,393,331 common shares valued at \$831,144 for debt settlement and convertible debenture agreements, 1,350,000 common shares valued at \$165,500 for consulting services to be rendered during the period, and 1,900,000 common shares valued at \$228,000 for employment incentives in accordance with employment agreements.

During the six months ended June 30, 2011, the Company received \$193,500 for share subscriptions. As at June 30, 2011, the Company has \$323,862 (December 31, 2010 - \$145,362) in private placement subscriptions which are reported as private placement subscriptions within stockholders' deficit.

The shares which were not issued as at June 30, 2011 or December 31, 2010 were not used to compute the total weighted average shares outstanding as at June 30, 2011 or December 31, 2010 respectively and were thus not used in the basic net loss per share calculation.

In conjunction with the 3,333,333 common shares issued during the period, the Company issued 2,000,000 warrants exercisable at \$0.25 per share for a period of one and a half years. The warrants were valued at \$207,846 calculated using the Black-Scholes option pricing model assuming a life expectancy of one and a half years, a risk free rate of 0.05%, a forfeiture rate of 0%, and volatility of 273.13%. In addition to these warrants, the Company signed a Stock Grant Agreement with the shareholder allowing the shareholder to receive up to an additional 569,444 shares of the Company (bonus shares). The shareholder will receive 0.284722 bonus shares for each warrant exercised. The bonus



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shares were valued at \$68,333 calculated using the Black-Scholes option pricing model assuming a life expectancy of one and a half years, a risk free rate of 0.05%, a forfeiture rate of 0%, and volatility of 273.13% . As at June 30, 2011, the Company had 2,000,000 warrants with an exercise price of \$0.25 expiring on December 31, 2012 outstanding.

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**ALTERNET SYSTEMS INC.**  
**NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

**June 30, 2011 and December 31, 2010**

**NOTE 8 - RELATED PARTY TRANSACTIONS**

As at June 30, 2011, a total of \$378,643 (December 31, 2010 - \$450,647) was payable to directors and officers of which \$237,557 (December 31, 2010 - \$388,869) was non-interest bearing and had no specific terms of repayment, \$Nil (December 31, 2010 - \$122,360) relates to a convertible debenture detailed in Note 5, and \$141,086 (December 31, 2010 - \$Nil) relates to a loan detailed in Note 5. Of the amount payable, \$67,052 (December 31, 2010 - \$40,388) was included in accounts payable for expense reimbursements and \$157,685 (December 31, 2010 - \$340,660) was included in wages payable for accrued fees.

During the six months ended June 30, 2011, the company expensed a total of \$327,796 (December 31, 2010 - \$847,610) in consulting fees, investor relations and salaries paid to directors and officers of the Company. Of the amounts incurred, \$159,549 (December 31, 2010 - \$373,394) has been accrued, \$100,747 (December 31, 2010 - \$474,216) has been paid in cash, and \$67,500 (December 31, 2010 - \$Nil) has been paid through the issuance of shares. In addition, during the year ended December 31, 2010, \$630,000 of deferred compensation relating to shares issued in June 2008 to a director of the Company was expensed to investor relations.

During the six months ended June 30, 2010, the company issued 3,797,726 shares of the Company's common stock valued at \$463,206 to three directors of the Company for accrued consulting fees and investor relations and 250,000 shares of the Company's common stock valued at \$27,500 to one director of the Company for consulting fees.

During the year ended December 31, 2010, the company issued 3,010,087 shares of the Company's common stock valued at \$90,303 to two directors of the Company and 1,836,890 shares of the Company's common stock valued at \$55,107 to a previous director of the Company for accrued consulting fees and investor relations.

**NOTE 9 DEFERRED COMPENSATION**

On June 26, 2008, 1,500,000 common shares valued at \$630,000 were issued to a consultant pursuant to a contract with certain terms and benchmarks. As at December 31, 2010, the contract with the consultant expired at which time the total \$630,000 had been expensed to investor relations.

On October 15, 2008, the Company entered into agreement with a consultant for a one-year term whereby the consultant will provide consulting services to the Company in exchange for 200,000 shares of the Company's common stock. As of December 31, 2008, 200,000 common shares valued at \$40,000 were recorded as obligation to issue shares during the year. This amount was expensed over the life of the contract. During the year ended December 31, 2010, the Company reversed the obligation to issue shares against the consulting fees previously expensed as the shares will not be issued and the services were never received.

On January 5, 2009, the Company entered into an agreement with a consultant for a one-year term whereby the consultant will provide business consulting services to the Company in exchange for 200,000 shares of the Company's common stock valued at \$20,000. This amount was expensed over the life of the contract.

