

Edgar Filing: CITY NETWORK INC - Form 10KSB/A

CITY NETWORK INC  
Form 10KSB/A  
January 27, 2006

U.S. SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-KSB  
(Amendment No. 2)

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

For the fiscal year ended \_\_\_\_\_

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

For the transition period from March 1, 2004 to December 31, 2004

Commission File Number: 333-61286

CITY NETWORK, INC.  
(Exact name of small business issuer as specified in its charter)

Nevada  
(State or other jurisdiction of  
incorporation or organization)

88-0467944  
(I.R.S. Employer  
Identification No.)

2F-1, No. 16, Jian Ba Road, Jhonghe City  
Taipei County 235, Taiwan, ROC N/A  
(Address of principal executive offices) (Zip Code)

Issuer's Telephone Number: 011-886-2-8226-5566

Securities Registered Under Section 12(b) of the Act:

\$0.001 Common Stock  
(Title of Class)

Securities Registered Under Section 12(g) of the Act:

None

Check whether the issuer is not required to file reports pursuant to Section 13  
or 15(d) to the Exchange Act.

Check whether the issuer (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 shorter period that the registrant was required to file such  
reports), and (2) has been subject to such filing requirements for the past 90  
days. YES  NO

Check if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K  
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 II of this Form 10-K or any amendments to this Form 10-K.

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

The issuer's revenues for the ten months ended December 31, 2004: \$15,674,613.

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As of January 23, 2006, there were 32,967,183 shares of the registrant's common stock, \$0.001 par value, outstanding. The aggregate market value of the common stock held by non-affiliates of the issuer was approximately 5,071,172 based on the closing price of \$.18 per share on January 23, 2006, as reported by the American Stock Exchange.

Documents incorporated by reference: None

Transitional Small Business Disclosure Format (Check one): Yes ; No

### EXPLANATORY NOTE (NEED TO REVISE TO ADD CHANGE TO LEGAL PROCEEDING ITEM)

The purpose of this Amendment No. 2 to Annual Report on Form 10-KSB/A of City Network, Inc. (the "Company," "we" or "our") for the fiscal period ended December 31, 2004, filed with the Securities and Exchange Commission ("SEC") on April 15, 2005 is to provide additional disclosure about the Company's ongoing legal proceedings. The only Items amended and restated herein are Part 1, Item 3 and Part II, Item 7.

Except as otherwise expressly noted herein, this Amendment No. 2 to the Annual Report on Form 10-KSB/A does not reflect events occurring after the April 15, 2005 filing of our Annual Report on Form 10-KSB in any way. The remaining Items contained within this Amendment No. 2 to our Annual Report on Form 10-KSB/A consist of all other Items originally contained in our Annual Report on Form 10-KSB and Form 10-KSB/A for the fiscal period ended December 31, 2004 in the form filed with the SEC on April 15, 2005 and July 6, 2005, respectively. These remaining Items are not amended hereby and are not included herein. In order to preserve the nature and character of the disclosures set forth in such Items as originally filed, except as expressly noted herein, this report continues to speak as of the date of the original filing, and we have not updated the disclosures in this report to speak as of a later date.

### ITEM 3. LEGAL PROCEEDINGS

#### HWA-CHING CO. AND RELATED LAWSUITS

In April 2004, Hwa-Ching Co. made purchases from City Network Inc.-Taiwan for products in the aggregate amount of approximately NT\$19 million or US\$575,757. In June 2004, Hwa-Ching Co. wrote a check to City Network Inc.-Taiwan paying for such products and City Network Inc.-Taiwan successfully cashed this check. Also in June 2004, Hwa-Ching Co. made purchases from City Network Inc.-Taiwan for additional products in the aggregate amount of approximately NT\$18 million or US\$545,454 and paid for such products with a check that City Network Inc.-Taiwan also successfully cashed.

During June to August 2004, Hwa-Ching Co. requested additional products from City Network Inc.-Taiwan in the aggregate amount of approximately NT\$27 million or US\$818,181. City Network Inc.-Taiwan filled these orders with confidence as Hwa-Ching had paid for the prior orders from April 2004 and June 2004. However, the check, in the amount of approximately NT\$27 million or US\$818,181 that Hwa-Ching Co. wrote to City Network, Inc.-Taiwan bounced upon deposit with the bank. Immediately thereafter, Hwa-Ching Co. closed down with this remaining account payable balance of approximately NT\$27 million or US\$818,181 outstanding and payable to City Network Inc.-Taiwan.

In August 2004, City Network Inc.-Taiwan filed a lawsuit against Yune-Chang Tsuo, the owner of Hwa-Ching Co., as well as the following eight individuals including, Yong-Zhang Zhuo, Shu-Tao Lu, Yong-Yi Zhuo, Zhuan-Xuan Dai, Ya-Hui Qiu, Mei-Zhen Huang, Zong-Ya Wu, Yao-Guo Cen in Taiwan Taipei district court of Taiwan, in Taipei, Taiwan, alleging fraud for closing down Hwa-Ching Co. without payment for the delivered merchandise. City Network Inc.-Taiwan sought

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approximately NT\$27 million or approximately US\$900,000 from Yune-Chang Tsuo to cover the outstanding account payable. To date, the court has not yet reached a verdict on this case.

RPPI INTERNATIONAL LTD.

On October 10, 2004, Rong-Dian filed a lawsuit against City Network Inc.-Taiwan in the Taiwan Taipei district court of Taiwan, in Taipei, Taiwan, alleging breach of contract for two different purchase agreements that City Network Inc.-Taiwan entered with them and two third-parties. Rong-Dian sought the aggregate amount of approximately NT\$40.2 million or US\$1.2 million for the alleged breaches. One purchase agreement was for an order that City Network Inc.-Taiwan sold to Hwa-Ching Co. in the amount of approximately NT\$27.3 million or US\$900,000 and the other purchase agreement was for an order City Network Inc.-Taiwan sold to a separate customer of the Company in the amount of approximately NT\$12.9 million or US\$390,909. As of the date of this Report, the Company had not entered into a settlement agreement.

