ALTERNET SYSTEMS INC
Form 10KSB
April 02, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-KSB

(Mark One)

[X] ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended **December 31, 2006**

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT OF 1934

For the transition period from ___________ to __________

COMMISSION FILE NUMBER: **000-31909**

ALTERNET SYSTEMS, INC.

(Name of small business issuer in its charter)

Nevada	**88-0473897**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

#610-815 West Hastings Street, Vancouver, BC, V6C 1B4
(Address of Principal Executive Offices)

604-608-2540
(Registrant's Telephone Number)

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

None
(Title of class)

Securities registered pursuant to Section 12(g) of the Exchange Act:
Common Stock, $0.00001 Par Value

Check mark whether the issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act of 1934 during the preceding 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 [X] No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (Section 229.405 of this Chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act) Yes [ ] No [X]

Of the 47,556,428 shares of voting stock of the registrant issued and outstanding as of March 13, 2007, 41,282,428 shares are held by non-affiliates.

The aggregate market value of the voting stock held by non-affiliates of the registrant as of December 31, 2006 was approximately $2,889,770 based upon the closing price per share of the registrant's common shares of $0.07 on that date.

The issuer had revenues of $3,604 for the fiscal year ended December 31, 2006.

Transitional Small Business Disclosure Format (check one) Yes [ ] No [X]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes [ ] No [X]

FORM 10-KSB ANNUAL REPORT
FOR THE YEAR ENDED DECEMBER 31, 2006
ALTERNET SYSTEMS, INC.

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PART I

Item 1. Description of Business

Forward Looking Statements

This report contains forward-looking statements. The forward-looking statements include all statements that are not statements of historical fact. The forward-looking statements are often identifiable by their use of words such as may, expect, believe, anticipate intend, could, estimate, or continue, or the negative or other variations of th comparable terms. Our actual results could differ materially from the anticipated results described in the forward-looking statements. Factors that could affect our results include, but are not limited to, those discussed in Item 6, Management s Discussion and Analysis and include elsewhere in this report.

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 June 26, 2000 the Company increased its authorized share capital from 20,000 shares with no par value to 100,000,000 shares with a par value of $0.00001. On December 20, 2001 the Company received shareholder approval to change its name from North Pacific Capital Corp. to its present name "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. distributes, markets and sells Internet access systems and software, marketed under the names "SchoolWeb", HealthWeb and "CommunityWeb".

Each basic SchoolWeb "system" or software / hardware package is comprised of the SchoolWeb virtual library software, Linux Operating System, a network server, redundant file system, software configuration, uninterruptible power supply, satellite or cable port, SchoolWeb user license, 24 hour technical support , on-site installation(provided by resellers and distributors), training , system maintenance and 5X9 on-site warranty.

Because SchoolWeb is a relatively new software technology, acceptance of the SchoolWeb software (the Company believes) must be preceded by a test period of placing the SchoolWeb software and servers in schools for as long as a year to build comfort with the system and generate (after the test period has been completed) orders and revenue. The Company has found, in dealing with potential clients, that a new software system or company has to prove itself before a sale can be made. Testing is the easiest way of accomplishing this (SchoolWeb software does not, at this time, have the established reputation of software, like Microsoft Word or Outlook Express which most potential customers are aware of and know will meet their needs).

For example, the SchoolWeb system and software were installed on a test basis in Burnaby School District in Vancouver, Canada for almost two years prior to Burnaby School District placing an order for installation in 52 schools. This installation was completed in February of 2003.

The Company markets SchoolWeb into the US and Canadian school district market and internationally. Company personnel have also been attending trade shows in North America and making presentations to school districts in the United States.

SchoolWeb 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.

The Company anticipates that it will begin the process of registering the "HealthWeb" and "CommunityWeb" names. There can be no guarantee that all, or any, of these names will be successfully registered in the United States or Canada.

Additional Products

SchoolWeb InMotion Web Conferencing

The Company also offers a web conferencing product that is sold to schools for the purpose of video conferencing for principals and teachers, as well as distance learning to remote or at home students. The Company sources software and services from several suppliers and resells it under the SchoolWeb InMotion name. The Company acts as a reseller of any such software, not as a proprietor and developer.

TekVoice Inc. Merger Proposal

On March 21, 2007 Alternet Systems Inc. announced it had executed a letter of intent (LOI) agreement to commence with due diligence for a proposed merger with TekVoice Communications, Inc. of Miami, Florida. TekVoice is a telecommunications services company with operations in North and South America. TekVoice revenues were $3 million in 2006, and the company is forecasting significant growth in 2007. The specific terms for the proposed merger are subject to further negotiations between the parties.

The combined entity will be called Alternet Systems Inc. and its primary business will be to acquire and develop wireless broadband networks in under-served countries in Latin America and the Caribbean, delivering voice, data and content services to customers in these regions. Alternet will offer a portfolio of next-generation wireless broadband and telecom solutions for government, business, schools, hospitals and community residents.

Management believes that the combination of Alternet with TekVoice is the ideal strategy to achieve our goal of offering a complete wireless telecommunications solution for this growing market.

The combination of Alternet s proprietary software systems, with the TekVoice VoIP based telecommunications offerings, supplied over a cost-effective network platform, will significantly improve the way rural telecom services, education and medical information technology are delivered in rural areas of Latin America.

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. With sales of over $3 million in 2006, it 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, Dallas, Caracas, Venezuela and Lima, Peru.

Terms of the merger are to be negotiated after due diligence by both parties is completed.

Item 2. Description of Property

The Company does not own any real property as of March 13, 2007.

The Company rents approximately 1700 sq. ft. of office space at Suite #610 815 West Hastings Street, British Columbia, Canada V6C 1B4. The rent is on a month to month basis and is $2,500.

Item 3. 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 13, 2004, the Company filed a Writ of Summons and Statement of Claim (No. S041464) in the Supreme Court of British Columbia in the Vancouver, British Columbia Court Registry. The writ stated that the defendants, Advanced Interactive, Inc. (AII) had breached the License Agreement between the Company and AI as follows and damages are sought in the amount of $1,804,709. The Company alleged that AII breached the agreement by failing to grant exclusivity to the Company as required by the License Agreement, failed to provide technical support, failed to provide technical support at a reasonable price, failed to provide usable software and failed to provide working software. The defendant in this action made a counterclaim of Cdn $1,379,150 plus interest and costs. This amount represented license payments that would be owed if the License Agreement were in effect plus interest and costs. The counterclaim also included unspecified additional damages.

This lawsuit was settled during the fourth quarter of 2005 and a Consent Dismissal Order was entered in the Supreme Court of British Columbia on November 1 2005. The settlement called for the cancellation of all claims and debts between the two parties. Alternet has recorded a net gain on settlement of the License Agreement on its Consolidated Statement of Operations for the year ending December 31, 2005 of $398,552.

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. As a result of the settlement, the Company recorded a net gain of $8,443 in 2006.

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 4. Submission of Matters To A Vote of Security Holders

No matters were submitted to a vote of security holders during the fourth quarter of the fiscal year ended December 31, 2006.

PART II

Item 5. Market for Common Equity and Related Stockholder Matters

Market for Common Stock

The Company s securities trade on the NASD s OTCBB under the symbol ASYI .

The following table summarizes the high and low bid prices for our common stock for the periods indicated as reported by the OTC Bulletin Board:

2006	HIGH	LOW
First Quarter	$0.185	$0.07
Second Quarter	$0.24	$0.13
Third Quarter	$0.19	$0.14
Fourth Quarter	$0.19	$0.07

Holders of Common Stock

On December 31, 2006, there were approximately 96 holders of record of our common stock and there were 47,556,428 shares outstanding. There are 205 indirect holders of common shares in outside institutions or stock brokerage firms, and we estimate that there are no additional beneficial shareholders beyond the 96 registered shareholders and 205 non-registered shareholders at December 31, 2006.

Dividends

We have not declared or paid a cash dividend to stockholders since our incorporation. The Board of Directors presently intends to retain any earnings to finance company operations and does not expect to authorize cash dividends in the foreseeable future. Any payment of cash dividends in the future will depend upon our earnings, capital requirements and other factors.

Recent Sales of Unregistered Securities

Sales in 2006

On February 20 2006 the Company issued a total of 5,765,000 shares at a price of $0.05 per share. Of this amount, 1,523,000 shares were sold to 1 person resident in the United States and a total of 4,242,000 shares to 4 persons resident in Canada. All of the shares were sold at a price of $0.05 per shares for total proceeds of $288,250.

On June 1 2006 the Company issued a total of 4,690,000 shares at a price of $0.05 per share, to 4 persons resident in Canada for total proceeds of $234,500.

Sales in 2005

There were no sales of unregistered securities in 2005.

Sales in 2004:

On May 17, 2004 the Company issued a total of 2,628,499 shares to 46 persons resident in the United States and a total of 1,413,000 shares to 16 persons resident in Canada. All of the shares were sold at a price of $0.15 per shares for total proceeds of $606,225.

On October 25, 2004, the Company issued a total of 621,900 shares at a price of $0.15 to 5 persons resident in Canada for total proceeds of $93,285.

Sales in 2003:

On March 14, 2003 the Company issued a total of 165,944 units to a total of 15 persons resident in Canada at a price of $0.35 per unit for total proceeds of $58,080. Each unit was comprised of one common share and one share purchase warrant exercisable for a period of 2 years at $0.50 per warrant.

