

ALTERNET SYSTEMS INC
Form 10-Q
November 14, 2008

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

Form 10-Q

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

For the quarterly period ended September 30, 2008

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

For the transition period from _____ to _____

Commission file number **000-31909**

ALTERNET SYSTEMS INC.

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

Nevada
(State of Incorporation)

88-047897

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

**One Glen Royal Parkway, Suite 401
Miami, Florida 33125
Tel: 786-265-1840**

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

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

<u>Class</u>	<u>Outstanding at November 14, 2008</u>
Common Stock, \$0.00001 par value per share	19,740,179 shares

PART 1 FINANCIAL INFORMATION

Item 1. Financial Statements.

Our unaudited interim consolidated financial statements for the nine month period ended September 30, 2008 form part of this quarterly report. They are stated in United States Dollars (US\$) and are prepared in accordance with United States generally accepted accounting principles.

**ALTERNET SYSTEMS INC.
CONSOLIDATED BALANCE SHEET**

As at September 30, 2008

	September 30, 2008	December 31, 2007
ASSETS		
Current Assets		
Cash	\$ 10,627	\$ 18,604
Accounts receivable	36,698	430,497
Prepays and deposits	12,870	12,107
Total Current Assets	60,195	461,208
Fixed Assets - net of depreciation of \$404,116 (2007 - \$402,342)	7,048	7,551
TOTAL ASSETS	\$ 67,243	\$ 468,759
LIABILITIES		
Current Liabilities		
Accounts payable	\$ 280,203	\$ 394,095
Accrued taxes	81,026	66,385
Due to related parties (Note 5)	340,941	41,397
Demand loan	147,000	-
Total Current Liabilities	849,170	501,877
Long Term Debt	-	147,000
TOTAL LIABILITIES	849,170	648,877
STOCKHOLDERS' DEFICIENCY		
Capital Stock (Note 4)	197	103
Additional paid-in capital	5,212,700	3,424,336
Private placement subscriptions	225,415	231,487
Obligation to issue shares	50,000	-
Deferred compensation	(952,526)	(29,677)
Deficit	(5,317,713)	(3,806,367)
TOTAL STOCKHOLDERS' DEFICIENCY	(781,927)	(180,118)
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIENCY	\$ 67,243	\$ 468,759

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

ALTERNET SYSTEMS INC.
CONSOLIDATED STATEMENT OF LOSS AND DEFICIT

(Unaudited)

	Three months ended September 30, 2008	Three months ended September 30, 2007	Nine months ended September 30, 2008	Nine months ended September 30, 2007
REVENUE				
Sales	\$ 82,874	\$ 67,366	\$ 547,122	\$ 218,232
COST OF SALES				
Direct Cost of Sales	34,793	16,304	454,356	91,933
GROSS PROFIT	48,081	51,062	92,766	126,299
OPERATING EXPENSES				
Bad Debt	267,128	-	410,654	-
Bank Charges and Interest	3,419	4,695	14,732	22,037
Commissions	-	-	1,450	-
Depreciation and Amortization	591	-	1,774	-
Financing Costs	5,426	-	143,480	-
Investor Relations	50,499	-	147,081	-
License Fees	15	-	118	-
Management and Consulting	224,906	-	577,846	675,437
Marketing	1,050	-	33,114	6,260
Office and General	8,246	5,166	40,939	5,731
Professional fees	21,097	-	107,502	-
Rent	8,100	13,734	39,964	19,134
Salaries	63,846	16,000	148,256	46,202
Telephone and Utilities	10,291	2,580	23,130	7,894
Travel	18,492	1,255	63,814	1,255
TOTAL OPERATING EXPENSES	683,106	43,430	1,753,854	783,950
NET INCOME/(LOSS) BEFORE OTHER ITEMS	(635,025)	7,632	(1,661,088)	(657,651)
Customer fees	6,317	284	6,771	3,990
Other income/(expense)	(373)	(137)	(3,267)	25,813
Increase (decrease) in Derivative Liability	113,389	-	143,480	-
NET INCOME/(LOSS) FOR THE PERIOD	\$ (515,692)	\$ 7,779	\$ (1,514,104)	\$ (627,848)
BASIC NET LOSS PER SHARE	\$ (0.03)	\$ 0.00	\$ (0.09)	\$ (0.07)
	19,064,151	10,010,534	16,765,667	9,565,536

