ALTERNET SYSTEMS INC
Form 10KSB/A
January 05, 2007

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

FORM 10-KSB/A
Amendment No. 1

(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, 2005**

¨ 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 36,729,428 shares of voting stock of the registrant issued and outstanding as of March 27, 2006, 29,820,428 shares are held by non-affiliates.

The aggregate market value of the voting stock held by non-affiliates of the registrant as of December 30, 2005 was approximately $3,280,247 based upon the closing price per share of the registrant's common shares of $0.11 on that date.

The issuer had revenues of $15,027 for the fiscal year ended December 31, 2005.

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, 2005
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.

AI Systems Group, Inc., the wholly owned subsidiary of the Company, was incorporated in the State of Nevada on October 13, 2000 under the name of Alternet Systems, Inc. On January 1, 2001 it entered into a software license agreement (the "License Agreement") with Advanced Interactive Inc. and its subsidiary, Advanced Interactive (Canada) Inc. (collectively, "AII"). On July 3, 2001 the company's name was changed to "SchoolWeb Holdings Inc.". In June of 2002, the company's name was changed to "AI Systems Group, Inc.", its present name.

On July 2, 2001, the Company entered into an agreement (the "Share Exchange Agreement") to purchase all of the 12,343,000 outstanding shares of common stock of SchoolWeb Holdings Inc. in exchange for 12,343,000 shares of common stock of the Company, in a transaction in which the Company was the surviving corporation. The 12,343,000 shares of common stock represented approximately 86% of the issued and outstanding shares of common stock as of December 31, 2001.

Under the terms of the Share Exchange Agreement, AII, which had licensed software to SchoolWeb under the terms of a software license agreement (the "License Agreement") dated January 1, 2001 as amended June 29, 2001 and September 10, 2001, acquired a total of 3,000,000 shares of common stock upon closing of the Share Exchange Agreement.

As a result of the closing of the Share Exchange Agreement, Mr. Michael Dearden and Mr. Griffin Jones, who were concurrently appointed as Directors, acquired 17.85% and 17.84% of the issued and outstanding, at the time, shares of common stock respectively.

A copy of the Share Exchange Agreement was filed as an exhibit to the report on Form 8-K dated September 10, 2001 and is incorporated in its entirety herein. A copy of the License Agreement dated January 1, 2001 and amendment dated June 29, 2001 and the Settlement Agreement dated September 10, 2001 are filed as exhibits to the report on Form 8-K dated September 10, 2001 and are incorporated in their entirety herein.

Michael Dearden, Greg Protti, Patrick Fitzsimmons, Brandon Douglas, Griffin Jones and Karim Lakhani were appointed to the board of directors of the Company when the Company purchased AI Systems Group, Inc.

Alternet Systems, Inc. distributes, markets and sells Internet access systems and software, marketed under the names "SchoolWeb Systems" and "Community Link".

In the fall of 2001, Hewlett Packard (Canada) expressed an interest in acquiring from the Company some or all of its rights under the License Agreement. On March 3, 2003 Hewlett Packard (Canada) and AII entered into an agreement (the Hewlett Packard Agreement) where Hewlett Packard agreed to market and distribute the software which Alternet had licensed from AII under the License Agreement.

Because of the distribution capacity of Hewlett Packard (Canada), and the relative lack of distribution and sales capacity of the Company, management of the Company believed it to be in the Company s best interest to consent to the Hewlett Packard Agreement. In exchange for Hewlett Packard (Canada) s agreement to market and distribute the Licensed Technology, the Company and AII agreed to use Hewlett Packard hardware whenever sales of the Licensed Technology were made (provided that Hewlett Packard was able to provide the hardware).

The Company and AII also agreed to give Hewlett Packard Finance (a division of Hewlett Packard) the right of first refusal to provide lease financing for sales of the Licensed Technology (by the Company or any other party). The agreement with Hewlett Packard expired on March 3, 2003 and the Company no longer has any agreement, directly or through AII, with Hewlett Packard.

Alternet licensed the SchoolWeb Technology from Advanced Interactive Inc. ("AII") under the terms of a license agreement (the "License Agreement") which had a term commencing on January 1, 2001. The President and director of AII and AIC became a director of the Company under the terms of this License Agreement.