On December 8, 2009, the Company entered into an agreement with a consultant for a one-year term whereby the consultant will provide business consulting services to the Company in exchange for 250,000 shares of the Company's common stock valued at \$16,250 based on the date of issuance. This amount was expensed over the life of the contract.

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On January 5, 2010, the Company entered into an agreement with a consultant for a one-year term whereby the consultant will provide business consulting services to the Company in exchange for 300,000 shares of the Company's common stock originally valued at \$19,500. This amount is being expensed over the life of the contract. The shares were issued on October 5, 2010 resulting in an increase in the value of \$6,000 to \$25,500.

On July 1, 2010, the Company entered into an agreement with a consultant for a one-year term whereby the consultant will provide business consulting services to the Company in exchange for 1,200,000 shares of the Company's common stock valued at \$159,000 of which 900,000 shares are to be issued by September 30, 2010 and 300,000 shares are to be issued by December 31, 2010. The shares were fully issued on April 21, 2011 resulting in a decrease in the value of \$30,000 to \$129,000. This amount was expensed over the life of the contract.

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**ALTERNET SYSTEMS INC.**  
**NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

**June 30, 2011 and December 31, 2010**

**NOTE 9 DEFERRED COMPENSATION (continued)**

On March 29, 2011, the Company entered into an agreement with a consultant for a six-month term whereby the consultant will provide business consulting services to the Company in exchange for 250,000 shares of the Company's common stock valued at \$32,500 based on the date of issuance, April 19, 2011. This amount is being expensed over the life of the contract.

On April 12, 2011, the Company entered into an agreement with a consultant for a six month term whereby the consultant will provide business consulting services. The agreement requires the first and last month's payment of \$5,000 each, total \$10,000, to be paid through the issuance of 250,000 shares of the Company's common stock. This amount is being expensed over the life of the contract.

The Company recorded the aggregate fair value of the shares issued pursuant to the above agreements as deferred compensation and amortizes the costs of all these services on a straight-line basis over the respective terms of the contracts. During the six months ended June 30, 2011, the Company expensed \$71,082 (December 31, 2010 - \$749,849) relating to the above contracts. At June 30, 2011, the unamortized portion of the deferred compensation totalled \$21,250 (December 31, 2010 - \$79,832). The shares issued were all valued at their market price on the date of issuance or in accordance with defined agreement terms.

**NOTE 10 LAWSUITS**

On October 16, 2009, the Company received notice that they had been named as Defendants in a lawsuit whereby the Plaintiffs are seeking a judgment of \$39,000 plus interest thereon from March 11, 2009 for breach of contract. The Company had 30 days to respond to the notice before a default judgment is awarded. As at June 30, 2011, no amounts have been accrued as the likelihood of an unfavorable judgment is considered low.

On May 10, 2010, the Company received notice that they had been named as Defendants in a lawsuit whereby the Plaintiffs are seeking a judgment of \$6,889 including interest of \$1,444 for unpaid invoices. The Company had 30 days to respond to the notice before a default judgment is awarded. As at June 30, 2011, the full amount has been accrued and is included in accounts payable.

**NOTE 11 SUBSEQUENT EVENTS**

- a) On July 1, 2011, the Company entered into an agreement with a consultant for a one-year term commencing January 1, 2011 whereby the consultant will provide business consulting services to the Company in exchange for 450,000 shares of the Company's common stock.
- b) On July 7, 2011, the Company issued 250,000 common shares of the Company valued at \$25,000 for consulting fees.
- c) On July 14, 2011, the Company issued 1,935,000 common shares of the Company valued at \$193,500 for share subscriptions previously received.
- d) On July 14, 2011, the Company issued 252,934 common shares of the Company to repay \$35,000 of accounts payable recorded as at June 30, 2011.

- e) On July 20, 2011, the Company issued 2,265,207 common shares of the Company to a creditor for the conversion of debt valued at \$136,252.
  - f) On July 25, 2011, the Company issued 133,304 common shares of the Company to a director of the Company in accordance with a Compensation Settlement agreement signed on July 21, 2011.
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**ALTERNET SYSTEMS INC.  
NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

**June 30, 2011 and December 31, 2010**

**NOTE 11 SUBSEQUENT EVENTS (continued)**

- g) On August 2, 2011, the Company signed a debt settlement agreement with a creditor to convert outstanding debt and interest of \$110,000 into 733,333 common shares of the Company. In addition, the creditor invested an additional \$90,000 for 600,000 common shares of the Company. The shares were issued in full on August 2, 2011.
- h) Subsequent to the quarter end, the operations of the Company's wholly owned subsidiary, Tekvoice Communications, Inc., were discontinued.