**WEIGHTED COMMON SHARES
OUTSTANDING**

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

ALTERNET SYSTEMS INC.
CONSOLIDATED STATEMENT OF CASH FLOWS

(Unaudited)

	Nine months ended September 30, 2008	Nine months ended September 30, 2007
OPERATING ACTIVITIES		
Net Income (Loss) From Operations	\$ (1,514,104)	\$ (627,848)
Add: Items Not Affecting Cash		
Depreciation	1,774	-
Shares for services	317,857	-
Stock-based compensation	133,125	-
Changes In Non-Cash Working Capital:		
Accounts receivable	393,799	647,759
Prepays and deposit	(763)	(5,000)
Accounts Payable & Accrued charges	(113,892)	(9,493)
Accrued taxes	14,641	17,330
Related party payables	299,544	(49,578)
	(468,019)	(26,830)
INVESTING ACTIVITIES		
Acquisition of fixed assets	(1,271)	-
	(1,271)	-
FINANCING ACTIVITIES		
Change in demand loan payable	-	(10,000)
Net proceeds on sale of common stock and subscriptions	464,071	-
	464,071	(10,000)
OTHER COMPREHENSIVE INCOME	(2,758)	-
NET CHANGE IN CASH DURING THE PERIOD	(7,977)	(36,830)
CASH, BEGINNING OF PERIOD	18,604	41,139
CASH, END OF PERIOD	\$ 10,627	\$ 4,309

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

ALTERNET SYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2008

NOTE 1 NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Alternet Systems Inc. (Alternet or the Company) designs, markets and sells 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 Company also provides Voice over IP services, primarily in Latin America.

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

By agreement entered into December 31, 2007, Alternet issued 4,000,000 shares of restricted common stock to the shareholders of TekVoice Communications, Inc., a Company incorporated on May 17, 2002 in the State of Florida, in exchange for all of the issued and outstanding shares of TekVoice Communications, Inc. (refer to note 7).

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

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-QSB of Regulation S-B. They may not include all information and footnotes required by generally accepted accounting principles for complete financial statements. However, except as disclosed herein, there has been no material change in the information disclosed in the notes to the financial statements for the year ended December 31, 2007 included in the Company s Annual Report on Form 10-KSB filed with the Securities and Exchange Commission. The interim unaudited financial statements should be read in conjunction with those financial statements included in the Form 10-KSB. In the opinion of Management, all adjustments considered necessary for a fair presentation, consisting solely of normal recurring adjustments, have been made. Operating results for the nine months ended September 30, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008.

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 September 30, 2008 the Company had a working capital deficiency of \$788,975. 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.

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., AI Systems Group (Canada) Ltd. and TekVoice Communications, Inc.. All significant intercompany transactions and account balances have been eliminated.

Principles of Consolidation

The consolidated financial statements are a continuation of the financial statements of TekVoice Communications, Inc. and accordingly reflect the operations of TekVoice for the comparative quarter ended September 30, 2007 and the results of TekVoice and Altnet for the quarter ended September 30, 2008.

ALTERNET SYSTEMS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2008

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Use of Estimates and Assumptions

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

Cash and Cash Equivalents

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

Equipment

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

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

Impairment of Long lived Assets

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

Revenue Recognition

Revenues are recognized when title transfers or services are rendered. Telecommunications services are billed at the end of the month the services are provided.

Foreign Currency Translation

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

Fair Value of Financial Instruments

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

Income Taxes

The Company accounts for income taxes under a method, which requires the Company to recognize deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in the Company's financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on the

difference between the financial statements carrying amounts and tax basis of assets and liabilities using enacted tax rates. The Company presently prepares its tax returns on the cash basis and financial statement on the accrual basis. No deferred tax assets or liabilities have been recognized at this time, since the Company has shown losses for both tax and financial reporting.

Stock-Based Compensation

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

ALTERNET SYSTEMS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2008

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

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

For the purpose of computing earnings per share in which a reverse takeover occurs and for the year for which comparative statements are presented, the number of shares outstanding for the period from the beginning of the fiscal year to the date of the reverse takeover is the number of shares issued by the Company to the shareholders of TekVoice Communications, Inc., the legal subsidiary. For the period from the date of the reverse takeover to the end of the fiscal year, the number of shares used in the calculation of the earnings per share is the actual number of shares of the Company's outstanding in that period. The earnings per share for the comparative period are computed by dividing the earnings (loss) of TekVoice Communications, Inc. by the number of shares of the Company's issued in the reverse takeover transactions.