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### ITEM 7. FINANCIAL STATEMENTS

Our Financial Statements together with the independent auditor's report thereon are included on pages F-1 through F-20 hereof.

### ITEM 13. EXHIBITS AND REPORTS ON FORM 8-K

(a) The following documents are filed as part of this Form 10-KSB/A.

1. The following financial statements of our company, with the independent auditor's report, are filed as part of this Form 10-KSB/A:

Independent Auditor's Report	F-2
Consolidated Balance Sheets	F-3
Consolidated Statements of Income	F-4
Consolidated Statements of Cash Flow	F-5
Consolidated Statements of Changes in Stockholders' Equity	F-6
Notes to Consolidated Financial Statements	F-7

2. The following exhibits are filed with this report and incorporated by reference as set forth below:

Exhibit	Description
-----	-----
2.1 (1)	Exchange Agreement dated December 4, 2002 by and among City Network, Inc., the shareholders of City Network, Inc., Investment Agents, Inc., Pamela Ray Stinson, Raymond Robert Acha, and Joseph H. Panganiban
3.1 (2)	Articles of Incorporation
3.2 (2)	Certificate of Amendment to Articles of Incorporation
3.3 (3)	Certificate of Amendment of the Articles of Incorporation
3.4 (4)	Amended and Restated Bylaws
14.1 (5)	Code of Ethics
21.1 (4)	Subsidiaries
31.1	Certification of Chief Executive Officer Pursuant to Section

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302 of the Sarbanes-Oxley Act of 2002.

- 31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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- (1) Previously filed with the SEC as an Exhibit to City Network's Form 8-K filed March 5, 2003, and incorporated herein by reference.
  - (2) Previously filed with the SEC as an Exhibit to City Network's Form SB-2 filed May 18, 2001, and incorporated herein by reference.
  - (3) Previously filed with the SEC as an Exhibit to City Network's Proxy Statement filed March 21, 2003, and incorporated herein by reference.
  - (4) Previously filed with the SEC as an Exhibit to City Network's Annual Report on Form 10-KSB filed April 15, 2005, and incorporated herein by reference.
  - (5) Previously filed with the SEC as an Exhibit to City Network's Annual Report on Form 10-KSB filed June 16, 2003, and incorporated herein by reference.
- (b) Current Reports on Form 8-K.

Report on Form 8-K filed December 20, 2004 announcing the appointment of Yung-Yi Tseng as CFO and director of our company and Chung-Chieh "Kevin" Lin, Yong Su, and Pi-Liang Liu as directors of our company.

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### SIGNATURES

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

CITY NETWORK, INC.

Date: January 27, 2006

By: /s/ Tiao-Tsan Lai

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Tiao-Tsan Lai  
Chief Executive Officer

Date: January 27, 2006

By: /s/ Yun-Yi Tseng

-----  
Yun-Yi Tseng  
Chief Financial Officer

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CITY NETWORK, INC. AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2004 AND FEBRUARY 29, 2004

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LICHTER, YU AND ASSOCIATES  
Certified Public Accountants

9191 Towne Centre Drive, Suite 406  
San Diego, CA 92122  
(858) 320-2808

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and  
Stockholders of City Network, Inc.

We have audited the accompanying balance sheets of City Network, Inc. (the "Company") as of December 31, 2004 and February 29, 2004, and the related statements of income, stockholders' equity, and cash flows for the ten months ended December 31, 2004 and the year ended February 29, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of City Network, Inc. as of December 31, 2004 and February 29, 2004, and the results of its operations and its cash flows for ten months ended December 31, 2004 and the year ended February 29, 2004 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note O to the financial statements, the Company has restated its financial statements to include disclosures regarding certain legal proceedings. There is no effect on net income.

/s/ Lichter, Yu & Associates

March 7, 2005, except for Note O, as to which the date is December 7, 2005  
San Diego, California

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CITY NETWORK, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
DECEMBER 31, 2004 AND FEBRUARY 29, 2004

	December 31, 2004 -----	February 29, 2004 -----
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 2,010,644	\$ 2,723,573
Accounts receivable, net	3,333,990	7,173,149
Inventory	732,027	910,190
Other receivables	6,863	126,492
Prepaid expenses	102,896	557,903
	-----	-----
Total Current Assets	6,186,420	11,491,307
	-----	-----
Fixed Assets, net	2,586,872	2,745,664
	-----	-----
Total Fixed Assets	2,586,872	2,745,664
	-----	-----
Other Assets		
Deposits	1,724,542	255,706
Trademarks	1,812	1,966
Equity in net assets of affiliated company	829,008	770,678
Intangible assets	961,053	1,000,000
Other current assets	8,255	96
	-----	-----
Total Other Assets	3,524,670	2,028,446
	-----	-----
Total Assets	\$ 12,297,962 =====	\$ 16,265,417 =====
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts payable and accrued expenses	\$ 3,335,286	\$ 6,838,620
Due to related party	80,083	334,812
Loan payable	0	1,680,329
Deferred revenue	14,566	260,498
Deposits payable	0	4,371
Current portion, long-term debt	3,226,181	2,316,689
	-----	-----
Total Current Liabilities	6,656,116	11,435,319
	-----	-----
Long-term debt, net of current portion	246,330	263,041
	-----	-----
Total Liabilities	6,902,446	11,698,360
	-----	-----
Stockholders' Equity		
Common stock, \$.001 par value, 100,000,000 shares authorized, 27,500,000 and 25,000,000 issued and outstanding, respectively	27,500	25,000
Additional paid in capital	5,937,946	4,260,117

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Cumulative foreign-exchange translation adjustment	142,453	29,663
Retained earnings	(712,383)	252,277
	-----	-----
Total Stockholders' Equity	5,395,516	4,567,057
	-----	-----
Total Liabilities and Stockholders' Equity	\$ 12,297,962	\$ 16,265,417
	=====	=====

See Accompanying Notes and Auditor's Report

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CITY NETWORK, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF INCOME  
TEN MONTHS ENDED DECEMBER 31, 2004 AND FISCAL YEAR ENDED FEBRUARY 29, 2004