**ITEM 2. MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS:**

**Overview**

This quarterly report may contain certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These include statements about our expectations, beliefs, intentions or strategies for the future, which we indicate by words or phrases such as "anticipate," "expect," "intend," "plan," "will," "we believe," "our company believes," "management believes" and similar language. These forward-looking statements are based on our current expectations and are subject to certain risks, uncertainties and assumptions, including those set forth in the following discussion, including under the heading "Risk Factors". Our actual results may differ materially from results anticipated in these forward-looking statements. We base our forward-looking statements on information currently available to us, and we assume no obligation to update them. In addition, our historical financial performance is not necessarily indicative of the results that may be expected in the future and we believe that such comparisons cannot be relied upon as indicators of future performance. Other important factors that could cause actual results to differ materially include the following: business conditions, the price of precious metals, ability to attract and retain personnel; the price of the Company's stock; and the risk factors set forth from time to time in the Company's SEC reports, including but not limited to its annual report on Form 10-K; its quarterly reports on Forms 10-Q; and any reports on Form 8-K. In addition, the Company disclaims any obligation to update or correct any forward-looking statements in all the Company's annual reports and SEC filings to reflect events or circumstances after the date hereof.

**Company History and Business**

Alternet Systems, Inc. (the "Company"), was organized under the laws of the State of Nevada on June 26, 2000 under the name North Pacific Capital Corp. On December 20, 2001 the Company received shareholder approval to change its name from North Pacific Capital Corp. to "SchoolWeb Systems Inc."

On April 26, 2002, the Company received shareholder approval to change its name from SchoolWeb Systems Inc. to Alternet Systems, Inc. and in May of 2002 this change of name was completed.

Alternet Systems, Inc. previous to the merger with TekVoice, sold network systems and software for education and healthcare, marketed under the names "SchoolWeb" and HealthWeb.

Alternet Systems has been granted trademark rights in the Canada for the trademark "SchoolWeb". The initial application was filed in Canada on March 30, 2001 and it was granted in March of 2003. The trademark is also

registered on the supplemental register in the United States, as the United States trademark was applied for based on the Canadian trademark application. Once a company has used a supplemental register mark in the United States for five years, the company's mark is placed on the full register. In the meantime, its rights in the United States are protected.

**TekVoice Inc. Merger**

Alternet Systems Inc. executed a merger with TekVoice Communications, Inc. of Miami, Florida, on December 31, 2007. TekVoice is a telecommunications services company with operations in North America and Latin America. The combined entity is called Alternet Systems Inc. and its primary business is delivering electronic transaction services, telecom services; and education / healthcare application software and content; and to customers primarily located in Latin America, North America and the Caribbean. Alternet offers a portfolio of next-generation solutions for government, business, schools, hospitals and residents.

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## About TekVoice Communications Inc.

**TekVoice Communications, Inc.** is a Voice over IP telecommunications company that since 2002, offers convergent voice and data services over IP networks. TekVoice has capitalized on its in-depth knowledge of the Hispanic and Latin American market, the quality of its telecommunications network and the dramatic cost savings that the network delivers to its customers. As a pioneer in the VOIP industry, TekVoice has been at the leading edge in the design and deployment of new products and services for the corporate and residential markets. TekVoice Communications, Inc. is a U.S. corporation with offices in Miami, Florida.

**TekVoice Share Acquisition** On December 31, 2007, Altnet Systems, Inc. (the Company) Fabio Alvino, Eduardo & Monica Bello, Henryk Dabrowski, Manfred Koroschetz, New Market Technology, Inc., John Puente, Red Hawke, Inc., Hector Rodriguez (each, a Transferor and collectively, the Transferors) and TekVoice Communications, Inc. ( TekVoice ) entered into and closed a Stock Acquisition Agreement (the Agreement) pursuant to which the Company acquired all of the issued and outstanding shares of capital stock of TekVoice from the Transferors in consideration for an aggregate amount of four million (4,000,000) shares of common stock of the Company (the Acquisition Shares). In addition to the Acquisition Shares, the Transferors, in the aggregate, shall be entitled to receive an up to an additional two million (2,000,000) shares of common stock of the Company if TekVoice's sales for the fiscal year ending December 31, 2008 exceed sales for fiscal year ended December 31, 2007 by twenty percent (20%) (the Additional Consideration). In the event the Company is merged with another entity prior to December 31, 2008, the Additional Consideration shall be issued to the Transferors on the day immediately prior to the day that such merger takes place. The Transferors shall be entitled to appoint three (3) members to the Company's board of directors, effective at the closing, provided, however, in no event shall Transferors be required to appoint a member to the Company's Board of Directors.

The Company's results, on a consolidated basis, reflected its own results consolidated with its subsidiary TekVoice Communications Inc. For the remainder of this part, the term Company refers to both the Company and its wholly owned subsidiary above.