The License Agreement granted Alternet and its subsidiary, AI Systems Group, Inc., for a term of five (5) years renewable for an additional five (5) years, the exclusive right to distribute, market, sell and sub-license the Licensed Technology in the US and Canada for educational related purposes and granted SchoolWeb Holdings Inc., for a period of five (5) years renewable for an additional five (5) years, the non-exclusive worldwide right to distribute, market, sell and license the "OfficeServer" portion of the Licensed Technology. Under the terms of the License Agreement, SchoolWeb Holdings Inc. was to pay to AII the sum of $10,000 per month in year one, $20,000 per month in year two and increased payments in subsequent years. AII also was to receive a royalty of 40% on net revenue realized from SchoolWeb Holding Inc.'s sales of the Licensed Technology which, after the first three years of the License Agreement, is subtracted from the amount of the specified monthly payment.

On May 16, 2003, the president of Advanced Interactive Inc. Mr. Karim Lakhani, resigned as a director of Alternet Systems Inc.

On October 14, 2003, Alternet 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 Alternet North American exclusivity for technologies and software licensed under the License Agreement.

On March 13 2004, the Company filed a Writ of Summons and Statement of Claim in the Supreme Court of BC, Vancouver, BC. The writ stated that the defendants, Advanced Interactive Inc., have breached the License Agreement as follows and damages are being sought in the amount of $1,804,709. The defendants had breached the Agreement as follows: failed to grant exclusivity to the Plaintiff as required by the License Agreement; failed to provide technical support and/or provide technical support at a reasonable price; and failed to provide usable and working software as is required by the License Agreement and the defendant in the lawsuit had counterclaimed for damages (see Legal Proceedings). The lawsuit with Advanced Interactive Inc. was settled and a Consent Dismissal Order was entered in the Supreme Court of British Columbia on November 1 2005.

Since notification of termination of the License Agreement was given to AII, Alternet Systems Inc. developed and currently supports its own proprietary software. Although the names of its products remain the same, the software comprising these products is its own and not licensed software.

The Company's Internet access system and software is presently installed in 54 schools and communities in Canada under the names "SchoolWeb" and "1nterlink" 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 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 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.

To this end, the Company has installed a co-located server in Vancouver, British Columbia which acts to service web-based video conferencing clients and currently offers this product to school districts in North America and internationally. No attempt has yet been made to trademark or otherwise protect the InMotion name.

Item 2. Description of Property

The Company does not own any real property as of March 28, 2006.

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 and a Consent Dismissal Order was entered in the Supreme Court of British Columbia on November 1 2005. The settlement calls for the cancellation of all claims and debts between the two parties. Alternet has entered a gain on settlement of debt on its Consolidated Statement of Operations for the year ending December 31, 2005 of $407,552.

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 requests an order to pay the Plaintiff Cdn $53,500 and 100,000 common shares for trade shows attended by the Company. Alternet Systems Inc. disputes this claim and is defending this action.

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, 2005.

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:

2004	HIGH	LOW
First Quarter	$0.185	$0.068
Second Quarter	$0.135	$0.06
Third Quarter	$0.16	$0.12
Fourth Quarter	$0.22	$0.08

Holders of Common Stock

On December 31, 2005, there were approximately 128 holders of record of our common stock and there were 29,974,428 shares outstanding. There are no indirect holdings of registered shares to outside institutions or stock brokerage firms, and we estimate that there are no additional beneficial shareholders beyond the 128 registered shareholders at December 31, 2005.

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 1,523,000 shares 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.

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 Canadian 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, 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.

Issuance 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 and financial 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 a 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.

Sales 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.

INCENTIVE STOCK OPTION PLAN

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

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 4,550,000shares 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).

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

We believe that the estimates, assumptions and judgments involved in the accounting policies described below have the greatest potential impact on our financial statements, so we consider these to be our critical accounting policies. Because of the uncertainty inherent in these matters, actual results could differ from the estimates we used in applying the critical accounting policies. Within the context of these critical accounting policies, we are not currently aware of any reasonably likely event that would result in materially different amounts being reported.

Results of Operations :

(For the year ended December 31, 2005 compared to the year ended December 31, 2004).

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, 2005, the Company had sales of $15,027. During the corresponding year ended December 31, 2004, the Company had sales of $57,220. The 74% decrease in sales is attributable to the fact that the Company has been undergoing a re-organization of its sales and marketing staff over the past year. The objective of the re-organization of the sales and marketing functions was to reduce overhead by utilizing independent sales agents to market SchoolWeb and CommunityWeb. The Company s CommunityWeb Sales Manager and a former director of the Company, Mr. Greg Protti resigned on August 1 2004.

The Company continues to market SchoolWeb and CommunityWeb in North America and internationally.