The 165,944 units were sold under the exemption from registration made available by Regulation S.

Where the offerings described in Sales in 2003 and Sales in 2004 and Sales in 2006 above were made to Canadia residents they were undertaken under Regulation S and they were made under Rule 903 (Category 3, equity securities) and:

- the sale was made in an offshore transaction;
- no directed selling efforts were made in the United States by the Company;
- the purchaser certified that it is not a US person and is not acquiring the securities for the account or benefit of any US person;
- the purchaser agreed to resell such securities only in accordance with the provisions of the Securities Act of 1933 or regulations applicable to their securities;
- the securities contained a legend to the effect that transfer was prohibited unless the securities were first registered under the Securities Act of 1933 or resale was made pursuant to an exemption therefrom.

No commission or professional fees were paid in connection with the Company's sales of unregistered securities under Regulation S.

Where the sales were made to residents of the United States under Regulation D each person to whom the sale was made was asked by the Company to confirm in writing that they were accredited investors, as that term is defined in the rules and regulations of the Securities Exchange Commission.

Neither we nor any person acting on our behalf offered or sold the foregoing securities by means of any form of general solicitation or general advertising. All purchasers represented in writing that they acquired the securities for their own accounts. A resale legend has been provided for the stock certificates stating that the securities have not been registered under the Securities Act of 1933 and cannot be resold or otherwise transferred without registration or an exemption (such as that provided by Regulation S or Rule 144).

ISSUANCE OF NON- RESTRICTED STOCK

The Company has issued the following non-restricted stock:

Issuance in 2006

On January 11, 2006, the Company issued a total of 990,000 shares at a price of $0.09 per share pursuant to the Company s S8 Registration Statement filed on January 21 2005. These shares were issued to 1 person resident in Canada under the terms of a management agreement by which they provided product marketing and financial consulting services to the Company.

On May 15 2006 the Company issued 80,000 shares at a price of $0.15 per share pursuant to the Company S8 Registration Statement filed on May 5 2006. These shares were issued under a debt settlement for accounting and administrative services.

On August 4 2006 the Company issued a total of 3,000,000 shares to three directors at a price of $0.16 pursuant to the Company s S8 Registration Statement filed on May 5 2006. These shares were issued under management consulting agreements by which the three directors provide marketing consulting services to the Company over a twelve month period.

On August 30 2006 the Company issued a total of 200,000 shares at a price of $0.15 per share pursuant to the Company s S8 Registration Statement filed on May 5 2006. These shares were issued to one person resident in Canada under a management consulting agreement by which they provided product marketing consulting services.

On October 25 2006 the Company issued 57,000 shares at a price of $0.13 per share under a debt settlement agreement for accounting and administrative services, pursuant to the Company s S8 Registration Statement filed on May 5 2006.

On October 30 2006 the Company issued 2,000,000 shares at a price of $0.10 per share pursuant to a management contract for product marketing services over a twelve month period under the Company s S8 Registration Statement filed on May 5 2006. These shares were issued to one person resident in Canada.

On November 15 2006 the company issued 200,000 shares for cash at a price of $0.10 per share pursuant to the exercise of stock options. These shares were registered under the Company s S8 Registration Statement filed on May 5 2006.

On November 15 2006 the Company issued 100,000 shares at a price of $0.10 per share under a debt settlement agreement for administrative services, pursuant to the Company s S8 Registration Statement filed on May 5 2006

On December 22 2006 the Company issued 500,000 shares at a price of $0.07 per share pursuant to the company s S8 Registration Statement filed on May 5 2006. These shares were issued to one person resident in Canada under a management contract for product marketing consulting services over a twelve month period.

Issuances in 2005:

On January 5, 2005 the Company issued 70,000 shares to one person for settlement of debt for legal services at a price of $0.20 per share. These shares were issued pursuant to the Company s S8 Registration Statement filed on March 1 2003.

On May 2 2005 the Company issued a total of 1,000,000 shares at a price of $0.095 per share to one person pursuant to the Company s S8 Registration Statement filed on January 21, 2005. These shares were issued to 1 person resident in Canada under the terms of management agreements by which they provided various services including product marketing consulting services.

On May 4 2005 the Company issued 400,000 shares at a price of $0.08 per share to two Companies resident in Canada for settlement of debt for accounting and administrative services pursuant to the Company s S8 Registration filed on January 21 2005.

On June 15, 2005, the Company issued a total of 1,000,000 shares at a price of $0.135 per share pursuant to the Company s S8 Registration Statement filed on January 21, 2005. These shares were issued to 2 persons resident in Canada under the terms of management agreements by which they provided various services to the Company including product marketing consulting and administrative services.

On July 15, 2005, the Company issued a total of 360,000 shares at an average price of $0.15 per share pursuant to the Company s S8 Registration Statement filed on January 21 2005. These shares were issued to 2 persons resident in Canada under the terms of management agreements by which they provided various services to the Company including product marketing consulting and other services.

On August 16, 2005, the Company issued a total of 200,000 shares at a price of $0.135 per share pursuant to the Company s S8 Registration Statement filed on January 21 2005. These shares were issued to 1 person resident in Germany under the terms of a management agreement by which they provided product marketing consulting services to the Company.

On September 23, 2005, the Company issued a total of 300,000 shares at a price of $0.15 per share pursuant to the Company s S8 Registration Statement filed on January 21 2005. These shares were issued to 1 person resident in Germany under the terms of management agreements by which they provided product marketing consulting services to the Company.

On October 7, 2005, the Company issued a total of 165,000 shares at a price of $0.16 per share pursuant to the Company s S8 Registration Statement filed on January 21 2005. These shares were issued to 2 persons resident in Canada under the terms of debt settlement agreements by which they provided accounting and administrative consulting services to the Company.

On October 10, 2005, the Company issued a total of 200,000 shares at prices of $0.18 and $0.16 per share pursuant to the Company s S8 Registration Statement filed on January 21 2005. These shares were issued to 2 persons resident in Canada under the terms of management agreements by which they provided product marketing consulting services to the Company.

On October 20 2005, the Company issued a total of 60,000 shares at a price of $0.22 per share pursuant to the Company s S8 Registration Statement filed on January 21 2005. These shares were issued to 1 person resident in Canada under the terms of a management agreement by which they provided product marketing consulting services to the Company.

On December 4, the Company issued a total of 440,000 shares at prices of $0.15 and $0.162 per share pursuant to the Company s S8 Registration Statement filed on January 21 2005. These shares were issued to 1 person resident in Canada and 1 person resident in Germany under the terms of management agreements by which they provided product marketing consulting and administrative services to the Company.

Issuances in 2004:

On January 6, 2004, the Company issued a total of 1,785,000 shares at a price of $0.26 per share pursuant to the Company s S8 Registration Statement filed on March 1, 2003. These shares were issued to 10 persons resident in Canada under the terms of management agreements by which they provided various services, including management consulting, software programming and software manual development.

On June 10, 2004, the Company issued a total of 1,500,000 shares at a price of $0.11 per share pursuant to the Company s S8 Registration Statement filed on March 1, 2003. These shares were issued to 3 persons resident in Canada under the terms of management agreements by which they provided various services to the Company including product marketing consulting and other services.

On August 30, 2004, the Company issued 431,000 shares at a price of $0.23 pursuant to the Company s S8 Registration Statement filed on March 1, 2003. Of these shares, 406,000 shares were issued to 6 persons resident in Canada and 25,000 shares were issued to 1 person resident in the United States under the terms of management agreements by which they provided various services including product marketing, financial consulting and software development services.

Issuances in 2003:

The Company issued a total of 640,000 shares of non-restricted common stock in the year ending December 31, 2003.

On May 29, 2003, a total of 100,000 shares were issued to a Canadian resident under the terms of a management agreement at a price of $0.33 per share. The shares were registered pursuant to the Company s S8 Registration Statement filed on March 1, 2003.

On June 10, 2003, a total of 540,000 shares were issued to four Canadian residents under the terms of management agreements by which they provide various services, including software programming, management consulting and software manual development, at a price of $0.31 per share. The shares were registered pursuant to the Company s S8 Registration Statement filed on March 1, 2003.

RETAINER STOCK PLAN - 2004

The Company adopted an incentive stock option plan on May 31, 2004. The Option Plan calls for the issuance of up to 3,000,000 incentive stock options to directors, officers, employees and consultants. To date, no incentive stock options have been issued. The Option Plan is managed by the Company s Board of Directors and options, when granted under the terms of the Option Plan, can be granted for a term of up to five (5) years at an option exercise price determined at the discretion of the Board of Directors considering the prevailing market prices for the Company s shares.

RETAINER STOCK PLAN - 2005

The Company adopted a retainer stock plan on January 21, 2005. The Retainer Plan calls for the issuance of up to 5,000,000 shares of common stock to directors, officers, employees and consultants to compensate them for services rendered to the Company in lieu of cash compensation.

To date, a total of 4,750,000 shares of common stock have been issued under the terms of the Retainer Plan for various management and product marketing related services (see Issuance of Non-Restricted Stock above).

RETAINER STOCK PLAN - 2006

The Company adopted a retainer stock plan on May 3, 2006. The Retainer Plan calls for the issuance of up to 6,000,000 shares of common stock to directors, officers, employees and consultants to compensate them for services rendered to the Company in lieu of cash compensation. To date a total of 5,500,000 shares have issued under this plan.

