

ALTERNET SYSTEMS INC  
Form 10-K/A  
December 16, 2013

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

**FORM 10-K / A**

**Amendment No. 2**

(Mark One)

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended **December 31, 2012**

☐ TRANSITION REPORT UNDER 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 registrant as specified in its charter)

**Nevada**

(State or other jurisdiction of incorporation or organization)

**88-0473897**

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

**2665 S Bayshore Drive Miami FL**

(Address of principal executive offices)

**33133**

(Zip Code)

Registrant's telephone number, including area code: **786-265-1840**

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class

**N/A**

Name of Each Exchange On Which Registered

**N/A**

Securities registered pursuant to Section 12(g) of the Act:

**N/A**

(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 the Securities Act.  
Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes [ ] No [X]

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Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities 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 last 90 days.

Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§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 a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition 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 ☒

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

Yes ☐ No ☒

The aggregate market value of Common Stock held by non-affiliates of the Registrant on June 29, 2012 was \$10,819,219 based on a \$0.13 closing price for the Common Stock on June 29, 2012. For purposes of this computation, all executive officers and directors have been deemed to be affiliates. Such determination should not be deemed to be an admission that such executive officers and directors are, in fact, affiliates of the Registrant.

Indicate the number of shares outstanding of each of the registrant's classes of common stock as of the latest practicable date. 90,511,878 **as of April 11, 2013**

DOCUMENTS INCORPORATED BY REFERENCE

None.

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**EXPLANATORY NOTE**

Alternet Systems, Inc. (“we,” “us,” or the “Company”) is filing this Amendment No. 2 on Form 10-K/A (the “Amendment”) to its Annual Report on Form 10-K for the year ended December 31, 2012 filed on April 15, 2013 (the “Original Filing”) to restate its consolidated financial statements and related financial information. This Amendment reflects the restatement of the Company’s consolidated financial statements and amendment of related disclosures as at December 31, 2012 and the year ended December 31, 2012 as discussed below and in Note 17 to the accompanying restated consolidated financial statements. Other than as set forth herein, this Amendment No. 2 to Form 10-K does not reflect subsequent events occurring after the filing of the Original Filing.

On November 12, 2013, management of Alternet Systems, Inc. (the “Company”), after consultation with the Board of Directors, determined that the Company’s consolidated financial statements for year ended December 31, 2012 contained errors relating to the omission of material accruals at December 31, 2012 and should no longer be relied upon and be restated accordingly. This Amendment reflects the restatement of the Company’s consolidated financial statements and amendment of related disclosures as at December 31, 2012 and the year ended December 31, 2012.

In September 30, 2013, the Company agreed to accept invoices and credits notes valued at \$266,534 and \$47,442, respectively, from Utiba Pte. (“Utiba”), a non-controlling interest investor in ATS, for work performed on a revenue contract held by ATS during the Company’s 2012 fiscal year. The Company was unaware that Utiba had performed the services until Utiba had approached the Company during the Company’s 2013 third quarter. Additionally, Utiba agreed to accept an invoice valued at \$126,261 from the Company for work performed by the Company on the same contract. Management initially had no intention of charging any amounts to Utiba; however, after being approached by Utiba, it was determined to be the best course of action for the Company as management has determined that cancellation of the revenue contract, which occurred during the period ended June 30, 2012, had in fact triggered revenue recognition and recognition of the related costs of revenues in accordance with accounting principles generally accepted in the United States of America. Given that the results of these transactions have been assessed as material to the previously issued financial statements as of December 31, 2012, management determined that an accounting error had occurred and therefore, restatement of that period is appropriate.

The corrections of errors resulted in a \$126,621 increase to sales, \$266,534 increase to cost of sales, and \$68,734 decrease to non-controlling interest for the year ended December 31, 2012; and a \$92,831 increase to accounts payable and accrued charges and \$21,292 decrease to non-controlling interest as at December 31, 2012.

The corrections of errors did not impact the consolidated balance sheet as at December 31, 2011 or the consolidated statement of operations and the consolidated statement of cash flows for the year ended December 31, 2011. The impact to the Quarterly Reports on Form 10-Q for the periods ended March 31, 2013 and June 30, 2013 was not material. The consolidated balance sheets at March 31, 2013 and June 30, 2013 were impacted by a \$92,831 increase in accounts payable and accrued charges, a \$21,292 decrease to non-controlling interest, and a \$71,539 decrease to accumulated deficit. There was no material impact to the consolidated statements of operations and cash flows for the periods ended three and six months, March 31, 2013 and June 30, 2013, respectively.

No attempt has been made in this Amendment to modify or update the disclosures in the Original Filing except as required to reflect the effect of the restatement discussed herein. Except as otherwise noted herein, this Amendment continues to describe conditions as of the date of the Original Filing and the disclosures contained herein have not been updated to reflect events, results or developments that occurred after the date of the Original Filing, or to modify or update those disclosures affected by subsequent events. Other forward-looking statements made in the Original Filing have not been revised to reflect events, results or developments that occurred or facts that became known to us after the date of the Original Filing, other than the restatement, and such forward-looking statements should be read in conjunction with our filings with the SEC subsequent to the filing of the Original Filing. Accordingly, this Amendment should be read in conjunction with the Company’s other filings with the SEC.

Part II Item 7 (Management's Discussion and Analysis of Financial Condition and Results of Operations), Part II Item 8 (Financial Statements and Supplementary Data), have been amended from the Original Filing as a result of the restatement.

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## PART I

### Item 1. Description of Business

#### Forward Looking Statements

This annual report contains forward-looking statements. These statements relate to future events or our future financial performance. In some cases, you can identify forward-looking statements by terminology such as "may", "should", "expects", "plans", "anticipates", "believes", "estimates", "predicts", "potential" or "continue" or the negative of these terms or other comparable terminology. These statements are only predictions and involve known and unknown risks, uncertainties and other factors, including the risks in the section entitled "Risk Factors" that may cause our or our industry's actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Except as required by applicable law, including the securities laws of the United States, we do not intend to update any of the forward-looking statements to conform these statements to actual results.

Our financial statements are stated in United States Dollars (US\$) and are prepared in accordance with United States Generally Accepted Accounting Principles.

In this annual report, unless otherwise specified, all dollar amounts are expressed in United States dollars and all references to "common shares" refer to the common shares in our capital stock.

#### 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. In 2001 the Company changed its name to SchoolWeb Systems Inc. and then, in 2002, to Alternet Systems, Inc. On December 31, 2007, the Company executed a merger with TekVoice Communications, Inc. of Miami, Florida. Since then the Company has changed business focus and strategy to mobile financial services and mobile security. In 2011, TekVoice became inactive.

#### **2009 to Present Focus on Mobile Financial Services and Security**

Since late 2009, the Company has focused its investment and operational expertise on the mobile value added services markets of mobile financial transactions and security, through two new subsidiaries. These subsidiaries, Alternet Transaction Systems (dba Utiba Americas, which is 49% owned by Utiba Pte, Ltd) and International Mobile Security (IMS, which is 40% owned by General Services Holding LLC) were launched within the fiscal year 2010. The new lines of business and Company focus were intended to provide new revenue streams and profitability from the high growth segments of the mobile value added service market, namely mobile financial services and mobile security. Growth of both of these market segments is driven by the exponential adoption of mobile phones which in 2012 reached more than 70%, of the global population, with a total of 5 billion phones.

### ***Competition***

The Company competes in two distinct industries, mobile financial services and mobile security. In mobile financial services, the Company has unique features in its product offerings and is considered a global pioneer and market leader, consistently ranked by independent surveys amongst the top three in the world. The Company's technology has been developed and improved over numerous years and provides clients with a complete suite of applications and functionality that addresses all current market applications and usage. The Company is geographically focused on the entire Western Hemisphere (North, Central and South America and the Caribbean), it is the market leader in terms of deployments.

Nevertheless, the Company competes with significantly larger companies that are better financed. However, these competitors, while larger, are not entirely focused on mobile financial services resulting in opportunities for the Company to leverage its greater experience, flexibility and agility to garner business and market share. Over the last couple of years there has been market consolidation resulting in smaller companies, with market name recognition, being absorbed by larger organizations eager to capture market share and/or obtain technology. This trend is expected to continue over the foreseeable time horizon. The Company is one of the last independent players in the industry with name recognition, market share and proven technology.

### ***Research and Development***

The Company spends a judicious amount in research and development expenditures. In mobile financial services, the Company primarily relies on its joint-venture partner's longstanding and continued research and development, and as needed, purchases the necessary technology. In 2011, the Company purchased \$1.5 million in intellectual property from Utiba Pte., the minority interest shareholder in Alternet Transaction Systems Inc. which is doing business as Utiba Americas. The intellectual property encompasses all applications and functionality of Utiba's platform, permitting the Company to offer comprehensive services to clients. In mobile security, the Company has its own proprietary technology and is in constant development to address client and market needs. Further product development and refinement in mobile security is required.

### ***Employees***

The Company's staff remained stable in 2012, primarily in its operating subsidiaries. At the corporate level, one management position has been outsourced to an independent service provider in order to have access to greater resources and expertise as well as reduce the cash impact. The service provider is being compensated with company shares based on the deliverables detailed in the underlying service agreement. At year-end 2012, total staff stood at 20 (21 in 2011). The Company continues to outsource contract employment as appropriate.

### **Item 1A. Risk Factors**

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

- The Company may be unable to market and sell its products;
- The Company's sales are currently insufficient and its future prospects are dependent on the ability to market its products and services;
- The Company has a history of operating 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 Company is active in competitive industries and faces competition from more established companies 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.

Our business operations are also subject to a number of risks and uncertainties, including, but not limited to those set forth below:

*We have had negative cash flows from operations. If we are unable to obtain financing in the amounts and on terms deemed acceptable to us, we may be unable to continue our business and as a result may be required to scale back or cease operations, the result of which would be that our stockholders would lose some or all of their investment.*

To date we have had negative cash flows from operations and we have been dependent on sales of our equity securities and debt financing to meet our cash needs. We expect positive cash flow from operations to begin within the year but there is no assurance that actual cash requirements will not exceed our estimates, or that our sales projections will be realized as estimated. The occurrence of any of the aforementioned events could adversely affect our ability to meet our business plans.

In the near term we will depend on outside capital to pay for the continued development of our business. The Company has engaged an investment bank to assist in raising additional capital. The overall raise under consideration is up to \$10 million and includes funding for regional and product expansion and, possibly, strategic acquisitions and or mergers. Capital may not continue to be available to meet these continuing development costs or, if the capital is available, that it will be on terms acceptable to us. The issuance of additional equity securities by us would result in a significant dilution in the equity interests of our current stockholders. Obtaining commercial loans, assuming those loans would be available, will increase our liabilities and future cash commitments.

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

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

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

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

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

The Company's operating subsidiaries began operations in 2010. Since then changes to the business model have been made in response to market requirements and opportunities, most significantly demonstrated by the shift to hosted services (offered as Software as a Service - SaaS). This shift was a direct response to expressed client preference, requiring significant additional resources, in staffing and infrastructure, as well as changes in pricing, marketing and deal structuring. The impact, while expected to be considerably favorable to the Company over the medium term due to the multi-year nature of SaaS contracts, was adverse from a cash flow perspective. Accordingly the transition to SaaS has affected the Company's ability to generate net income and there can be no assurance that we will ever operate profitably. Our company's operations will be subject to all the risks inherent in developing and introducing new technology. Accordingly potential investors should be aware of the difficulties normally encountered by enterprises introducing new applications and changing, to a large extent, the paying habits of individuals across multiple countries. If our business plan is not successful, and we are not able to operate profitably, investors may lose some or all of their investment in our company.

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

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

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

In addition to the "penny stock" rules described above, FINRA has adopted rules that require that in recommending an investment to a customer, a broker-dealer must have reasonable grounds for believing that the investment is suitable for that customer. Prior to recommending speculative low priced securities to their non-institutional customers, broker-dealers must make reasonable efforts to obtain information about the customer's financial status, tax status, investment objectives and other information. Under interpretations of these rules, FINRA believes that there is a high probability that speculative low priced securities will not be suitable for at least some customers. FINRA requirements make it more difficult for broker-dealers to recommend that their customers buy our common stock, which may limit

their ability to buy and sell our stock and have an adverse effect on the market for our shares.

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

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

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

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

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

#### **Item 1B. Unresolved Staff Comments**

None.

#### **Item 2. Properties**

Executive Offices

Our corporate headquarters are leased and are located at 2665 S. Bayshore Dr., Suite 301, Miami Florida, 33133. At the present time, we do not have any real estate holdings and there are no plans to acquire any real property interests.

#### **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 October 16, 2009 the Company received notice that they had been named as Defendants in a lawsuit whereby the Plaintiffs are seeking a judgment of \$39,000 plus interest thereon from March 11, 2009 for breach of contract. The company had 30 days to respond to the notice before a default judgment is awarded. As at December 31, 2012, no amounts have been accrued as the likelihood of an unfavorable judgment is considered low.

On May 10, 2010, the Company received notice that they had been named as Defendants in a lawsuit whereby the Plaintiffs are seeking a judgment of \$6,889 including interest of \$1,444 for unpaid invoices. The Company had 30 days to respond to the notice before a default judgment is awarded. As at December 31, 2012, the full amount has been accrued and is included in accounts payable.

On September 20, 2012, the Company received a Demand for Arbitration notice that it had been named as party in a claim whereby the Claimant is seeking a judgment for damages that may exceed \$1,000,000, subsequently increased to \$5,000,000 resulting from failure to perform its obligations under an Agreement signed between the Claimant and the Company's joint-venture partner. The Company was not party to the Agreement but was named in the notice. The Company has engaged legal representatives. As of December 31, 2012, no amounts have been accrued as the claim is without basis.

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. Mine Safety Disclosures

Not applicable.

## 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 OTCQB under the symbol "ALYI".

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:

| 2012           | HIGH |      | LOW |      |
|----------------|------|------|-----|------|
| First Quarter  | \$   | 0.38 | \$  | 0.14 |
| Second Quarter | \$   | 0.30 | \$  | 0.13 |
| Third Quarter  | \$   | 0.19 | \$  | 0.11 |
| Fourth Quarter | \$   | 0.17 | \$  | 0.10 |

| 2011           | HIGH |      | LOW |      |
|----------------|------|------|-----|------|
| First Quarter  | \$   | 0.20 | \$  | 0.11 |
| Second Quarter | \$   | 0.14 | \$  | 0.09 |
| Third Quarter  | \$   | 0.14 | \$  | 0.09 |
| Fourth Quarter | \$   | 0.21 | \$  | 0.12 |

#### Holder of Common Stock

On December 31, 2012, there were 346 holders of record of our common stock and there were 89,056,203 shares outstanding. There are an estimated 421 indirect holders of common shares in outside institutions or stock brokerage firms, and we estimate that there are no additional beneficial shareholders beyond the 346 registered shareholders and 421 non-registered shareholders at December 31, 2012.

### *Dividend Policy*

We have not paid any cash dividends on our common stock and have no present intention of paying any dividends on the shares of our common stock. Our current policy is to retain earnings, if any, for use in our operations and in the development of our business. Our future dividend policy will be determined from time to time by our board of directors.

### **Recent Sales of Unregistered Securities**

During the year ended December 31, 2012, the Company:

- issued 3,333,333 common shares valued at \$500,000 for share subscriptions received in the prior year;
- issued 5,978,317 common shares valued at \$1,210,344 for debt settlements and convertible debenture agreements of which 2,138,358 shares valued at \$113,333 were obligated to be issued at December 31, 2011;
- issued 372,703 common shares valued at \$56,873 for employment incentives in accordance with employment agreements;
- issued 1,200,025 common shares valued at \$204,803 for legal, accounting, and consulting services rendered; and
- cancelled 1,000,000 common shares valued at \$140,000 previously issued for employment incentives during the year ended December 31, 2011.

In addition, during the year ended December 31, 2012, the Company issued common shares for the following subscriptions received during the year:

- on May 17, 2012, the Company issued 1,402,116 common shares at \$0.10 per share for total cash proceeds of \$143,528;
- on June 4, 2012, the Company issued 1,264,550 common shares at \$0.10 per share for total cash proceeds of \$134,171; and
- on December 26, 2012, the Company issued 2,333,333 common shares at \$0.15 per share for total cash proceeds of \$350,000.

During the year ended December 31, 2011, the Company:

- issued 500,000 common shares valued at \$15,000 for share subscriptions received in prior years;
- issued 5,516,145 common shares valued at \$717,623 for debt settlements and convertible debenture agreements;
- issued 2,614,337 common shares valued at \$325,862 for legal, accounting, and consulting services rendered of which 1,200,000 shares valued at \$108,000 were obligated to be issued as of December 31, 2010; and
- issued 8,120,030 common shares valued at \$1,008,606 for employment incentives in accordance with employment agreements.

In addition, during the year ended December 31, 2011, the Company issued common shares for the following subscriptions received during the year:

- on June 15, 2011, the Company issued 3,333,333 common shares at \$0.15 per share for total cash proceeds of \$500,000,
- on July 14, 2011, the Company issued 1,935,000 common shares at \$0.10 per share for total cash proceeds of \$193,500,



- on August 2, 2011, the Company issued 600,000 common shares at \$0.15 per share for total proceeds of \$90,000, and
- on December 29, 2011, the Company issued 3,333,333 common shares at \$0.15 per share for total cash proceeds of \$500,000.

### **Convertible Debenture Notes**

On February 4, 2008, the Company issued a note payable in the amount of \$50,000. The note carried interest at the rate of 8% per quarter and was due on May 4, 2008. If the note was not repaid on maturity or in any other event of default, the holder was 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 July 20, 2011, the creditor converted \$136,252 of debt into 2,265,207 common shares of the Company resulting in a full repayment of the loan.