	December 31, 2004	February 29, 2004
	-----	-----
Sales, net	\$ 15,674,613	\$ 19,647,749
Cost of sales	14,924,938	17,827,486
	-----	-----
Gross profit	749,675	1,820,263
General and administrative expenses	1,395,388	1,391,658
	-----	-----
Income (loss) from operations	(645,713)	428,605
	-----	-----
Other (Income) Expense		
Interest income	(3,785)	(20,202)
Rental income	(17,858)	(3,085)
Commission income	(281)	(15,517)
(Gain) loss on currency exchange	(10,720)	(13,815)
Other income	(32,120)	(11,263)
Equity in earnings of investee	(58,330)	1,674
Miscellaneous	1,303	2,499
Bad debt expense	185,858	159,238
Loss on sale of fixed assets	32,068	0
Interest expense	112,922	67,691
	-----	-----
Total Other (Income) Expense	209,057	167,220
	-----	-----
Income (loss) before income taxes	(854,770)	261,385
Provision for income taxes	109,890	85,190
	-----	-----
Net income (loss)	\$ (964,660)	\$ 176,195
	=====	=====
Net income (loss) per share (basic and diluted)		
Basic	\$ (0.036)	\$ 0.007
Diluted	\$ (0.036)	\$ 0.007
Weighted average number of shares		
Basic	27,000,000	24,958,333

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Diluted

27,000,000

24,958,333

See Accompanying Notes and Auditor's Report

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CITY NETWORK, INC. AND SUBSIDIARIES  
 CONSOLIDATED STATEMENTS OF CASH FLOWS  
 TEN MONTHS ENDED DECEMBER 31, 2004 AND FISCAL YEAR ENDED FEBRUARY 29, 2004

	December 31, 2004	February 29, 2004
	-----	-----
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net Income (loss)	\$ (964,660)	\$ 176,195
Adjustments to reconcile net income (loss) to net cash provided by (used) in operating activities:		
Depreciation and amortization	161,296	44,057
Equity in earning of investee	(58,330)	1,674
Loss on disposal of assets	32,068	0
Bad debt	185,858	159,238
(Gain) loss on foreign currency exchange	(10,720)	(13,815)
Decrease (Increase) in receivables	3,839,159	(5,652,808)
Decrease (Increase) in inventory	178,163	(543,184)
Decrease (Increase) in other receivables	119,629	(115,032)
Decrease (Increase) in prepaid expenses	455,007	(347,946)
Decrease (Increase) in deposit	(1,468,836)	(254,737)
Decrease (Increase) in deferred charges	0	36,836
Decrease (Increase) in other current assets	(8,159)	72,662
(Decrease) Increase in accounts payable and accrued expenses	(3,503,334)	6,297,694
(Decrease) Increase in deferred revenue	(245,932)	260,498
(Decrease) Increase in deposits payable	(4,371)	4,371
	-----	-----
Total Adjustments	(328,502)	(50,492)
	-----	-----
Net cash provided by (used in) operations	(1,293,162)	125,703
	-----	-----
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from sale of investments	0	108,594
Proceeds from sale of fixed assets	35,462	0
Purchase of intangibles	0	(838)
Purchase of investments	0	(772,352)
Purchase of furniture and equipment	(5,008)	(462,722)
	-----	-----
Net cash used in investing activities	30,454	(1,235,912)
	-----	-----
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Payment on notes payable	(5,217,702)	(2,229,705)
Payment of loan from related party	(455,227)	0
Loan from related party	200,498	743,386
Issuance of notes payable	477,953	3,974,994
Issuance of short-term debt	5,621,631	0
Issuance of common stock	0	720,000
	-----	-----
Net cash provided by financing activities	627,153	3,208,675
	-----	-----

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Effect of exchange rate change on cash	(77,374)	4,843
Net change in cash and cash equivalents	(712,929)	2,103,309
	-----	-----
Cash and cash equivalents at beginning of year	2,723,573	620,264
	-----	-----
Cash and cash equivalents at end of year	\$ 2,010,644	\$ 2,723,573
	=====	=====
Supplemental cash flows disclosures:		
Income tax payments	\$ 35,750	\$ 9,235
	-----	-----
Interest payments	\$ 112,922	\$ 67,691
	-----	-----
Non cash transaction:		
Conversion of debt to equity	\$ 1,680,329	\$ 0
	-----	-----

See Accompanying Notes and Auditor's Report

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CITY NETWORK, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY  
TEN MONTHS ENDED DECEMBER 31, 2004 AND FISCAL YEAR ENDED FEBRUARY 29, 2004

	December 31, 2004	February 29
	-----	-----
Common stock, number of shares outstanding		
Balance at beginning of period	25,000,000	24,500,
Stock cancellation	0	
Stock split	0	
Common stock issued	2,500,000	500,
	-----	-----
Balance at end of period	27,500,000	25,000,
	=====	=====
Common stock, par value \$.001 (thousands of shares)		
Balance at beginning of year	\$ 25,000	\$ 24,
Stock cancellation	0	
Stock split	0	
Common stock issued	2,500	
	-----	-----
Balance at end of year	27,500	25,
	-----	-----
Additional paid in capital		
Balance at beginning of year	4,260,117	3,540,
Issuance of stock	1,677,829	719,
	-----	-----
Balance at end of year	5,937,946	4,260,
	-----	-----
Cumulative foreign-exchange translation adjustment		
Balance at beginning of year	29,663	
Foreign currency translation	123,689	29,
	-----	-----
Balance at end of year	153,352	29,
	-----	-----
Retained (deficits)		

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Balance at beginning of year	252,277	76,
Issuance of stock dividend	0	
Net income (loss)	(964,660)	176,
	-----	-----
Balance at end of year	(712,383)	252,
	-----	-----
Total stockholders' equity at end of year	\$ 5,406,415	\$ 4,567,
	=====	=====

See Accompanying Notes and Auditor's Report

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CITY NETWORK, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 DECEMBER 31, 2004 AND FEBRUARY 29, 2004

Note A - ORGANIZATION

City Network, Inc., formerly Investment Agents, Inc., was incorporated on August 8, 1996 under the laws of the State of Nevada. City Network Technology, Inc., formerly Gelcrest Investments Limited, was incorporated under the laws of the British Virgin Islands on March 1, 2002. City Network, Inc. -Taiwan, formerly City Engineering, Inc., was incorporated under the laws of Republic of China on September 6, 1994. City Construction was incorporated under the laws of Republic of China on October, 10, 2003. City Network, Inc. owns 100% of the capital stock of City Network Technology, Inc., and City Network Technology, Inc. owns 100% of the capital stock of City Network, Inc. - Taiwan, and City Construction. Collectively the four corporations are referred to herein as the "Company".