RETAINER STOCK PLAN - 2007

The Company adopted a retainer stock plan on February 15 2007. The Retainer Plan calls for the issuance of up to 10,000,000 shares of common stock to directors, officers, employees and consultants to compensate them for services rendered to the Company in lieu of cash compensation. The 2007 Plan will terminate on February 15, 2012. The Company filed a Registration Statement on Form S8 to register the underlying shares included in the 2007 Plan.

Item 6. Management s Discussion and Analysis or Plan of Operation

The following discussion should be read in conjunction with the Company s consolidated financial statements and the notes thereto. The discussion of results, causes and trends should not be construed to imply any conclusion that such results or trends will necessarily continue in the future.

Critical Accounting Policies

In Note 2 to the audited financial statements for the years ended December 31, 2006 and 2005, included in this Form 10-KSB, the Company discusses those accounting policies that are considered to be significant in determining the results of operations and its financial position. The Company believes that the accounting principles utilized by it conform to accounting principles generally accepted in the United States of America.

The preparation of financial statements requires Company management to make significant estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. By their nature, these judgments are subject to an inherent degree of uncertainty. On an on-going basis, the Company evaluates estimates. The Company bases its estimates on historical experience and other facts and circumstances that are believed to be reasonable, and the results form the basis for making judgments about the carrying value of assets and liabilities. The actual results may differ from these estimates under different assumptions or conditions.

Results of Operations :

For the year ended December 31, 2006 compared to the year ended December 31, 2005

With the closing of the SchoolWeb Agreement in September of 2001, the Company s results, on a consolidated basis, reflected its own results consolidated with its subsidiary, AI Systems Group Inc. formerly known as SchoolWeb Holdings Inc). For the remainder of this part, the term Company refers to both the Company and its wholly owned subsidiary, AI Systems Group Inc.

Net Sales

For the year ending December 31, 2006, the Company had sales of $3,604. During the corresponding year ended December 31, 2005, the Company had sales of $15,027. The decrease in sales is attributable to the fact that the Company re-organized its sales and marketing plan and has been implementing the new plan over the past year. The objective of the Company s marketing plan was to establish a pilot wireless broadband network in a developing country in Latin America, Africa or Eastern Europe. Due to a variety of factors, the Company was unable to establish the pilot network it required to demonstrate the Company s SchoolWeb, HealthWeb and CommunityWeb system software. The Company continues to market SchoolWeb, HealthWeb and CommunityWeb in North America and internationally.

Net Loss

For the year ending December 31, 2006, the Company had a net loss of $1,000,692 or ($0.03) per share, which was an increase of 380% when compared to the net loss for the corresponding year to December 31, 2005 of $263,564 or $(0.01) per share. The increased loss was due primarily to a gain on settlement of our License Agreement in the year ended December 31 2005 of $398,552; and an increase in management, consulting and marketing fees of approximately $340,000. The net loss from operations for the year ended

December 31 2005, before the settlement gain, was $662,116, compared to the net loss from operations of $1,000,692 for the year ended December 31 2006, which was an increase of 34% from the previous year.

Gross Profit

Gross Profit was $3,604 in the year ended December 31 2006, compared to $8,478 for the year ended December 31, 2005. This represents a 60% decrease when compared to last year and is primarily due to the decline in sales of SchoolWeb, HealthWeb and CommunityWeb.

Selling, General and Administrative Expenses

For the year ended December 31 2006 the Company incurred office and general expenses of $30,585, which was virtually unchanged from the $28,987 incurred in the previous year ending December 31 2005. Marketing expenses of $436,175 were 65% higher than the marketing expenses of $258,316 for the year ending December 31 2005.

Management and consulting fees of $431,398 represents a 62% increase from the management and consulting fees of $268,731 incurred in the year ending December 31 2005. Professional fees of $53,394 were incurred in the period ending December 31 2006, which was a 24% reduction from the professional fees of $69,702 incurred in the previous year ending December 31 2005. The increase in marketing expenses is a result of increased activity in 2006 in marketing SchoolWeb, HealthWeb and CommunityWeb systems and the increase in management consulting expense this year, is a result of increased staffing levels compared to the corresponding year ending December 31, 2005.

Accounts payable were $215,884 at December 31 2006, which was an 18% increase when compared to accounts payable of $177,163 at December 31 2005.

Interest and other expenses

The Company had no material interest expenses.

Liquidity and Capital Resources

As at December 31, 2006, the Company had $2,527 cash in the bank and prepaid expenses of $1,727. The Company had a working capital deficiency of $221,880 as at December 31 2006. The Company is currently pursuing financing to fund ongoing operations and to pay current debts. The Company s ability to continue as a going concern will be negatively affected if it is unsuccessful.

PLAN OF OPERATION

Over the next 12 months the Company will be concentrating on marketing its SchoolWeb, HealthWeb and CommunityWeb in North America and internationally.

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

Although the Company believes that demand will exist for its products, there can be no assurance that any sales will be made in the future.

The Company is also marketing the InMotion web conferencing product. Marketing of InMotion is accomplished through the Company s existing sales staff, who offer the web conferencing product in conjunction with SchoolWeb in all direct mail, personal sales calls, trade shows and industry associations. No development costs are anticipated with InMotion web conferencing as the Company will be outsourcing the software development and service through outside providers and is essentially, acting as a reseller.

The Company is expected to remain dependent upon debt or equity financing unless revenues from operations grow significantly.

FUND REQUIRED FOR OPERATIONS

The Company anticipates the following for monthly cash expenses in the next 12 months (excluding the cost of any share issuances which may be made pursuant to management agreements between the Company and senior management):

Consulting Fees	$	12,000
Product Development Expense:	$	1,000
Office Rent	$	2,500
Telephones	$	1,000
Travel	$	2,000
Marketing Expenses	$	4,000
Professional Fees	$	1,500

Accounting fees	$	1,000
Total Monthly Expenses:	$	25,000

The Company is dependent for the continuance of its operations on further debt or equity financings. Failure to obtain such financings could result in the Company being unable to continue its operations.

There can be no certainty that such financings would be obtained on favorable terms, if at all, and any equity financings could dilute the interests of existing shareholders.

Inflation

Management does not believe that inflation had a material adverse affect on the financial statements for the periods presented.

Qualitative and Quantitative Disclosure Regarding Risk

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

- The Company may be unable to market and sell its software products;
- 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 given its past sales performance;
- If further equity financing is obtained, it will dilute the value of existing shareholders stock;
- The Company has no working capital with which to continue operations;
- The software industry is extremely competitive and the Company faces competition from more established software 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 software industry have been steadily eroding such that, even if it is able to make sales for its software products, the Company may be unable to do so at a profitable margin.

Item 7. Financial Statements

The audited Consolidated Financial Statements are included in this Form 10-KSB beginning on page F-1 following the signature page.

Item 8. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

During the Company s two most recent fiscal years and to the date of change in certifying accountant, there were no disagreements with the Company s accountants on any matter of accounting principle or practices, financial statement disclosure or auditing scope or procedure. In addition, there were no reportable events as described in Item 304(a)(1)(iv)(B)1 through 3 of Regulation S-B that occurred within the Company s two most recent fiscal years and the subsequent interim periods.

Item 8A . Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the U.S. Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in our reports filed under the Exchange Act is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure. As of December 31, 2006, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-14. Based upon the foregoing, our Chief Executive Officer /Chief Financial Officer concluded that our disclosure controls and procedures are effective in the timely alerting of management to material information relating to us which is required to be included in our periodic SEC filings.

There were no changes in our internal controls or in other factors that could materially affect these controls subsequent to the date of their evaluation and since the last period reported, including any significant deficiencies or material weaknesses of internal controls that would require corrective action.

PART III

Item 9. Directors, Executive Officers, Promoters and Control Persons; Compliance with Section 16(a) of the Exchange Act

The following discussion contains disclosure concerning the directors, officers and control persons of the Company. There are no persons which have acted as a promoter, controlling person, or significant employee of the Company other than as disclosed below.

Name	Position	Term of Office*1*2
Patrick Fitzsimmons	President, CEO and Director	Expires at next AGM
Griffin Jones	Secretary, Treasurer, CFO and Director	Expires at next AGM
Michael Dearden	Director	Expires at next AGM

1. Directors, whether appointed at a meeting of stockholders or by the remaining directors, are appointed until the next annual meeting of stockholders. The Company anticipates holding its next AGM during May of 2007.
2. The President, Secretary, CEO and Treasurer do not have a set term of office. They serve at the pleasure of the Directors and can be removed at any time by the Directors.

Patrick Fitzsimmons, President and Director

Pat Fitzsimmons, age 53. Mr. Fitzsimmons has extensive sales and management experience gained from a 27-year career in the high-technology marketplace. Mr. Fitzsimmons has represented firms such as NCR, Timeplex, Rogers Cable, and Newbridge Networks, offering a wide range of technology solutions. His most recent position was Manager, Major Accounts, AT&T Canada, Vancouver B.C., Canada.

Griffin Jones, Secretary, Treasurer, CFO and Director

Griffin Jones, age 52. Mr. Jones has been self-employed for approximately 20 years as a management consultant. Mr. Jones brings to the Company experience in financial management, and experience in providing management to companies in a number of industry areas including high technology, industrial products and mining. Mr. Jones has worked in marketing management, finance and corporate relations.