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

On December 18, 2009, the Company entered into a debt settlement agreement whereby a creditor agreed to receive shares in lieu of payment of a \$152,916 promissory note. The holder was entitled to receive common stock of the Company at a conversion value equal to 50% of the lowest closing price of the Company's stock for the 10 days prior to the date of conversion. The holder may not hold more than 4.99% of the outstanding common stock of the Company at any point in time. During the year ended December 31, 2010, the creditor converted \$113,750 of debt into 4,457,699 common shares of the company. On February 25, 2011, the creditor converted \$72,833 of debt into 1,220,363 common shares of the Company resulting in a full repayment of the loan.

On March 8, 2010, the Company issued a note payable in the amount of \$25,000. The note carried interest at the rate of 12% per annum and was due on April 8, 2010. If the note was not repaid on maturity or in any other event of default, the holder was entitled to convert all or any portion of the original principal face value of the note into shares of common stock of the Company at a conversion value equal to 50% of the lowest closing price of the Company's stock for the 10 trading days immediately preceding and including the date of conversion. On August 29, 2011, the Company repaid the loan in full.

On April 14, 2010, the Company issued a note payable in the amount of \$15,000. The note carried interest at the rate of 10% per annum and was due on May 18, 2010. If the note was not repaid on maturity or in any other event of default, the holder was entitled to convert all or any portion of the original principal face value of the note into shares of common stock of the Company at a conversion value equal to 50% of the lowest closing price of the Company's stock for the 10 trading days immediately preceding and including the date of conversion. On October 20, 2011, the Company repaid the loan in full.

On April 30, 2010, the Company issued a note payable in the amount of \$100,000. The note carried interest at the rate of 10% per annum and was due on July 30, 2010. The note was not repaid on maturity, thus, the holder converted all 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 closing price of the Company's stock for the 10 trading days immediately preceding and including the date of conversion. On August 22, 2011, the creditor submitted a Notice of Conversion to convert \$113,333 of debt into 2,138,358 common shares of the company resulting in a full repayment of the loan. At December 31, 2011,

the shares had not been issued to the creditor resulting in the full balance being included in obligation to issue shares. On March 5, 2012, the Company issued the 2,138,358 common shares of the Company resulting in a full repayment of the loan.

On August 29, 2012, the Company issued a note payable in the amount of \$44,438. The note carries interest at the rate of 10% per annum and is due on February 28, 2013. 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 of \$0.075. The beneficial conversion feature discount resulting from the conversion price being \$0.045 below the market price on August 29, 2012 of \$0.12 provided a value of \$26,663. During the year ended December 31, 2012, \$18,067 of the debt discount was amortized. As of December 31, 2012, \$37,364 of principal, accrued interest, and unamortized debt discount on this note was included in other loans payable. The note was not repaid by February 28, 2013 and continues to accrue interest at the rate of 10% per annum.

On September 26, 2012, the Company issued a note payable in the amount of \$60,000. The note carries interest at the rate of 10% per annum and is due on March 31, 2013. 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 of \$0.075. The beneficial conversion feature discount resulting from the conversion price being \$0.045 below the market price on September 26, 2012 of \$0.12 provided a value of \$36,000. During the year ended December 31, 2012, \$18,581 of the debt discount was amortized. As of December 31, 2012, \$44,175 of principal, accrued interest, and unamortized debt discount on this note was included in other loans payable. The note was not repaid by March 31, 2013 and continues to accrue interest at the rate of 10% per annum.

On October 19, 2012, the Company issued a note payable in the amount of \$80,000. The note carries interest at the rate of 10% per annum and is due on April 30, 2013. 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 of \$0.075. The beneficial conversion feature discount resulting from the conversion price being \$0.085 below the market price on October 19, 2012 of \$0.16 provided a value of \$80,000. During the year ended December 31, 2012, \$30,259 of the debt discount was amortized. As of December 31, 2012, \$31,881 of principal, accrued interest, and unamortized debt discount on this note was included in other loans payable.

#### **Other Loans Payable**

On October 22, 2007, the Company signed a promissory note whereby the Company agreed to repay a creditor \$20,000 plus interest at 8% per annum on November 22, 2007. On March 7, 2011, the Company signed a debt settlement agreement with the creditor to convert the outstanding balance into shares of the Company. On April 21, 2011, the creditor converted \$27,000 of debt into 444,079 common shares of the company resulting in a full repayment of the loan.

On January 25, 2011, the Company signed a promissory note whereby the Company agreed to repay a director \$20,000 plus interest at 10% per annum on April 25, 2011. This loan was not repaid on its maturity and has since been renewed several times with the unpaid principal and interest being capitalized to the loan balance on each renewal. As of December 31, 2012, the Company owes this director \$2,598 of unpaid principal and \$131 of accrued interest on a promissory note which matures on December 31, 2012. The loan was renewed on January 1, 2013 with the unpaid principal and interest being capitalized to the loan balance, the maturity date extended to June 30, 2013, and the interest rate remaining at 10% per annum. The balance owing is included in due to related parties.

On February 9, 2011, the Company signed a promissory note whereby the Company agreed to repay a director \$5,000 plus interest at 10% per annum on May 9, 2011. This loan was not repaid on its maturity and has since been renewed several times with the unpaid principal and interest being capitalized to the loan balance on each renewal. As of December 31, 2012, the Company owes this director \$5,736 of unpaid principal and \$289 of accrued interest on a promissory note which matured on December 31, 2012. The loan was renewed on January 1, 2013 with the unpaid principal and interest being capitalized to the loan balance, the maturity date extended to June 30, 2013, and the interest rate remaining at 10% per annum. The balance owing is included in due to related parties.

On February 11, 2011, the Company signed a promissory note whereby the Company agreed to repay a director \$8,988 plus interest at 10% per annum on May 11, 2011. This loan was not repaid on its maturity and has since been renewed several times with the unpaid principal and interest being capitalized to the loan balance on each renewal. As of December 31, 2012, the Company owes this director \$10,308 of unpaid principal and \$520 of accrued interest on a promissory note which matured on December 31, 2012. The loan was renewed on January 1, 2013 with the unpaid principal and interest being capitalized to the loan balance, the maturity date extended to June 30, 2013, and the interest rate remaining at 10% per annum. The balance owing is included in due to related parties.

On March 2, 2011, the Company signed a promissory note whereby the Company agreed to repay a director \$100,000 plus interest at 10% per quarter on June 2, 2011. On July 14, 2011, the director of the Company sold the loan to an unrelated third party. On August 8, 2011, the creditor converted \$110,000 of debt into 733,333 common shares of the company resulting in a full repayment of the loan.

On January 25, 2012, the Company signed a promissory note whereby the Company agreed to repay a creditor \$100,000 plus interest at 12% per annum on April 24, 2012. As of March 31, 2012, the Company has accrued \$2,203 of interest relating to this loan. On April 8, 2012, the Company signed a debt settlement agreement with the creditor whereby the creditor will convert the outstanding principal and interest of \$102,466 into 683,105 common shares of the Company and 409,863 warrants. Each warrant entitles the holder to purchase one common shares of the Company at an exercise price of \$0.25 per share until October 8, 2013. The Company issued 409,863 warrants on April 8, 2011, 113,889 common shares on April 11, 2012, 400,000 common shares on April 19, 2012, 152,778 common shares on April 26, 2012, and 16,438 common shares on May 7, 2012 resulting in a full repayment of the loan. Using the Black-Scholes option pricing model, the fair market value of the warrants at the time of issuance was determined to be \$85,198 with the following assumptions: (1) risk-free rate of interest of 0.07%, (2) an expected life of 1.5 years, (3) expected stock price volatility of 178.93%, and (4) expected dividend yield of zero.

On February 1, 2012, the Company signed a promissory note whereby the Company agreed to repay a creditor \$200,000 plus interest at 24% per annum on May 1, 2012. On May 1, 2012, the Company signed a new promissory note with the creditor which capitalized the unpaid principal and interest of \$211,836 under the previous promissory note and extended the maturity date to September 30, 2012. On October 1, 2012, the Company signed a new promissory note with the creditor which capitalized the unpaid principal and interest of \$233,147 under the previous promissory note and extended the maturity date to January 31, 2013. As of December 31, 2012, the Company has accrued \$14,104 of interest relating to this loan.

On August 24, 2012, the Company signed a debt settlement agreement with a director of the Company whereby the Company agreed to settle \$103,125 of unpaid wages and \$19,730 of outstanding accounts payable plus interest at 10% per annum starting January 1, 2012 for 983,445 common shares of the Company. On August 24, 2012, the director of the Company sold the loan to an unrelated third party. On September 4, 2012, the 983,445 common shares were issued resulting in a full repayment of all balances outstanding.

On August 24, 2012, the Company signed a debt settlement agreement with an officer of the Company whereby the Company agreed to settle \$126,667 of unpaid wages and \$4,255 of outstanding accounts payable plus interest at 10% per annum starting January 1, 2012 for 1,048,016 common shares of the Company. On August 24, 2012, the director of the Company sold the loan to an unrelated third party. On September 4, 2012, the 1,048,016 common shares were issued resulting in a full repayment of all balances outstanding.

On August 29, 2012, the Company signed a debt settlement agreement with a director of the Company whereby the Company agreed to settle \$75,833 of unpaid wages and \$16,473 of outstanding accounts payable plus interest at 10% per annum starting January 1, 2012 for 597,277 common shares of the Company. On August 29, 2012, the 597,277 common shares were issued resulting in a full repayment of all balances outstanding.

On August 29, 2012, the Company signed a debt settlement agreement with an employee of the Company whereby the Company agreed to settle \$58,333 of unpaid wages and \$17,089 of outstanding accounts payable plus interest at 10% per annum starting January 1, 2012 for 528,116 common shares of the Company. On August 29, 2012, the 528,116 common shares were issued resulting in a full repayment of all balances outstanding.

On October 10, 2012, the Company signed a promissory note whereby the Company agreed to repay a creditor \$50,000 plus interest at 10% per annum on April 8, 2013. As of December 31, 2012, the Company has accrued \$1,137 of interest relating to this loan.

On November 19, 2012, the Company signed a promissory note whereby the Company agreed to repay a creditor \$100,000 plus interest at 10% per annum on May 18, 2013. As of December 31, 2012, the Company has accrued \$1,178 of interest relating to this loan.

On November 19, 2012, the Company signed a promissory note whereby the Company agreed to repay a creditor \$100,000 plus interest at 10% per annum on May 18, 2013. As of December 31, 2012, the Company has accrued \$1,178 of interest relating to this loan.

On December 5, 2012, the Company signed a promissory note whereby the Company agreed to repay a creditor \$25,000 plus interest at 10% per annum on June 3, 2013. As of December 31, 2012, the Company has accrued \$185 of interest relating to this loan.

#### **Recent Issuance of Non- Restricted Securities**

##### **Employee and Consultant Retainer Stock Plan 2008**

During 2010, the Company issued restricted shares as compensation to key management. Juan Cubides, CEO of International Mobile Security Inc. received 1,000,000 shares, Luz Villanueva, CFO, received 1,000,000 shares and Erin Clancy received 250,000 shares, as part of 2010 compensation and sign up bonuses. During 2011, the Company issued restricted shares as compensation to key management. Michael Viadero, the new CFO, received 1,000,000 shares as sign up bonus, and Jesus Luzardo, VP - Sales, 500,000 as compensation bonus. During 2012, Angel Pacheco returned his 1,000,000 shares which were then cancelled.

***Purchase of Equity Securities by the Issuer and Affiliated Purchasers***

We did not purchase any of our shares of common stock or other securities during our fourth quarter of our fiscal year ended December 31, 2012.

**Item 6. Selected Financial Data**

As a smaller reporting company, we are not required to provide the information required by this Item.

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion should be read in conjunction with our consolidated audited financial statements and the related notes that appear elsewhere in this annual report. The following discussion contains forward-looking statements that reflect our plans, estimates and beliefs. Our actual results could differ materially from those discussed in the forward looking statements. Factors that could cause or contribute to such differences include, but are not limited to those discussed below and elsewhere in this annual report, particularly in the section entitled "Risk Factors".

Our consolidated audited financial statements are stated in United States Dollars and are prepared in accordance with United States Generally Accepted Accounting Principles.

**Restatement**

With this Amendment 1, we have restated the following previously filed consolidated financial statements, data and related disclosures: the consolidated balance sheet as at December 31, 2012, the consolidated statement of operations, the consolidated statement of cash flows and consolidated statement of stockholders' equity (deficiency) for the year ended December 31, 2012. See Note 17 to the consolidated financial statements, restated. The following Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) should be read in conjunction with the amended audited consolidated financial statements and notes thereto for the fiscal year ended December 31, 2012, as well as the Company's other filings with the SEC.

The restatement results from management's determination that the Company's consolidated financial statements for the year ended December 31, 2012 contained errors relating to the omission of material accruals at December 31, 2012.

The following MD&A reflects the restatements. For this reason, the data set forth in this section may differ from that presented in discussions and data in our previously filed Annual Report on Form 10-K for the year ended December 31, 2012.

***Overview***

Alternet Systems Inc competes in two distinct industries, mobile financial services and mobile security. In mobile financial services, the Company has unique features in its product offerings and is considered a global pioneer and market leader, consistently ranked by independent surveys amongst the top three in the world. The Company's technology has been developed and improved over numerous years and provides clients with a complete suite of applications and functionality that addresses all current market applications and usage. The Company is geographically focused on the entire Western Hemisphere (North, Central and South America and the Caribbean), it is the market leader in terms of deployments.

**Mobile Financial Services**



In 2010, the Company launched its mobile financial and mobile commerce suite of services, which it offers in equity partnership with the leading mobile financial services software developer, Utiba. Utiba Americas enjoys exclusive rights to the Utiba software platform for the Americas region, sold as a software license, or as a hosted service, also known as Software as a Service (SaaS).

Demand for our mobile financial transaction services is driven by the widespread adoption of mobile phone service and the existence of large segments of the global population which possess a mobile phone, but do not possess a bank account. The global mobile commerce industry is in its early growth and adoption stages and several successful initiatives have been launched worldwide by our competitors. We believe that as wireless usage expands, the demand for our services will grow.

Since launching in 2010, the Company has implemented mobile financial service solutions in Bolivia, Colombia, Ecuador, Guatemala, and Honduras. Revenue will come from organic growth of its existing operations, primarily from its hosted service, and the Company's robust sales pipeline with many qualified opportunities throughout the region. The Company also benefits from its name recognition and reputation, being one of the leading names in mobile financial services.

Sales and marketing is accomplished through the Company's existing sales staff, who contact potential clients directly, and through agent sales, channel partners, trade shows, and industry associations. Marketing materials such as brochures, web sites, and technical specifications are continuously updated with an increased emphasis being placed on its offerings for specific vertical industries, specifically the telecom, financial, government and utilities sectors.

The Company has been successful in capturing a leading market share in regional deployments and is widely recognized as having among the broadest and most robust product offerings. In 2012 the Company was awarded a multi country license sale agreement with Digicel Group, with an initial launch in Haiti, as well as the sale of a license to Astra Holdings, S.A. a Central America mobile payment service provider, that initially launched in Honduras and will expand in 5 Central America countries. It also successfully launched in January 2013, the electronic top up platform for Corporación Digitel S.A. a mobile network operator in Venezuela.

The SaaS product offering has successfully garnered key clients in Guatemala, Bolivia, México and Latin America. The Company is currently working in several other projects with a regional player with a multi country reach, and is continuing to receive widespread interest as it is currently negotiating several SaaS proposals with regional banks and mobile payment service providers.

In 2013, the Company expects to leverage its market leadership and regional footprint to garner additional profitable business and market share and aggressively replicate the SaaS business model throughout the region.

In 2012 the company entered into strategic alliances with complimentary players in the industry. The strategic partnership with Spindle, Inc., a United States based mobile payments processor and technology developers allows ATS to enter this market and leverages Spindle's merchant acquisition suite into the existing Utiba mobile commerce offering. This partnership will expand as the companies are seeking additional technological and commercial integration. It also signed an MOU with i2C, Inc., a payments processor based in Redwood City, California to leverage their payment processing, card management and prepaid platform into a Utiba's converging payment offering. This initiative follows the MasterCard global partnership signed by Utiba Pte. Ltd. in October 2011, and the announcements made in 2012 on our expansion into the physical payments markets, as described in our Converging Payments offering.

ATS also continues to actively work with MasterCard operations in Latin America, developing a joint offering leveraging the brands strength and Utiba's market presence. Management expects several of these offers to close in 2013 in several key markets, specifically launching payments services to the unbanked markets in Latin America and the Caribbean.



The Company also expects to pursue potential opportunities to grow through mergers and acquisitions. Several opportunities have been identified and the Company has initiated initial discovery processes.

#### Digital and Mobile Security Software and Services

International Mobile Security (IMS) finalized the acquisition of proprietary technology in early 2011 and was positioned to offer software and security products in the global market segments of law enforcement, corporate, and consumer sales. Sales efforts have been conducted in house and through value added resellers. Drivers of demand include smart phones and the newly arrived mobile tablet computers.

IMS has entered into an agreement to develop opportunities with Delma MSS Ltd. ( Delma ), a company based in the United Kingdom developing location and tracking technologies. As part of the agreement, Delma will develop and enhance some of the IMS products, with the intent to develop joint business opportunities and products. The relationship with Delma will allow IMS to expand its sales reach into the Middle East and Asian markets.

#### **Results of Operations:**

Results of Operations are for the year ended December 31, 2012 compared to the year ended December 31, 2011.

The Company's results, on a consolidated basis, reflect its own results consolidated with its subsidiaries. For the remainder of this part, the term "Company" refers to both the Company and its wholly owned and two majority owned subsidiaries, International Mobile Security, Inc. ( IMS ) and Altnet Transactions Systems, Inc. ( ATS ) doing business as Utiba Americas. Altnet has a controlling interest in both subsidiaries.