On November 14, 2002, City Network Technology, Inc. became a wholly owned subsidiary of City Network, Inc. through an Exchange Agreement, which was amended on December 4, 2002 whereby City Network, Inc. acquired all of the issued and outstanding capital stock of City Network Technology, Inc. in exchange for 12,000,000 shares of City Network, Inc.

The Company is a provider of internet broadband and wireless infrastructure equipment and service for the rapidly expanding broadband marketplace. The Company intends to be an important provider of these services predicated upon its dedication to delivering user friendly, cost effective, and customer tailored high speed internet access equipment to meet the business needs of the hospitality, residential property and telecommunication industry worldwide.

On December 16, 2004, the Company changed its fiscal year end from February 28 to December 31.

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CITY NETWORK, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)  
 DECEMBER 31, 2004 AND FEBRUARY 29, 2004

Note B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

REVENUE RECOGNITION

Revenue from sales of products to customers is recognized upon shipment or

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when title passes to customers based on the terms of the sales, and is recorded net of returns, discounts and allowances. Service income is recognized as the related services are provided pursuant to the terms of the service agreement.

### PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of City Network, Inc., and its wholly owned subsidiaries City Network Technology, Inc. and its wholly owned subsidiaries, City Network, Inc. - Taiwan and City Construction, collectively referred to within as the Company. All material intercompany accounts, transactions and profits have been eliminated in consolidation.

### RISKS AND UNCERTAINTIES

The Company is subject to substantial risks from, among other things, intense competition from the providers of broadband products, services and the telecommunication industry in general, other risks associated with financing, liquidity requirements, rapidly changing customer requirements, limited operating history, and the volatility of public markets.

### CONTINGENCIES

Certain conditions may exist as of the date the financial statements are issued, which may result in a loss to the Company but which will only be resolved when one or more future events occur or fail to occur. The Company's management and legal counsel assess such contingent liabilities, and such assessment inherently involves an exercise of judgment. In assessing loss contingencies related to legal proceedings that are pending against the Company or unasserted claims that may result in such proceedings, the Company's legal counsel evaluates the perceived merits of any legal proceedings or unasserted claims as well as the perceived merits of the amount of relief sought or expected to be sought.

If the assessment of a contingency indicates that it is probable that a material loss has been incurred and the amount of the liability can be estimated, then the estimated liability would be accrued in the Company's financial statements. If the assessment indicates that a potential material loss contingency is not probable but is reasonably possible, or is probable but cannot be estimated, then the nature of the contingent liability, together with an estimate of the range of possible loss if determinable and material would be disclosed.

Loss contingencies considered to be remote by management are generally not disclosed unless they involve guarantees, in which case the guarantee would be disclosed.

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CITY NETWORK, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)  
DECEMBER 31, 2004 AND FEBRUARY 29, 2004

Note B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make certain 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. Actual results could differ from those estimates. Significant estimates include collectibility of accounts

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receivable, accounts payable, sales returns and recoverability of long-term assets.

### ALLOWANCE FOR DOUBTFUL ACCOUNTS

The Company has made an allowance for doubtful accounts for trade receivables based on a combination of write-off history, aging analysis, and any specific known troubled accounts.

### FIXED ASSETS

Property and equipment are stated at cost less accumulated depreciation. Expenditures for major additions and improvements are capitalized and minor replacements, maintenance and repairs are charged to expense as incurred. Depreciation is provided on the straight-line method over the estimated useful lives of the assets, or the remaining term of the lease, as follows:

Furniture and Fixtures	5 years
Equipment	5 years
Computer Hardware and Software	3 years
Building and Improvements	50 years

### INTANGIBLE ASSETS

Effective July 2002, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets." The adoption of SFAS No. 142 required an initial impairment assessment involving a comparison of the fair value of trademarks, patents and other intangible assets to current carrying value. No impairment loss was recognized for the years ended December 31, 2004 and February 29, 2004.

Trademarks and other intangible assets determined to have indefinite useful lives are not amortized. The Company tests such trademarks and other intangible assets with indefinite useful lives for impairment annually, or more frequently if events or circumstances indicate that an asset might be impaired. Trademarks and other intangible assets determined to have definite lives are amortized over their useful lives or the life of the trademark and other intangible asset, whichever is less.

### EXCHANGE GAIN (LOSS)

During year ended December 31, 2004 and February 29, 2004, the transactions of City Network, Inc. - Taiwan and City Construction were denominated in a foreign currency and are recorded in New Taiwan dollars at the rates of exchange in effect when the transactions occur. Exchange gains and losses are recognized for the different foreign exchange rates applied when the foreign currency assets and liabilities are settled.

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CITY NETWORK, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)  
DECEMBER 31, 2004 AND FEBRUARY 29, 2004

#### Note B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

##### TRANSLATION ADJUSTMENT

As of December 31, 2004 and February 29, 2004, the accounts of City Network, Inc. - Taiwan and City Construction were maintained, and their financial statements were expressed, in New Taiwan Dollars (NTD). Such financial statements were translated into U.S. Dollars (USD) in accordance SFAS No. 52, "Foreign Currency Translation", with the NTD as the functional currency. According to the Statement, all assets and liabilities were translated at the current exchange rate, stockholder's equity are translated at the historical rates and income statement items are

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translated at the weighted average exchange rate for the period. The resulting translation adjustments are reported under other comprehensive income in accordance with SFAS No. 130, "Reporting Comprehensive Income".