Michael Dearden, Director

Michael Dearden, age 52. Mr. Dearden has over 27 years experience in sales and marketing, and for the past 17 years has focused specifically on corporate marketing and venture capital financing. Prior to joining Alternet in 2000, Mr. Dearden was, for five years, a director of Rolland Virtual Business Systems Limited (formerly Americ Resources Corp.), where he helped to facilitate the merger of Rolland Virtual Business Systems Limited and Americ Resources Corp.

Item 10. Executive Compensation

Summary Compensation Table

		Annual Compensation			**Long-term compensation**			
					Awards		**Payouts**	
Name and principal position **(a)**	Year **(b)**	Salary ($) **(c)**	Bonus ($) **(d)**	Other Annual Compen-sation ($) **(e)**	Restricted Stock Award(s) ($) **(f)**	Securities Underlying options/ SARs (#) **(g)**	LTIP payouts ($) **(h)**	All other Compen-sation ($) **(i)**
Patrick Fitzsimmons, President	2006	44,051	0	0	75,000	1,000,000	0	0
Griffin Jones, Treasurer and CFO	2006 2005 2004 2003 2002	67,554 9,249 46,100 77,998 35,164	0 0 0 0 0	0 0 0 0 0	0 0 0 0 0	0 0 0 0 0	0 0 0 0 0	0 0 0 0 0
Michael Dearden, Director	2006 2005	26,495 0	0 0	0 0	0 0	0 0	0 0	0 0
Paul Brandenberg, Director	2006	33,165	0	0	75,000	1,000,000	0	0
John Puente, Director	2006	0	0	0	75,000	1,000,000	0	0

Item 11. Security Ownership of Certain Beneficial Owners and Management

The following table sets forth information regarding the beneficial ownership of shares of the Company s common stock as of December 31, 2005 (29,974,428 issued and outstanding) by (i) all stockholders known to the Company to be beneficial owners of more than 5% of the outstanding common stock; and (ii) all directors and executive officers of the Company, and as a group (each person has sole voting power and sole dispositive power as to all of the shares shown as beneficially owned by them):

Name and Address	Position	Amount of Stock Beneficially Owned	Percentage of Class
Patrick Fitzsimmons 1406-151 E. Keith Rd. N. Vancouver, BC V7L 4M3	President, Director,	1,345,000	3.7%
Griffin Jones and Nahatlatch Capital Corp. (3) 711 South Carson St. Carson City, Nevada 89701	Director, Secretary/ Treasurer	2,173,000 common shares of which 260,000 are held personally and 1,913,000 are held in Nahatlatch Capital Corp.	7.2%
Michael Dearden and Mikden Investments Inc. (formerly Streamline Investments, Inc.) (2) 711 South Carson St. Carson City, Nevada 89701	Director,	2,756,000 common shares of which 373,000 are held personally and 2,383,000 are held by Mikden Investments	8.9%
Directors, Officers and 5% stockholders in total		5,924,000	20%

Item 12. Certain Relationships and Related Transactions

Except as concerns compensation to directors and officers, during the past two years, there have not been any transactions that have occurred between the Company and its officers, directors, and five percent or greater shareholders. Executive compensation and related party compensation are disclosed in the notes to the Company s financial statements included herein and in Executive Compensation above.

Certain of the officers and directors of the Company are engaged in other businesses, either individually or through partnerships and corporations in which they have an interest, hold an office, or serve on a board of directors. As a result, certain conflicts of interest may arise between the Company and its officers and directors. The Company will attempt to resolve such conflicts of interest in favor of the Company. The officers and directors of the Company are accountable to it and its shareholders as fiduciaries, which require that such officers and directors exercise good faith and integrity in handling the company s affairs. A shareholder may be able to institute legal action on behalf of the Company or on behalf of itself and other similarly situated shareholders to recover damages or for other relief in cases of the resolution of conflicts is in any manner prejudicial to the Company.

Item 13. Exhibits and Reports on Form 8-K

The exhibits to be filed with this Form 10-KSB are listed below in the Exhibit Index.

During the reporting period and subsequent to it but prior to the date of this Report, the Registrant filed three reports on Form 8-K on January 13 2006, June 19 2006, and August 30 2006 and one report on Form 8K subsequent to the year ended December 31 2006 on January 13 2007 on the SEC s EDGAR system available at www.sec.gov.

Item 14. Principal Accountant Fees and Services

As of the date of this Annual Report, the Company has not appointed members to an audit committee and, therefore, the respective role of an audit committee has been conducted by the board of directors of the Company. When established, the audit committee s primary function will be to provide advice with respect to the Company s financial matters and to assist the board of Directors in fulfilling its oversight responsibilities regarding finance, accounting, tax and legal compliance. The audit committee s primary duties and responsibilities will be to: (i) serve as an independent and objective party to monitor the Company s financial reporting process and internal control system; (ii) review and appraise the audit efforts of the Company s independent accountant s; (iii) evaluate the Company s quarterly financial performance as well as its compliance with laws and regulations; (iv) oversee management s establishment and enforcement of financial policies and business practices; and (v) provide an open avenue of communication among the independent accountants, management and the board of directors.

The board of directors has considered whether the regulatory provision of non-audit services is compatible with maintaining the principal independent accountant s independence.

Audit Fees

During the years ended December 31, 2006 and December 31, 2005, the Company will incur approximately $26,000 and has incurred $21,300, respectively, in fees to its principal independent accountants for professional services rendered in connection with the audits of the Company s financial statements. Included in these amounts are billing for other accounting services consisting solely of review of the Company s quarterly reports filed on Form 10-QSB for the periods ended March 31, June 30, and September 30.

Audit-related Fees

During the years ended December 31, 2006 and 2005, the Company did not incur any audit-related fees for professional services rendered by its principal independent accountant.

Tax Fees

During the years ended December 31, 2006 and 2005, the Company did not incur any fees for tax compliance, advisory or planning services rendered by its principal independent accountant.

During fiscal year ended December 31, 2006, the Company did not incur any fees for professional services rendered by its principal independent accountant for certain information technology services which may include, but is not limited to, operating or supervising or managing the Company s information or local area network or designing or implementing a hardware or software system that aggregate source data underlying the financial statements.

All Other Fees

During the years ended December 31, 2006 and 2005, the Company did not incur any other fees for professional services rendered by its principal independent accountant for all other non-audit services which may include, but is not limited to, tax-related services, actuarial services or valuation services.

EXHIBIT INDEX

Number	**Exhibit Description**
3.1	Articles of Incorporation (incorporated by reference to Exhibit 3.1 of the Registration Statement on Form 10SB filed on EDGAR on November 6, 2000)
3.2	Certificate of amendment to Aricles of Incorporation (incorporated by reference to Exhibit 3.2 on the report on Form 8-K filed on May 23, 2002
14.1	Code of Business Conduct
23.1	Consent of Auditor, Dale Matheson Carr-Hilton LaBonte LLP
31.1	Section 302 Certification of Chief Executive Officer
31.2	Section 302 Certification of Chief Financial Officer
32.1	Section 906 Certification of Chief Executive Officer
32.2	Section 906 Certification of Chief Financial Officer

SIGNATURE

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.

Dated: March 30, 2007 By: /s/ Patrick Fitzsimmons
Patrick Fitzsimmons, President and Director

In accordance with the Exchange Act, this report has been signed by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Dated: March 30, 2007 By: /s/ Griffin Jones
Griffin Jones, Director, Secretary,
Treasurer

Dated: March 30, 2007 By: /s/ Patrick Fitzsimmons
Patrick Fitzsimmons, President and Director

ALTERNET SYSTEMS, INC.
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ALTERNET SYSTEMS INC.

(A Development Stage Company)

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2006

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

CONSOLIDATED BALANCE SHEETS

CONSOLIDATED STATEMENTS OF OPERATIONS

CONSOLDIATED STATEMENT OF STOCKHOLDERS DEFICIT

CONSOLIDATED STATEMENTS OF CASH FLOWS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board of Directors of Alternet Systems Inc.

We have audited the accompanying consolidated balance sheets of Alternet Systems Inc. (a development stage company) as of December 31, 2006 and 2005 and the consolidated statements of operations, stockholders deficit and cash flows for the years then ended and the period from October 13, 2000 (inception) to December 31, 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2006 and 2005 and the results of its operations and its cash flows for the years ended December 31, 2006 and 2005 and the period from October 13, 2000 (inception) to December 31, 2006 in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the financial statements, the Company has not generated revenues since inception, has incurred losses in developing its business, and further losses are anticipated. The Company requires additional funds to meet its obligations and to fund the costs of its operations. These factors raise substantial doubt about the Company s ability to continue as a going concern. Management s plans in this regard are described in Note 1. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

“DMCL”

DALE MATHESON CARR-HILTON LABONTE LLP
CHARTERED ACCOUNTANTS

Vancouver, Canada
March 20, 2007

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ALTERNET SYSTEMS INC.