#### **Net Sales (restated)**

For the year ending December 31, 2012, the Company had net sales of \$1,355,935 versus \$1,210,766, for the prior year, an 11% increase. While the Company signed two license sales contracts in the fourth quarter of 2012, only one sale was recorded in the year. ATS has experienced continued challenges in closing other large complex projects, due to their scope and size. The Company accrues these sales on a performance basis, so additional revenues will be recorded as they are deemed delivered.

The other transaction, given its underlying financing structure, is being recognized over the term of the contract. Projects continue to take significant time and effort to close due to the complexity, the required participation of multiple parties, differing levels of expertise and experience amongst parties and, at times, shifting regulatory conditions.

As a result sales are below expectations. SaaS revenue, the Company's preferred product offering and pricing structure, is rapidly getting traction, while license sales have experienced a deceleration. ATS is actively engaged in final discussions and contract negotiations, with the largest clients in the market and expects to sign major projects in 2013.

IMS continues to underperform and management is reviewing various options, including divestiture, reorganization or merger opportunities. Based on its limited success, it is evident that IMS' product offering requires further development and additional investment to keep them up to date with current market expectations and requirements. In light of the results to date, management is reticent in continuing directing resources to the endeavor, and is actively evaluating different scenarios.

Accordingly, the Company may focus entirely on Mobile Financial Transaction Services and ancillary businesses within this space, such as Mobile Remittances, Consumer Analytics, Mobile Advertising Monetization and integration of its Mobile Commerce suit to Social Media opportunities.

### Cost of Sales and Gross Margin (restated)

The Company has cost of sales of \$923,076 and a gross margin of \$432,859 for the year ending December 31, 2012 as compared to cost of sales of \$1,122,536 and a gross margin of \$88,230 for the year ending December 31, 2011. The decrease in the cost of sales is due to the prior year including a one time charge of \$421,000 from Utiba Pte for additional support services performed during the year and prior years.

### Selling, General and Administrative Expenses

The operating and administrative expenses for the year ended December 31, 2012 totaled \$3,834,404 as compared to \$2,996,391 for the year ended December 31, 2011. The table below details the major changes in administrative expenditures for the year ended December 31, 2012 as compared to the corresponding year ended December 31, 2011.

| Expenses                  | Increase / Decrease in Expenses | Explanation for Change<br>Year Ended December 31, 2012 as<br>Compared to Year Ended December 31, 2011                                                                             |
|---------------------------|---------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Bad debts                 | Increase of \$174,549           | Collection of the remaining balance on one contract and one note receivable was determined to be uncertain.                                                                       |
| Depreciation              | Increase of \$67,936            | Additional assets were acquired during the year.                                                                                                                                  |
| Investor relations        | Increase of \$14,885            | More activity during the year in respect to financing transactions.                                                                                                               |
| Management and consulting | Increase of \$500,861           | Increased number of consultants hired during the year to assist with the customization required to complete the increased number of contracts the Company signed during the year. |
| Professional fees         | Increase of \$71,243            | Increase due to lawyers reviewing more customer contracts in the current year.                                                                                                    |
| Rent                      | Increase of \$41,924            | The Company moved offices at the end of 2011.                                                                                                                                     |
| Salaries                  | Increase of \$11,327            | Increased cost of new employees filling open positions.                                                                                                                           |
| Telephone and utilities   | Increase of \$27,551            | Increased usage of long-distance telephone calls to increase customer sales                                                                                                       |
| Travel                    | Decrease of \$72,318            | Decreased amount of travel required to more stringent travel policy and use of remote conferencing.                                                                               |

### Interest and Other Expenses

The Company's interest expense increased to \$457,283 for the year ended December 31, 2012 compared to \$45,143 the previous year due to 1) the increase in loans received by the Company during the year, 2) the recording of financing costs of \$66,905 relating to convertible debentures, and 3) the estimation of potential tax penalties.



### **Net Loss (restated)**

For the year ending December 31, 2012, the Company had a net loss of \$4,843,607 or (\$0.04) per share and total comprehensive loss of \$3,334,946 or (\$0.04) per share, an increase of 56% and 36%, respectively, when compared to corresponding year December 31, 2011 which had a net loss of \$3,095,376 or \$(0.04) per share and a total comprehensive loss of \$2,444,395 or (\$0.04) per share. The increased loss is primarily attributable to higher Other Items, consisting of the aforementioned interest expense (\$457,283), foreign exchange loss (\$404,736) and loss on debt settlement (\$579,375), up \$1,252,293 from the prior year. The foreign exchange loss is attributable to the devaluation of the Venezuelan Bolivar.

### **Liquidity and Capital Resources (restated)**

As of December 31, 2012, the Company had \$5,751 cash in the bank and accounts receivable of \$1,249,447. At December 31, 2012, the Company had a working capital deficiency of \$3,258,624. The Company is currently pursuing financing, and has engaged an investment bank to raise additional capital to fund ongoing operations. The Company's ability to continue as a going concern will be negatively affected if it is unsuccessful.

Accounts payable were \$1,549,885 at December 31, 2012 compared to accounts payable of \$1,778,876 at December 31, 2011. Accounts receivable decreased to \$1,249,447 for 2012 versus \$2,215,586 for 2011. Both items reflect the timing impact of sales closed at the end of the year.

As of December 31, 2012, the Company holds an accounts receivable of \$789,565 (VEF 6,674,709) with a related company that has been outstanding for longer than one year. Due to the relationship with this Company, management is certain the funds will be collected.

### **Plan of Operation**

Over the next 12 months, the Company will continue selling mobile financial services, in the form of software licenses and, increasingly more given market demand, as a service, commonly referred to as Software as a Services (SaaS), through its subsidiary Alternet Transaction Systems (dba Utiba Americas). The Company is in advanced negotiations with various clients to roll out single market, multi-market and regional mobile financial services, primarily under the SaaS product offering. SaaS transactions are multi-year in nature and are priced based on active wallets, transactions or a combination thereof. The Company is also in discussions for the sale of additional licenses and/or expansions.

As for International Mobile Security (IMS), provider of mobile security solutions, management is currently reviewing the strategic fit of the subsidiary within the Company's overall vision and business focus. While the market for IMS products, primarily the government, law enforcement and, to a lesser degree, corporate segments, appears to be large and growing, IMS' product offering needs further refinement and development. Similarly, significantly more management time will be required to address the current challenges and well as additional resources, which may distract from the Company's primary focus.

### **Conclusion**

The Company has positioned itself as the regional go-to, if not preferred, provider of mobile financial services and solutions and is confident in the future demand for its products and services. However, there can be no assurance that sales will increase in the future. The Company is expected to remain dependent upon debt or equity financing unless revenues from operations grow significantly.



## **Critical Accounting Policies**

The discussion and analysis of our financial condition and results of operations are based upon our financial statements, which have been prepared in accordance with the accounting principles generally accepted in the United States of America. Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. These estimates and assumptions are affected by management's application of accounting policies. We believe that understanding the basis and nature of the estimates and assumptions involved with the following aspects of our financial statements is critical to an understanding of our financial statements.

### *Basis of Presentation and Consolidation*

These consolidated financial statements and related notes are presented in accordance with accounting principles generally accepted in the United States, and are expressed in United States dollars. These financial statements include the accounts of the Company and its wholly owned and majority owned subsidiaries. Our fiscal year-end is December 31.

*Use of Estimates and Assumptions*

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Our company regularly evaluates estimates and assumptions. Our company bases its estimates and assumptions on current facts, historical experience and various other factors that it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities and the accrual of costs and expenses that are not readily apparent from other sources. The actual results experienced by our Company may differ materially and adversely from our Company's estimates. To the extent there are material differences between the estimates and the actual results, future results of operations will be affected.

*Accounts Receivable and Allowance for Doubtful Accounts*

Trade accounts receivable are stated at the amount the Company expects to collect. The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. Management considers the following factors when determining the collectability of specific customer accounts: customer credit-worthiness, past transaction history with the customer, current economic industry trends, and changes in customer payment terms. Past due balances over 90 days and other higher risk amounts are reviewed individually for collectability. If the financial condition of the Company's customers were to deteriorate, adversely affecting their ability to make payments, additional allowances would be required. Based on management's assessment, the Company provides for estimated uncollectible amounts through a charge to earnings or customer deposits depending on whether the corresponding income has been recognized by the Company, and a credit to a valuation allowance. Balances that remain outstanding after the Company has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts receivable.

*Foreign Currency Translation*

The Company's functional currency and its reporting currency is the United States Dollar. 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' equity (deficit), whereas gains or losses resulting from foreign currency transactions are included in the results of operations.

Refer to the Risk Management section for further discussions on foreign exchange exposure.

*Long-Lived Assets Including Other Acquired Intellectual Property*

Management monitors the recoverability of long-lived assets and intangibles 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. The Company did not record any significant impairments during 2012 and 2011.

Intangible assets deemed to have an indefinite life are not amortized but are subject to impairment tests at each reporting date. The Company assesses the impairment of intangible assets on a quarterly basis or whenever events or changes in circumstances indicate that the fair value is less than its carrying value. If the carrying amount of the intangible asset exceeds its fair value, the intangible asset is considered impaired and the second step of the test is performed to determine the amount of impairment loss, if any. The Company did not recognize any impairment

charges related to indefinite lived intangible assets during 2012 and 2011.

### *Revenue Recognition*

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

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

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

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

### *Deferred Income*

The Company recognizes revenues as earned. Amounts billed in advance of the period in which service is rendered are recorded as a liability under Deferred income.

### *Debt with Conversion Options*

The Company accounts for convertible debentures in accordance with ASC Topic 470-20, *Debt with Conversion and Other Options*, which applies to all convertible debt instruments that have a net settlement feature, which means instruments that by their terms may be settled either wholly or partially in cash upon conversion. Accordingly, the liability and equity components of convertible debt instruments that may be settled wholly or partially in cash upon conversion should be accounted for separately in a manner reflective of their issuer's nonconvertible debt borrowing rate. Conversion features determined to be beneficial to the holder are valued at fair value and recorded to additional paid in capital. Any discount derived from determining the fair value to the debenture conversion features is amortized to interest expense over the life of the debenture. The unamortized costs, if any, upon the conversion of the debentures is expensed to interest immediately.

### *Financial Instruments*

The carrying value of our company's financial instruments, consisting of cash, accounts receivable, accounts payable and accrued liabilities, wages payable, accrued taxes, customer deposits, deferred income, other loans payable, and due to related parties, approximate their fair value due to the relatively short maturity of these instruments.

*Stock-Based Compensation*

The Company accounts for its share-based compensation plans in accordance with the fair value recognition provisions of ASC 718 *Compensation - Stock Compensation*. The Company utilizes the Black-Scholes option pricing model as its method for determining the fair value of stock option grants. ASC 718 requires the fair value of all share-based awards that are expected to vest to be recognized in the statements of operations over the service or vesting period of each award. The Company uses the straight-line method of attributing the value of share-based compensation expense for all stock option grants over the requisite service period.

*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, given the relative size of a typical contract, the number of clients, timing of sales and the revenue recognition of said sales, will have an inherent concentration of sales. The Company is cognizant of such concentration and takes steps to mitigate such risks via accelerated and/or progress payment structures and contractual legal recourse. The tables below demonstrate the level of concentration in the two prior periods:

## 2012 Sales Concentration

| Client Description            | Rank | Percentage |
|-------------------------------|------|------------|
| Global Mobile Operator        | 1    | 34%        |
| Local Mobile Operator         | 2    | 33%        |
| Global Mobile Operator        | 3    | 18%        |
| Local Mobile Service Provider | 4    | 9%         |
| Total                         |      | 94%        |

## 2011 Sales Concentration

| Client Description     | Rank | Percentage |
|------------------------|------|------------|
| Local Mobile Operator  | 1    | 87%        |
| Global Mobile Operator | 2    | 9%         |
| Total                  |      | 96%        |

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 to the Company's operations 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.

The Company also operates in countries with strict foreign exchange controls, i.e. Venezuela, which limit access and convertibility to US dollars. While the Company is familiar with such restrictions and the programs available in each country to access foreign exchange, when available, is exposed to government vagary and fiat. Management actions are limited in such cases.

*Recent Accounting Pronouncements*

In July 2012, the FASB issued ASU 2012-02, *Testing Indefinite-Lived Intangible Assets for Impairment*

(*Intangibles - Goodwill and Other Topic 350*), which is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. This update simplifies how an entity tests these assets for impairment and tries to improve the consistency in testing guidance among long-lived asset categories. This standard is not expected to have an effect on the Company's reported financial position or results of operations.



In October 2012, the FASB issued ASU 2012-04, *Technical Corrections and Improvements*, which is effective for financial statements issued for interim and annual periods beginning on or after December 15, 2012. This update contains amendments that affect various Topics in the Codification. This standard is not expected to have an effect on the Company's reported financial position or results of operations.

**Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

As a smaller reporting company, we are not required to provide the information required by this Item.

**Item 8. Financial Statements and Supplementary Data**

**ALTERNET SYSTEMS INC.**

**CONSOLIDATED FINANCIAL STATEMENTS**

**DECEMBER 31, 2012**

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

CONSOLIDATED BALANCE SHEETS (as restated)

CONSOLIDATED STATEMENTS OF OPERATIONS (as restated)

CONSOLIDATED STATEMENTS OF CASH FLOWS (as restated)

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (as restated)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

*Report of Independent Registered Public Accounting Firm*

Board of Directors and Stockholders  
Alternet Systems, Inc.

We have audited the accompanying consolidated balance sheet of Alternet Systems, Inc. as of December 31, 2012, and the related consolidated statements of operations and comprehensive loss, stockholders' equity, and cash flows for the year then ended. These financial statements are the responsibility of the entity's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Alternet Systems, Inc. as of December 31, 2012, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that the entity will continue as a going concern. As discussed in Note 1 to the consolidated financial statements, the entity has suffered recurring losses from operations and has a net capital deficiency that raises substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 1. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

As discussed in Note 17 to the consolidated financial statements, the accompanying financial statements and schedule have been restated to correct for errors for unrecorded material accruals.

/s/ StarkSchenkein, LLP  
StarkSchenkein, LLP

Denver, Colorado

April 15, 2013, Except for note 17 and the related changes as to which the Date is December 16, 2013

**ALTERNET SYSTEMS INC.**  
**CONSOLIDATED BALANCE SHEETS**  
**As at December 31, 2012 and December 31, 2011**

|                                                                      | <i>(restated)</i><br><b>2012</b> | <b>2011</b>      |
|----------------------------------------------------------------------|----------------------------------|------------------|
|                                                                      | <b>\$</b>                        | <b>\$</b>        |
| <b>ASSETS</b>                                                        |                                  |                  |
| <b>Current Assets</b>                                                |                                  |                  |
| Cash                                                                 | 5,751                            | 77,312           |
| Accounts receivable, net                                             | 1,249,447                        | 2,215,586        |
| Prepaid cost of sales                                                | 108,382                          | 294,855          |
| Deposits and other assets                                            | 53,643                           | 44,155           |
| <b>Total current assets</b>                                          | <b>1,417,223</b>                 | <b>2,631,908</b> |
| <b>Fixed assets</b>                                                  | <b>281,804</b>                   | <b>142,408</b>   |
| <b>Intellectual property</b>                                         | <b>1,600,000</b>                 | <b>1,600,000</b> |
| <b>TOTAL ASSETS</b>                                                  | <b>3,299,027</b>                 | <b>4,374,316</b> |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIENCY)</b>             |                                  |                  |
| <b>Current liabilities</b>                                           |                                  |                  |
| Accounts payable and accrued charges                                 | 1,549,885                        | 1,778,876        |
| Wages payable                                                        | 821,628                          | 345,285          |
| Accrued taxes                                                        | 921,347                          | 505,833          |
| Customer deposits                                                    | -                                | 655,828          |
| Deferred income                                                      | 288,688                          | 359,400          |
| Other loans payable, net of beneficial conversion features           | 642,796                          | 2,448            |
| Due to related parties                                               | 255,376                          | 50,040           |
| Current portion of long-term debt                                    | 166,099                          | -                |
| Current portion of capital leases                                    | 30,028                           | 44,499           |
| <b>Total current liabilities</b>                                     | <b>4,675,847</b>                 | <b>3,742,209</b> |
| <b>Long term debt</b>                                                | <b>69,039</b>                    | <b>-</b>         |
| <b>Capital leases</b>                                                | <b>5,043</b>                     | <b>23,142</b>    |
|                                                                      | <b>4,749,929</b>                 | <b>3,765,351</b> |
| <b>Stockholders' equity (deficiency)</b>                             |                                  |                  |
| Capital stock                                                        |                                  |                  |
| Authorized: 100,000,000 common shares with a par value of \$0.00001  |                                  |                  |
| Issued and outstanding: 89,056,203 common shares (2011 - 74,171,826) | 890                              | 738              |
| Additional paid-in capital                                           | 13,849,991                       | 11,171,559       |
| Private placement subscriptions                                      | 130,362                          | 630,362          |
| Obligation to issue shares                                           | -                                | 113,333          |
| Accumulated other comprehensive income                               | (331,349)                        | (331,396)        |
| Accumulated Deficit                                                  | (14,629,698)                     | (11,294,752)     |
|                                                                      | (979,804)                        | 289,844          |
| Non-controlling interest                                             | (471,098)                        | 319,121          |
|                                                                      | (1,450,902)                      | 608,965          |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIENCY)</b>       | <b>3,299,027</b>                 | <b>4,374,316</b> |