As of December 31, 2004 and February 29, 2004 the exchange rates between NTD and the USD was NTD\$1=USD\$0.03128 and NTD\$1=USD\$0.02994, respectively. The weighted-average rate of exchange between NTD and USD was NTD\$1=USD\$0.02998 and NTD\$1=USD\$0.02617, respectively. Total translation adjustment recognized for the year ended December 31, 2004 and February 29, 2004 is \$153,352 and \$29,663, respectively.

### FAIR VALUE OF FINANCIAL INSTRUMENTS

Our Company measures its financial assets and liabilities in accordance with generally accepted accounting principles. For certain of the Company's financial instruments, including accounts receivable (trade and related party), notes receivable and accounts payable (trade and related party), and accrued expenses, the carrying amounts approximate fair value due to their short maturities. The amounts owed for long-term debt and revolving credit facility also approximate fair value because interest rates and terms offered to the Company are at current market rates.

### STATEMENT OF CASH FLOWS

In accordance with SFAS No. 95, "Statement of Cash Flows", cash flows from the Company's operations are based upon the local currencies. As a result, amounts related to assets and liabilities reported on the statement of cash flows will not necessarily agree with changes in the corresponding balances on the balance sheet.

### CONCENTRATION OF CREDIT RISK

Financial instruments that potentially subject the Company to concentrations of credit risk are accounts receivable and other receivables arising from its normal business activities. The Company has a diversified customer base. The Company controls credit risk related to accounts receivable through credit approvals, credit limits and monitoring procedures. The Company routinely assesses the financial strength of its customers and, based upon factors surrounding the credit risk, establishes an allowance, if required, for un-collectible accounts and, as a consequence, believes that its accounts receivable credit risk exposure beyond such allowance is limited.

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CITY NETWORK, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)  
DECEMBER 31, 2004 AND FEBRUARY 29, 2004

#### Note B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

##### INVENTORY

Inventory is valued at the lower of cost or market. Cost is determined on the weighted average method. As of December 31, 2004 and February 29, 2004, inventory consisted only of finished goods.

##### PRODUCT WARRANTIES

The Company estimates its warranty costs based on historical warranty claim experience and applies this estimate to the revenue stream for products under warranty. Future costs for warranties applicable to revenue recognized in the current period are charged to cost of revenue. The warranty accrual is reviewed quarterly to verify that it properly reflects the remaining obligation based on anticipated expenditures over the balance of the obligation period. Adjustments are made when accrual warranty claim

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experience differs from estimate.

### LONG-TERM EQUITY INVESTMENTS

Long-term equity investments are accounted for by the equity method when the Company and its subsidiaries owns 20% or more of the investee's voting shares, or less than 20% of investee's voting shares but is able to exercise significant influence over the investee's operation and financial policies, but not more than 50%. All other long-term equity investments are accounted for by either the lower-of-cost-or-market method or cost method. For long-term equity investments accounted for under the equity method related to investee's that are publicly listed companies, unrealized losses resulting from declines in the market value below cost are recorded as a separate component of stockholders' equity.

For long-term equity investments in non-listed companies accounted for under the cost method, investments are stated at original cost. A write-down of the investment balance to earnings is taken only if it is determined that there is a permanent decline in the investment's value. Stock dividends do not result in the recognition of investment income.

For long-term equity investments accounted for by the equity method, the investment is initially recorded at cost, then reduced by dividends and increased or decreased by investor's proportionate share of the investee's net earnings or loss.

### CASH AND CASH EQUIVALENTS

The Company considers all highly liquid investments purchased with initial maturities of three months or less to be cash equivalents.

### ADVERTISING

Advertising costs are expensed in the year incurred.

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## CITY NETWORK, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED) DECEMBER 31, 2004 AND FEBRUARY 29, 2004

### Note B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### INCOME TAXES

Provisions for income taxes are based on taxes payable or refundable for the current year and deferred taxes on temporary differences between the amount of taxable income and pretax financial income and between the tax bases of assets and liabilities and their reported amounts in the financial statements.

Deferred tax assets and liabilities are included in the financial statements at currently enacted income tax rates applicable to the period in which the deferred tax assets and liabilities are expected to be realized or settled as prescribed in SFAS No. 109, "Accounting for Income Taxes". As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

#### EARNINGS PER SHARE

The Company uses SFAS No. 128, "Earnings Per Share", for calculating the basic and diluted earnings (loss) per share. Basic earnings (loss) per share are computed by dividing net income (loss) attributable to common stockholders by the weighted average number of common shares outstanding. Diluted earnings per share are computed similar to basic earnings per share except that the denominator is increased to include common stock

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equivalents, if any, as if the potential common shares had been issued.

IMPAIRMENT OF LONG-LIVED ASSETS AND LONG-LIVED ASSETS TO BE DISPOSED OF  
The Company adopted the provision of The Financial Accounting Standards Board ("FASB") No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of". This statement requires that long-lived assets and certain identifiable intangibles be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amounts of the assets exceed the fair values of the assets. In assessing the impairment of these identifiable intangible assets, identifiable goodwill will be allocated on a pro rata basis using fair values of the assets at the original acquisition date. In estimating expected future cash flows for determining whether an asset is impaired and if expected future cash flows are used in measuring assets that are impaired, assets will be grouped at the lowest level (entity level) for which there are identifiable cash flows that are largely independent of the cash flows of other groups of assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. In recording an impairment loss, any related goodwill would be reduced to zero before reducing the carrying amount of any identified impaired asset.

For goodwill not identifiable with an impaired asset, the Company will establish benchmarks at the lowest lever (entity level) as its method of assessing impairment. In measuring impairment, unidentifiable goodwill will be considered impaired if the fair value at the lowest level is less than its carrying amount. The fair value of unidentifiable goodwill will be determined by subtracting the fair value of the recognized net asset at the lowest level (excluding goodwill) from the value at the lowest level. The amount of the impairment loss should be equal to the difference between the carrying amount of goodwill and the fair value of goodwill. In the event that impairment is recognized, appropriate disclosures would be made.