(A Development Stage Company)

CONSOLIDATED BALANCE SHEETS

	December, 31			
		2006		2005
ASSETS				
Current Assets				
Cash	$	2,527	$	5
Prepaid expenses		1,727		3,981
Total Current Assets		4,254		3,986
EQUIPMENT (Note 3)		10,625		12,598
TOTAL ASSETS	$	14,879	$	16,584
LIABILITIES				
Current Liabilities				
Accounts payable and accrued liabilities	$	215,884	$	177,163
Deferred license revenue		-		2,140
Due to related parties (Note 6)		10,250		5,299
TOTAL LIABILITIES		226,134		184,602
CONTINGENCIES (Notes 1 and 9)				
STOCKHOLDERS' DEFICIT				
Capital Stock (Note 5)				
Common stock, $0.00001 par value, 100,000,000 shares authorized				
47,556,428 (2005 29,947,428) issued and outstanding		477		301
Additional paid-in capital		4,513,639		3,014,635
Private placement subscriptions		175,122		161,808
Obligation to issue shares (Note 9)		-		26,000
Accumulated other comprehensive income		2,072		2,139
Deferred compensation (Note 7)		(528,972)		-
Deficit accumulated during the development stage		(4,373,593)		(3,372,901)
TOTAL STOCKHOLDERS' DEFICIT		(211,255)		(168,018)
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	$	14,879	$	16,584

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

ALTERNET SYSTEMS INC.

(A Development Stage Company)

CONSOLIDATED STATEMENTS OF OPERATIONS

	Year ended December 31, 2006	Year ended December 31, 2005	Results of Operations from October 13, 2000 (inception) to December 31, 2006
REVENUE			
License fees and hardware sales	$ 3,604	$ 15,027	$ 225,973
COST OF SALES			
Purchases	-	-	16,393
Royalties	-	2,697	29,233
Installation costs and other	-	-	58,127
	-	2,697	103,753
GROSS PROFIT	3,604	12,330	122,220
OPERATING EXPENSES			
Advertising and promotion	-	-	110,753
Bad debt	-	-	15,344
Commissions	-	-	13,439
Depreciation	3,932	4,369	44,153
License fees	-	-	696,000
Management and consulting (Note 6)	431,398	268,731	1,635,075
Marketing	436,175	258,316	1,459,393
Office and general	30,585	28,987	228,896
Professional fees	53,394	69,702	291,528
Rent	36,003	32,874	149,431
Telephone and utilities	7,693	8,617	41,718
Training and documentation	-	-	153,154
Travel	13,559	2,850	63,924
	1,012,739	674,446	4,902,808
LOSS FROM OPERATIONS	(1,009,135)	(662,116)	(4,780,588)
Gain on license settlement (Note 4)	-	398,552	398,552
Gain on settlement of lawsuit (Note 9)	8,443	-	8,443
NET LOSS	$ (1,000,692)	$ (263,564)	$ (4,373,593)
BASIC AND DILUTED NET LOSS PER SHARE	$ (0.03)	$ (0.01)	

WEIGHTED AVERAGE COMMON SHARES OUTSTANDING BASIC AND DILUTED	40,439,198	27,757,894

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

ALTERNET SYSTEMS INC.
(A Development Stage Company)
CONSOLIDATED STATEMENT OF STOCKHOLDERS DEFICIT
FOR THE PERIOD FROM OCTOBER 13, 2000 (INCEPTION) TO DECEMBER 31, 2006

	Number of shares	Amount	Additional paid-in capital	Obligation to issue shares	Private placement subscriptions	Deficit accumulated during development stage	Deferred compensation	Other comprehensive income (loss)	T
Issuance of common stock for cash at $.001 per share									
October 16, 2000	3,000	$ 3	$ -	$ -	$ -	$ -	$ -	$ -	$
Balance, December 31, 2000	3,000	3	-	-	-	-	-	-	
Issuance of common stock for cash at $.007 per share									
May 24, 2001	5,500,000	5,500	33,000	-	-	-	-	-	3
Issuance of common stock for cash at $.01 per share									
June 4, 2001	4,010,000	4,010	36,090	-	-	-	-	-	4
Issuance of common stock for cash at $.15 per share									
June 8, 2001	330,000	330	49,170	-	-	-	-	-	4
Issuance of common stock for license agreement at $.01 per share June 29, 2001 (Note 4)	2,500,000	2,500	22,500	-	-	-	-	-	2
Schoolweb Holdings Inc. balance before reverse acquisition	12,343,000	12,343	140,760	-	-	-	-	-	15

Schoolweb Systems Inc. balance before reverse acquisition (Note 5)	1,350,000	14	19	-	-	(7,937)	-	-	
Issued to effect reverse acquisition	12,343,000	123	(123)	-	-	-	-	-	
Reverse acquisition recapitalization adjustment	(12,343,000)	(12,343)	4,406	-	-	7,937	-	-	
Schoolweb Systems Inc. balance after reverse acquisition	13,693,000	137	145,062	-	-	-	-	-	14
Issuance of common stock for license agreement at $.01 per share September 10, 2001	500,000	5	4,995	-	-	-	-	-	
Issuance of common stock for cash at $.10 per share September 11, 2001	100,000	1	9,999	-	-	-	-	-	
Issuance of common stock for cash at $.10 per share November 5, 2001	50,000	1	4,999	-	-	-	-	-	
Issuance of common stock for cash at $.15 per share November 8, 2001	15,000	-	2,250	-	-	-	-	-	
Issuance of common stock for cash at $.20 per share November 24, 2001	375,000	3	74,997	-	-	-	-	-	

Foreign exchange translation adjustment	-	-	-	-	-	-	-	(1,950)	
Net loss for the year ended December 31, 2001	-	-	-	-	-	(263,249)	-	-	(26
Balance, December 31, 2001	14,733,000	$ 147	$ 242,302	$ -	$ -	$ (263,249)	-	$ (1,950)	$ (2

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

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ALTERNET SYSTEMS INC.
(A Development Stage Company)
CONSOLIDATED STATEMENT OF STOCKHOLDERS DEFICIT
FOR THE PERIOD FROM OCTOBER 13, 2000 (INCEPTION) TO DECEMBER 31, 2006

	Number of shares	Amount	Additional paid-in capital	Obligation to issue shares	Private placement subscriptions	Deficit accumulated during development stage	Deferred compensation	Other comprehensive income (loss)	Tot
Balance, December 31, 2001	14,733,000	$ 147	$ 242,302	$ -	$ -	$ (263,249)	$ -	$ (1,950)	$ (22,
Issuance of common stock for cash at $.20 per share March 1, 2002	510,000	5	101,995	-	-	-	-	-	102,
Issuance of common stock for cash at $.35 per share March 15, 2002	100,000	1	34,999	-	-	-	-	-	35,
Issuance of common stock for cash at $.35 per share April 30, 2002	140,000	1	48,999	-	-	-	-	-	49,
Issuance of common stock for cash at $.35 per share June 27, 2002	97,371	1	34,079	-	-	-	-	-	34,
Issuance of common stock for cash at $.35 per share July 8, 2002	49,143	1	17,199	-	-	-	-	-	17,

Issuance of common stock for debt at $.35 per share - September 11, 2002	228,571	2	79,998	-	-	-	-	-	80,
Issuance of common stock for cash at $.35 per share October 9, 2002	193,000	2	67,548	-	-	-	-	-	67,
Issuance of common stock for cash at $.35 per share December 16, 2002	93,000	1	32,549	-	(5,250)	-	-	-	27,
Private placement subscriptions received	-	-	-	-	8,900	-	-		8,
Foreign exchange translation adjustment	-	-	-	-	-	-	-	2,683	2,
Net loss for the year ended December 31, 2002	-	-	-	-	-	(511,157)	-	-	(511,
Balance, December 31, 2002	16,144,085	161	659,668	-	3,650	(774,406)	-	733	(110,
Issuance of common stock for cash at $.35 per share March 20, 2003	165,944	2	58,078	-	(3,650)	-	-	-	54,
Issuance of common stock for services at $.24 per share May 29, 2003	100,000	1	23,999	-	-	-	-	-	24,

Issuance of common stock for services at $.34 per share June 10, 2003	300,000	3	101,156	-	-	-	-	-	101,
Issuance of common stock for services at $.35 per share June 10, 2003	180,000	2	62,998	-	-	-	-	-	63,
Issuance of common stock for services at $.20 per share June 10, 2003	60,000	1	12,399	-	-	-	-	-	12,
Issuance of common stock for services at $.35 per share October 27, 2003	100,000	1	34,999	-	-	-	-	-	35,
Issuance of common stock for services at $.26 per share October 27, 2003	350,000	4	90,996	-	-	-	-	-	91,
Subtotal	17,400,029	$ 175	$ 1,044,293	$ -	$ -	$ (774,406)	$ -	$ 733	$ 270,

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

ALTERNET SYSTEMS INC.
(A Development Stage Company)
CONSOLIDATED STATEMENT OF STOCKHOLDERS DEFICIT
FOR THE PERIOD FROM OCTOBER 13, 2000 (INCEPTION) TO DECEMBER 31, 2006