Risk Management

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

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

Recent Accounting Pronouncements

In December 2007, The FASB issued SFAS No. 141 (revised 2007), *Business Combination*, is effective for fiscal years beginning after December 15, 2008. The standard requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose to investors and other users all of the information they need to evaluate and understand the nature and financial effect of the business combination. This standard is not expected to have a significant effect on the Company's reported financial position or results of operations.

In December 2007, The FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements*, is effective for fiscal years beginning after December 15, 2008. The statement requires all entities to report

noncontrolling or minority interests in subsidiaries in the same way as equity in the consolidated financial statements. Moreover, the Statement eliminates the diversity that currently exists in accounting for transactions between an entity and noncontrolling interests by requiring they be treated as equity transactions. This standard is not expected to have a significant effect on the Company's reported financial position or results of operations.

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

ALTERNET SYSTEMS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2008

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

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

NOTE 3 CONVERTIBLE DEBENTURE NOTES

On February 4, 2008, the Company issued a note payable in the amount of \$50,000. The note carries interest at the rate of 8% per annum and is due on May 4, 2008. If the note is not repaid on maturity or in any other event of default, the holder is entitled to convert all or any portion of the original principal face value of the note into shares of common stock of the Company at a conversion value equal to 50% of the average market price of the Company's stock for the 30 days prior to the date of conversion.

On February 13, 2008, the Company issued a note payable in the amount of \$50,000. The note carries interest at the rate of 8% per annum and is due on May 13, 2008. If the note is not repaid on maturity or in any other event of default, the holder is entitled to convert all or any portion of the original principal face value of the note into shares of common stock of the Company at a conversion value equal to 50% of the average market price of the Company's stock for the 30 days prior to the date of conversion.

On April 9, 2008, the Company issued a note payable in the amount of \$10,000. The note carries interest at the rate of 8% per annum and is due on July 9, 2008. If the note is not repaid on maturity or in any other event of default, the holder is entitled to convert all or any portion of the original principal face value of the note into shares of common stock of the Company at a conversion value equal to 50% of the average market price of the Company's stock for the 30 days prior to the date of conversion.

On April 28, 2008, the Company issued a note payable in the amount of \$20,000. The note carries interest at the rate of 8% per annum and is due on July 16, 2008. If the note is not repaid on maturity or in any other event of default, the holder is entitled to convert all or any portion of the original principal face value of the note into shares of common stock of the Company at a conversion value equal to 50% of the average market price of the Company's stock for the 30 days prior to the date of conversion.

The Company accounts for debt with embedded conversion features and warrant issues in accordance with EITF 98-5: Accounting for convertible securities with beneficial conversion features or contingency adjustable conversion and EITF No. 00-27: Application of issue No 98-5 to certain convertible instruments. Conversion features determined to

be beneficial to the holder are valued at fair value and recorded to additional paid in capital. The Company determines the fair value to be ascribed to the detachable warrants issued with the convertible debentures utilizing the *Black-Scholes* method. Any discount derived from determining the fair value to the debenture conversion features and warrants is amortized to financing cost over the life of the debenture. The unamortized costs if any, upon the conversion of the warrants is expensed to financing cost on a pro rata basis over the life of the warrant.

Debt issue with the variable conversion features are considered to be embedded derivatives and are accountable in accordance with FASB 133; Accounting for Derivative Instruments and Hedging Activities. The fair value of the embedded derivative is recorded to derivative liability. This liability is required to be marked each reporting period. The resulting discount on the debt is amortized to interest expense over the life of the related debt.

On July 16, 2008, the Company issued a total of 383,364 shares to repay three convertible notes valued at \$130,000

ALTERNET SYSTEMS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2008

NOTE 4 CAPITAL STOCK

The Company has 100,000,000 shares of Common Stock authorized, of which 62,781,428 shares of Common Stock were outstanding as at December 27, 2007. On December 27, 2007, the Company held its annual and special meeting of shareholders, at which the Company's shareholders approved a special resolution authorizing a share consolidation of the issued and outstanding common shares on the basis of a ratio of ten existing common shares for one new consolidated common share. After this consolidation, the Company had 6,278,146 outstanding shares. The amendment did not change the total authorized number of shares of capital stock. The par value of the Common Stock remained unchanged at \$0.00001 per share. As a result, as of the effective date, the stated capital attributable to the Common Stock on the Company's balance sheet was reduced proportionately based on the reverse stock split ratio of 10 for 1. The additional paid in capital account has been credited with the amount by which the stated capital is reduced. On December 31, 2007, the Company issued an additional 4,000,000 shares for the acquisition of TekVoice Communications, Inc. (refer to note 7). After this acquisition, the total issued and outstanding shares of common stock as at December 31, 2007 were 10,278,146.