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CITY NETWORK, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)  
DECEMBER 31, 2004 AND FEBRUARY 29, 2004

Note B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

NEW ACCOUNTING PRONOUNCEMENTS

In January 2003, FASB issued FASB Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN46"). This interpretation of Accounting Research Bulletin No. 51, requires companies to consolidate the operations of all variable interest entities ("VIE's") for which they are the primary beneficiary. The term "primary beneficiary" is defined as the entity that will absorb a majority of expected losses, receive a majority of the expected residual returns, or both. This interpretation was later revised by the issuance of Interpretation No. 46R ("FIN 46R"). The revision was issued to address certain implementation issues that had arisen since the issuance of the original interpretation and to provide companies with the ability to defer the adoption of FIN46 to period after March 15, 2004. The implementation of FIN46 and FIN 46R, had no material impact on the Company's financial statements.

On July 16, 2004 the FASB ratified the Emerging Issues Task Force ("EITF")

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consensus of Issue 02-14, "Whether the Equity Method of Accounting Applies when an Investor Does Not Have an Investment in Voting Stock of an Investee but Exercises Significant Influence through Other Means" ("EITF 02-14"). The consensus concluded that an investor should apply the equity method of accounting when it can exercise significant influence over an entity through a means other than holding voting rights. The consensus is effective for reporting periods beginning after September 2004. The adoption of EITF 02-14 did not have a material impact on the Company's financial statements.

On December 16, 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123R"), which replaces SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123") and supercedes APB Opinion No. 25, "Accounting for Stock Issued to Employees." SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values, beginning with the first interim or annual period after June 15, 2005. The pro forma disclosures previously permitted under SFAS 123 no longer will be an alternative to financial statement recognition. The Company is required to adopt SFAS 123R in its three months ending September 30, 2005. Under SFAS 123R, The Company must determine the appropriate fair value model to be used for valuing share-based payments, the amortization method for compensation cost and the transition method to be used at date of adoption. The transition methods include prospective and retroactive adoption options. Under the retroactive options, prior periods may be restated either as of the beginning of the year of adoption or for all periods presented. The prospective method requires that compensation expense be recorded for all unvested stock options and restricted stock at the beginning of the first quarter of adoption of SFAS 123R, while the retroactive methods would record compensation expense for all unvested stock options and restricted stock beginning with the first period restated. The Company is evaluating the requirements of SFAS 123, and it expects that the adoption of SFAS 123R will have no material impact on the Company's financial statements.

In September 2004, the EITF Issue No. 04-08, "The Effect of Contingently Convertible Debt on Diluted Earnings per Share" ("EITF 04-08") was issued stating that contingently convertible debt should be included in diluted earnings per share computations regardless of whether the market price trigger has been met. EIFT 04-08 is effective for reporting periods ending after December 15, 2004. EITF 04-08 will have no material impact on the Company's financial statements.

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CITY NETWORK, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)  
DECEMBER 31, 2004 AND FEBRUARY 29, 2004

### Note D -CASH

The Company maintains its cash balances at various banks in Taiwan and Hong Kong. All balances are insured by the Central Deposit Insurance Corporation (CDIC). As of December 31, 2004 and February 29, 2004, there were no uninsured portions of the balances held at the bank.

### Note E - FIXED ASSETS

Fixed assets consist of the following:

December 31, 2004                      February 29, 2004

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Land	\$ 1,916,328	\$ 1,966,694
Building	283,977	305,429
Machinery and equipment	430,880	427,126
Furniture and fixtures	143,655	142,402
	-----	-----
	\$ 2,774,840	\$ 2,841,651
Accumulated depreciation	(187,968)	(95,987)
	-----	-----
	\$ 2,586,872	\$ 2,745,664
	=====	=====

Note F - INTANGIBLE ASSETS

Intangible assets consist of the following:

	December 31, 2004	February 29, 2004
	-----	-----
Trademarks	\$ 2,150	\$ 2,150
Intangible asset	1,000,000	1,000,000
	-----	-----
	\$ 1,002,150	\$ 1,002,150
Accumulated depreciation	(39,285)	(184)
	-----	-----
	\$ 962,865	\$ 1,001,966
	=====	=====

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CITY NETWORK, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)  
 DECEMBER 31, 2004 AND FEBRUARY 29, 2004

Note G- COMMITMENTS

A BEST INFORMATION

City Network, Inc. - Taiwan, signed an agreement with A Best Information in 2003 for the exclusive right to sell A Best Information's products. There is no expiration date in the agreement, and the Company has the rights to transfer the agreement to any third party with a negotiable price. The Company paid \$1,000,000 for these rights.

RESELLER AGREEMENTS

City Network, Inc. - Taiwan has several signed reseller agreements with various customers. These resellers are given special sales prices and are paid commissions for their sales orders.

CO-CONSTRUCTION AGREEMENT

In April 2004, City Construction Co., Ltd. Entered into a Co-Construction Agreement with another company in Taipei, Taiwan. Under the Agreement, the Company will finance, construct and own 50% of the building project. The Company has not yet begun construction on the building.

OPERATING LEASES

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The Company leases various office facilities under operating leases that terminate on various dates. Rental expense for these leases consisted of \$50,029 for the ten months ended December 31, 2004 and \$13,482 for the year ended February 29, 2004. The Company has future minimum lease obligations as follows:

2005 \$20,122

Note H - LONG-TERM INVESTMENT

BEIJING PUTAIN HEXIN NETWORK TECHNOLOGY CO., LTD  
 On August 31, 2003 the Company purchased approximately twenty-five percent (25%) of Beijing Putain Hexin Network Technology Co., Ltd for \$325,000. On December 4, 2003 the Company purchased an additional fifteen percent (15%) for \$398,500. Beijing Putain Hexin Network Technology Co., Ltd is not publicly traded or listed. The Company is using the complete equity method to record its share of the subsidiary's net income and loss. As of December 31, 2004 and February 29, 2004 the Company recognized an income of \$58,330 and a loss \$1,674 from their acquisition.