	Number of shares	Amount	Additional paid-in capital	Obligation to issue shares	Private placement subscriptions	Deficit accumulated during development stage	Deferred compensat-ion	Other compre-hensive income (loss)	To
Balance forward	17,400,029	$ 175	$ 1,044,293	$ -	$ -	$ (774,406)	$ -	$ 733	$ 27
Private placement subscriptions received	-	-	-	-	365,921	--	-	-	36
Obligation to issue shares for services rendered	-	-	-	553,720	-	-	-	-	55
Foreign exchange translation adjustment	-	-	-	-	-		-	(7,202)	(
Net loss for the year ended December 31, 2003	-	-	-	-	-	(1,706,867)	-	-	(1,70
Balance, December 31, 2003	17,400,029	175	1,044,293	553,720	365,921	(2,481,273)	-	(6,469)	(52
Private placement subscriptions received	-	-	-	-	360,054	-	-		36
Issuance of common stock for services January 6, 2004	1,785,000	18	466,302	(466,320)	-	-	-	-	
Issuance of common stock for cash at $.15 per share May 17,									

2004	4,041,499	40	606,185	-	(606,225)	-	-	-	
Issuance of common stock for services at $.11 per share June 10, 2004	1,500,000	15	164,985	-	-	-	-	-	16
Issuance of common stock for services August 30, 2004	407,000	4	91,876	(61,400)	-	-	-	-	
Issuance of common stock for services at $.10 per share August 30, 2004	24,000	1	2,400	-	-	-	-	-	
Issuance of common stock for cash at $.15 per share October 25, 2004	621,900	6	93,279	-	(69,500)	-	-	-	2
Obligation to issue shares for services rendered	-	-	-	11,150	-	-	-	-	4
Foreign exchange translation adjustment	-	-	-	-	-	-	-	5,912	
Net loss for the year ended December 31, 2004	-	-	-	-	-	(628,064)	-	-	(62
Balance, December 31, 2004	25,779,428	259	2,469,320	37,150	50,250	(3,109,337)	-	(557)	(55
Issuance of common stock for services at									

$.20 per share January 5, 2005	70,000	1	13,999	-	-	-	-	-	1
Issuance of common stock for services at $0.10 per share May 2, 2005	1,000,000	10	94,990	-	-	-	-	-	9
Issuance of common stock for debt settlement at $0.08 per share May 4, 2005	200,000	2	15,998	-	-	-	-	-	1
Issuance of common stock for debt settlement at $0.08 per share May 4, 2005	200,000	2	16,156	-	-	-	-	-	1
Issuance of common stock for services at $0.14 per share June 15, 2005	500,000	5	67,495	-	-	-	-	-	6
Issuance of common stock for services at $0.14 per share June 15, 2005	500,000	5	67,495	-	-	-	-	-	6
Issuance of common stock for services at $0.15 per share July 15, 2005	250,000	2	38,498	-	-	-	-	-	3
Issuance of common stock for									

services at $0.15 per share July 15, 2005	110,000	1	15,949	-	-	-	-	-	1
Subtotal	28,609,428	$ 287	$ 2,799,900	$ 37,150	$ 50,250	$ (3,109,337)	$ -	$ (557)	$ (22

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

ALTERNET SYSTEMS INC.
(A Development Stage Company)
CONSOLIDATED STATEMENT OF STOCKHOLDERS   DEFICIT
FOR THE PERIOD FROM OCTOBER 13, 2000 (INCEPTION) TO DECEMBER 31, 2006

	Number of shares	Amount	Additional paid-in capital	Obligation to issue shares	Private placement subscriptions	Deficit accumulated during development stage	Deferred compensat-ion	Other compre-hensive income (loss)	To
Balance forward	28,609,428	$ 287	$ 2,799,900	$ 37,150	$ 50,250	$ (3,109,337)	$ -	$ (557)	$ (222
Issuance of common stock for services at $0.14 per share									
August 16, 2005	200,000	2	26,998	-	-	-	-	-	27
Issuance of common stock for services at $0.15 per share									
September 23, 2005	300,000	3	44,997	-	-	-	-	-	45
Issuance of common stock for debt settlement at $0.15 per share									
October 7, 2005	65,000	1	9,749	-	-	-	-	-	9
Issuance of common stock for debt settlement at $0.16 per share									
October 7, 2005	100,000	1	15,999	-	-	-	-	-	16
Issuance of common stock for services at $0.16 per share									

October 10, 2005	50,000	1	7,999	-	-	-	-	-	8
Issuance of common stock for services at $0.18 per share									
October 10, 2005	150,000	1	26,998	-	-	-	-	-	26
Issuance of common stock for services at $0.22 per share									
October 20, 2005	60,000	1	13,199	-	-	-	-	-	13
Issuance of common stock for services at $0.16 per share									
December 4, 2005	240,000	2	38,798	-	-	-	-	-	38
Issuance of common stock for services at $0.15 per share									
December 4, 2005	200,000	2	29,998	-	-	-	-	-	30
Obligation to issue shares for services rendered	-	-	-	(11,150)	-	-	-	-	(11
Private placement subscriptions received	-	-	-	-	111,558	-	-	-	111
Foreign exchange translation adjustment	-	-	-	-	-	-	-	2,696	2
Net loss for the year	-	-	-	-	-	(263,564)	-	-	(263
Balance, December 31,	29,974,428	301	3,014,635	26,000	161,808	(3,372,901)	-	2,139	(168

2005									
Issuance of common stock for services at $0.09 per share									
January 11, 2006	990,000	10	89,090	-	-	-	-	-	89
Issuance of common stock for cash at $0.05 per share									
February 20, 2006	1,285,000	13	64,237	-	(64,250)	-	-	-	
Issuance of common stock for cash at $0.05 per share									
February 20, 2006	1,554,000	15	77,685	-	(77,700)	-	-	-	
Issuance of common stock for cash at $0.05 per share									
February 20, 2006	500,000	5	24,995	-	(25,000)	-	-	-	
Issuance of common stock for cash at $0.05 per share									
February 20, 2006	645,000	6	32,244	-	(32,250)	-	-	-	
Issuance of common stock for cash at $0.05 per share									
February 20, 2006	1,523,000	15	76,135	-	(76,150)	-	-	-	
Subtotal	36,471,428	$ 365	$ 3,379,021	$ 26,000	$ (113,542)	$ (3,372,901)	$ -	$ 2,139	$ (789

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

ALTERNET SYSTEMS INC.
(A Development Stage Company)
CONSOLIDATED STATEMENT OF STOCKHOLDERS DEFICIT
FOR THE PERIOD FROM OCTOBER 13, 2000 (INCEPTION) TO DECEMBER 31, 2006

	Number of shares	Amount	Additional paid-in capital	Obligation to issue shares	Private placement subscriptions	Deficit accumulated during development stage	Deferred compensation	Other comprehensive income (loss)	T
Balance forward	36,471,428	$ 365	$ 3,379,021	$ 26,000	$ (113,542)	$ (3,372,901)	$ -	$ 2,139	$ (7
Issuance of common stock for cash at $0.05 per share									
February 20, 2006	258,000	3	12,897	-	(12,900)	-	-	-	
Issuance of common stock for debt settlement at $0.175 per									
share May 15, 2006	80,000	1	13,999	-	-	-	-	-	
Issuance of common stock for cash at $0.05 per share June 1,									
2006	1,500,000	15	74,985	-	(75,000)	-	-	-	
Issuance of common stock for cash at $0.05 per share June 1,									
2006	300,000	3	14,997	-	(15,000)	-	-	-	
Issuance of common stock for cash at $0.05 per share June 1,									
2006	1,460,000	15	72,985	-	(73,000)	-	-	-	
Issuance of common stock for cash at $0.05 per share June 1,									

2006	1,430,000	14	71,486	-	(71,500)	-	-	-
Issuance of common stock for services at $0.18 per share								
August 4, 2006	1,000,000	10	179,990	-	-	-	(105,000)	-
Issuance of common stock for services at $0.18 per share								
August 4, 2006	1,000,000	10	179,990	-	-	-	(105,000)	-
Issuance of common stock for services at $0.18 per share								
August 4, 2006	1,000,000	10	179,990	-	-	-	(105,000)	-
Issuance of common stock for services at $0.17 per share								
August 30, 2006	200,000	2	33,998	-	-	-	-	-
Stock-based compensation (Note 5)	-	-	11,920		-	-	-	-
Issuance of common stock for debt settlement at $0.13 per share								
October 25, 2006	57,000	1	7,409	-	-	-	-	-
Issuance of common stock for debt settlement at $0.10 per share								
October 25, 2006	100,000	1	9,999	-	-	-	-	-
Exercise of stock options at $0.10 per	200,000	2	19,998	-	-	-	-	-

share October 25, 2006									
Issuance of common stock for services at $0.10 per share									
October 30, 2006	2,000,000	20	199,980	-	-	-	(165,479)	-	
Issuance of common stock for services at $0.10 per share									
December 22, 2006	500,000	5	49,995	-	-	-	(48,493)	-	
Private placement subscriptions received	-	-	-	-	536,064	-	-	-	5
Foreign exchange translation adjustment	-	-	-	-	-	-	-	(67)	
Settlement of lawsuit (Note 9)			-	(26,000)	-	-	-	-	(
Net loss for the year	-	-	-	-	-	(1,000,692)	-	-	(1,0
Balance, December 31, 2006	47,556,428 $	477 $	4,513,639 $	- $	175,122 $	(4,373,593)$	(528,972)$	2,072 $	(2

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

ALTERNET SYSTEMS INC.