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

**ALTERNET SYSTEMS INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
For the years ended December 31, 2012 and 2011

|                                                              | <i>(restated)</i>  |                    |
|--------------------------------------------------------------|--------------------|--------------------|
|                                                              | <b>2012</b>        | <b>2011</b>        |
|                                                              | <b>\$</b>          | <b>\$</b>          |
| <b>REVENUE</b>                                               |                    |                    |
| Sales                                                        | 1,355,935          | 1,219,421          |
| Sales discounts                                              | -                  | (8,655)            |
|                                                              | 1,355,935          | 1,210,766          |
| <b>COST OF SALES</b>                                         | 923,076            | 1,122,536          |
| <b>GROSS PROFIT</b>                                          | 432,859            | 88,230             |
| <b>OPERATING EXPENSES</b>                                    |                    |                    |
| Bad debt                                                     | 177,572            | 3,023              |
| Bank charges                                                 | 11,520             | 9,194              |
| Depreciation                                                 | 93,461             | 25,525             |
| Investor relations                                           | 55,535             | 40,650             |
| Licenses, dues, and insurance                                | 5,848              | 8,873              |
| Management and consulting                                    | 1,596,824          | 1,095,963          |
| Marketing                                                    | 19,932             | 11,727             |
| Office and general                                           | 72,993             | 80,444             |
| Professional fees                                            | 391,727            | 320,484            |
| Rent                                                         | 128,312            | 86,388             |
| Salaries                                                     | 1,067,512          | 1,056,185          |
| Telephone and utilities                                      | 58,527             | 30,976             |
| Travel                                                       | 154,641            | 226,959            |
|                                                              | 3,834,404          | 2,996,391          |
| <b>NET LOSS BEFORE OTHER ITEMS</b>                           | (3,401,545)        | (2,908,161)        |
| <b>OTHER ITEMS</b>                                           |                    |                    |
| Interest expense                                             | (457,283)          | (45,143)           |
| Loss on foreign exchange                                     | (404,736)          | -                  |
| Interest income                                              | 1,886              | 2,231              |
| Loss on debt settlement                                      | (579,375)          | (144,303)          |
|                                                              | (1,439,508)        | (187,215)          |
| <b>NET LOSS BEFORE INCOME TAXES</b>                          | (4,841,053)        | (3,095,376)        |
| <b>INCOME TAXES</b>                                          | 2,554              | -                  |
| <b>NET LOSS BEFORE NON-CONTROLLING INTEREST</b>              | (4,843,607)        | (3,095,376)        |
| <b>NON-CONTROLLING INTEREST</b>                              | (1,508,661)        | (816,715)          |
| <b>NET LOSS ATTRIBUTABLE TO ALTERNET SYSTEMS INC.</b>        | <b>(3,334,946)</b> | <b>(2,278,661)</b> |
| <b>OTHER COMPREHENSIVE LOSS</b>                              |                    |                    |
| Gain (loss) on derivative liabilities                        | -                  | (165,734)          |
| <b>TOTAL COMPREHENSIVE LOSS</b>                              | <b>(3,334,946)</b> | <b>(2,444,395)</b> |
| <b>BASIC AND DILUTED NET LOSS PER COMMON SHARE</b>           | \$ (0.04)          | \$ (0.04)          |
| <b>BASIC AND DILUTED COMPREHENSIVE LOSS PER COMMON SHARE</b> | \$ (0.04)          | \$ (0.04)          |
| <b>WEIGHTED COMMON SHARES OUTSTANDING</b>                    | <b>82,767,827</b>  | <b>60,474,129</b>  |

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

**ALTERNET SYSTEMS INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**For the years ended December 31, 2012 and 2011**

|                                                        | <i>(restated)</i><br><b>2012</b><br>\$ | <b>2011</b><br>\$ |
|--------------------------------------------------------|----------------------------------------|-------------------|
| <b>OPERATING ACTIVITIES</b>                            |                                        |                   |
| Net income attributable to Alternet Systems Inc.       | (3,334,946)                            | (2,278,661)       |
| Non-controlling interest                               | (1,508,661)                            | (816,715)         |
| Add items not affecting cash                           |                                        |                   |
| Depreciation                                           | 93,461                                 | 25,525            |
| Interest accrued in other loans payable                | 85,953                                 | -                 |
| Bad debt expense                                       | 177,572                                | -                 |
| Shares for services                                    | 261,676                                | 1,226,468         |
| Reversal of shares for services                        | (140,000)                              | -                 |
| Warrants issued in debt settlement                     | 85,198                                 | -                 |
| Accretion of debt discount                             | 66,905                                 | -                 |
| Unrealized foreign exchange loss                       | 404,736                                | -                 |
| Deferred compensation                                  | -                                      | 79,832            |
| Loss on debt settlement                                | 579,375                                | 144,303           |
| Changes in non-cash working capital:                   |                                        |                   |
| Accounts receivable                                    | 383,831                                | (1,359,247)       |
| Prepaid cost of sales                                  | 186,473                                | (85,042)          |
| Deposits and other assets                              | 37,570                                 | (31,136)          |
| Accounts payable and accrued charges                   | 482,470                                | 525,049           |
| Wages payable                                          | 897,847                                | (74,871)          |
| Accrued taxes                                          | 415,514                                | 305,509           |
| Customer deposits                                      | (655,828)                              | 511,828           |
| Deferred income                                        | (70,712)                               | 217,088           |
| Due to related parties                                 | 205,336                                | 163,111           |
| Net cash (used in) operating activities                | (1,346,230)                            | (1,446,959)       |
| <b>INVESTING ACTIVITIES</b>                            |                                        |                   |
| Acquisition of fixed assets                            | -                                      | (165,389)         |
| Acquisition of intellectual property                   | -                                      | (100,000)         |
| Net cash (used in) investing activities                | -                                      | (265,389)         |
| <b>FINANCING ACTIVITIES</b>                            |                                        |                   |
| Proceeds from loans payable                            | 759,438                                | 4,143             |
| Payments for loans payable                             | (20,000)                               | (40,342)          |
| Proceeds from capital leases                           | -                                      | 137,690           |
| Payments for capital leases                            | (51,527)                               | (70,049)          |
| Payments for long term debt                            | (31,992)                               | -                 |
| Net proceeds on sale of common stock and subscriptions | 627,699                                | 1,783,500         |
| Share issue costs                                      | (8,996)                                | (39,000)          |
| Net cash provided by financing activities              | 1,274,622                              | 1,775,942         |
| <b>EFFECT OF EXCHANGE RATES ON CASH</b>                | 47                                     | -                 |
| <b>NET INCREASE (DECREASE) IN CASH</b>                 | (71,561)                               | 63,594            |

|                                |              |               |
|--------------------------------|--------------|---------------|
| <b>CASH, BEGINNING OF YEAR</b> | 77,312       | 13,718        |
| <b>CASH, END OF YEAR</b>       | <b>5,751</b> | <b>77,312</b> |

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

**ALTERNET SYSTEMS INC.**  
**CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIENCY)**

|                                                                   |                   |                       |                                        |                                             |                                |                                     | <i>(restated)</i>            |    |
|-------------------------------------------------------------------|-------------------|-----------------------|----------------------------------------|---------------------------------------------|--------------------------------|-------------------------------------|------------------------------|----|
|                                                                   | Shares            | Common<br>Stock<br>\$ | Additional<br>Paid in<br>Capital<br>\$ | Private<br>Placement<br>Subscriptions<br>\$ | Deferred<br>Compensation<br>\$ | Obligation to<br>Issue shares<br>\$ | Accumulated<br>Deficit<br>\$ | Co |
| <b>Balance<br/>December 31,<br/>2010</b>                          | <b>48,219,648</b> | <b>483</b>            | <b>7,860,223</b>                       | <b>145,362</b>                              | <b>(79,832)</b>                | <b>108,000</b>                      | <b>(9,016,091)</b>           |    |
| Shares issued<br>for debt<br>settlements                          | 5,516,145         | 55                    | 717,568                                | -                                           | -                              | -                                   | -                            |    |
| Shares issued<br>for services                                     | 10,734,367        | 104                   | 1,334,364                              | -                                           | 16,250                         | (223,000)                           | -                            |    |
| Shares issued<br>for cash                                         | 9,201,666         | 91                    | 1,283,409                              | (693,500)                                   | -                              | -                                   | -                            |    |
| Share issue<br>costs                                              | -                 | -                     | (39,000)                               | -                                           | -                              | -                                   | -                            |    |
| Share<br>subscriptions<br>from prior<br>years issued              | 500,000           | 5                     | 14,995                                 | (15,000)                                    | -                              | -                                   | -                            |    |
| Private<br>placement<br>subscriptions<br>received                 | -                 | -                     | -                                      | 1,193,500                                   | -                              | -                                   | -                            |    |
| Services<br>provided per<br>term of<br>contracts                  | -                 | -                     | -                                      | -                                           | 76,082                         | -                                   | -                            |    |
| Obligation to<br>issue shares                                     | -                 | -                     | -                                      | -                                           | (12,500)                       | 228,333                             | -                            |    |
| Decrease in<br>derivative<br>liability                            | -                 | -                     | -                                      | -                                           | -                              | -                                   | -                            |    |
| Subsidiary<br>shares issued to<br>non-<br>controlling<br>interest | -                 | -                     | -                                      | -                                           | -                              | -                                   | -                            |    |
| Non-controlling<br>interest                                       | -                 | -                     | -                                      | -                                           | -                              | -                                   | -                            |    |
| Net loss                                                          | -                 | -                     | -                                      | -                                           | -                              | -                                   | (2,278,661)                  |    |
| <b>Balance<br/>December 31,</b>                                   | <b>74,171,826</b> | <b>738</b>            | <b>11,171,559</b>                      | <b>630,362</b>                              | <b>-</b>                       | <b>113,333</b>                      | <b>(11,294,752)</b>          |    |

**2011**

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

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**ALTERNET SYSTEMS INC.**  
**CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY**  
**(DEFICIENCY)**

|                                                                     |                   |                       |                                        |                                             |                                     | (restated)                   |                                        |         |
|---------------------------------------------------------------------|-------------------|-----------------------|----------------------------------------|---------------------------------------------|-------------------------------------|------------------------------|----------------------------------------|---------|
|                                                                     | Shares            | Common<br>Stock<br>\$ | Additional<br>Paid in<br>Capital<br>\$ | Private<br>Placement<br>Subscriptions<br>\$ | Obligation to<br>Issue shares<br>\$ | Accumulated<br>Deficit<br>\$ | Other<br>Comprehensive<br>Income<br>\$ | Co<br>I |
| <b>Balance<br/>December 31,<br/>2011</b>                            | <b>74,171,826</b> | <b>738</b>            | <b>11,171,559</b>                      | <b>630,362</b>                              | <b>113,333</b>                      | <b>(11,294,752)</b>          | <b>(331,396)</b>                       |         |
| Shares issued<br>for debt<br>settlements                            | 5,978,317         | 60                    | 1,210,284                              | -                                           | (113,333)                           | -                            | -                                      |         |
| Shares issued<br>for services                                       | 1,572,728         | 15                    | 261,661                                | -                                           | -                                   | -                            | -                                      |         |
| Shares issued<br>for cash                                           | 4,999,999         | 50                    | 627,649                                | -                                           | -                                   | -                            | -                                      |         |
| Cancellation of<br>shares issued<br>for services                    | (1,000,000)       | (6)                   | (139,994)                              | -                                           | -                                   | -                            | -                                      |         |
| Share<br>subscriptions<br>from prior years<br>issued                | 3,333,333         | 33                    | 499,967                                | (500,000)                                   | -                                   | -                            | -                                      |         |
| Share issue<br>costs                                                | -                 | -                     | (8,996)                                | -                                           | -                                   | -                            | -                                      |         |
| Warrants issued<br>for debt                                         | -                 | -                     | 85,198                                 | -                                           | -                                   | -                            | -                                      |         |
| Beneficial<br>conversion<br>features                                | -                 | -                     | 142,663                                | -                                           | -                                   | -                            | -                                      |         |
| Foreign<br>exchange<br>translation<br>adjustment                    | -                 | -                     | -                                      | -                                           | -                                   | -                            | -                                      | 47      |
| Subsidiary<br>shares issued to<br>non- controlling<br>interest      | -                 | -                     | -                                      | -                                           | -                                   | -                            | -                                      | -       |
| Adjustment to<br>non-controlling<br>interest<br>accounts<br>payable | -                 | -                     | -                                      | -                                           | -                                   | -                            | -                                      | -       |
| Non-controlling<br>interest                                         | -                 | -                     | -                                      | -                                           | -                                   | -                            | -                                      | -       |
| Net loss                                                            | -                 | -                     | -                                      | -                                           | -                                   | (3,334,946)                  | -                                      | -       |

**Balance**

**December 31,**

**2012      89,056,203      890   13,849,991      130,362      -      (14,629,698)      (331,349)**

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

**ALTERNET SYSTEMS INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2012 and 2011**

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

Alternet Systems Inc., through its subsidiaries ( Alternet or the Company ), provides leading edge mobile financial solutions and mobile security and related solutions. The former are offered throughout the Western Hemisphere, but most actively in Central and South America and the Caribbean, and the latter are offered globally.

The Company was organized under the laws of the State of Nevada on June 26, 2000, under the name North Pacific Capital Corp. In 2001, the Company changed its name to SchoolWeb Systems Inc. and then, in 2002, to Alternet Systems, Inc. On December 31, 2007 the Company executed a merger with TekVoice Communications, Inc. of Miami, Florida. Since then the Company has changed business focus and strategy to mobile financial services and mobile security. In 2011 TekVoice became inactive.

In July 2009, the Company purchased 51% of the outstanding shares of Alternet Transactions Systems, Inc. ( ATS ), a company incorporated in the State of Florida on July 29, 2009, for \$5,100. ATS is doing business as Utiba Americas. In December 2011, ATS opened a branch in Ecuador.

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

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

In August 2011, ATS incorporated a wholly owned subsidiary, Utiba Guatemala, S.A., in Guatemala.

In September 2011, the Company formed two one-member limited liability companies, Alternet Financial Solutions, L.L.C. and Alternet Payment Solutions, L.L.C., in the State of Florida.

These consolidated financial statements have been prepared on the basis of a going concern, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. At December 31, 2012 the Company had a working capital deficiency of \$3,258,624. 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.

**ALTERNET SYSTEMS INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2012 and 2011**

**NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and are prepared in US dollars unless otherwise noted.

**Principles of Consolidation**

These consolidated financial statements include the accounts of the following companies:

- Alternet Systems Inc.
- AI Systems Group, Inc., a wholly owned subsidiary of Alternet
- Tekvoice Communications, Inc., a wholly owned subsidiary of Alternet
- Alternet Transactions Systems, Inc., a 51% owned subsidiary of Alternet
- Utiba Guatemala, S.A., a wholly-owned subsidiary of Alternet Transactions Systems Inc.
- International Mobile Security, Inc, a 60% owned subsidiary of Alternet
- Megatecnica, S.A., a wholly owned subsidiary of International Mobile Security, Inc.
- Alternet Financial Solutions, L.L.C, wholly-owned subsidiary of Alternet
- Alternet Payment Solutions, L.L.C, wholly-owned subsidiary of Alternet

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

**Use of Estimates and Assumptions**

The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the financial statement date and the reported amounts of revenues and expenses during the reporting period. The Company regularly evaluates estimates and assumptions related to the useful life and recoverability of long-lived assets, fair value of convertible notes payable and derivative liabilities. The Company bases its estimates and assumptions on current facts, historical experience and various other factors that it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities and the accrual of costs and expenses that are not readily apparent from other sources. The actual results experienced by the Company may differ materially and adversely from the Company's estimates. To the extent there are material differences between estimates and the actual results, future results of operations will be affected.

**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.

**ALTERNET SYSTEMS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****December 31, 2012 and 2011****NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)****Accounts Receivable and Allowance for Doubtful Accounts**

Trade accounts receivable are stated at the amount the Company expects to collect. The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. Management considers the following factors when determining the collectability of specific customer accounts: customer credit-worthiness, past transaction history with the customer, current economic industry trends, and changes in customer payment terms. Past due balances over 90 days and other higher risk amounts are reviewed individually for collectability. If the financial condition of the Company's customers were to deteriorate, adversely affecting their ability to make payments, additional allowances would be required. Based on management's assessment, the Company provides for estimated uncollectible amounts through a charge to earnings and a credit to a valuation allowance. Balances that remain outstanding after the Company has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts receivable.

At December 31, 2012, the Company had \$154,845 (2011 - \$Nil) in allowance for doubtful accounts.

**Equipment**

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

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

**Long-Lived Assets Including Other Acquired Intellectual Property**

Management monitors the recoverability of long-lived assets and intangibles 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. The Company did not record any significant impairments during 2012 and 2011.

Intangible assets deemed to have an indefinite life are not amortized but are subject to impairment tests at each reporting date. The Company assesses the impairment of intangible assets on a quarterly basis or whenever events or changes in circumstances indicate that the fair value is less than its carrying value. If the carrying amount of the intangible asset exceeds its fair value, the intangible asset is considered impaired and the second step of the test is performed to determine the amount of impairment loss, if any. The Company did not recognize any impairment charges related to indefinite lived intangible assets during 2012 and 2011.

**ALTERNET SYSTEMS INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2012 and 2011**

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

**Revenue Recognition**

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

- e) Revenue from the sale of licenses is recognized when the title of the license transfers to the customer.
- f) Revenue from implementation services performed is recognized upon completion of the service.
- g) Revenue from support services is recognized as earned.
- h) Revenue from telecommunications and hosted services are recognized when billed, which occurs in the month the services are provided.

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

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

**Deferred Income**

The Company recognizes revenues as earned. Amounts billed in advance of the period in which service is rendered are recorded as a liability under Deferred income.

**Debt with Conversion Options**

The Company accounts for convertible debentures in accordance with ASC Topic 470-20, *Debt with Conversion and Other Options*, which applies to all convertible debt instruments that have a net settlement feature, which means instruments that by their terms may be settled either wholly or partially in cash upon conversion. Accordingly, the liability and equity components of convertible debt instruments that may be settled wholly or partially in cash upon conversion should be accounted for separately in a manner reflective of their issuer's nonconvertible debt borrowing rate. Conversion features determined to be beneficial to the holder are valued at fair value and recorded to additional paid in capital. Any discount derived from determining the fair value to the debenture conversion features is amortized to interest expense over the life of the debenture. The unamortized costs, if any, upon the conversion of the debentures is expensed to interest immediately.