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CITY NETWORK, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)  
 DECEMBER 31, 2004 AND FEBRUARY 29, 2004

Note I - COMPENSATED ABSENCES

Employees earn annual vacation leave at the rate of seven (7) days per year for the first three years. Upon completion of the third year of employment, employees earn annual vacation leave at the rate of ten (10) days per year for years four through five. Upon completion of the fifth year of employment, employees earn annual vacation leave at the rate of fourteen (14) days per year for years six through ten. Upon completion of the tenth year of employment, one (1) additional day for each additional year, until it reaches thirty (30) days per year. At termination, employees are paid for any accumulated annual vacation leave. As of December 31, 2004 and February 29, 2004 vacation liability existed in the amount of \$1,892 and \$0 respectively.

Note J - INCOME TAXES

Total Federal and State income tax expense for the years ended December 31, 2004 and February 29, 2004 amounted to \$109,890 and \$85,190, respectively. For the years ended December 31, 2004 and February 29, 2004, there is no difference between the federal statutory tax rate and the effective tax rate.

The following is a reconciliation of income tax expense:

12/31/04	U.S.	State	International	Total
	-----	-----	-----	-----
Current	\$ 0	\$ 0	\$109,890	\$109,890
Deferred	0	0	0	0
Total	\$ 0	\$ 0	\$109,890	\$109,890
	=====	=====	=====	=====
02/29/04	U.S.	State	International	Total
	-----	-----	-----	-----
Current	\$ 3,321	\$ 0	\$ 44,180	\$ 47,501

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Deferred	0	0	0	0
	-----	-----	-----	-----
Total	\$ 3,321	\$ 0	\$ 44,180	\$ 47,501
	=====	=====	=====	=====

Reconciliation of the differences between the statutory U.S. Federal income tax rate and the effective rate is as follows:

	12/31/2004	2/29/2004
	-----	-----
Federal statutory tax rate	33%	33%
State, net of federal benefit	0%	0%
	----	----
Effective tax rate	33%	33%
	=====	=====

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CITY NETWORK, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)  
 DECEMBER 31, 2004 AND FEBRUARY 29, 2004

NOTE K - DEBT

At December 31, 2004 and February 29, 2004, the Company had notes payable outstanding in the aggregate amount of \$3,461,162 and \$2,579,730, respectively. Payable as follows:

December 31, 2004	February 29, 2004
-----	-----
Secured note payable to a bank in Taiwan, interest at 3.175% per annum, due by May 29, 2016	Secured note payable to a bank in Taiwan, interest at 3.175% per annum, due by May 29, 2016
\$280,689	
Note payable to a bank in Taiwan, interest at 3.616% per annum, due by October 8, 2005	Secured note payable to a bank in Taiwan, interest at 7.425% per annum, due by May 9, 2004
500,480	
Note payable to a bank in Taiwan, interest at 3.828% per annum, due by February 13, 2005	Secured note payable to a bank in Taiwan, interest at 4.25% per annum, due by June 6, 2005
125,120	
Note payable to a bank in Taiwan, interest at 4.42% per annum, due by March 29, 2005	Note payable to a bank in Taiwan, interest at 4.25% per annum, due by June 12, 2005
246,921	
Note payable to a bank in Taiwan, interest at 4.42% per annum, due by March 15, 2005	Note payable to a bank in Taiwan, interest at 7.5% per annum, due by June 16, 2004
68,004	
Note payable to a bank in Taiwan, interest at 4.42% per annum, due by April 11, 2005	Note payable to a bank in Taiwan, interest at 3.77% per annum, due by December 31, 2004
76,548	
Note payable to a bank in Taiwan, interest at 4.42% per annum, due by April 10, 2005	Note payable to a bank in Taiwan, interest at 3.77% per annum, due by March 13, 2004
54,995	

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Note payable to a bank in Taiwan, interest at 4.42% per annum, due by May 29, 2005	233,493	Note payable to a bank in Taiwan, interest at 3.77% per annum, due by March 26, 2004
Note payable to a bank in Taiwan, interest at 3.616% per annum, due by March 10, 2005	196,563	Note payable to a bank in Taiwan, interest at 3.77% per annum, due by April 4, 2004
Note payable to a bank in Taiwan, interest at 3.616% per annum, due by February 15, 2005	60,761	Note payable to a bank in Taiwan, interest at 3.77% per annum, due by March 5, 2004

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CITY NETWORK, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)  
 DECEMBER 31, 2004 AND FEBRUARY 29, 2004

NOTE K - DEBT (CONTINUED)

Note payable to a bank in Taiwan, interest at 3.616% per annum, due by March 8, 2005	141,511	Note payable to a bank in Taiwan, interest at 3.77% per annum, due by April 8, 2004
Note payable to a bank in Taiwan, interest at 3.616% per annum, due by March 2, 2005	35,121	Note payable to a bank in Taiwan, interest at 3.77% per annum, due by April 23, 2004
Note payable to a bank in Taiwan, interest at 3.616% per annum, due by March 15, 2005	43,498	Note payable to a bank in Taiwan, interest at 3.77% per annum, due by April 8, 2004
Note payable to a bank in Taiwan, interest at 3.616% per annum, due by March 11, 2005	13,085	Note payable to a bank in Taiwan, interest at 3.77% per annum, due by April 8, 2004
Note payable to a bank in Taiwan, interest at 3.616% per annum, due by April 9, 2005	591,192	Note payable to a bank in Taiwan, interest at 4.269% per annum, due by August 25, 2004
Note payable to a bank in Taiwan, interest at 3.616% per annum, due by April 9, 2005	53,895	
Note payable to a bank in Taiwan, interest at 3.616% per annum, due by April 9, 2005	59,521	
Note payable to a bank in Taiwan, interest at 3.26% per annum, due by March 11, 2005	312,752	
Note payable to a bank in Taiwan, interest at 3.26% per annum, due by April 22, 2005	121,866	
Note payable to a corporation in		

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Taiwan, interest at 6.265% per annum, due by November 20, 2005, personally guaranteed by an office of the Company	256,496 -----
Total	3,461,612
Current portion	\$3,215,282 -----
Long-term portion	\$ 246,330 =====

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CITY NETWORK, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)  
DECEMBER 31, 2004 AND FEBRUARY 29, 2004

NOTE L - RELATED PARTY TRANSACTIONS

Throughout the history of the Company, certain members of the Board of Directors and general management have made loans to the Company to cover operating expenses or operating deficiencies.