On July 29, 2009 the Company incorporated Altnet Transactions Systems, Inc. ( ATS ) in the State of Florida in partnership with Utiba PTE Ltd. The Company owns 5,100 shares (51%) of the outstanding shares of ATS with Utiba PTE Ltd. owning the remaining 4,900 (49%). ATS is doing business as Utiba Americas.

On September 17, 2009 the Company incorporated International Mobile Security, Inc. ( IMS ) in the State of Florida in partnership with General Services Holdings, LLC. The Company owns 6,000 shares (60%) of the outstanding shares of IMS with General Services Holdings, LLC. owning the remaining 4,000 (40%).

Effective July 31, 2011, the operations of the Company's wholly owned subsidiary, Tekvoice Communications, Inc., were discontinued.

## Plan of Operation

The Company has been concentrating on marketing its mobile financial transaction and telecommunications platforms, in the telecommunication, public utility, government and financial industries.

Sales and marketing is accomplished through the Company's existing sales staff, who contact potential clients through personal and agent sales, trade shows and industry associations.

Sales come from organic growth from its existing operations. The Company may identify in the course of business, strategic acquisition targets.



Company has accomplished the execution of framework agreements with critical vendors, and is in the process of launching its mobile financial and mobile commerce suite of services.

We have also initiated a program to participate in the financial services industry, by enabling cellular phone technologies that will allow customers to make mobile to mobile , mobile to cash and mobile to money remittances .

Demand for our services is driven primarily by mobile subscriber purchasing activity via their cellular phone. The global mobile commerce industry is in its early growth and adoption stages. The drivers for growth are cellular phone penetration, large unbanked population worldwide, user acceptance of the cell phone as a means of payment. Subscriber adoption of new wireless technologies and services can also drive demand for our services due to the resulting increase in interoperability complexities. We believe that as wireless usage expands and complexity continues to increase, the demand for our services will grow.

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A structured plan has been defined to close and pursue opportunities. The company has a funnel of potential prospects in different stages of closing. The needs and opportunities of these initial prospects have been identified and we are preparing offers and agreements.

The Company will be updating its marketing material, including web presence and technical information. It will also be focusing on its electronic transaction products, targeting specific vertical industries, specifically the telecom, financial, utilities and transportation sectors.

Currently our sales and business development partners have identified and pursued projects in Colombia, Ecuador, Bolivia, Guatemala, Panama, Mexico, Brazil, Costa Rica, El Salvador, Honduras, Venezuela, Guyana, Haiti, Dominican Republic and the United States.

Although the Company believes that demand exists for its products and services, there can be no assurance that sales will increase in the future. The Company is expected to remain dependent upon debt or equity financing unless revenues from operations grow significantly.

### **Six Months Ended June 30, 2011 Compared to the Six Months Ended June 30, 2010**

#### **Net Sales**

For the six months ended June 30, 2011, the Company had \$76,844 in sales compared to \$97,604 for the corresponding period in 2010. The decrease in sales resulted from delays in proposal closing and timing factors of qualified prospects of sales of mobile commerce license software in the same period by Altnet Transaction Systems, DBA Utiba Americas, an Altnet majority owned subsidiary, as well as revenue recognition of executed contracts. VoIP telephony sales in the Company's subsidiary, TekVoice Inc., continued to decline.

#### **Gross Profit**

Gross profit of \$26,196 in the six months ending June 30, 2011 compared to a gross profit of \$64,240 in the six month period ending June 30, 2010. This represents a decrease in gross profit for the period of \$38,044.

#### **Selling, General and Administrative Expenses**

For the six months ended June 30, 2011, the Company had office and general expenses of \$22,293, marketing expenses of \$5,300, management and consulting fees of \$333,730, professional fees of \$109,057 and rent of \$36,306.

For the corresponding period in 2010 the Company incurred office and general expenses of \$56,746, marketing expenses of \$0; management and consulting fees of \$191,248, \$42,274 in professional fees and \$14,266 in rent.

Accounts payable totaled \$682,527 and accounts receivable were \$630,532 at June 30, 2011

#### **Net Loss**

For the six months ended June 30, 2011, the Company had a net loss of \$1,249,041 or \$(0.02) per share, which was an increase of 25.8% when compared to the net loss for the corresponding period to June 30, 2010 of \$992,781 or \$(0.04) per share. The increased loss was primarily due to losses incurred in debt settlements and increased derivative liabilities during the period ending June 30, 2011.

#### **Interest and other expenses**

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For the six months ended June 30, 2011, the Company had bank charges and interest expenses of \$34,631 compared with \$20,671 for the corresponding period to June 30, 2010.

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## Liquidity and Capital Resources

The Company had current assets including cash on hand of \$1,070,800 as at June 30, 2011. The Company had a working capital deficiency of \$1,083,435 at June 30, 2011. Management of the Company has determined that the Company's ability to continue as a going concern is dependent on raising additional capital and achieving increased sales of its operating subsidiaries products and services.