**ALTERNET SYSTEMS INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2012 and 2011**

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

**Leases**

The Company leases operating facilities which include switches, other network equipment, and premises. Rentals payable under operating leases are charged to the statements of operation on a straight line basis over the term of the relevant lease. For capital leases, the present value of future minimum lease payments at the inception of the lease is reflected as an asset and a liability in the statement of financial position. Amounts due within one year are classified as short-term liabilities and the remaining balance as long-term liabilities.

**Foreign Currency Translation**

The Company's functional currency and its reporting currency is the United States Dollar. 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' equity (deficit), whereas gains or losses resulting from foreign currency transactions are included in the results of operations.

Refer to the Risk Management section for further discussions on foreign exchange exposure.

**Fair Value of Financial Instruments**

The Company has determined the estimated fair value of financial instruments using available market information and appropriate valuation methodologies. The carrying value of the Company's financial instruments, consisting of cash, accounts receivable, accounts payable and accrued liabilities, wages payable, accrued taxes, customer deposits, deferred income, other loans payable, and due to related parties, approximate their fair value due to the relatively short maturity of these 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 recognizes the tax benefit from an uncertain tax position only if it is more likely than not the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such positions are then measured based on the largest benefit that has a greater than 50% likelihood of being realized upon settlement.

**ALTERNET SYSTEMS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****December 31, 2012 and 2011****NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)****Stock-Based Compensation**

The Company accounts for its share-based compensation plans in accordance with the fair value recognition provisions of ASC 718 *Compensation - Stock Compensation*. The Company utilizes the Black-Scholes option pricing model as its method for determining the fair value of stock option grants. ASC 718 requires the fair value of all share-based awards that are expected to vest to be recognized in the statements of operations over the service or vesting period of each award. The Company uses the straight-line method of attributing the value of share-based compensation expense for all stock option grants over the requisite service period.

**Loss per Share**

The Company computes net earnings (loss) per share in accordance with ASC Topic 260, *Earnings Per Share*. Topic 260 requires presentation of both basic and diluted earnings per share (EPS) on the face of the statement of operations. Basic EPS is computed by dividing net loss available to common shareholders (numerator) by the weighted average number of common shares outstanding (denominator) during the period. Diluted EPS gives effect to all dilutive potential common shares outstanding during the period including warrants using the treasury stock method. Diluted EPS excludes all dilutive potential common shares if their effect is anti-dilutive. As the Company has net losses, no common equivalent shares have been included in the computation of diluted net loss per share as the effect would be anti-dilutive.

At December 31, 2012, 6,009,863 (2011 6,569,444) warrants were excluded from the loss per share calculation as their effect would be anti-dilutive.

**Risk Management**

The Company is exposed to credit risk through accounts receivable and therefore, the Company maintains adequate provisions for potential credit losses. The Company, given the relative size of a typical contract, the number of clients, timing of sales and the revenue recognition of said sales, will have an inherent concentration of sales. The Company is cognizant of such concentration and takes steps to mitigate such risks via accelerated and/or progress payment structures and contractual legal recourse. The tables below demonstrate the level of concentration in the two prior periods:

**2012 Sales Concentration**

| Client Description            | Rank | Percentage |
|-------------------------------|------|------------|
| Global Mobile Operator        | 1    | 34%        |
| Local Mobile Operator         | 2    | 33%        |
| Global Mobile Operator        | 3    | 18%        |
| Local Mobile Service Provider | 4    | 9%         |
| Total                         |      | 94%        |

**ALTERNET SYSTEMS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****December 31, 2012 and 2011****NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)****Risk Management (continued)**

## 2011 Sales Concentration

| Client Description     | Rank | Percentage |
|------------------------|------|------------|
| Local Mobile Operator  | 1    | 87%        |
| Global Mobile Operator | 2    | 9%         |
| Total                  |      | 96%        |

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 to the Company's operations 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.

The Company also operates in countries with strict foreign exchange controls, i.e. Venezuela, which limit access and convertibility to US dollars. While the Company is familiar with such restrictions and the programs available in each country to access foreign exchange, when available, is exposed to government vagary and fiat. Management actions are limited in such cases.

**Recent Accounting Pronouncements**

In July 2012, the FASB issued ASU 2012-02, *Testing Indefinite-Lived Intangible Assets for Impairment (Intangibles Goodwill and Other Topic 350)*, which is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. This update simplifies how an entity tests these assets for impairment and tries to improve the consistency in testing guidance among long-lived asset categories. This standard is not expected to have an effect on the Company's reported financial position or results of operations.

In October 2012, the FASB issued ASU 2012-04, *Technical Corrections and Improvements*, which is effective for financial statements issued for interim and annual periods beginning on or after December 15, 2012. This update contains amendments that affect various Topics in the Codification. This standard is not expected to have an effect on the Company's reported financial position or results of operations.

**Reclassification**

Certain comparative figures have been reclassified in order to conform to the current year's presentation.

**ALTERNET SYSTEMS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2012 and 2011**  
**NOTE 3 FIXED ASSETS**

|                    |                | <b>December 31, 2012</b> |                             |                   |
|--------------------|----------------|--------------------------|-----------------------------|-------------------|
|                    |                | Cost                     | Accumulated<br>Depreciation | Net Book<br>Value |
|                    |                | \$                       | \$                          | \$                |
| Computer equipment |                | 344,252                  | 328,614                     | <b>15,638</b>     |
| Computer equipment | capital leases | 156,746                  | 58,452                      | <b>98,294</b>     |
| Computer software  |                | 289,028                  | 121,453                     | <b>167,575</b>    |
| Equipment          |                | 10,576                   | 10,279                      | <b>297</b>        |
|                    |                | 800,602                  | 518,798                     | <b>281,804</b>    |

|                    |                | <b>December 31, 2011</b> |                             |                   |
|--------------------|----------------|--------------------------|-----------------------------|-------------------|
|                    |                | Cost                     | Accumulated<br>Depreciation | Net Book<br>Value |
|                    |                | \$                       | \$                          | \$                |
| Computer equipment |                | 344,252                  | 321,912                     | <b>22,340</b>     |
| Computer equipment | capital leases | 137,790                  | 20,669                      | <b>117,121</b>    |
| Computer software  |                | 75,128                   | 72,552                      | <b>2,576</b>      |
| Equipment          |                | 10,576                   | 10,205                      | <b>371</b>        |
|                    |                | 567,746                  | 425,338                     | <b>142,408</b>    |

Depreciation expense in 2012 and 2011 was \$93,461 and \$25,525, respectively.

**NOTE 4 INTELLECTUAL PROPERTY**

On January 25, 2011, the Company signed a Copyright Agreement with a supplier for various intellectual properties of which \$100,000 was due upon signing of the agreement. As of December 31, 2012, the Company had \$68,900 (December 31, 2011 - \$68,900) included in accounts payable and accrued charges relating to this agreement.

In December 2011, the Company purchased four software licenses from Utiba Pte., a non-controlling interest investor in ATS, valued at \$1,500,000. Each license provides the Company the ability to offer mobile financial services under a Software as a Services (SaaS) arrangement to its customers by providing unlimited access to Utiba's underlying platform. Utiba Pte is required to maintain the systems in working order and provide all necessary services to the Company. As the licenses are for a service that is emerging on a global scale and there is no set term for the service, the licenses have been determined to have an indefinite life.

**ALTERNET SYSTEMS INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2012 and 2011**

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

**Convertible Debentures**

On February 4, 2008, the Company issued a note payable in the amount of \$50,000. The note carried interest at the rate of 8% per quarter and was due on May 4, 2008. If the note was not repaid on maturity or in any other event of default, the holder was 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 July 20, 2011, the creditor converted \$136,252 of debt into 2,265,207 common shares of the Company resulting in a full repayment of the loan.

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

On December 18, 2009, the Company entered into a debt settlement agreement whereby a creditor agreed to receive shares in lieu of payment of a \$152,916 promissory note. The holder was entitled to receive common stock of the Company at a conversion value equal to 50% of the lowest closing price of the Company's stock for the 10 days prior to the date of conversion. The holder may not hold more than 4.99% of the outstanding common stock of the Company at any point in time. During the year ended December 31, 2010, the creditor converted \$113,750 of debt into 4,457,699 common shares of the company. On February 25, 2011, the creditor converted \$72,833 of debt into 1,220,363 common shares of the Company resulting in a full repayment of the loan.

On March 8, 2010, the Company issued a note payable in the amount of \$25,000. The note carried interest at the rate of 12% per annum and was due on April 8, 2010. If the note was not repaid on maturity or in any other event of default, the holder was entitled to convert all or any portion of the original principal face value of the note into shares of common stock of the Company at a conversion value equal to 50% of the lowest closing price of the Company's stock for the 10 trading days immediately preceding and including the date of conversion. On August 29, 2011, the Company repaid the loan in full.

**ALTERNET SYSTEMS INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2012 and 2011**

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

**Convertible Debentures (continued)**

On April 14, 2010, the Company issued a note payable in the amount of \$15,000. The note carried interest at the rate of 10% per annum and was due on May 18, 2010. If the note was not repaid on maturity or in any other event of default, the holder was entitled to convert all or any portion of the original principal face value of the note into shares of common stock of the Company at a conversion value equal to 50% of the lowest closing price of the Company's stock for the 10 trading days immediately preceding and including the date of conversion. On October 20, 2011, the Company repaid the loan in full.

On April 30, 2010, the Company issued a note payable in the amount of \$100,000. The note carried interest at the rate of 10% per annum and was due on July 30, 2010. The note was not repaid on maturity, thus, the holder converted all 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 closing price of the Company's stock for the 10 trading days immediately preceding and including the date of conversion. On August 22, 2011, the creditor submitted a Notice of Conversion to convert \$113,333 of debt into 2,138,358 common shares of the company resulting in a full repayment of the loan. At December 31, 2011, the shares had not been issued to the creditor resulting in the full balance being included in obligation to issue shares. On March 5, 2012, the Company issued the 2,138,358 common shares of the Company resulting in a full repayment of the loan.

On August 29, 2012, the Company issued a note payable in the amount of \$44,438. The note carries interest at the rate of 10% per annum and is due on February 28, 2013. 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 of \$0.075. The beneficial conversion feature discount resulting from the conversion price being \$0.045 below the market price on August 29, 2012 of \$0.12 provided a value of \$26,663. During the year ended December 31, 2012, \$18,067 of the debt discount was amortized. As of December 31, 2012, \$37,364 of principal, accrued interest, and unamortized debt discount on this note was included in other loans payable. The note was not repaid by February 28, 2013 and continues to accrue interest at the rate of 10% per annum.

**ALTERNET SYSTEMS INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2012 and 2011**

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

**Convertible Debentures (continued)**

On September 26, 2012, the Company issued a note payable in the amount of \$60,000. The note carries interest at the rate of 10% per annum and is due on March 31, 2013. 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 of \$0.075. The beneficial conversion feature discount resulting from the conversion price being \$0.045 below the market price on September 26, 2012 of \$0.12 provided a value of \$36,000. During the year ended December 31, 2012, \$18,581 of the debt discount was amortized. As of December 31, 2012, \$44,175 of principal, accrued interest, and unamortized debt discount on this note was included in other loans payable. The note was not repaid by March 31, 2013 and continues to accrue interest at the rate of 10% per annum.

On October 19, 2012, the Company issued a note payable in the amount of \$80,000. The note carries interest at the rate of 10% per annum and is due on April 30, 2013. 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 of \$0.075. The beneficial conversion feature discount resulting from the conversion price being \$0.085 below the market price on October 19, 2012 of \$0.16 provided a value of \$80,000. During the year ended December 31, 2012, \$30,259 of the debt discount was amortized. As of December 31, 2012, \$31,881 of principal, accrued interest, and unamortized debt discount on this note was included in other loans payable.

**Other Loans Payable**

On October 22, 2007, the Company signed a promissory note whereby the Company agreed to repay a creditor \$20,000 plus interest at 8% per annum on November 22, 2007. On March 7, 2011, the Company signed a debt settlement agreement with the creditor to convert the outstanding balance into shares of the Company. On April 21, 2011, the creditor converted \$27,000 of debt into 444,079 common shares of the company resulting in a full repayment of the loan.

On January 25, 2011, the Company signed a promissory note whereby the Company agreed to repay a director \$20,000 plus interest at 10% per annum on April 25, 2011. This loan was not repaid on its maturity and has since been renewed several times with the unpaid principal and interest being capitalized to the loan balance on each renewal. As of December 31, 2012, the Company owes this director \$2,598 of unpaid principal and \$131 of accrued interest on a promissory note which matures on December 31, 2012. The loan was renewed on January 1, 2013 with the unpaid principal and interest being capitalized to the loan balance, the maturity date extended to June 30, 2013, and the interest rate remaining at 10% per annum. The balance owing is included in due to related parties.

**ALTERNET SYSTEMS INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2012 and 2011**

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

**Other Loans Payable (continued)**

On February 9, 2011, the Company signed a promissory note whereby the Company agreed to repay a director \$5,000 plus interest at 10% per annum on May 9, 2011. This loan was not repaid on its maturity and has since been renewed several times with the unpaid principal and interest being capitalized to the loan balance on each renewal. As of December 31, 2012, the Company owes this director \$5,736 of unpaid principal and \$289 of accrued interest on a promissory note which matured on December 31, 2012. The loan was renewed on January 1, 2013 with the unpaid principal and interest being capitalized to the loan balance, the maturity date extended to June 30, 2013, and the interest rate remaining at 10% per annum. The balance owing is included in due to related parties.

On February 11, 2011, the Company signed a promissory note whereby the Company agreed to repay a director \$8,988 plus interest at 10% per annum on May 11, 2011. This loan was not repaid on its maturity and has since been renewed several times with the unpaid principal and interest being capitalized to the loan balance on each renewal. As of December 31, 2012, the Company owes this director \$10,308 of unpaid principal and \$520 of accrued interest on a promissory note which matured on December 31, 2012. The loan was renewed on January 1, 2013 with the unpaid principal and interest being capitalized to the loan balance, the maturity date extended to June 30, 2013, and the interest rate remaining at 10% per annum. The balance owing is included in due to related parties.

On March 2, 2011, the Company signed a promissory note whereby the Company agreed to repay a director \$100,000 plus interest at 10% per quarter on June 2, 2011. On July 14, 2011, the director of the Company sold the loan to an unrelated third party. On August 8, 2011, the creditor converted \$110,000 of debt into 733,333 common shares of the company resulting in a full repayment of the loan.

On January 25, 2012, the Company signed a promissory note whereby the Company agreed to repay a creditor \$100,000 plus interest at 12% per annum on April 24, 2012. As of March 31, 2012, the Company has accrued \$2,203 of interest relating to this loan. On April 8, 2012, the Company signed a debt settlement agreement with the creditor whereby the creditor will convert the outstanding principal and interest of \$102,466 into 683,105 common shares of the Company and 409,863 warrants. Each warrant entitles the holder to purchase one common shares of the Company at an exercise price of \$0.25 per share until October 8, 2013. The Company issued 409,863 warrants on April 9, 2012, 113,889 common shares on April 11, 2012, 400,000 common shares on April 19, 2012, 152,778 common shares on April 26, 2012, and 16,438 common shares on May 7, 2012 resulting in a full repayment of the loan. Using the Black-Scholes option pricing model, the fair market value of the warrants at the time of issuance was determined to be \$85,198 with the following assumptions: (1) risk-free rate of interest of 0.07%, (2) an expected life of 1.5 years, (3) expected stock price volatility of 178.93%, and (4) expected dividend yield of zero.

**ALTERNET SYSTEMS INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2012 and 2011**

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

**Other Loans Payable (continued)**

On February 1, 2012, the Company signed a promissory note whereby the Company agreed to repay a creditor \$200,000 plus interest at 24% per annum on May 1, 2012. On May 1, 2012, the Company signed a new promissory note with the creditor which capitalized the unpaid principal and interest of \$211,836 under the previous promissory note and extended the maturity date to September 30, 2012. On October 1, 2012, the Company signed a new promissory note with the creditor which capitalized the unpaid principal and interest of \$233,147 under the previous promissory note and extended the maturity date to January 31, 2013. As of December 31, 2012, the Company has accrued \$14,104 of interest relating to this loan. The note was not repaid by January 31, 2013 and continues to accrue interest at the rate of 24% per annum plus a 0.01% daily late charge penalty on the outstanding balance.

On August 24, 2012, the Company signed a debt settlement agreement with a director of the Company whereby the Company agreed to settle \$103,125 of unpaid wages and \$19,730 of outstanding accounts payable plus interest at 10% per annum starting January 1, 2012 for 983,445 common shares of the Company. On August 24, 2012, the director of the Company sold the loan to an unrelated third party. On September 4, 2012, the 983,445 common shares were issued resulting in a full repayment of all balances outstanding.

On August 24, 2012, the Company signed a debt settlement agreement with an officer of the Company whereby the Company agreed to settle \$126,667 of unpaid wages and \$4,255 of outstanding accounts payable plus interest at 10% per annum starting January 1, 2012 for 1,048,016 common shares of the Company. On August 24, 2012, the director of the Company sold the loan to an unrelated third party. On September 4, 2012, the 1,048,016 common shares were issued resulting in a full repayment of all balances outstanding.

On August 29, 2012, the Company signed a debt settlement agreement with a director of the Company whereby the Company agreed to settle \$75,833 of unpaid wages and \$16,473 of outstanding accounts payable plus interest at 10% per annum starting January 1, 2012 for 597,277 common shares of the Company. On August 29, 2012, the 597,277 common shares were issued resulting in a full repayment of all balances outstanding.

On August 29, 2012, the Company signed a debt settlement agreement with an employee of the Company whereby the Company agreed to settle \$58,333 of unpaid wages and \$17,089 of outstanding accounts payable plus interest at 10% per annum starting January 1, 2012 for 528,116 common shares of the Company. On August 29, 2012, the 528,116 common shares were issued resulting in a full repayment of all balances outstanding.