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

During the period, a total of 970,218 shares valued at \$339,572 were issued with respect to private placement. The Company has received a total of \$225,415 (December 31, 2007 - \$291,895) in respect of a further private placement of common stock. These shares were not issued as at September 30, 2008 and this amount is reported as private placement subscriptions within stockholders' deficit.

The Company is obligated to issue 100,000 common shares valued at \$50,000 as at September 30, 2008 for services rendered to a consultant during the period.

NOTE 5 - RELATED PARTY TRANSACTIONS

At September 30, 2008, a total of \$64,415 (December 2007 - \$41,397) was owed to directors. Amounts due to related parties are non-interest bearing and have no specific terms of repayment.

During the period, the company has paid a total \$489,701 (2007 - \$336,968) in consulting fees to related parties.

Of the amounts incurred to directors and officers, \$358,451 was accrued or paid in cash and \$131,250 was paid by way of 5,250,000 common shares for services.

NOTE 6 DEFERRED COMPENSATION

On June 26, 2008, 1,500,000 common shares valued at \$630,000 were issued to a consultant pursuant to a contract with certain terms and benchmarks. As of June 30, 2008 these benchmarks have not been met, thus the entire amount

has been classified as deferred compensation.

On April 15, 2008, the Company entered into agreement with a consultant for a one-year term whereby the consultant will provide investor relations services to the Company in exchange for 200,000 shares of the Company's common stock. On June 6, 2008, 100,000 common shares valued at \$50,000 were issued to the consultant and 100,000 common shares valued at \$50,000 were recorded as obligation to issue share during the period (refer to note 4). These amounts are being expensed over the life of the contract.

On May 12, 2008, the Company entered into an agreement with a consultant for a one-year term whereby the consultant will provide business consulting services to the Company (valued at \$76,500) in exchange for 150,000 shares of the Company's common stock which was issued on May 23, 2008.

ALTERNET SYSTEMS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2008

NOTE 6 DEFERRED COMPENSATION (continued)

On September 15, 2008, the Company entered into agreement with two consultants for a one-year term whereby the consultants will provide marketing services to the Company (valued at \$82,000) in exchange for 200,000 shares of the Company's common stock. The consultants will provide such services as developing sales channels for 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 aggregate fair value of the shares issued pursuant to the above agreements as deferred compensation and amortizes the costs of all these services on a straight-line basis over the respective terms of the contracts. During the period the Company expensed \$317,357 relating to the above contracts. At September 30, 2008, the unamortized portion of the deferred compensation totalled \$952,526. The shares issued were all valued at their market price on the date of issuance.

NOTE 7 STOCK ACQUISITION

By agreement dated December 31, 2007, the Company acquired 100% of the issued and outstanding shares of TekVoice Communications, Inc. in exchange of 4,000,000 shares of the common stock of Altnet. At the time of the transaction, the former shareholders of TekVoice Communications, Inc. (the "Transferors") acquired 38.92% of the 10,278,146 total issued and outstanding shares of Altnet.

In addition to the shares issued upon acquisition, the Transferors, in the aggregate, shall be entitled to receive up to an additional 2,000,000 shares in the common stock of the Company if the sales of TekVoice Communications, Inc. for the fiscal year ended December 31, 2008 exceed sales for fiscal year ended December 31, 2007 by 20%. In the event the Company is merged with another entity prior to December 31, 2008, the Additional Consideration shall be issued to the Transferors on the day immediately prior to the day that such merger takes place. The Transferors shall be entitled to appoint three members to the Company's board of directors, effective at the closing, provided, however, in no event shall Transferors be required to appoint a member to the Company's Board of Directors.

This acquisition has been accounted for as a capital transaction in substance using accounting principles applicable to reverse acquisitions, with TekVoice Communications, Inc. being treated as the accounting parent (acquirer) and Altnet being treated as the accounting subsidiary (acquiree). The acquisition has been valued at the net carrying value of the assets and liabilities of TekVoice Communications, Inc. as at December 31, 2007 immediately prior to the reverse acquisition.