Management can give no assurance that any increase in sales will occur in the future and if they do occur, may not be enough to cover the Company's operating expenses or any other costs. Should this be the case, we would be forced, unless sufficient working capital can be raised, to suspend operations and possibly liquidate the assets and wind up and dissolve the Company.

## RISK FACTORS

The Company is exposed to a number of risks, including the following:

- The Company may be unable to market and sell its software and sales of its telecommunications products could decline;
- The Company has a history of operating its software business at a significant loss;
- The Company requires additional equity financing to continue operations and may be unable to obtain this financing;
- If further equity financing is obtained, it will dilute the value of existing shareholders' stock;
- The Company has limited working capital with which to continue operations;
- The telecom and software industries are extremely competitive and the Company faces competition from more established distributors and producers with greater financial resources and established sales and distribution capabilities;
- The Company has a significant number of shares outstanding which may be eligible for resale under Rule 144 and which, if sold, could depress the market price of the Company's shares;
- The profit margins in the telecom industry have been steadily eroding such that, even if it is able to make sales for its products, the Company may be unable to do so at a profitable margin.
- *We have had negative cash flows from operations. If we are unable to obtain financing in the amounts and on terms deemed acceptable to us, we may be unable to continue our business and as a result may be required to scale back or cease operations for our business, the result of which would be that our stockholders would lose some or all of their investment.* To date we have had negative cash flows from operations and we have been dependent on sales of our equity securities and debt financing to meet our cash. We do not expect positive cash flow from operations in the near term and there is no assurance that actual cash requirements will not exceed our estimates, or that our sales projections will be realized as estimated. The occurrence of any of the aforementioned events could adversely affect our ability to meet our business plans.
- *We will depend almost exclusively on outside capital to pay for the continued development of our business.* Such outside capital may include the sale of additional stock and/or commercial borrowing. Capital may not

continue to be available if necessary to meet these continuing development costs or, if the capital is available, that it will be on terms acceptable to us. The issuance of additional equity securities by us would result in a significant dilution in the equity interests of our current stockholders. Obtaining commercial loans, assuming those loans would be available, will increase our liabilities and future cash commitments. If we are unable to obtain financing in the amounts and on terms deemed acceptable to us, we may be unable to continue our business and as a result may be required to scale back or cease operations for our business, the result of which would be that our stockholders would lose some or all of their investment.

- *A decline in the price of our common stock could affect our ability to raise further working capital and adversely impact our operations.*

A prolonged decline in the price of our common stock could result in a reduction in the liquidity of our common stock and a reduction in our ability to raise capital. Because our operations have been primarily financed through the sale of equity securities, a decline in the price of our common stock could be especially detrimental to our liquidity and our continued operations. Any reduction in our ability to raise equity capital in the future would force us to reallocate funds from other planned uses and would have a significant negative effect on our business plans and operations, including our ability to develop new products and continue our current operations. If our stock price declines, we may not be able to raise additional capital or generate funds from operations sufficient to meet our obligations.

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- *We have a history of losses and fluctuating operating results.*

There is no assurance that we will operate profitably or will generate positive cash flow in the future. In addition, our operating results in the future may be subject to significant fluctuations due to many factors not within our control, such as the unpredictability of when customers will purchase our products and/or services, the size of customers' purchases, the demand for our production and/or services, and the level of competition and general economic conditions. If we cannot generate positive cash flows in the future, or raise sufficient financing to continue our normal operations, then we may be forced to scale down or even close our operations.

- *We have a limited operating history and if we are not successful in continuing to grow our business, then we may have to scale back or even cease our ongoing business operations.*

We have limited history of revenues from operations and have limited significant tangible assets. We have yet to generate positive earnings and there can be no assurance that we will ever operate profitably. Our company has a limited operating history and must be considered in the development stage. Our company's operations will be subject to all the risks inherent in the establishment of a developing enterprise and the uncertainties arising from the absence of a significant operating history. We are in the development stage and potential investors should be aware of the difficulties normally encountered by enterprises in the development stage. If our business plan is not successful, and we are not able to operate profitably, investors may lose some or all of their investment in our company.