On October 10, 2012, the Company signed a promissory note whereby the Company agreed to repay a creditor \$50,000 plus interest at 10% per annum on April 8, 2013. As of December 31, 2012, the Company has accrued \$1,137 of interest relating to this loan.

**ALTERNET SYSTEMS INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2012 and 2011**

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

**Other Loans Payable (continued)**

On November 19, 2012, the Company signed a promissory note whereby the Company agreed to repay a creditor \$100,000 plus interest at 10% per annum on May 18, 2013. As of December 31, 2012, the Company has accrued \$1,178 of interest relating to this loan.

On November 19, 2012, the Company signed a promissory note whereby the Company agreed to repay a creditor \$100,000 plus interest at 10% per annum on May 18, 2013. As of December 31, 2012, the Company has accrued \$1,178 of interest relating to this loan.

On December 5, 2012, the Company signed a promissory note whereby the Company agreed to repay a creditor \$25,000 plus interest at 10% per annum on June 3, 2013. As of December 31, 2012, the Company has accrued \$185 of interest relating to this loan.

**NOTE 6 LONG-TERM DEBT**

On April 1, 2012, the Company signed an Agreement with a creditor to purchase various computer software valued at \$213,900 and one year technical support valued at \$47,058. The loan requires one payment of \$35,000 on May 23, 2012 and seven quarterly payments of \$35,495 starting October 1, 2012. The loan includes an implicit interest rate of 7.51% and matures on April 1, 2014. As of December 31, 2012, the balance on the loan was \$235,138.

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

|      |            |
|------|------------|
| 2013 | \$ 166,099 |
| 2014 | 69,039     |
|      | \$ 235,138 |

**ALTERNET SYSTEMS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2012 and 2011**  
**NOTE 7 CAPITAL LEASES**

On April 27, 2011, the Company signed a lease agreement with a creditor to lease various computer equipment. The lease requires 24 monthly payments of \$3,620 including implicit interest of 14.99% and expires on May 1, 2013. As of December 31, 2012, the balance on the lease was \$17,439 (December 31, 2011 - \$55,132).

On September 26, 2011, the Company signed a lease agreement with a creditor to lease additional computer equipment. The lease requires 24 monthly payments of \$668 including implicit interest of 12.75% and expires on September 1, 2013. As of December 31, 2012, the balance on the lease was \$5,702 (December 31, 2011 - \$12,509).

On June 13, 2012, the Company signed a lease agreement with a creditor to lease additional computer equipment. The lease requires a down payment of \$2,777 to be paid upon signing and 24 monthly payments of \$396. The lease includes implicit interest of 13.21% and expires on June 1, 2014. As of December 31, 2012, the balance on this lease was \$6,772.

On August 1, 2012, the Company signed a lease agreement with a creditor to lease additional computer equipment. The lease requires a down payment of \$1,956 to be paid upon signing and 24 monthly payments of \$282. The lease includes implicit interest of 15.60% and expires on September 1, 2014. As of December 31, 2012, the balance on this lease was \$5,158.

The future minimum lease payments required under the capital leases and the present value of the net minimum lease payments as of December 31, 2012, are as follows:

|                                                       |    |          |
|-------------------------------------------------------|----|----------|
| 2013                                                  | \$ | 32,257   |
| 2014                                                  |    | 5,319    |
| Net minimum lease payments                            |    | 37,576   |
| Less: Amount representing interest                    |    | (2,505)  |
| Present value of net minimum lease payments           |    | 35,071   |
| Less: Current maturities of capital lease obligations |    | (30,028) |
| Long-term capital lease obligations                   | \$ | 5,043    |

**ALTERNET SYSTEMS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2012 and 2011**  
**NOTE 8 CAPITAL STOCK**

**Common Shares**

The Company is authorized to issue up to 100,000,000 shares of the Company's common stock with a par value of \$0.00001.

On September 21, 2012, the Company's shareholders approved through a majority vote to amend the Company's Articles of Incorporation by increasing the authorized stock of the Company to 510,000,000 consisting of 500,000,000 common shares with a par value of \$0.00001 per share and 10,000,000 preferred shares with a par value of \$0.00001 per share. In addition, the shareholders approved the 2012 Incentive Stock Option Plan whereby the Company can grant stock options to employees of the Company to acquire up to a maximum of 5% of the Company's authorized stock. Options granted under the plan are non transferable, will vest over a period of three years, can have a maximum term of five years from each vesting date, and are subject to the employee being employed by the Company on the grant and exercise dates. The increase in the authorized share capital and the acceptance of the 2012 Incentive Stock Option Plan are subject to approval by the Securities Exchange Commission.

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

During the year ended December 31, 2012, the Company:

- issued 3,333,333 common shares valued at \$500,000 for share subscriptions received in the prior year;
- issued 5,978,317 common shares valued at \$1,210,344 for debt settlements and convertible debenture agreements of which 2,138,358 shares valued at \$113,333 were obligated to be issued at December 31, 2011;
- issued 372,703 common shares valued at \$56,873 for employment incentives in accordance with employment agreements;
- issued 1,200,025 common shares valued at \$204,803 for legal, accounting, and consulting services rendered; and
- cancelled 1,000,000 common shares valued at \$140,000 previously issued for employment incentives during the year ended December 31, 2011.

**ALTERNET SYSTEMS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2012 and 2011**  
**NOTE 8 CAPITAL STOCK (continued)**

**Common Shares (continued)**

In addition, during the year ended December 31, 2012, the Company issued common shares for the following subscriptions received during the year:

- on May 17, 2012, the Company issued 1,402,116 common shares at \$0.10 per share for total cash proceeds of \$143,528;
- on June 4, 2012, the Company issued 1,264,550 common shares at \$0.10 per share for total cash proceeds of \$134,171; and
- on December 26, 2012, the Company issued 2,333,333 common shares at \$0.15 per share for total cash proceeds of \$350,000.

During the year ended December 31, 2011, the Company:

- issued 500,000 common shares valued at \$15,000 for share subscriptions received in prior years;
- issued 5,516,145 common shares valued at \$717,623 for debt settlements and convertible debenture agreements;
- issued 2,614,337 common shares valued at \$325,862 for legal, accounting, and consulting services rendered of which 1,200,000 shares valued at \$108,000 were obligated to be issued as of December 31, 2010; and
- issued 8,120,030 common shares valued at \$1,008,606 for employment incentives in accordance with employment agreements.

In addition, during the year ended December 31, 2011, the Company issued common shares for the following subscriptions received during the year:

- on June 15, 2011, the Company issued 3,333,333 common shares at \$0.15 per share for total cash proceeds of \$500,000,
- on July 14, 2011, the Company issued 1,935,000 common shares at \$0.10 per share for total cash proceeds of \$193,500,
- on August 2, 2011, the Company issued 600,000 common shares at \$0.15 per share for total proceeds of \$90,000, and
- on December 29, 2011, the Company issued 3,333,333 common shares at \$0.15 per share for total cash proceeds of \$500,000.

At December 31, 2012, the Company had \$130,362 (December 31, 2011 - \$630,362) in private placement subscriptions which are reported as private placement subscriptions within stockholders' deficit.

The shares which were not issued as at December 31, 2012 or December 31, 2011 were not used to compute the total weighted average shares outstanding as at December 31, 2012 or December 31, 2011 respectively and were thus not used in the basic net loss per share calculation.

**ALTERNET SYSTEMS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2012 and 2011**  
**NOTE 8 CAPITAL STOCK (continued)**

**Warrants**

The Company's warrant transactions are summarized as follows:

|                            | <b>Number of<br/>Warrants</b> | <b>Weighted<br/>Average<br/>Exercise<br/>Price<br/>\$</b> |
|----------------------------|-------------------------------|-----------------------------------------------------------|
| Balance, December 31, 2010 | -                             | -                                                         |
| Issued                     | 6,569,444                     | 0.23                                                      |
| Balance, December 31, 2011 | 6,569,444                     | 0.23                                                      |
| Issued                     | 2,009,863                     | 0.25                                                      |
| Expired                    | (2,569,444)                   | 0.19                                                      |
| Balance, December 31, 2012 | 6,009,863                     | 0.25                                                      |

- a) In conjunction with the 3,333,333 common shares issued on June 15, 2011, the Company issued 2,000,000 warrants exercisable at \$0.25 per share for a period of one and a half years. The warrants were valued at \$207,846 calculated using the Black-Scholes option pricing model assuming a life expectancy of one and a half years, a risk free rate of 0.05%, a forfeiture rate of 0%, and volatility of 273.13%. In addition to these warrants, the Company signed a Stock Grant Agreement with the shareholder allowing the shareholder to receive up to an additional 569,444 shares of the Company ( bonus shares ). The shareholder will receive 0.284722 bonus shares for each warrant exercised. The bonus shares were valued at \$68,333 calculated using the Black-Scholes option pricing model assuming a life expectancy of one and a half years, a risk free rate of 0.05%, a forfeiture rate of 0%, and volatility of 273.13%. These warrants, totaling 2,569,444, expired on December 31, 2012.
- b) In conjunction with two subscription agreements signed on December 21, 2011, the Company issued 4,000,000 warrants exercisable at \$0.25 per share for a period of one and a half years. The warrants were valued at \$398,752 calculated using the Black-Scholes option pricing model assuming a life expectancy of 1.53 years, a risk free rate of 0.01%, a forfeiture rate of 0%, and volatility of 180.97%.
- c) In conjunction with a debt settlement agreement signed on April 8, 2012, the Company issued 409,863 warrants exercisable at \$0.25 per share for a period of one and a half years. The warrants were valued at \$85,198 calculated using the Black-Scholes option pricing model assuming a life expectancy of 1.50 years, a risk free rate of 0.07%, a forfeiture rate of 0%, and volatility of 178.93%. The value of these warrants is included in bank charges and interest on the consolidated interim statement of operations.

**ALTERNET SYSTEMS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****December 31, 2012 and 2011****NOTE 8 CAPITAL STOCK (continued)****Warrants (continued)**

- d) In conjunction with 1,402,116 common shares issued on May 17, 2012, the Company issued 841,270 warrants exercisable at \$0.25 per share for a period of one year and five months. The warrants were valued at \$122,122 calculated using the Black-Scholes option pricing model assuming a life expectancy of 1.42 years, a risk free rate of 0.10%, a forfeiture rate of 0%, and volatility of 179.99%.
- e) In conjunction with 1,264,550 common shares issued on June 4, 2012, the Company issued 758,730 warrants exercisable at \$0.25 per share for a period of one and a half years. The warrants were valued at \$89,840 calculated using the Black-Scholes option pricing model assuming a life expectancy of 1.5 years, a risk free rate of 0.07%, a forfeiture rate of 0%, and volatility of 172.01%.

All warrants issued can be called by the Company in the event the average closing price of the common stock of the Company for any 60 day period is \$0.40 or greater.

The following table summarizes the warrants outstanding at December 31, 2012:

| <b>Warrants<br/>outstanding</b> | <b>Exercise<br/>price<br/>\$</b> | <b>Expiration date</b> |
|---------------------------------|----------------------------------|------------------------|
| 4,000,000                       | 0.25                             | June 30, 2013          |
| 409,863                         | 0.25                             | October 8, 2013        |
| 841,270                         | 0.25                             | October 11, 2013       |
| 758,730                         | 0.25                             | November 30, 2013      |
| 6,009,863                       |                                  |                        |

The weighted average life of warrants outstanding at December 31, 2012 was 0.61 years. All warrants outstanding had an intrinsic value of \$Nil.

**ALTERNET SYSTEMS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****December 31, 2012 and 2011****NOTE 8 CAPITAL STOCK (continued)****Warrants (continued)**

The following table summarizes the warrants outstanding at December 31, 2011:

| <b>Warrants<br/>outstanding</b> | <b>Exercise<br/>price<br/>\$</b> | <b>Expiration date</b> |
|---------------------------------|----------------------------------|------------------------|
| 2,000,000                       | 0.25                             | December 31, 2012      |
| 569,444                         | 0.25                             | December 31, 2012      |
| 4,000,000                       | 0.25                             | June 30, 2013          |
| 6,569,444                       |                                  |                        |

The weighted average life of warrants outstanding at December 31, 2011 was 1.30 years. All warrants outstanding had an intrinsic value of \$Nil.

**NOTE 9 - RELATED PARTY TRANSACTIONS**

As at December 31, 2012, a total of \$664,113 (December 31, 2011 - \$282,801) was payable to directors and officers of the Company of which \$644,531 (December 31, 2011 - \$245,581) was non-interest bearing and had no specific terms of repayment and \$19,582 (December 31, 2011 - \$37,220) related to loans detailed in Note 5. Of the amount payable, \$58,401 (December 31, 2011 - \$47,368) was included in accounts payable for expense reimbursements, \$573,310 (December 31, 2011 - \$185,393) was included in wages payable for accrued fees, and \$32,402 (December 31, 2011 - \$50,040) was included in due to related parties.

During the year ended December 31, 2012, the Company expensed a total of \$807,500 (December 31, 2011 - \$767,870) in consulting fees, investor relations and salaries paid to directors and officers of the Company. Of the amounts incurred, \$445,417 (December 31, 2011 - \$185,393) has been accrued, \$113,958 (December 31, 2011 - \$354,907) has been paid in cash, and \$248,125 (December 31, 2011 - \$227,570) has been paid through the issuance of shares. During the year, the Company signed debt settlement agreements with two directors and one officer of the Company to settle total accrued wages of \$305,625 and expense reimbursements of \$40,457 by issuing 2,628,738 shares of the Company's common stock. One director and the officer sold their debt settlement agreements to an unrelated third party. All shares were issued during the period.

**ALTERNET SYSTEMS INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2012 and 2011**

**NOTE 9 - RELATED PARTY TRANSACTIONS (continued)**

During the year ended December 31, 2011, the Company issued 3,931,030 shares of the Company's common stock valued at \$480,536 to three directors of the Company for accrued consulting fees and investor relations and 1,539,000 shares of the Company's common stock valued at \$187,570 to three directors of the Company for consulting and management fees.

As at December 31, 2012, the Company held an accounts receivable from a company with a director in common with the Company for \$789,565 (6,674,709 Venezuelan bolivar fuerte ( VEF )) (December 31, 2011 - \$1,552,258 (VEF 6,674,709)). Of the total invoice, \$399,735 (VEF 2,164,009) (December 31, 2011 - \$1,049,000 (VEF 4,510,700)) is included in revenue, \$Nil (December 31, 2011 - \$388,628 (VEF 1,671,100)) is included in customer deposits, and \$Nil (December 31, 2011 - \$114,630 (VEF 492,909)) is included in deferred income. In addition, the Company owes this company \$221,969 (VEF 3,329,532) (December 31, 2011 - \$Nil) which is non-interest bearing and has no specific terms of repayment and is included in Due to related parties.

**NOTE 10 DEFERRED COMPENSATION**

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

On March 29, 2011, the Company entered into an agreement with a consultant for a six-month term whereby the consultant will provide business consulting services to the Company in exchange for 250,000 shares of the Company's common stock valued at \$32,500 based on the date of issuance, April 19, 2011. On August 25, 2011, the agreement was terminated and the shares were cancelled. The full balance was reversed.

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

The Company recorded the aggregate fair value of the shares issued pursuant to the above agreements as deferred compensation and amortizes the costs of all these services on a straight-line basis over the respective terms of the contracts. During the year ended December 31, 2012, the Company expensed \$Nil (year ended December 31, 2011 - \$76,082) relating to the above contracts. The shares issued were all valued at their market price on the date of issuance or in accordance with defined agreement terms.

**ALTERNET SYSTEMS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2012 and 2011**  
**NOTE 11 INCOME TAXES**

There is no provision for federal or state income taxes for the years ended December 31, 2012 and 2011 since the Company has established a valuation allowance equal to the total deferred tax asset related to losses incurred during such periods.

A reconciliation of the effect of applying the federal statutory rate and the effective income tax rate used to calculate the Company's income tax provision is as follows:

|                                       | <b>December 31,</b> |               |
|---------------------------------------|---------------------|---------------|
|                                       | <b>2012</b>         | <b>2011</b>   |
|                                       | <b>\$</b>           | <b>\$</b>     |
| Loss for the year before income taxes | (4,841,053)         | (3,095,376)   |
| <i>Effective tax rate</i>             | <i>40.50%</i>       | <i>40.50%</i> |
| Income tax benefit                    | (1,960,600)         | (1,253,600)   |
| Share issue costs                     | (3,600)             | (15,800)      |
| Non-deductible expenses               | 354,000             | 202,600       |
| Other deductible items                | (26,600)            | (66,500)      |
| Tax benefits not recognized           | 1,636,800           | 1,133,300     |
| Income tax expense                    | -                   | -             |

Deferred tax assets and liabilities and related valuation allowance as of December 31, 2012 and 2011 are as follows:

|                                                    | <b>December 31,</b> |             |
|----------------------------------------------------|---------------------|-------------|
|                                                    | <b>2012</b>         | <b>2011</b> |
|                                                    | <b>\$</b>           | <b>\$</b>   |
| Deferred tax assets:                               |                     |             |
| Net operating loss carryforwards                   | 7,145,800           | 5,575,700   |
| Deferred tax liabilities:                          |                     |             |
| Capital assets                                     | (45,500)            | (56,500)    |
| Net deferred tax assets before valuation allowance | 7,100,300           | 5,519,200   |
| Valuation allowance                                | (7,100,300)         | (5,519,200) |
| Net deferred tax assets (liabilities)              | -                   | -           |

Based on the Company's historical losses and its expectation of continuation of losses for the foreseeable future, the Company has determined that it is not more likely than not that the deferred tax assets will be realized and accordingly, has provided a valuation allowance.