(A Development Stage Company)

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year ended December 31, 2006	Year ended December 31, 2005	October 13, 2000 (inception) to December 31, 2006
OPERATING ACTIVITIES			
Net loss	$ (1,000,692)	$ (263,564)	$ (4,373,593)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation	3,932	4,369	44,153
Gain on disposal of assets	-	-	(215)
Gain on settlement of debt	-	(398,552)	(398,552)
Issuance of shares for services rendered (Note 7)	384,128	487,450	1,457,417
Obligation to issue shares for services rendered	-	(11,150)	492,320
Stock-based compensation	11,920	-	11,920
Gain on settlement of lawsuit	(8,443)	-	(8,443)
Changes in operating assets and liabilities:			
Prepaid expenses	2,254	-	(1,727)
Deferred license revenue	(2,140)	(8,254)	-
Accounts payable and accrued liabilities	52,574	95,904	762,056
Net cash used in operating activities	(556,467)	(93,797)	(2,014,664)
INVESTING ACTIVITIES			
Acquisition of equipment	(1,959)	(3,628)	(24,564)
Cash acquired on reverse acquisition of SchoolWeb	-	-	74
Net cash used in investing activities	(1,959)	(3,628)	(24,490)
FINANCING ACTIVITIES			
Advances (to) from related parties	4,951	(16,854)	6,412
Net proceeds on sale of common stock and subscriptions	556,064	111,558	2,033,194
Net cash provided by financing activities	561,015	94,704	2,039,606
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(67)	2,696	2,072
NET INCREASE (DECREASE) IN CASH	2,522	(25)	2,524
CASH, BEGINNING	5	30	3
CASH, ENDING	$ 2,527	$ 5	$ 2,527

SUPPLEMENTAL CASH FLOW INFORMATION AND NON-CASH TRANSACTIONS:

Cash paid for:

Interest	$ -	$ -	$ -
Income taxes	$ -	$ -	$ -

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

ALTERNET SYSTEMS INC.
(A Development Stage Company)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006

NOTE 1 NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Alternet Systems Inc. (Alternet or the Company) is in the development stage of operations which includes the design, marketing and ales of proprietary software and hardware systems known as SchoolWeb and CommunityWeb . The Company s products provide high speed Internet access to schools and rural communities, in North America and internationally.

The consolidated 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 December 31, 2006, the Company had a working capital deficiency of $221,880. The Company has incurred losses since inception and further losses are anticipated in the development of its products raising substantial doubt as to the Company s ability to continue as a going concern. 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. It is management's intention to continue to pursue market acceptance for its proprietary software and hardware systems technology, to settle its outstanding debts and to identify funding sources until such time that there is sufficient operating cash flow to fund operating requirements. Funding for continuing operations will be pursued on a private placement basis with qualified investors in applicable US states and Canada.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

Principles of Consolidation
The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, AI Systems Group, Inc. and AI Systems Group (Canada) Ltd. 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.

License Rights
The Company amortizes the cost of acquiring license rights on a straight-line basis over the term of the license. The Company evaluates the carrying amount of its unamortized license rights against the undiscounted future anticipated cash flows associated with them. If the evaluation indicates that the future undiscounted cash flows are not sufficient to recover the carrying value, an impairment provision is recorded to adjust the carrying value of the license rights to their fair value. During 2003 management determined that based on evaluation there was no reliable basis for estimating new cash flows from the license and the Company wrote off the carrying balance of the AII license.

Equipment

Equipment is recorded at cost and depreciated at the following rates:

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

ALTERNET SYSTEMS INC.
(A Development Stage Company)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

Revenue Recognition
The Company licenses its SchoolWeb system on a prepaid basis for terms ranging from one to three years. The Company recognizes license revenues on a straight-line basis over the license term upon completion of the required hardware and software installations and upon acceptance by the purchasers, subject to collection being reasonably assured. License fees paid in advance are recorded as deferred revenue.

The Company has generated revenues from hardware sales in connection with the testing of the SchoolWeb system. Hardware sales are recognized upon completion and acceptance of installation by the purchasers and when collection is reasonably assured.

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, Disclosures about Fair Value of Financial Instruments , 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.

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. Results for prior periods have not been restated.

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.

The Company had not granted any options to December 31, 2005; therefore, no pro-forma disclosures are required.

ALTERNET SYSTEMS INC.
(A Development Stage Company)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006

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, it did not include common equivalent shares in the computation of diluted net loss per share because the effect would be anti-dilutive.

Risk Management
As the Company had no customers in the current year, the Company was not exposed to significant credit concentration. The Company is not exposed to significant interest rate risk.

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 February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments-an amendment of FASB Statements No. 133 and 140 , to simplify and make more consistent the accounting for certain financial instruments. SFAS No. 155 amends SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, to permit fair value remeasurement for any hybrid financial instrument with an embedded derivative that otherwise would require bifurcation, provided that the whole instrument is accounted for on a fair value basis. SFAS No. 155 amends SFAS No. 140, Accounting for the Impairment or Disposal of Long-Lived Assets, to allow a qualifying special-purpose entity to hold a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS No. 155 applies to all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006, with earlier application allowed. This standard is not expected to have a significant effect on the Company s reported financial position or results of operations.

In March 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets . The Standard, which is an amendment to FAS No. 140, will simplify the accounting for servicing assets and liabilities, such as those common with mortgage securitization activities. The new Standard addresses the recognition and measurement of separately recognized servicing assets and liabilities and provides an approach to simplify efforts to obtain hedge-like (offset) accounting. This standard is not expected to have a significant effect on the Company s reported financial position or results of operations.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements , is effective for financial statements issued for fiscal years beginning after November 15, 2007. Under the standard, fair value refers to the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts. The standard clarifies the principle that fair value should be based on the assumptions market participants would use when pricing the asset or liability. In support of this principle, the standard establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data, for example, the reporting entity s own data. Under the standard, fair value measurements would be separately disclosed by level within the fair value hierarchy. This standard is not expected to have a significant effect on the Company s reported financial position or results of operations.

In September 2006, the FASB issued SFAS No. 158, Employer s Accounting for Defined Benefit Pension and Other Postretirement Plans . The standard requires an employer to recognize in its statement of financial position an asset for a plan s overfunded status or a liability for a plan s underfunded status; to measure a plan s assets and its obligations that determine its funded status as of the end of the employer s fiscal year (with limited exceptions), and to recognize changes in the funded status of a defined benefit postretirement plan in the year in which the changes occur. Those changes will be reported in comprehensive income of a business entity and in changes in net assets of a not-for-profit organization. This standard is not expected to have a significant effect on the Company s reported financial position or results of operations.

ALTERNET SYSTEMS INC.
(A Development Stage Company)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Recent Accounting Pronouncements (continued)

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities . The standard requires companies to provide additional information that will help investors and other users of financial statements to more easily understand the effect of the company s choice to use fair value on its earnings. It also requires entities to display the fair value of those assets and liabilities for which the company has chosen to use fair value on the face of the balance sheet. The new Statement does not eliminate disclosure requirements included in other accounting standards, including requirements for disclosures about fair value measurements included in FASB Statements No. 157, Fair Value Measurements , and No. 107, Disclosures about Fair Value of Financial Instruments . This standard is not expected to have a significant effect on the Company s reported financial position or results of operations.

NOTE 3 - EQUIPMENT

	2006			2005
	Cost	Accumulated depreciation	**Net Book Value**	Net Book Value
Computer equipment	$ 16,768	$ 9,612	**$ 7,156**	$ 7,845
Computer software	4,684	2,348	**2,336**	3,337
Equipment	1,967	834	**1,133**	1,416
	$ 23,419	$ 12,794	**$ 10,625**	$ 12,598

NOTE 4 - LICENSE SETTLEMENT

By agreement dated January 1, 2001, AI Systems entered into an agreement with Advanced Interactive Inc. (AII) whereby AI Systems acquired exclusive and non-exclusive rights and licenses to commercialize, distribute and market AII technology, products and services in the United States and Canada for a period of five years, renewable for a further five years at SW Holdings option. On October 14, 2003, AI Systems terminated its software license agreement (the "License Agreement") with AII. The License Agreement was terminated for a number of reasons including the failure by AII to grant to AI Systems North American exclusivity for technologies and software licensed under the License Agreement.

On July 15, 2005, the Company executed a settlement agreement with AII and all other parties to the License Agreement, whereby the parties agreed to settle all outstanding issues related to court proceedings brought by the Company against AII and any counter claims by AII. The terms of settlement included the mutual full and final release of all outstanding debts, liabilities and obligations outstanding, a three year option whereby the Company or its nominees may acquire a total of 3,228,571 shares of the Company s stock held by AII for $10,000, and the retention by the Company of the software, code, trademarks and intellectual property relating to SchoolWeb and CommunityWeb. As at the date of the settlement agreement the Company had accrued license fees of $386,162 and royalties of $21,390 in respect of the License Agreement. As a result of this settlement the Company was not required to pay these amounts and has therefore recognized a gain in the amount of $407,552 in the year ended December 31,2005. The amount was offset by $9,000 due to a loss recorded by settling $7,000 of debt for shares valued at $16,000, resulting in a net gain of $398,552.

The Company has developed its own proprietary software and continues to market SchoolWeb and CommunityWeb in North America and internationally.

