

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

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

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

FORM 10-QSB/A  
(Amendment No. 1)

(Mark One)

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

For the quarterly period ended: March 31, 2005

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-31954

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  
(Address of principal executive offices)

011-886-2-8226-5566  
(Issuer's telephone number)

N/A  
(Former name, former address and former fiscal year,  
if changed since last report)

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

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

The number of shares outstanding of the issuer's common stock, \$0.001 par  
value, as of the close of business on January 23, 2006 was 32,967,183.

Transitional Small Business Disclosure Format (Check One): Yes  No

EXPLANATORY NOTE

## Edgar Filing: CITY NETWORK INC - Form 10QSB/A

The purpose of this Amendment No. 1 to Quarterly Report on Form 10-QSB/A of City Network, Inc. (the "Company," "we" or "our") for the fiscal period ended March 31, 2005, filed with the Securities and Exchange Commission ("SEC") on May 23, 2005, is to (i) reflect additional commitments due to a contract between City Construction Co., Ltd and three individuals for the construction of property in Keelung, Taiwan; and (ii) reflect complete information on credit facility arrangements.

The Items which are amended and restated herein are:

1. Part I, Item 1 - Financial Statements (only Footnote 8, Footnote 10 and Footnote 12); and
2. Part II, Item 1 - Legal Proceedings.

Except as otherwise expressly noted herein, this Amendment No. 1 to Quarterly Report on Form 10-QSB/A does not reflect events occurring after the May 23, 2005 filing of our Quarterly Report on Form 10-QSB in any way, except as those required to reflect the effects of this restatement of our financial statements for the periods presented, as deemed necessary in connection with the completion of revised notes to the financial statements.

The remaining Items contained within this Amendment No. 1 to our Quarterly Report on Form 10-QSB/A consist of all other Items originally contained in our Quarterly Report on Form 10-QSB for the quarterly period ended March 31, 2005 in the form filed with the SEC on May 23, 2005. These remaining Items are not amended hereby, but are included for the convenience of the reader. 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. While this report primarily relates to the historical periods covered, events may have taken place since the original filing that might have been reflected in this report if they had taken place prior to the original filing.

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### PART I. FINANCIAL INFORMATION

#### ITEM 1. FINANCIAL STATEMENTS

RESTATED  
CITY NETWORK, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS

	March 31, 2005	December
	-----	-----
	(Unaudited)	
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 1,319,326	\$ 2,0
Accounts receivable, net	2,973,167	3,3
Inventory	702,514	7
Other receivables	61,361	
Prepaid expenses	333,938	1
	-----	-----
Total Current Assets	5,390,306	6,1
	-----	-----
Fixed Assets, net	2,127,769	2,5
	-----	-----
Total Fixed Assets	2,127,769	2,5
	-----	-----
Other Assets		
Deposits	1,755,754	1,7
Trademarks	1,776	
Equity in net assets of affiliated company	818,354	8
Intangible assets	943,892	9
Other assets	19,084	
	-----	-----
Total Other Assets	3,538,860	3,5
	-----	-----
Total Assets	\$ 11,056,935	\$ 12,2
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts payable and accrued expenses	\$ 3,166,324	\$ 3,3
Due to related party	73,790	
Deferred revenue	8,873	
Current portion, long-term debt	3,388,219	3,2
	-----	-----
Total Current Liabilities	6,637,206	6,6
Long-term debt, net of current portion	0	2
	-----	-----
Total Liabilities	6,637,206	6,9

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Stockholders' Equity		
Common stock, \$.001 par value, 100,000,000 shares authorized, 27,500,000 issued and outstanding	27,500	5,9
Additional paid in capital	5,937,946	1
Cumulative foreign-exchange translation adjustment	190,552	(7
Retained earnings	(1,736,269)	(7
	-----	-----
Total Stockholders' Equity	4,419,729	5,3
	-----	-----
Total Liabilities and Stockholders' Equity	\$ 11,056,935	\$ 12,2
	=====	=====

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RESTATED  
CITY NETWORK, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF INCOME  
(Unaudited)