**ALTERNET SYSTEMS INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2012 and 2011**

**NOTE 11 INCOME TAXES (continued)**

At December 31, 2012, the Company has available unused net operating loss carryforwards of approximately \$17.6 million that expire from 2021 to 2032 for federal tax purposes and approximately \$13.1 million for Florida state tax purposes, which expire from 2027 to 2032. Additionally, the Company has loss carryforwards of approximately \$1,500 in Guatemala and \$9,700 in Ecuador.

As of December 31, 2012, the Company believes that it has no liability for uncertain tax provisions. If the Company were to determine there were an uncertain tax provisions, the Company would recognize the liability and related interest and penalties within income tax expense. As of December 31, 2012, the Company has no provisions for interest or penalties related to uncertain tax positions.

The Company files income tax returns in Guatemala, Ecuador, and the U.S. including both the federal jurisdiction and Florida state jurisdiction. There are no income tax examinations currently underway in any jurisdictions, however to the extent that net operating losses have been utilized in either the current or preceding years such losses may be subject to future income tax examination.

**NOTE 12 OPERATING LEASES**

The Company leases its operating and office facilities for various terms under long-term operating lease agreements. The leases expire at various dates through 2016 with one lease providing a renewal option of one year. In the normal course of business, it is expected that these lease will be renewed or replaced by leases on other properties.

One lease provides for increases in future minimum annual rental payments and requires the Company to pay executory costs (real estate taxes, insurance, and repairs). Lease expense totaled \$143,383 and \$36,198 during 2012 and 2011, respectively.

The following is a schedule by year of future minimum rental payments required under the operating lease agreements:

|      |            |
|------|------------|
| 2013 | \$ 146,592 |
| 2014 | 122,592    |
| 2015 | 166,894    |
| 2016 | 110,092    |
|      | \$ 546,170 |

Total minimum lease payments do not include contingent rentals that may be paid under certain leases because of use in excess of specified amounts. Contingent rental payments were not significant in 2012 or 2011.

**ALTERNET SYSTEMS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****December 31, 2012 and 2011****NOTE 13 SUPPLEMENTAL DISCLOSURE WITH RESPECT TO CASH FLOWS**

|                                                            | <b>December 31,</b> |             |
|------------------------------------------------------------|---------------------|-------------|
|                                                            | <b>2012</b>         | <b>2011</b> |
|                                                            | <b>\$</b>           | <b>\$</b>   |
| Supplemental cash flow disclosures:                        |                     |             |
| Interest paid during the year in cash                      | 25,137              | 14,120      |
| Cash paid for income taxes                                 | 2,554               | -           |
| Supplemental financing and investing non-cash disclosures: |                     |             |
| Shares issued for debt repayment                           | 1,210,344           | 717,623     |
| Shares issued for previously received share subscriptions  | 500,000             | -           |
| Value of beneficial conversion features                    | 142,663             | -           |
| Shares obligated to be issued                              | (113,333)           | 113,333     |
| Loss on settlement of convertible debentures               | -                   | 165,734     |
| Acquisition of intellectual property                       | -                   | 1,500,000   |
| Wages payable converted to other loans payable             | 421,504             | -           |
| Equipment purchased through capital lease                  | 18,957              | -           |
| Software purchased through long term debt                  | 213,900             | -           |

**NOTE 14 FAIR VALUE**

Fair value accounting establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described below:

- Level 1 Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;
- Level 2 Quoted prices in markets that are not active, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability;
- Level 3 Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (supported by little or no market activity).

**ALTERNET SYSTEMS INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2012 and 2011**

**NOTE 14 FAIR VALUE (continued)**

The fair value of the Company's accounts receivable, accounts payable and accrued liabilities, wages payable, accrued taxes, customer deposits, deferred income, other loans payable, and due to related parties approximate their carrying values. The Company's other financial instruments, being cash, are measured at fair value using Level 1 inputs.

**NOTE 15 CONCENTRATIONS**

**Concentrations in Sales to Few Customers:**

In 2012, the two largest customers accounted for 34% and 33% of sales and 33% and 63% of accounts receivable, respectively. In 2011, the two largest customers accounted for 87% and 9% of sales and 70% and 3% of accounts receivable, respectively.

**Concentrations in Sales to Foreign Customers**

During 2012 and 2011, 100% of the Company's net sales were made to foreign customers. An adverse change in either economic conditions abroad or the Company's relationship with significant foreign distributors could negatively affect the volume of the Company's international sales and the Company's results of operations.

**Company is Dependent on Few Major Suppliers**

The Company is dependent on Utiba Pte., the non-controlling interest investor in ATS, for all of its hosting services needs. In 2012 and 2011, products purchased from this company were approximately 88% and 80% of cost of sales, respectively. The Company is dependent on the ability of Utiba Pte. to provide uninterrupted services. The loss of this supplier or a significant reduction in product availability from this supplier could have a material adverse effect on the Company. The Company believes that its relationships with this supplier are in good standing.

**NOTE 16 LAWSUIT**

On September 20, 2012, the Company received a Demand for Arbitration notice that it had been named as party in a claim whereby the Claimant is seeking a judgment for damages that may exceed \$1,000,000, subsequently increased to \$5,000,000 resulting from failure to perform its obligations under an Agreement signed between the Claimant and the Company's joint-venture partner. The Company was not party to the Agreement but was named in the notice. The Company has engaged legal representatives. As of December 31, 2012, no amounts have been accrued as management believes the claim is without basis.

**ALTERNET SYSTEMS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****December 31, 2012 and 2011****NOTE 17 RESTATEMENT OF CONSOLIDATED FINANCIAL STATEMENTS (restated)**

Management, after consultation with the Board of Directors determined that the Company's consolidated financial statements for year ended December 31, 2012 contained errors relating to the omission of material accruals at December 31, 2012 and should be restated and, accordingly, that the Original Filing should no longer be relied upon.

Financial statement effect of the restatement:

The correction of the error resulted in a \$126,621 increase to sales, \$266,534 increase to cost of sales, and \$68,734 decrease to non-controlling interest for the year ended December 31, 2012; and a \$92,831 increase to accounts payable and accrued charges and \$21,292 decrease to non-controlling interest as at December 31, 2012.

The tables below shows the effects of the restatement on the consolidated balance sheet as of December 31, 2012 and the consolidated statement of operations, the consolidated statement of cash flows and consolidated statement of stockholders' equity (deficiency) for the year ended December 31, 2012.

|                                                          | As Previously<br>Reported<br>December 31,<br>2012 | As Restated<br>December 31<br>2012 | Restatement<br>Adjustments<br>December 31<br>2012 |
|----------------------------------------------------------|---------------------------------------------------|------------------------------------|---------------------------------------------------|
| <b>CONSOLIDATED BALANCE SHEET</b>                        |                                                   |                                    |                                                   |
|                                                          | \$                                                | \$                                 | \$                                                |
| <b>Liabilities and Stockholders' Equity (Deficiency)</b> |                                                   |                                    |                                                   |
| <b>Current liabilities</b>                               |                                                   |                                    |                                                   |
| Accounts payable and accrued charges                     | 1,457,054                                         | 1,549,885                          | 92,831                                            |
| Total current liabilities                                | 4,583,016                                         | 4,675,847                          | 92,831                                            |
| <b>Stockholders' equity (deficiency)</b>                 |                                                   |                                    |                                                   |
| Accumulated deficit                                      | (14,558,159)                                      | (14,629,698)                       | (71,539)                                          |
|                                                          | (908,265)                                         | (979,804)                          | (71,539)                                          |
| Non-controlling interest                                 | (449,806)                                         | (471,098)                          | (21,292)                                          |
|                                                          | (1,358,071)                                       | (1,450,902)                        | (92,831)                                          |

**ALTERNET SYSTEMS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2012 and 2011**

|                                                | As Previously<br>Reported<br>Year ended<br>December 31,<br>2012 | As Restated<br>Year ended<br>December 31,<br>2012 | Restatement<br>Adjustment<br>Year ended<br>December 31,<br>2012 |
|------------------------------------------------|-----------------------------------------------------------------|---------------------------------------------------|-----------------------------------------------------------------|
| <b>CONSOLIDATED STATEMENT OF OPERATIONS</b>    | \$                                                              | \$                                                | \$                                                              |
| Revenue                                        |                                                                 |                                                   |                                                                 |
| Sales                                          | 1,229,674                                                       | 1,355,935                                         | 126,261                                                         |
|                                                | 1,229,674                                                       | 1,355,935                                         | 126,261                                                         |
| Cost of Sales                                  | 656,542                                                         | 923,076                                           | 266,534                                                         |
| Gross Profit                                   | 573,132                                                         | 432,859                                           | (140,273)                                                       |
| Net Loss Before Other Items                    | (3,261,272)                                                     | (3,401,545)                                       | (140,273)                                                       |
| Net Loss Before Income Taxes                   | (4,700,780)                                                     | (4,841,053)                                       | (140,273)                                                       |
| Net Loss Before Non-Controlling Interest       | (4,703,334)                                                     | (4,843,607)                                       | (140,273)                                                       |
| Non-Controlling Interest                       | (1,439,927)                                                     | (1,508,661)                                       | (68,734)                                                        |
| Net Loss Attributable to Alternet Systems Inc. | (3,263,407)                                                     | (3,334,946)                                       | (71,539)                                                        |
| Total Comprehensive Loss                       | (3,263,407)                                                     | (3,334,946)                                       | (71,539)                                                        |

|                                                  | Year ended<br>December 31,<br>2012 | Year ended<br>December 31,<br>2012 | Year ended<br>December 31,<br>2012 |
|--------------------------------------------------|------------------------------------|------------------------------------|------------------------------------|
| <b>CONSOLIDATED STATEMENT OF CASH FLOWS</b>      | \$                                 | \$                                 | \$                                 |
| Operating Activities                             |                                    |                                    |                                    |
| Net income attributable to Alternet Systems Inc. | (3,263,407)                        | (3,334,946)                        | (71,539)                           |
| Non-controlling interest                         | (1,439,927)                        | (1,508,661)                        | (68,734)                           |
| Changes in non-cash working capital:             |                                    |                                    |                                    |
| Accounts payable and accrued charges             | 342,197                            | 482,470                            | 140,273                            |

|                                                                       | Year ended<br>December 31,<br>2012 | Year ended<br>December 31,<br>2012 | Year ended<br>December 31,<br>2012 |
|-----------------------------------------------------------------------|------------------------------------|------------------------------------|------------------------------------|
| <b>CONSOLIDATED STATEMENT OF STOCKHOLDERS<br/>EQUITY (DEFICIENCY)</b> | \$                                 | \$                                 | \$                                 |
| Adjustment to non-controlling interest accounts payable               | -                                  | 47,442                             | 47,442                             |
| Non-controlling interest                                              | (1,439,927)                        | (1,508,661)                        | (68,734)                           |
| Net Loss                                                              | (3,263,407)                        | (3,334,946)                        | (71,539)                           |

**ALTERNET SYSTEMS INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2012 and 2011**

**NOTE 18 SUBSEQUENT EVENTS**

- On January 1, 2013, the Company signed three new Promissory Notes with a creditor which capitalized the unpaid principal and interest totaling \$19,582 under the previous Promissory Notes and extended the maturity dates to June 30, 2013.
- The Company issued four tranches of shares to a consultant of the Company for investor relation services provided on a monthly basis valued at \$2,800 per month: January 1, 2013, 23,891 shares valued at \$3,106; February 4, 2013, 22,400 shares valued at \$2,688; March 1, 2013, 20,741 shares valued at \$2,489; and April 2, 2013, 23,333 shares valued at \$2,800.
- On February 12, 2013, the Company issued 116,667 shares valued at \$21,000 to a contractor to settle \$17,500 of commissions earned on the issuance of shares.
- On February 12, 2013, the Company issued 571,967 shares valued at \$102,954 to an ex- employee to settle \$85,795 of salaries and benefits payable.
- On February 15, 2013, the Company signed an investor relations agreement with a consultant to provide investor relations services for a term of one year. The consultant will be compensated with monthly payments of \$5,000 if the Company is able to raise \$1,000,000 by May 16, 2013. The consultant will also receive 700,000 shares, which are deliverable in four equal tranches of 175,000 each on or before February 20, 2013, May 16, 2013, August 14, 2013, and November 12, 2013. On February 19, 2013, the Company issued 700,000 shares in the name of the consultant valued at \$105,000 of which 175,000 valued at \$26,250 were delivered to the consultant. The remaining 525,000 shares will be delivered to the consultant over the term of the contract as described above.

Events occurring after December 31, 2012 were evaluated through the date this Annual Report was issued, in compliance FASB ASC Topic 855 Subsequent Events , to ensure that any subsequent events that met the criteria for recognition and/or disclosure in this report have been included.

## **Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

There were no disagreements related to accounting principles or practices, financial statement disclosure, internal controls or auditing scope or procedure during the two fiscal years and interim periods, including the interim period up through the date the relationship ended.

### **Change in Accountant**

On March 24, 2010, the Registrant engaged the firm of Hamilton PC as the Registrant's principal independent accountant to audit the Registrant's financial statements. The members of the Registrant's Board of Directors unanimously approved the engagement of Hamilton PC. Prior to the engagement of Hamilton PC, neither the Registrant nor any person on the Registrant's behalf consulted Hamilton PC regarding either (i) the application of accounting principles to a specified completed or proposed transaction or the type of audit opinion that might be rendered on the Registrant's financial statements, or (ii) any matter that was the subject of a disagreement (as defined in Item 304(a)(1)(iv) of Regulation S-K and the related instructions to such Item) or a reportable event (as defined in Item 304(a)(1)(v) of Regulation S-K).

On December 17, 2012, the members of the Board of Directors of Alternet Systems, Inc., a Nevada corporation (the Registrant), unanimously approved the dismissal of Hamilton PC, as the Registrant's independent registered public accounting firm. No reports of Hamilton PC on the Registrant's financial statements for the past two fiscal years, specifically the fiscal years ended December 31, 2010 and 2011 and through September 30, 2012, contained any adverse opinion or disclaimer of opinion or was qualified or modified as to uncertainty, audit scope, or accounting principles.

On January 15, 2013, the Registrant engaged the firm of StarkSchenkein, LLP as the Registrant's principal independent accountant to audit the Registrant's financial statements. The members of the Registrant's Board of Directors unanimously approved the engagement of StarkSchenkein, LLP. Prior to the engagement of StarkSchenkein, LLP, neither the Registrant nor any person on the Registrant's behalf consulted StarkSchenkein, LLP regarding either (i) the application of accounting principles to a specified completed or proposed transaction or the type of audit opinion that might be rendered on the Registrant's financial statements, or (ii) any matter that was the subject of a disagreement (as defined in Item 304(a)(1)(iv) of Regulation S-K and the related instructions to such Item) or a reportable event (as defined in Item 304(a)(1)(v) of Regulation S-K).

## **Item 9A. 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) and our secretary, treasurer and chief financial officer (also our principal financial and accounting officer) to allow for timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, our management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and our management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.



As of December 31, 2012, the end of our fiscal year 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 not effective as of the end of the period covered by this annual report in providing reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with US generally accepted accounting principles.

On November 12, 2013, management of Alternet Systems, Inc. (the Company), after consultation with the Board of Directors, determined that the Company's consolidated financial statements for year ended December 31, 2012 contained errors relating to the omission of material accruals at December 31, 2012 and should be restated accordingly. This Amendment reflects the restatement of the Company's consolidated financial statements and amendment of related disclosures as at December 31, 2012 and the year ended December 31, 2012.

### ***Management's Report on Internal Control over Financial Reporting***

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of internal control include providing management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States. Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2012. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ( COSO ) in *Internal Control-Integrated Framework* . Our management has concluded that, as of December 31, 2012, our internal control over financial reporting is not effective in providing reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with US generally accepted accounting principles. Our management reviewed the results of their assessment with our Board of Directors.

This annual report does not include an attestation report of our company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by our company's registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit our company to provide only management's report in this annual report.

***Inherent Limitations on Effectiveness of Controls***

Internal control over financial reporting has inherent limitations which include but is not limited to the use of independent professionals for advice and guidance, interpretation of existing and/or changing rules and principles, segregation of management duties, scale of organization, and personnel factors. Internal control over financial reporting is a process which involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper management override. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements on a timely basis, however these inherent limitations are known features of the financial reporting process and it is possible to design into the process safeguards to reduce, though not eliminate, this risk. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

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

There have been no significant changes in our internal controls over financial reporting that occurred during the year ended December 31, 2012 that have materially or are reasonably likely to materially affect, our internal controls over financial reporting.

**Item 9B. Other Information**

None.

**PART III**

**Item 10. Directors, Executive Officers and Corporate Governance**

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  |
|------------------|----------------------------------|---------------------|
| Henryk Dabrowski | President, Chairman and Director | Expires at next AGM |
| Fabio Alvino     | Director                         | Expires at next AGM |
| Robin Bjorklund  | 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.
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.

**Henryk Dabrowski, President and Chairman**

Mr. Dabrowski is a successfully serial entrepreneur with more than 25 years of experience in the IT and telecommunications industries. He has founded, grown and sold multiple businesses in the systems integration, computer and IP telephony sectors in North and South America, and managed and expanded multi-country operations in Europe and the Americas.

After co-founding and growing multi-million dollar integrations firm, RKM IT of Venezuela, Mr. Dabrowski served as COO/President of Vox2Vox Communications in Miami, a multimillion dollar IP telecommunications and value added services company, with presence in three continents and eight countries. After Vox2Vox he served as President of TekVoice Communications Inc., a Miami FL based Voice over IP telecommunications company, which merged with Altnet Systems Inc. in 2008.

**Fabio Alvino, Director and VP of Business Development**

Mr. Alvino has over 30 years of international entrepreneurship and management experience in the information technology, multimedia and business and information consulting industries. He has been involved in large project management and deployment experience in multi country and disciplinary teams. He has also been involved in successful founding and selling of multiple companies in the multimedia and internet consulting industries.