The acquisition has been accounted for as follows:

Assets of TekVoice Communications, Inc.	
Current Assets	
Cash	\$ 18,563
Accounts receivable	430,497
Prepays and deposits	10,181
Total Assets	\$ 459,241
Liabilities of TekVoice Communications, Inc.	
Current Liabilities	
Accounts payable	\$ 194,828

Edgar Filing: ALTERNET SYSTEMS INC - Form 10-Q

Accrued taxes	63,261
Due to related parties	32,321
Total Current Liabilities	290,410
Long Term Debt	147,000
Total Liabilities	\$ 437,410
Total Assets less Total Liabilities	\$ 21,831
Capital Stock	\$ 40
Additional paid in capital	21,791
	\$ 21,831

ALTERNET SYSTEMS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2008

NOTE 8 LAWSUIT

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

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

Overview

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

Company's stock; and the risk factors set forth from time to time in the Company's SEC reports, including but not limited to its annual report on Form 10-K; its quarterly reports on Forms 10-Q; and any reports on Form 8-K. In addition, the Company disclaims any obligation to update or correct any forward-looking statements in all the Company's annual reports and SEC filings to reflect events or circumstances after the date hereof.

Company History and Business

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

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

Alternet Systems, Inc sells electronic transaction systems, VOIP telephony services and network systems and software for education and healthcare, marketed under the names "SchoolWeb" and HealthWeb.

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.

TekVoice Inc. Merger

Alternet Systems Inc. executed a merger with TekVoice Communications, Inc. of Miami, Florida, on December 31, 2007 . TekVoice is a telecommunications services company with operations in North America and Latin America. TekVoice revenues exceeded \$3 million in 2007 and 2006.

The combined entity is called Alternet Systems Inc. and its primary business is delivering electronic transaction services, telecom services; and education / healthcare application software and content; and to customers primarily located in Latin America, North America and the Caribbean. Alternet offers a portfolio of next-generation solutions for government, business, schools, hospitals and residents.

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 both 2006 and 2007, 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, Florida.

TekVoice also sells electronic transaction systems for mass-transportation fare collection, and utility company prepaid payments.

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

The Company's results, on a consolidated basis, reflected its own results consolidated with its subsidiaries, TekVoice Communications Inc, AI Systems Group Inc. and AI Systems Group (Canada) Ltd. For the remainder of this part, the term Company refers to both the Company and its wholly owned subsidiaries, TekVoice Communications Inc., AI Systems Group Inc. and AI Systems Group (Canada) Ltd.

Plan of Operation

In addition to the operating the Company's VOIP telephony business, management is pursuing opportunities in mass-transportation electronic fare-collection management; electronic transaction platforms for utility bill prepayment and network and content management services for education and healthcare. We have also initiated a program to participate in the money remittance service industry, by enabling technologies that will allow the remitter to make mobile to mobile, mobile to cash and mobile to ATM remittances through a cell-phone.

Alternet personnel continue to make presentations on the electronic transaction services offered by the Company for the telecom, financial, utilities and transportation sectors, as well as our content delivery software for the education and health sectors.

A structured plan has been defined to pursue immediate opportunities. Management has identified and contacted initial prospects. The needs and opportunities of these initial prospects have been identified and we have prepared offers and agreements. Management is in the final stages of closing of the business opportunities prospected in the 1st and 2nd Quarter. Additional opportunities have been identified and management has been actively pursuing them.

Currently our sales personnel and business development partners have identified and pursued projects in Colombia, Guatemala, Panama, Mexico and the United States.

Although the Company believes that demand exists for its products and services, there can be no assurance that sales will increase in the future.

Nine Months Ended September 30, 2008 Compared to Nine Months Ended September 30, 2007

Net Sales

For the nine months ended September 30 2008, the Company had \$547,122 in sales compared to \$218,232 for the corresponding period in 2007. The 150% increase in sales resulted from an increase in VoIP telephony sales primarily due to the launch of the distribution program to sell the prepaid products from its subsidiary TekVoice Communications, Inc.

Gross Profit

Gross profit was \$92,766 in the nine months ended September 30, 2008 and \$126,299 for the nine months ended September 30, 2007. This represents a decrease in gross profit of 27%, due to an increase in the direct cost of sales of the Company's VOIP telecom product in the nine month period ending September 30, 2008.

Selling, General and Administrative Expenses

For the nine months ended September 30 2008, the Company had office and general expenses of \$40,939, marketing expenses of \$33,114, management and consulting fees of \$577,846, professional fees of \$107,502 and rent of \$39,964.