	Three Months Ended	
	March 31, 2005	March 31, 2004
	-----	-----
Sales, net	\$ 1,293,350	\$ 6,287,093
Cost of sales	1,255,040	5,697,879
	-----	-----
Gross profit	38,310	589,214
General and administrative expenses	323,145	382,440
	-----	-----
Income (loss) from operations	(284,835)	206,774
	-----	-----
Other (Income) Expense		
Interest income	(399)	(128)
Rental income	(47,670)	(3,154)
Commission income	(3,921)	(1,179)
(Gain) loss on currency exchange	8,258	2,823
Other income	(35,868)	(1,255)
Reserve for bad debt	685,000	0
Equity in earnings of investee	10,654	0
Miscellaneous	2,339	0
Loss on sale of fixed assets	82,260	0
Interest expense	38,398	17,090
	-----	-----
Total Other (Income) Expense	739,051	14,197
	-----	-----
Income (loss) before income taxes	(1,023,886)	192,577
Provison for income taxes	0	0
	-----	-----

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Net income (loss)	\$ (1,023,886)	\$ 192,577
	=====	=====
Net income (loss) per share (basic and diluted)		
Basic	\$ (0.037)	\$ 0.008
Diluted	\$ (0.037)	\$ 0.008
Weighted average number of shares		
Basic	27,500,000	25,000,000
Diluted	27,500,000	25,000,000

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RESTATED  
CITY NETWORK, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

	Three Months Ended	
	March 31, 2005	March 2004
	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income (loss)	\$ (1,023,886)	\$ 192,577
Adjustments to reconcile net income (loss) to net cash provided by (used) in operating activities:		
Depreciation and amortization	43,113	
Equity in earning of investee	10,654	
Loss on disposal of assets	82,260	
(Gain) loss on foreign currency exchange	8,258	
Translation adjustment	21,726	(7,250)
Decrease (Increase) in receivables	360,823	(2,311)
Decrease (Increase) in inventory	29,513	(27,111)
Decrease (Increase) in other receivables	(54,498)	(36,250)
Decrease (Increase) in prepaid expenses	(231,042)	(65,000)
Decrease (Increase) in deposit	(31,212)	17,000
Decrease (Increase) in other current assets	(10,829)	70,000
(Decrease) Increase in accounts payable and accrued expenses	(168,962)	3,190
(Decrease) Increase in deferred revenue	(5,693)	(29,000)
(Decrease) Increase in deposits payable	0	
	-----	-----
Total Adjustments	54,111	10,000
	-----	-----
Net cash (used in) provided by operations	(969,775)	30,000
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sale of fixed assets	369,042	
Purchase of furniture and equipment	0	(2,000)
	-----	-----
Net cash (used in) provided by investing activities	369,042	(2,000)
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES		
Payment on notes payable	(1,579,160)	(1,190,000)
Payment of loan from related party	(6,293)	(6,293)
Loan from related party	0	2,000
Issuance of short-term debt	1,494,868	890,000
	-----	-----

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Net cash (used in) financing activities	(90,585)	(28)
	-----	-----
Net change in cash and cash equivalents	(691,318)	(
	-----	-----
Cash and cash equivalents at beginning of period	2,010,644	1,14
	-----	-----
Cash and cash equivalents at end of period	\$ 1,319,326	\$ 1,14
	=====	=====
Supplemental cash flows disclosures:		
Income tax payments	\$ 0	\$
	-----	-----
Interest payments	\$ 38,398	\$ 1
	-----	-----
Non cash transaction:		
Conversion of debt to equity	\$ 0	\$ 1,68
	-----	-----

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RESTATED  
CITY NETWORK, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