Andy Lai - As of December 31, 2004 and February 29, 2004, the Company has a non interest-bearing loan from Andy Lai, the Company's President, in the amount of \$73,827 and \$334,812, respectively. Mr. Lai has also personally guaranteed a note payable of the Company in the amount of \$477,953. As of December 31, 2004, the balance for the note was \$256,496.

Huang Hui Maio - As of December 31, 2004, the Company has a non interest-bearing loan from Huang Hui Maio, a shareholder of the Company, in the amount of \$6,256.

NOTE M - FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amounts of cash and cash equivalents, accounts receivable, deposits and accounts payable approximate their fair value because of the short maturity of those instruments.

The carrying amounts of the Company's long-term debt approximate their fair value because of the short maturity and/or interest rates which are comparable to those currently available to the Company on obligations with similar terms.

NOTE N - STOCK

On February 14, 2003 the Board of Directors of the Company approved and recommended that Company's Articles of Incorporation be amended to increase the number of authorized shares of common stock, par value \$0.001 of the Company, from 25,000,000 shares to 100,000,000; and to authorize 50,000,000 shares of preferred stock, par value \$0.001.

On February 17, 2003, the holders of approximately 52% of the outstanding shares of common stock of City Network executed a written consent adopting and approving the Charter Amendment. The Charter Amendment was filed with the Secretary of State of the State of Nevada in March 2003.

In May 2004, the Company issued 2,500,000 shares of its common stock as consideration for the conversion in full of a note and short term debt

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payable to third parties in the aggregate of \$1,680,329. The note and short term debt payable were converted into shares of common stock at a price of approximately \$0.672 per share.

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### CITY NETWORK, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED) DECEMBER 31, 2004 AND FEBRUARY 29, 2004

#### Note O - LEGAL PROCEEDINGS

The Company is party to certain litigation that has arisen in the normal course of its business and that of its subsidiary.

HWA-CHING - In August 2004, a customer closed business and did not pay the remaining balance due to City Network - Taiwan on outstanding receivables in the amount of \$880,649. City Network - Taiwan has filed criminal and civil litigation against the customer for fraud. This case is currently ongoing.

In August 2004, City Network Inc.-Taiwan filed a lawsuit against the owner of Hwa-Ching Co., as well as eight individuals in Taiwan, alleging fraud for closing down Hwa-Ching Co. without payment for the delivered merchandise. City Network Inc.-Taiwan sought approximately NT\$27 million or approximately US\$900,000. To date, the court has not yet reached a verdict on this case.

In December 2004, the Company filed a lawsuit against Tain-Kang Co., a customer of Hwa-Ching Co. in Taipei District Court claiming damages owed to Hwa-Ching from Tain-Kang in the amount of approximately NT\$5,796,000 or US\$172,963 to cover the outstanding account payable owed by Hwa-Ching to the Company. To date, the court has not yet reached a verdict on this case.

RPPI INTERNATIONAL LTD. - On October 10, 2004, Rong-Dian filed a lawsuit against City Network Inc.-Taiwan in the Taiwan Taipei district court of Taiwan, in Taipei, Taiwan, alleging breach of contract for two different purchase agreements that City Network Inc.-Taiwan entered with them and two third-parties. Rong-Dian sought the aggregate amount of approximately NT\$40.2 million or US\$1.2 million for the alleged breaches. One purchase agreement was for an order that City Network Inc.-Taiwan sold to Hwa-Ching Co. in the amount of approximately NT\$27.3 million or US\$900,000 and the other purchase agreement was for an order City Network Inc.-Taiwan sold to a separate customer of the Company in the amount of approximately NT\$12.9 million or US\$390,909. As of the date of this Report, the Company had not entered into a settlement agreement.

SHANGHAI BANK - On January 24, 2005, Shanghai Commercial and Savings Bank ("Shanghai Bank") filed a lawsuit with the Taipei District Court against the Company claiming approximately NT\$12 million or approximately US\$387,000 for the payment of an unpaid purchase price for goods. The Company purchased such goods from Chin Shin and Chin Shin assigned the account receivable to Shanghai Bank. As such, Shanghai Bank sued the Company for the payment of those goods. However, the Company returned the said goods because they were defective. The Company and Shanghai Bank are currently in negotiations for a settlement agreement in this matter. The Company deposited a bond in the amount of approximately NT\$3 million or approximately US\$90,000 with the court at the commencement of the lawsuit.

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CITY NETWORK, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)  
 DECEMBER 31, 2004 AND FEBRUARY 29, 2004

NOTE P - TRANSITION REPORTS

In accordance to Regulation 13A-10, the following table present the statements of income for the ten months ended December 31, 2004 and 2003 for the Company, due to the change in the fiscal year ended from February 28 to December 31.

	Ten months ended December 31, 2004	Ten months ended December 31, 2003
	----- (Audited)	----- (Unaudited)
Sales, net	\$ 15,674,613	\$ 16,119,649
Cost of sales	14,924,938 -----	14,798,578 -----
Gross profit	749,675.00	1,321,071
General and administrative expenses	1,395,388 -----	758,032 -----
Income (loss) from operations	(645,713) -----	563,039 -----
Other (Income) Expense		
Interest income	(3,785)	(21,137)
Rental income	(17,858)	(2,093)
Commission income	(281)	(14,767)
(Gain) loss on currency exchange	(10,720)	(5,100)
Other income	(32,120)	(36,067)
Equity in earnings of investee	(58,330)	2,676
Miscellaneous	1,303	61,774
Bad debt expense	185,858	362,075
Loss on sale of fixed assets	32,068	0
Interest expense	112,922 -----	55,655 -----
Total Other (Income) Expense	209,057 -----	403,016 -----
Income (loss) before income taxes	(854,770)	160,023
Provison for income taxes	109,890 -----	137,095 -----
Net income (loss)	(\$ 964,660) =====	\$ 22,928 =====
Net income (loss) per share (basic and diluted)		
Basic	\$ (0.036)	\$ 0.001
Diluted	\$ (0.036)	\$ 0.001
Weighted average number of shares		
Basic	27,000,000	24,777,778
Diluted	27,000,000	24,777,778