Net Loss

For the year ending December 31, 2005, the Company had a net loss of $263,564 or ($0.01) per share, which was a reduction of 58% when compared to the net loss for the corresponding year to December 31, 2004 of $628,064 or $(0.03) per share. The decreased loss was due primarily to: a decrease in management and consulting fees, and a gain on settlement of debt incurred to our former software developer, Advanced Interactive Inc.

Gross Profit

Gross Profit was $12,330 in the year ended December 31 2005, compared to $20,591 for the year ended December 31, 2004. This represents a 40% decrease when compared to last year and is primarily due to the decline in sales of SchoolWeb and CommunityWeb.

Selling, General and Administrative Expenses

For the year ended December 31 2005 the Company incurred office and general expenses of $28,987. Marketing expenses of $258,316 were 65% higher than the year ending 2004; management and consulting fees of $268,731 were a 23% reduction from the year ending December 31 2004; and $69,702 was incurred in professional fees. Training and documentation fees were $0 in the year ending December 31 2005.

For the corresponding year to December 31, 2004, the Company had office and general expenses of $46,307; marketing expenses of $90,898, management and consulting fees of $348,217, no fees were payable under the License Agreement and professional fees of $46,307. Training and documentation fees were $38,673 in 2004.

Accounts payable were $177,163 at December 31 2005. This compares to accounts payable of $537,719 at December 31 2004 of which $386,162 were disputed license fees owing.

The increase in marketing expenses is a result of increased activity in the last six months of 2005 in marketing the SchoolWeb and CommunityWeb when compared to 2004 and the reduction in management consulting expense this year, compared to the corresponding year to December 31, 2004, is a result of reduced staffing levels. The Company continued with its program of corporate downsizing during 2005, choosing to contract out its software development, in order to reduce overhead.

Advanced Interactive Inc. Software License Agreement

No license fees were incurred to Advanced Interactive during the year ending December 31, 2005 or 2004. This was due to the Company canceling the license agreement with Advanced Interactive during the year ending December 31 2003. The Company reached a settlement with Advanced Interactive Inc. and on November 5 2005 a Consent Dismissal Order was entered in the Supreme Court of British Columbia. The settlement calls for the cancellation of all debts owed by each Company to the other party, resulting in a Gain on Settlement of Debt for Alternet Systems Inc. of $407,552.

Interest and other expenses

The Company had no material interest expenses.

Liquidity and Capital Resources

As at December 31, 2005, the Company had $5 cash in the bank and prepaid expenses of $3,981. This compares to $30 cash in the bank and prepaid expenses of $3,981 as at December 31, 2004. The Company had a working capital deficiency $180,616 of as at December 31, 2005 compared to $552,915 as at December 31, 2004. 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.

Solflex Energy Development Corp.

On October 15 2004 the Company entered into a Letter of Intent (the Solflex Agreement) with Solflex Energy Development Corp. (Solflex).

Under the terms of the Solflex Agreement, the Company would acquire a 25% equity interest in Solflex and an exclusive license for North and South America to Solflex s proprietary solar panel technology. The terms of the agreement call for payment to Solfex of $170,000 within 14 days of signing the License Agreement and $320,000 by November 15 2004.

The Company did not advance any funds to Solflex for this acquisition and has not entered into a license agreement for Solflex s technology. In addition, the Company has not received any documentation from Solflex regarding this acquisition. On March 28 2005 the Company had not received its requested due diligence material and issued a letter to Solflex Energy Development Corp. declining to pursue an exclusive license agreement for the Solflex technology.

PLAN OF OPERATION

Over the next 12 months the Company will be concentrating on marketing its SchoolWeb products to US and Canadian school districts, and internationally to Departments of Education in each country. The Company currently markets its products internationally through approved independent sales agents.

Sales and marketing is also accomplished through the Company s existing sales staff, who contact school districts and state / provincial Departments of Education 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.

FUNDS 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	$	1,000
Marketing Expenses	$	4,000
Professional Fees	$	1,500
Accounting fees	$	1,000
Total Monthly Expenses:	$	24,000

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, 2005, 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
Michael Dearden	President and Director	Expires at next AGM
Griffin Jones	Secretary, Treasurer, CEO and Director	Expires at next AGM
Patrick Fitzsimmons	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 2006.
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.

Michael Dearden, President and Director

Michael Dearden, age 51. Mr. Dearden has over 26 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. and helped to facilitate a concurrent financing of $1,800,000. Rolland Virtual Business Systems Limited is a Montreal, Canada, based E-commerce software developer with approximately 35 employees.

Griffin Jones, Secretary, Treasurer, CEO and Director

Griffin Jones, age 51. Mr. Jones has been self-employed for approximately 18 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.