For the corresponding period in 2007 the Company incurred office and general expenses of \$5,731; marketing expenses of \$6,260; management and consulting fees of \$675,437; \$ nil in professional fees and \$19,134 in rent.

Office and general expenses increased \$35,208 compared to the corresponding period in 2007. Marketing expense increased by \$26,854 this period, compared to the corresponding period in 2007 and is a result of increased activity in marketing SchoolWeb and electronic transaction products internationally.

Professional fees increased \$107,502 in the current period compared to the corresponding period ending September 30 2007 due to increased costs of associated with the Company's merger with TekVoice.

Management and consulting expense decreased 15% to for the nine months ended September 30 2008, compared to the corresponding period in 2007.

The Company incurred \$410,654 in bad debt expense during the nine months ended September 30 2008.

Accounts payable totaled \$280,203 at September 30, 2008. This was a 29% reduction when compared to accounts payable of \$394,095 at September 30, 2007.

Net Loss

For the nine months ended September 30, 2008, the Company had a net loss of \$1,514,104 or \$(0.09) per share, which was an increase of 148% when compared to the net loss for the corresponding period to September 30 2007 of \$627,848 or \$(0.07) per share. The increased loss was due primarily to an increase in marketing expenses and bad debt, which was partially offset by a reduction in management expense.

Interest and other expenses

The Company had no material interest expenses.

Liquidity and Capital Resources

The Company had current assets including cash on hand of \$60,195 as at September 30, 2008. The Company also had a net loss of \$1,514,104 during the nine months ended September 30, 2008.

The Company had a working capital deficiency of \$788,975 at September 30 2008. Management of the Company has determined that the Company's ability to continue as a going concern is dependent on raising additional capital and achieving increased sales of its TekVoice, Electronic Transaction and SchoolWeb / HealthWeb products.

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

RISK FACTORS

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

- The Company may be unable to market and sell its software and sales of its telecommunications products could decline;
- The Company has a history of operating its software business at a significant loss;
- The Company requires additional equity financing to continue operations and may be unable to obtain this financing;
- If further equity financing is obtained, it will dilute the value of existing shareholders' stock;
- The Company has limited working capital with which to continue operations;
- The telecom and software industries are extremely competitive and the Company faces competition from more established distributors and producers with greater financial resources and established sales and distribution capabilities;
- The Company has a significant number of shares outstanding which may be eligible for resale under Rule 144 and which, if sold, could depress the market price of the Company's shares;
- The profit margins in the telecom industry have been steadily eroding such that, even if it is able to make sales for its products, the Company may be unable to do so at a profitable margin.

Recent Accounting Pronouncements

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.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Not applicable

Item 4. Controls and Procedures

Management's Report on Disclosure Controls and Procedures

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

As of September 30, 2008, the end of our second quarter covered by this report, we carried out an evaluation, under the supervision and with the participation of our president (also our principal executive officer) and our secretary, treasurer and chief financial officer (also our principal financial and accounting officer), of the effectiveness of the design and operation of our disclosure controls and procedures. Based on the foregoing, our president (also our principal executive officer) and our secretary, treasurer and chief financial officer (also our principal financial and accounting officer) concluded that our disclosure controls and procedures were effective in providing reasonable assurance in the reliability of our financial reports as of the end of the period covered by this quarterly report.

Changes in Internal Control over Financial Reporting

There have been no significant changes in our internal controls over financial reporting that occurred during the quarter ended September 30, 2008 that have materially or are reasonably likely to materially affect, our internal controls over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

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

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

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

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

On July 16, 2008, the Company issued a total of 383,364 shares to repay three convertible notes valued at \$80,000.

During the period, a total of 970,218 shares valued at \$339,572 were issued with respect to a private placement.

Item 3. Defaults upon Senior Securities

None.

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

None.

Item 5. Other Information

None.

Item 6. Exhibits

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Reports on Form 8-K. The Registrant filed no reports on Form 8K during the period ending September 30 2008.

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

EXHIBIT INDEX

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

SIGNATURES

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

ALTERNET SYSTEMS INC.

By: */s/ Henryk Dabrowski*
Henryk Dabrowski, President
(Principal Executive Officer)
November 14, 2008

By: */s/ Patrick Fitzsimmons*
Patrick Fitzsimmons, Secretary, Treasurer
(Principal Financial Officer and Principal Accounting Officer)
November 14, 2008