- *Trading of our stock may be restricted by the SEC's "Penny Stock" regulations, which may limit a stockholder's ability to buy and sell our stock.*

The U.S. Securities and Exchange Commission has adopted regulations which generally define "penny stock" to be any equity security that has a market price (as defined) less than \$5.00 per share or an exercise price of less than \$5.00 per share, subject to certain exceptions. Our securities are covered by the penny stock rules, which impose additional sales practice requirements on broker-dealers who sell to persons other than established customers and "accredited investors." The term "accredited investor" refers generally to institutions with assets in excess of \$5,000,000 or individuals with a net worth in excess of \$1,000,000 or annual income exceeding \$200,000 or \$300,000 jointly with their spouse. The penny stock rules require a broker-dealer, prior to a transaction in a penny stock not otherwise exempt from the rules, to deliver a standardized risk disclosure document in a form prepared by the SEC, which provides information about penny stocks and the nature and level of risks in the penny stock market. The broker-dealer also must provide the customer with current bid and offer quotations for the penny stock, the compensation of the broker-dealer and its salesperson in the transaction and monthly account statements showing the market value of each penny stock held in the customer's account. The bid and offer quotations, and the broker-dealer and salesperson compensation information, must be given to the customer orally or in writing prior to effecting the transaction and must be given to the customer in writing before or with the customer's confirmation. In addition, the penny stock rules require that prior to a transaction in a penny stock not otherwise exempt from these rules, the broker-dealer must make a special written determination that the penny stock is a suitable investment for the purchaser and receive the purchaser's written agreement to the transaction. These disclosure requirements may have the effect of reducing the level of trading activity in the secondary market for the stock that is subject to these penny stock rules. Consequently, these penny stock rules may affect the ability of broker-dealers to trade our securities. We believe that the penny stock rules discourage investor interest in and limit the marketability of, our common stock.

- *The Financial Industry Regulatory Authority, or FINRA, has adopted sales practice requirements which may also limit a stockholder's ability to buy and sell our stock.*

In addition to the "penny stock" rules described above, FINRA has adopted rules that require that in recommending an investment to a customer, a broker-dealer must have reasonable grounds for believing that

the investment is suitable for that customer. Prior to recommending speculative low priced securities to their non-institutional customers, broker-dealers must make reasonable efforts to obtain information about the customer's financial status, tax status, investment objectives and other information. Under interpretations of these rules, FINRA believes that there is a high probability that speculative low priced securities will not be suitable for at least some customers.

FINRA requirements make it more difficult for broker-dealers to recommend that their customers buy our common stock, which may limit your ability to buy and sell our stock and have an adverse effect on the market for our shares. FINRA requirements make it more difficult for broker-dealers to recommend that their customers buy our common stock, which may limit your ability to buy and sell our stock and have an adverse effect on the market for our shares.

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- *Trading in our common shares on the OTC Bulletin Board is limited and sporadic making it difficult for our shareholders to sell their shares or liquidate their investments.*

Our common shares are currently listed for public trading on the OTC Bulletin Board. The trading price of our common shares has been subject to wide fluctuations. Trading prices of our common shares may fluctuate in response to a number of factors, many of which will be beyond our control. The stock market has generally experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of companies with no current business operation. There can be no assurance that trading prices and price earnings ratios previously experienced by our common shares will be matched or maintained. These broad market and industry factors may adversely affect the market price of our common shares, regardless of our operating performance.

In the past, following periods of volatility in the market price of a company's securities, securities class-action litigation has often been instituted. Such litigation, if instituted, could result in substantial costs for us and a diversion of management's attention and resources.

- *Because of the early stage of development and the nature of our business, our securities are considered highly speculative.*

Our securities must be considered highly speculative, generally because of the nature of our business and the early stage of its development.

### **Recent Accounting Pronouncements**

In March 2008, the FASB issued SFAS No.161, *Disclosures about Derivative Instruments and Hedging Activities*, which is effective for fiscal years and interim periods beginning after November 15, 2008. The statement amends and expands the disclosure requirements of Statement 133 and requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative agreements. The Company has expanded the information included in Note 4 Convertible Debenture Notes to include the new requirements. This standard did not effect the Company's reported financial position or results of operations.

In May 2008, the FASB issued SFAS No.162, *The Hierarchy of Generally Accepted Accounting Principles*, which is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411. This statement identifies the sources of accounting principles and framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles in the United States, the GAAP hierarchy. This standard did not effect the Company's reported financial position or results of operations.

In May 2008, the FASB issued SFAS No.163, *Accounting for Financial Guarantee Insurance Contract*, which is effective for financial statements issued for fiscal years beginning after December 15, 2008. This statement requires that an insurance enterprise recognize a claim liability prior to an event of default when there is evidence that credit deterioration has occurred in an insured financial obligation. This Statement also clarifies how Statement 60, *Accounting and Reporting by Insurance Enterprises*, applies to financial guarantee insurance contract, including the recognition and measurement to be used to account for premium revenue and claim liabilities. This standard did not effect the Company's reported financial position or results of operations.

In May 2009, the FASB issued SFAS No.165, *Subsequent Events*, which is effective for interim or annual financial statements issued after June 15, 2009. This statement requires the Company to disclose the period for which subsequent events have been reported and clarifies when subsequent events should be disclosed. This standard did not effect the Company's reported financial position or results of operations.