ALTERNET SYSTEMS INC.
(A Development Stage Company)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006

NOTE 5 CAPITAL STOCK

During the year ended December 31, 2006, the Company filed an application under the registration exemptions available in Regulation D and Regulation S of the Securities Exchange Act of 1933, to sell up to 12,000,000 shares of its common stock at a price of $0.05 per share of common stock. On February 20, 2006, the Company completed a private placement of 5,765,000 common shares at a price of $0.05 per share for total proceeds of $288,250 under these exemptions of which $161,808 was received during 2005. On June 1, 2006, the Company completed another private placement of 4,690,000 common shares at a price of $0.05 per share for total proceeds of $234,500 under these exemptions.

During the year ended December 31, 2006, the Company issued 6,690,000 common shares valued at $913,100 for services to be provided pursuant to contracts entered into during 2006 and 237,000 common shares for settlement of debt valued at $31,410. During the year ended December 31, 2006, $384,128 of the services were charged to operations and the unamortized portion of the deferred compensation totalling $528,972 at December 31, 2006 will be amortized over the remaining term of the contacts. (refer to Note 7).

The Company has received $175,122 in respect of a further private placement of common stock at a price of $0.05 per share. These shares were not issued at December 31, 2006 and this amount is reported as private placement subscriptions within stockholders deficit.

Effective March 1, 2003, the Company adopted a Retainer Stock Plan for Employees, Directors and Consultants (the 2003 Plan) for the purpose of providing the Company with the means to compensate employees, directors and consultants for their efforts in furthering the business development of the Company. The 2003 Plan allows for direct awards of common stock as a reward or incentive to employees or as consideration to directors or consultants for their services. A total of 5,000,000 common shares may be awarded under this plan. The 2003 Plan will terminate February 29, 2008. The Company filed a Registration Statement on Form S-8 to cover the 2003 Plan. To date, 4,876,000 common shares valued at $1,066,160 relating to services provided in 2003, 2004 and 2005 have been awarded leaving a balance of 124,000 shares which maybe awarded under this plan.

Effective January 21, 2005 the Company adopted a Retainer Stock Plan for Employees, Directors and Consultants (the 2005 Plan) for the purpose of providing the Company with the means to compensate employees, directors and consultants for their efforts in furthering the business development of the Company. The 2005 Plan allows for direct awards of common stock as a reward or incentive to employees or as consideration to directors or consultants for their services. A total of 5,000,000 common shares may be awarded under this plan. The 2005 Plan will terminate January 21, 2010. The Company filed a Registration Statement on Form S-8 to cover the 2005 Plan. To date, 4,750,000 common shares valued at $596,550 relating to services provided have been awarded leaving a balance of 250,000 shares which maybe awarded under this plan.

Effective May 3, 2006 the Company adopted a Retainer Stock Plan for Employees, Directors and Consultants (the 2006 Plan) for the purpose of providing the Company with the means to compensate employees, directors and consultants for their efforts in furthering the business development of the Company. The 2006 Plan allows for direct awards of common stock as a reward or incentive to employees or as consideration to directors or consultants for their services. A total of 6,000,000 common shares may be awarded under this plan. The 2006 Plan will terminate April 23, 2011. The Company filed a Registration Statement on Form S-8 to cover the 2006 Plan. To date, 5,500,000 common shares valued at $790,000 relating to services provided or to be provided have been awarded under this plan.

Stock Options

To December 31, 2005, the Company had not granted any stock options although shareholders approved a stock option plan (the "Option Plan") for 3,000,000 incentive stock options at its annual meeting of shareholders held on May 31, 2004. Options under the Option Plan, when granted, can be for a term of up to five years at an exercise price to be determined by the Directors.

On October 20, 2006, the Company granted a total of 200,000 stock options to a consultant at an exercise price of $0.10 per common share under the 2006 Plan. These options vested immediately and expire on September 18, 2007. The Company estimated the fair value of stock options by applying the fair value method using the Black-Scholes option pricing model using an expected life of one year, a risk-free interest rate of 5.35% and an expected volatility of 113% resulting in a stock based compensation expense of $11,920. All of the stock options were exercised on October 25, 2006.

ALTERNET SYSTEMS INC.
(A Development Stage Company)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006

NOTE 5 CAPITAL STOCK (continued)

A summary of the stock options are as follows:

	2006	
	Number of Options	Exercise Price
Opening balance	-	$ -
Granted during the year	200,000	0.10
Exercised during the year	(200,000)	-
Closing balance	-	$ -

Option pricing models require the input of highly subjective assumptions including their life and expected price volatility. Changes in these subjective input assumptions can materially affect the fair value estimate, and therefore the existing models do not necessarily provide a reliable measure of the fair value of the Company s share purchase options.

There were no warrants outstanding at December 31, 2006 or December 31, 2005.

NOTE 6 RELATED PARTY TRANSACTIONS

At December 31, 2006, a total of $10,250 (December 31, 2005 - $5,299) was owed to directors. Amounts due to related parties are unscured, non-interest bearing and have no specific terms of repayment.

The following amounts were incurred to directors and officers of the Company or its subsidiary, a company with a director in common and a company controlled by a shareholder of the Company.

	Year ended December 31, 2006	Year ended December 31, 2005
Management and consulting	$ 169,049	$ 9,250
Marketing	227,216	21,085
	$ 396,265	$ 30,335

Of the amounts above, $171,265 was paid in cash and $225,000 was paid by way of common shares for services Refer to Note 7.

NOTE 7 DEFERRED COMPENSATION

On August 1, 2006, the Company entered into an agreement with three consultants who are also directors of the Company for a one-year term agreement whereby the consultants will provide marketing services to the Company (valued at $540,000 in aggregate) in exchange for 3,000,000 shares of the Company s common stock which were issued on August 4, 2006. The consultants will provide such services as developing sales channels of the Company s products, developing international marketing plans and maintaining customer relations and reporting to the Company s board of directors as determined by the board.

On August 15, 2006, the Company entered into an agreement with a consultant for a one-year term agreement whereby the consultant will provide marketing services to the Company (valued at $34,000) in exchange for 200,000 shares of the Company s common stock which were issued on August 30, 2006. The consultants will provide such services as developing sales channels of the Company s products, developing marketing plans and maintaining customer relations and reporting to the Company s board of directors as determined by the board.

ALTERNET SYSTEMS INC.
(A Development Stage Company)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006

NOTE 7 DEFERRED COMPENSATION (continued)

On October 30, 2006, the Company entered into an agreement with a consultant for a one-year term agreement whereby the consultant will provide marketing services to the Company (valued at $200,000) in exchange for 2,000,000 shares of the Company s common stock which were issued on October 30, 2006. The consultants will provide such services as developing sales channels of the Company s products, developing marketing plans and maintaining customer relations and reporting to the Company s board of directors as determined by the board.

On December 20, 2006, the Company entered into an agreement with a consultant for a one-year term agreement whereby the consultant will provide marketing services to the Company (valued at $50,000) in exchange for 500,000 shares of the Company s common stock which were issued on December 22, 2006. The consultants will provide such services as developing sales channels of the Company s products, developing marketing plans and maintaining customer relations and reporting to the Company s board of directors as determined by the board.

The Company recorded the fair value of the shares issued 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 year the company amortized $186,028 of deferred compensation to management and consulting fees and $109,000 to marketing expense.. At December 31, 2006, the unamortized portion of the deferred compensation totalled $528,972 of which $315,000 was incurred to directors of the Company.

NOTE 8 INCOME TAXES

The parent Company is subject to income taxes in the United States while its subsidiaries are subject to income taxes in Canada. U.S. federal net operating loss carryforwards of approximately $4,432,000, if not utilized to offset taxable income in future periods, expire between 2016 and 2026. Canadian net operating losses of approximately $4,000, if not utilized to offset taxable income in future periods, expire commencing in 2008. Management believes that the realization of the benefits from these deferred tax assets is uncertain and. accordingly, a full deferred tax asset valuation allowance has been provided and no deferred tax asset benefit has been recorded.

The significant components of the Company s net deferred tax assets are as follows:

		Year ended December 31, 2006		Year ended December 31, 2005
Tax benefit relating to net operating losses	$	1,485,000	$	1,178,000
Valuation allowance		(1,485,000)		(1,178,000)
Net deferred tax assets	$	Nil	$	Nil

NOTE 9 SETTLEMENT OF LAWSUIT

On March 14, 2005, Native Investment and Trade Association (plaintiff) filed a Writ of Summons and Statement of Claim for non-payment of services provided. The matter was ultimately decided on by the Supreme Court of British Columbia on February 6, 2007 awarding to the plaintiff, a total of $54,317 in damages, court interest and court costs in addition to a specific performance of the obligation to issue 100,000 free standing shares of the Company (previously recorded at a value of $26,000). As a result of the settlement, the Company recorded a net gain of $8,443.

NOTE 10 SUBSEQUENT EVENTS

Effective January 8, 2007, the Company adopted a Retainer Stock Plan for Employees, Directors and Consultants (the 2007 Plan) for the purpose of providing the Company with the means to compensate employees, directors and consultants for their efforts in furthering the business development of the Company. The 2007 Plan allows for direct awards of common stock as a reward or incentive to employees or as consideration to directors or consultants for their services. A total of 10,000,000 common shares may be awarded under this plan. The 2007 Plan will terminate on February 15, 2012. The Company filed a Registration Statement on Form S-8 to register the underlying shares included in the 2007 Plan.