Patrick Fitzsimmons, Director

Pat Fitzsimmons, age 52. Mr. Fitzsimmons brings to the Company sales and management experience, gained from a 25-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.

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)**
Michael Dearden, President	2005	0	0	0	0	0	0	0
	2004	46,100	0	0	0	0	0	0
	2003	74,186	0	0	0	0	0	0
	2002	18,515	0	0	0	0	0	0
Griffin Jones, Treasurer and CEO	2005	9,249	0	0	0	0	0	0
	2004	46,100	0	0	0	0	0	0
	2003	77,998	0	0	0	0	0	0
	2002	35,164	0	0	0	0	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
Michael Dearden and Mikden Investments Inc. (formerly Streamline Investments, Inc.) (2) 711 South Carson St. Carson City, Nevada 89701	Director, President	2,656,000 common shares of which 273,000 are held personally and 2,383,000 are held by Mikden Investments	8.9%
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%
Patrick Fitzsimmons 1406-151 E. Keith Rd. N. Vancouver, BC V7L 4M3	Director, VP Sales	1,095,000	3.7%
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 one report on Form 8-K on January 13 2006 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 and Audit Related Fees

During the fiscal years ended December 31, 2005 and December 31, 2004, the Company will incur approximately $18,500 and has incurred $16,800 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, 2005, June 30, 2005, and September 30, 2005.

Financial Information Systems Design and Implementation Fees

During fiscal year ended December 31, 2005, 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 fiscal year ended December 31, 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 (incorporated by reference to Exhibit 14.1 on the report on Form 10-KSB filed on March 30, 2006)
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: January 3, 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: January 3, 2007 By: /s/ Griffin Jones
Griffin Jones, Director, Secretary,
Treasurer

ALTERNET SYSTEMS INC.

(A Development Stage Company)

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2005

INDEX 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, 2005 and 2004 and the consolidated statements of operations, stockholders deficit and cash flows for the years ended December 31, 2005 and 2004 and the period from October 13, 2000 (inception) to December 31, 2005. 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, 2005 and 2004 and the results of its operations and its cash flows and the changes in stockholders deficit for the years ended December 31, 2005 and 2004 and the period from October 13, 2000 (inception) to December 31, 2005 in accordance 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 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.

Dale Matheson Carr-Hilton LaBonte

CHARTERED ACCOUNTANT

Vancouver, Canada
March 17, 2006

ALTERNET SYSTEMS INC.
(A Development Stage Company)
CONSOLIDATED BALANCE SHEETS

	December 31, 2005	December 31, 2004
ASSETS		
Current Assets		
Cash	$ 5	$ 30
Prepaid expenses	3,981	3,981
Total Current Assets	3,986	4,011
Property and Equipment - net of depreciation of $8,862 (2004 - $4,493)	12,598	13,340
TOTAL ASSETS	**$ 16,584**	**$ 17,351**
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities	$ 177,163	$ 537,719
Deferred license revenue	2,140	10,394
Due to related parties (Note 5)	5,299	22,153
Total Current Liabilities	184,602	570,266
CONTINGENCIES (Notes 1 and 7)		
STOCKHOLDERS' DEFICIT		
Capital Stock (Note 4)		
Common stock, $0.00001 par value, 100,000,000 shares authorized		
29,974,428 (2004 25,779,428) issued and outstanding	301	259
Additional paid-in capital	3,014,635	2,469,320
Private placement subscriptions	161,808	50,250
Obligation to issue shares	26,000	37,150
Accumulated other comprehensive income (loss)	2,139	(557)
Deficit accumulated during the development stage	(3,372,901)	(3,109,337)
TOTAL STOCKHOLDERS' DEFICIT	(168,018)	(552,915)
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	**$ 16,584**	**$ 17,351**

See accompanying notes to the consolidated financial statements.

ALTERNET SYSTEMS INC.
(A Development Stage Company)
CONSOLIDATED STATEMENT OF OPERATIONS

	Year ended December 31, 2005	Year ended December 31, 2004	Results of operations from October 13, 2000 (inception) to December 31, 2005
REVENUE			
License fees and hardware sales	$ 15,027	$ 57,220	$ 222,369
COST OF SALES			
Purchases	-	16,393	16,393
Royalties	2,697	15,443	29,233
Installation costs and other	-	4,793	58,127
	2,697	36,629	103,753
GROSS PROFIT	12,330	20,591	118,616
OPERATING EXPENSES			
Advertising and promotion	1,505	8,030	112,258
Bad debt	-	-	