In June 2009, the FASB issued SFAS No.166, *Accounting for Transfers of Financial Assets*, which is effective for financial statements issued for fiscal years beginning after November 15, 2009. This statement amends SFAS No.140, *Accounting for Transfers and Servicing of Financial Assets and extinguishments of Liabilities*, by removing the concept of special purpose entity from SFAS No.140. This statement also clarifies the objective of paragraph 9 of SFAS No.140 which is to determine whether a transferor and all of the entities included in the transferor's financial statements being presented have surrendered control of transferred financial assets. This standard did not affect the Company's reported financial position or results of operations.

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In June 2009, the FASB issued SFAS No.167, *Amendments to FASB Interpretation No.46(R)*, which is effective for financial statements issued for fiscal years beginning after November 15, 2009. This statement amends FASB Interpretation No.46(R), *Consolidation of Variable Interest Entities*, by requiring an entity to perform an analysis to determine whether the entity's variable interest or interest give it a controlling financial interest in a variable interest entity. This standard did not effect the Company's reported financial position or results of operations.

In June 2009, the FASB issued SFAS No.168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles*, which replaces SFAS 162 and is effective for financial statements issued for interim and annual periods ending after September 15, 2009. This statement identifies the sources of accounting principles and framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles in the United States, the GAAP hierarchy. This standard did not effect the Company's reported financial position or results of operations.

In January 2010, the FASB issued ASU 2010-01, *Accounting for Distributions to Shareholders with Components of Stock and Cash (Topic 505)*, which is effective for financial statements issued for interim and annual periods ending after December 15, 2009. This update identifies how companies should be reporting distributions to shareholders that offers them the ability to elect to receive the distribution in cash or an equivalent number of shares. It was determined that all distributions of shares relating to these payments should be recorded as new share issuances. This standard did not effect the Company's reported financial position or results of operations.

In January 2010, the FASB issued ASU 2010-02, *Consolidation (Topic 810)*, which replaces SFAS No. 160 and is effective for financial statements issued for interim and annual periods ending after December 15, 2009. This update establishes the accounting and reporting guidance for non-controlling interest and changes in ownership interests of a subsidiary. This standard did not effect the Company's reported financial position or results of operations.

In January 2010, the FASB issued ASU 2010-06, *Fair Value Measurements and Disclosures (Topic 820)*, which replaces SFAS No. 157 and is effective for financial statements issued for interim and annual periods ending after December 15, 2009 except for the disclosures about purchases, sales, issuances, and settlements in the roll forward activity in Level 3 fair value measurements which are effective for financial statements issued for fiscal years ending after December 15, 2010 and interim periods commencing December 16, 2009. This update identifies new disclosure requirements relating to fair value measurements. This standard did not affect the Company's reported financial position or results of operations.

In February 2010, the FASB issued ASU 2010-09, *Subsequent Event (Topic 855)s*, which is effective for financial statements issued for interim and annual periods ending after June 15, 2010. This update addresses both the interaction of the requirements of Topic 855 with the SEC's reporting requirements and the intended breadth of the reissuance disclosure provision related to subsequent events. This standard is not expected to have a significant effect on the Company's reported financial position or results of operations.

In March 2010, the FASB issued ASU 2010-11, *Derivatives and Hedging (Topic 815)*, which is effective for financial statements issued at the beginning of the entity's first fiscal quarter beginning after June 15, 2010. This update provides amendments to Subtopic 815-15, Derivatives and Hedging - Embedded Derivatives, such as clarification of the scope exception for embedded credit derivative features related to the transfer of credit risk in the form of subordination of one financial instrument to another and whether those derivatives are subject to potential bifurcation. This standard is not expected to have a significant effect on the Company's reported financial position or results of operations.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

Not applicable

**Item 4. Controls and Procedures**

**Management's Report on Disclosure Controls and Procedures**

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports filed under the *Securities Exchange Act of 1934*, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our president (also our principal executive officer, principal financial officer and principal accounting officer) to allow for timely decisions regarding required disclosure.

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As of June 30, 2011, the end of our second quarter covered by this report, we carried out an evaluation, under the supervision and with the participation of our president (also our principal executive officer) and our secretary, treasurer and chief financial officer (also our principal financial and accounting officer), of the effectiveness of the design and operation of our disclosure controls and procedures. Based on the foregoing, our president (also our principal executive officer) and our secretary, treasurer and chief financial officer (also our principal financial and accounting officer) concluded that our disclosure controls and procedures were effective in providing reasonable assurance in the reliability of our financial reports as of the end of the period covered by this quarterly report.