**Robin Bjorklund, Director**

Mr. Bjorklund has an extensive background in building successful multi-million dollar companies from start-up to profitability. Over the past 5 years he has worked as a venture capitalist and as a consultant with Alternet Systems Inc.

**Michael Viadero, Chief Financial Officer (CFO)**

Mr. Viadero is a finance executive with broad experience in multiple disciplines, diverse industries and markets throughout Latin America. With over 30 years of experience managing multi-functional organizations and operations at MasterCard International, W.R. Grace and First Chicago. Prior to joining Alternet he was Regional Financial Officer for MasterCard International, responsible for financial operations, product and service pricing strategy, and transitioning the company from privately-held to public entity, including compliance with Sarbanes-Oxley Act.

**Item 11. Executive Compensation**

The particulars of the compensation paid to the following persons:

- (a) our principal executive officer;
- (b) each of our two most highly compensated executive officers who were serving as executive officers at the end of the years ended December 31, 2012 and 2011; and
- (c) up to two additional individuals for whom disclosure would have been provided under (b) but for the fact that the individual was not serving as our executive officer at the end of the years ended December 31, 2012 and 2011,

who we will collectively refer to as the named executive officers of our company, are set out in the following summary compensation table, except that no disclosure is provided for any named executive officer, other than our principal executive officers, whose total compensation did not exceed \$100,000 for the respective fiscal year:

## Summary Compensation Table

| Name and principal position<br>(a)            | Year<br>(b) | Annual Compensation   |                      |                                             | Long-term compensation                         |                                                        |                                |                                          |
|-----------------------------------------------|-------------|-----------------------|----------------------|---------------------------------------------|------------------------------------------------|--------------------------------------------------------|--------------------------------|------------------------------------------|
|                                               |             | Salary<br>(\$)<br>(c) | Bonus<br>(\$)<br>(d) | Other Annual<br>Compensation<br>(\$)<br>(e) | Awards                                         |                                                        | Payouts                        | All other<br>Compensation<br>(\$)<br>(i) |
|                                               |             |                       |                      |                                             | Restricted<br>Stock<br>Award(s)<br>(\$)<br>(f) | Securities<br>Underlying<br>options/SARs<br>(#)<br>(g) | LTIP<br>payouts<br>(\$)<br>(h) |                                          |
| Henryk Dabrowski<br>President and<br>Chairman | 2012        | 165,000               | 82,500               | 17,865                                      | 0                                              | 0                                                      | 0                              | 0                                        |
|                                               | 2011        | 152,500               | 82,500               | 19,730                                      | 0                                              | 0                                                      | 0                              | 0                                        |
|                                               | 2010        | 105,000               | 70,000               | 10,000                                      | 0                                              | 0                                                      | 0                              | 0                                        |
| Fabio Alvino<br>Director                      | 2012        | 130,000               | 65,000               | 29,340                                      | 0                                              | 0                                                      | 0                              | 0                                        |
|                                               | 2011        | 130,000               | 65,000               | 16,472                                      | 0                                              | 0                                                      | 0                              | 0                                        |
|                                               | 2010        | 97,500                | 65,000               | 23,334                                      | 0                                              | 0                                                      | 0                              | 0                                        |
| Robin Bjorklund<br>Director                   | 2012        | 0                     | 0                    | 0                                           | 0                                              | 0                                                      | 0                              | 0                                        |
|                                               | 2011        | 0                     | 0                    | 0                                           | 0                                              | 0                                                      | 0                              | 0                                        |
|                                               | 2010        | 102,000               | 0                    | 0                                           | 0                                              | 0                                                      | 0                              | 0                                        |
| Michael Viadero,<br>CFO                       | 2012        | 160,000               | 80,000               | 9,944                                       | 0                                              | 0                                                      | 0                              | 0                                        |
|                                               | 2011        | 133,333               | 80,000               | 4,255                                       | 120,000                                        | 0                                                      | 0                              | 0                                        |
|                                               | 2010        | 0                     | 0                    | 0                                           | 0                                              | 0                                                      | 0                              | 0                                        |

| Name             | Year | Salary  | Bonus  | Other Annual | Stock Award(s) | Securities | LTIP | All other |
|------------------|------|---------|--------|--------------|----------------|------------|------|-----------|
| Henryk Dabrowski | 2012 | 165,000 | 82,500 | 17,865       | 0              | 0          | 0    | 0         |
| Paid in shares   | 2011 | 126,042 | 0      | 0            | 0              | 0          | 0    | 0         |
| (pending)        | 2011 | 26,458  | 82,500 | 19,730       | 0              | 0          | 0    | 0         |
| Paid in cash     | 2010 | 81,667  | 0      | 0            | 0              | 0          | 0    | 0         |
| Paid in shares   | 2010 | 23,333  | 70,000 | 10,000       | 0              | 0          | 0    | 0         |
| Paid in cash     |      |         |        |              |                |            |      |           |
| Paid in shares   |      |         |        |              |                |            |      |           |

|                |      |         |        |        |   |   |   |   |
|----------------|------|---------|--------|--------|---|---|---|---|
| Fabio Alvino   | 2012 | 130,000 | 65,000 | 29,340 | 0 | 0 | 0 | 0 |
| Paid in shares | 2011 | 119,167 | 0      | 0      | 0 | 0 | 0 | 0 |
| (pending)      | 2011 | 10,833  | 65,000 | 16,472 | 0 | 0 | 0 | 0 |
| Paid in cash   | 2010 | 75,833  | 0      | 0      | 0 | 0 | 0 | 0 |
| Paid in shares | 2010 | 21,667  | 65,000 | 23,330 | 0 | 0 | 0 | 0 |
| Paid in cash   |      |         |        |        |   |   |   |   |
| Paid in shares |      |         |        |        |   |   |   |   |

|                 |      |         |   |   |   |   |   |   |
|-----------------|------|---------|---|---|---|---|---|---|
| Robin Bjorklund | 2010 | 102,000 | 0 | 0 | 0 | 0 | 0 | 0 |
| Paid in shares  |      |         |   |   |   |   |   |   |

|                 |      |         |        |       |         |   |   |   |
|-----------------|------|---------|--------|-------|---------|---|---|---|
| Michael Viadero | 2012 | 160,000 | 80,000 | 9,945 | 0       | 0 | 0 | 0 |
| Paid in shares  | 2011 | 46,666  | 0      | 0     | 0       | 0 | 0 | 0 |
| (pending)       | 2011 | 86,667  | 80,000 | 4,255 | 120,000 | 0 | 0 | 0 |
| Paid in cash    |      |         |        |       |         |   |   |   |
| Paid in shares  |      |         |        |       |         |   |   |   |

### **Involvement in Certain Legal Proceedings**

None of our directors, executive officers, promoters or control persons has been involved in any of the following events during the past five years:

1. any bankruptcy petition filed by or against any business of which such person was a general partner or executive officer either at the time of the bankruptcy or within two years prior to that time;
2. any conviction in a criminal proceeding or being subject to a pending criminal proceeding, excluding traffic violations and other minor offences;
3. being subject to any order, judgment or decree, not subsequently reversed, suspended or vacated, of any court of competent jurisdiction, permanently or temporarily enjoining, barring, suspending or otherwise limiting his involvement in any type of business, securities or banking activities; or
4. being found by a court of competent jurisdiction in a civil action, the Securities and Exchange Commission or the Commodity Futures Trading Commission to have violated a federal or state securities or commodities law and the judgment has not been reversed, suspended, or vacated.

### **Compliance with Section 16(a) of the Securities Exchange Act of 1934**

Section 16(a) of the Securities Exchange Act of 1934 requires our executive officers and directors and persons who own more than 10% of our common stock to file with the Securities and Exchange Commission initial statements of beneficial ownership, reports of changes in ownership and annual reports concerning their ownership of our common stock and other equity securities, on Forms 3, 4 and 5 respectively. Executive officers, directors and greater than 10% shareholders are required by the SEC regulations to furnish us with copies of all Section 16(a) reports that they file.

Based solely on our review of the copies of such forms received by us, or written representations from certain reporting persons, we believe that during fiscal year ended December 31, 2008, all filing requirements applicable to our officers, directors and greater than 10% percent beneficial owners were complied with.

### **Code of Ethics**

Effective March 24, 2004, our Company's board of directors adopted a Code of Business Conduct and Ethics that applies to, among other persons, our company's president and secretary (being our principal executive officer, principal financial officer and principal accounting officer), as well as persons performing similar functions. As adopted, our Code of Business Conduct and Ethics sets forth written standards that are designed to deter wrongdoing and to promote:

1. honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;
2. full, fair, accurate, timely, and understandable disclosure in reports and documents that we file with, or submit to, the Securities and Exchange Commission and in other public communications made by us;
3. compliance with applicable governmental laws, rules and regulations;
4. the prompt internal reporting of violations of the Code of Business Conduct and Ethics to an appropriate person or persons identified in the Code of Business Conduct and Ethics; and
5. accountability for adherence to the Code of Business Conduct and Ethics.

Our Code of Business Conduct and Ethics requires, among other things, that all of our company's senior officers commit to timely, accurate and consistent disclosure of information; that they maintain confidential information; and that they act with honesty and integrity.

In addition, our Code of Business Conduct and Ethics emphasizes that all employees, and particularly senior officers, have a responsibility for maintaining financial integrity within our company, consistent with generally accepted accounting principles, and federal and state securities laws. Any senior officer who becomes aware of any incidents involving financial or accounting manipulation or other irregularities, whether by witnessing the incident or being told of it, must report it to our company. Any failure to report such inappropriate or irregular conduct of others is to be treated as a severe disciplinary matter. It is against our company policy to retaliate against any individual who reports in good faith the violation or potential violation of our company's Code of Business Conduct and Ethics by another.

Our Code of Business Conduct and Ethics is filed with the Securities and Exchange Commission as an Exhibit to our annual report.

### **Board and Committee Meetings**

Our board of directors held no formal meetings during the year ended December 31, 2012. All proceedings of the board of directors were conducted by resolutions consented to in writing by all the directors and filed with the minutes of the proceedings of the directors. Such resolutions consented to in writing by the directors entitled to vote on that resolution at a meeting of the directors are, according to the Nevada General Corporate Law and our Bylaws, as valid and effective as if they had been passed at a meeting of the directors duly called and held.

### **Nomination Process**

As of December 31, 2012, we did not affect any material changes to the procedures by which our shareholders may recommend nominees to our board of directors. Our board of directors does not have a policy with regards to the consideration of any director candidates recommended by our shareholders. Our board of directors has determined that it is in the best position to evaluate our company's requirements as well as the qualifications of each candidate when the board considers a nominee for a position on our board of directors. If shareholders wish to recommend candidates directly to our board, they may do so by sending communications to the president of our company at the address on the cover of this annual report.

### **Audit Committee**

Currently our Company's board of directors does not have an audit committee.

### **Option Exercises and Stock Vested**

During our Fiscal year ended December 31, 2012 there were no options exercised by our named officers.

### **Compensation of Directors**

We do not have any agreements for compensating our directors for their services in their capacity as directors, although such directors are expected in the future to receive stock options to purchase shares of our common stock as awarded by our board of directors.

### **Pension, Retirement or Similar Benefit Plans**

There are no arrangements or plans in which we provide pension, retirement or similar benefits for directors or executive officers. We have no material bonus or profit sharing plans pursuant to which cash or non-cash compensation is or may be paid to our directors or executive officers, except that stock options may be granted at the discretion of the board of directors or a committee thereof.

### **Indebtedness of Directors, Senior Officers, Executive Officers and Other Management**

None of our directors or executive officers or any associate or affiliate of our company during the last two fiscal years, is or has been indebted to our company by way of guarantee, support agreement, letter of credit or other similar agreement or understanding currently outstanding.

### **Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

The following table sets forth information regarding the beneficial ownership of shares of the Company's common stock as of April 11, 2013 (34,798,796 shares 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 |
|----------------------------------------------------------------------------|--------------------------------------------------|------------------------------------|---------------------|
| Henryk Dabrowski<br>5500-SW 86 <sup>th</sup> Street<br>Miami, FL 33143     | President, Director                              | 5,819,930                          | 6.43%               |
| Fabio Alvino<br>3225 Franklin Avenue,<br>Villa 2, Miami, FL 33133          | Vice President of Business Development, Director | 4,454,592                          | 4.92%               |
| Robin Bjorklund<br>473-1027 Davie Street<br>Vancouver BC V6E 4L2           | Director                                         | 4,688,170                          | 5.18%               |
| Michael Viadero<br>3607 SW 37 <sup>th</sup> Avenue<br>Miami, Florida 33133 | CFO                                              | 2,078,000                          | 2.30%               |
| Directors, Officers and<br>5%<br>stockholders in total                     |                                                  | 34,798,796                         | 34.03%              |

*Changes in Control*

We are unaware of any contract or other arrangement the operation of which may at a subsequent date result in a change in control of our company.

**Item 13. Certain Relationships and Related Transactions, and Director Independence**

Except as disclosed herein, no director, executive officer, shareholder holding at least 5% of shares of our common stock, or any family member thereof, had any material interest, direct or indirect, in any transaction, or proposed transaction since the year ended December 31, 2010, in which the amount involved in the transaction exceeded or exceeds the lesser of \$120,000 or one percent of the average of our total assets at the year-end for the last three completed fiscal years.

During the year ended December 31, 2012, the Company expensed a total of \$807,500 (December 31, 2011 - \$767,870) in consulting fees, investor relations and salaries paid to directors and officers of the Company. Of the amounts incurred, \$445,417 (December 31, 2011 - \$185,393) has been accrued, \$113,958 (December 31, 2011 - \$354,907) has been paid in cash, and \$248,125 (December 31, 2011 - \$227,570) has been paid through the issuance of shares. During the year, the Company signed debt settlement agreements with two directors and one officer of the Company to settle total accrued wages of \$305,625 and expense reimbursements of \$40,457 by issuing 2,628,738 shares of the Company's common stock. One director and the officer sold their debt settlement agreements to an unrelated third party. All shares were issued during the period.

During the year ended December 31, 2011, the Company issued 3,931,030 shares of the Company's common stock valued at \$480,536 to three directors of the Company for accrued consulting fees and investor relations and 1,539,000 shares of the Company's common stock valued at \$187,570 to three directors of the Company for consulting and management fees.

As at December 31, 2012, the Company held an accounts receivable from a company with a director in common with the Company for \$789,565 (6,674,709 Venezuelan bolivar fuerte ( VEF )) (December 31, 2011 - \$1,552,258 (VEF 6,674,709)). Of the total invoice, \$399,735 (VEF 2,164,009) (December 31, 2011 - \$1,049,000 (VEF 4,510,700)) is included in revenue, \$Nil (December 31, 2011 - \$388,628 (VEF 1,671,100)) is included in customer deposits, and \$Nil (December 31, 2011 - \$114,630 (VEF 492,909)) is included in deferred income. In addition, the Company owes this company \$221,969 (VEF 3,329,532) (December 31, 2011 - \$Nil) which is non-interest bearing and has no specific terms of repayment and is included in Due to related parties.

#### *Director Independence*

We currently act with three (3) directors, consisting of Henryk Dabrowski, Fabio Alvino and Robin Bjorklund. From inception to present date, we believe that the members of our board of directors have been and are collectively capable of analyzing and evaluating our financial statements and understanding internal controls and procedures for financial reporting.

#### **Item 14. Principal Accounting Fees and Services**

The aggregate fees billed for the most recently completed fiscal year ended December 31, 2012 and for fiscal year ended December 31, 2011 for professional services rendered by the principal accountant for the audit of our annual financial statements and review of the financial statements included in our quarterly reports on Form 10-Q and services that are normally provided by the accountant in connection with statutory and regulatory filings or engagements for these fiscal periods were as follows:

|                    | Year Ended        |                   |
|--------------------|-------------------|-------------------|
|                    | December 31, 2012 | December 31, 2011 |
| Audit Fees         | <b>\$54,000</b>   | <b>\$57,330</b>   |
| Audit Related Fees | <b>Nil</b>        | <b>Nil</b>        |

|                | Year Ended        |                   |
|----------------|-------------------|-------------------|
|                | December 31, 2012 | December 31, 2011 |
| Tax Fees       | <b>\$ 1,966</b>   | <b>\$3,988</b>    |
| All Other Fees | <b>Nil</b>        | <b>Nil</b>        |
| Total          | <b>\$ 55,966</b>  | <b>\$61,318</b>   |

Our board of directors pre-approves all services provided by our independent auditors. All of the above services and fees were reviewed and approved by the board of directors either before or after the respective services were rendered.

Our board of directors has considered the nature and amount of fees billed by our independent auditors and believes that the provision of services for activities unrelated to the audit is compatible with maintaining our independent auditors' independence.

**PART IV**

**Item 15. Exhibits, Financial Statement Schedules**

**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 Articles of Incorporation (incorporated by reference to Exhibit 3.2 on the report on Form 8-K filed on May 23, 2002)   |
| <u>14.1</u> | <u>Code of Business Conduct</u>                                                                                                                    |
| <u>31.1</u> | <u>Section 302 Certification of Chief Executive Officer</u>                                                                                        |
| <u>31.2</u> | <u>Section 302 Certification of Chief Financial Officer</u>                                                                                        |
| <u>32.1</u> | <u>Section 906 Certification of Chief Executive Officer</u>                                                                                        |
| <u>32.2</u> | <u>Section 906 Certification of Chief Financial Officer</u>                                                                                        |

## SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant 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)  
December 16, 2013

By: */s/ Michael T. Viadero*  
Michael T. Viadero, Secretary, Treasurer  
(Principal Financial Officer and Principal Accounting Officer)  
December 16, 2013

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

By: */s/ Henryk Dabrowski*  
Henryk Dabrowski, President  
(Principal Executive Officer)  
December 16, 2013

By: */s/ Michael T. Viadero*  
Michael T. Viadero, Secretary, Treasurer  
(Principal Financial Officer and Principal Accounting Officer)  
December 16, 2013