### **Changes in Internal Control over Financial Reporting**

There have been no significant changes in our internal controls over financial reporting that occurred during the quarter ended June 30, 2011 that have materially or are reasonably likely to materially affect, our internal controls over financial reporting.

## **PART II - OTHER INFORMATION**

### **Item 1. Legal Proceedings**

Other than as described below, management is not aware of any legal proceedings (either presently engaged in or contemplated) by any government authority or other party involving the Company, its properties or its products.

On March 14, 2005 the Company was named as a defendant in a Writ of Summons and Statement of Claim in the Supreme Court of British Columbia, Vancouver Registry in which the Native Trade and Investment Association requested an order to pay the Plaintiff Cdn \$53,500 and 100,000 common shares for trade shows attended by the Company. On February 6 2007 The Supreme Court of British Columbia ordered the Company to pay NITA \$53,500 plus interest of \$4,126 and costs of \$5,673 and 100,000 common shares, which were paid in March 2007. No directors, officers, or affiliate of the Company is (i) a party adverse to the Company in any legal proceedings, or (ii) has an adverse interest to the Company in any legal proceedings.

On June 30, 2008, the Company filed an action in the Circuit Court in and for Miami-Dade County, Florida against a customer seeking to recover a total of \$142,121 for services and loans provided. The Company is also seeking to recover interest and attorneys' fees and costs. The likelihood of any results from the above lawsuit is not determinable at this time, consequently the company has made bad debt provisions for the entire amounts.

On October 16 2009 the Company received notice that they had been named as Defendants in a lawsuit whereby the Plaintiffs are seeking a judgment of \$39,000 plus interest thereon from March 11 2009 for breach of contract. As at June 30, 2011 no amounts have been accrued as the result of the lawsuit is not determinable at this time.

On May 10, 2010, the Company received noticed that they had been named as Defendants in a lawsuit whereby the Plaintiffs are seeking a judgment of \$6,889 including interest of \$1,444 for unpaid invoices. The Company had 30 days to respond to the notice before a default judgment is awarded. As at June 30, 2011, the full amount has been accrued and is included in accounts payable.

No directors, officers, or affiliate of the Company is (i) a party adverse to the Company in any legal proceedings, or (ii) has an adverse interest to the Company in any legal proceedings.

### **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

During the six months ended June 30, 2011, the Company issued 6,393,331 common shares valued at \$831,444 for debt settlement and convertible debenture agreements, 3,333,333 common shares valued at \$500,000 for subscription received through the period, 500,000 shares valued at \$15,000 for share subscriptions previously received, 1,350,000 common shares valued at \$165,000 for consulting services to be rendered through the period and 1,900,000 common shares valued at \$228,000 for employee incentives in accordance with employment agreements. As at June 30, 2011, the Company has \$323, 862 (June 30, 2010 - \$145,362) in private placement subscriptions which are reported as private placement subscriptions within stockholders' deficit.

**Item 3. Defaults upon Senior Securities**

None.

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**Item 4. Submission of Matters to a Vote of Security Holders**

None.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

**ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K**

(a) Reports on Form 8-K. The Registrant filed one report on Form 8K during the period ending June 30, 2011.

(b) Exhibits. Exhibits included or incorporated by reference herein: See Exhibit Index below.

**EXHIBIT INDEX**

| Number      | Exhibit Description                                                                                                                                                   |
|-------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 3.1         | Articles of Incorporation (incorporated by reference to Exhibit 3 of the Registration Statement on Form 10- SB filed on September 28, 2000).                          |
| 3.2         | Certificate of Amendment to Articles of Incorporation (incorporated by reference to Exhibit 2 of the Form 10-SB filed on September 28, 2000).                         |
| 3.3         | Certificate of Amendment to Articles of Incorporation dated October 13, 2000. (incorporated by reference to Exhibit 3.3 of the Form 10-QSB filed on November 7, 2000) |
| 3.4.1       | By-Laws (incorporated by reference to Exhibit 3.3 of the Form 10-QSB filed on November 7, 2001)                                                                       |
| <u>14.1</u> | <u>Code of Business Conduct</u>                                                                                                                                       |
| <u>31.1</u> | <u>Section 302 Certifications - CEO</u>                                                                                                                               |
| <u>31.2</u> | <u>Section 302 Certifications - CFO</u>                                                                                                                               |
| <u>32.1</u> | <u>Section 906 Certifications - CEO</u>                                                                                                                               |
| <u>32.2</u> | <u>Section 906 Certifications - CFO</u>                                                                                                                               |

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**ALTERNET SYSTEMS INC.**

By: /s/ Henryk Dabrowski

Henryk Dabrowski, President

(Principal Executive Officer)

August 8, 2011

By: /s/ Michael Viadero

Michael Viadero, Secretary, Treasurer

(Principal Financial Officer and Principal Accounting Officer)

August 8, 2011

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