	March 31, 2005	December 31, 200
	-----	-----
	(Unaudited)	
Common stock, number of shares outstanding		
Balance at beginning of period	27,500,000	25,000,000
Common stock issued	0	2,500,000
	-----	-----
Balance at end of period	27,500,000	27,500,000
	=====	=====
Common stock, par value \$.001		
Balance at beginning of year	\$ 27,500	\$ 25,000
Common stock issued	0	2,500
	-----	-----
Balance at end of period	27,500	27,500
	-----	-----
Additional paid in capital		
Balance at beginning of year	5,937,946	4,260,117
Issuance of stock	0	1,677,829
	-----	-----
Balance at end of period	5,937,946	5,937,946
	-----	-----
Cumulative foreign-exchange translation adjustment		
Balance at beginning of year	142,453	29,663
Foreign currency translation	48,099	112,790
	-----	-----
Balance at end of period	190,552	142,453
	-----	-----
Retained (deficits)		
Balance at beginning of year	(712,383)	252,277
Net income (loss)	(1,023,886)	(964,660)
	-----	-----
Balance at end of period	(1,736,269)	(712,383)

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Total stockholders' equity at end of period	\$ 4,419,729 =====	\$ 5,395,516 =====
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RESTATED  
CITY NETWORK, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
MARCH 31, 2005 AND 2004

NOTE 1 - NATURE OF OPERATIONS

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, dated November 14, 2004 and 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 designs, manufactures and markets a comprehensive line of broadband communication and wireless Internet access product and solutions. The Company's product lines are used in residential building and hospitality markets and include the simple DSL bridge/modem for the home and small business user. The Company is also pursuing work in the building construction field.

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

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Unaudited Interim Financial Information - The accompanying financial statements have been prepared by City Network, Inc., pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC") Form 10-QSB and Item 310 of Regulation S-B and generally accepted accounting principles for interim financial reporting. These financial statements are unaudited and, in the opinion of management, include all adjustments (consisting of normal recurring adjustments and accruals) necessary for a fair presentation of the statement of financial position, operations, and cash flows for the periods presented. Operating results for the three months ended March 31, 2005 and 2004 are not necessarily indicative of the results that may be expected for the year ended December 31, 2005, or any future period, due to seasonal and other factors. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting policies have been omitted in accordance with the rules and regulations of the SEC. These financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes, included in the Company's Annual Report on Form 10-KSB for the year ended December 31, 2004.

RESTATED  
CITY NETWORK, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
MARCH 31, 2005 AND 2004

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Basis of Consolidation - The consolidated financial statements for 2004 include the accounts of City Network, Inc., it's wholly owned subsidiary City Network Technology, Inc. and its wholly-owned subsidiaries, City Network, Inc. - Taiwan and City Construction Co., Ltd. All material intercompany accounts, transactions and profits have been eliminated in consolidation.

Revenue Recognition - Revenue from sales of products to customers is recognized upon shipment or when title passes to customers based on the terms of the sales and is recorded net of returns, discounts, and allowances.

Cash and Cash Equivalents - Cash equivalents are stated at cost. Cash equivalents are highly liquid investments readily convertible into cash with an original maturity of three months or less and consist of time deposits with commercial banks.

Allowance for Doubtful Accounts - The Company establishes an allowance for doubtful accounts on a case-by-case basis when it believes the required payment of specific amounts owed is unlikely to occur after a review of historical collection experience, subsequent collections, and management's evaluation of existing economic conditions.

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 expensed as incurred. Whenever an asset is retired or disposed of, its cost and accumulated depreciation or amortization are removed from the respective accounts and the resulting gain or loss is credited or charged to income.

Depreciation is computed using the straight-line and declining-balance methods over the following estimated useful lives:

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 period ended March 31, 2005.

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.



RESTATED  
CITY NETWORK, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
MARCH 31, 2005 AND 2004

NOTE 2 - 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 March 31, 2005, inventory consisted only of finished goods.

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. As of March 31, 2005, there are no matters that warrant disclosure in the financial statements.

Advertising - Advertising costs are expensed in the period incurred.

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

Concentration of Credit Risk - Financial instruments, which subject the Company to credit risk, consist primarily of cash equivalents and trade accounts receivable arising from its normal business activities. The Company places its cash in what it believes to be credit-worthy financial institutions. Concentration of credit risk with respect to trade accounts receivable is primarily from customers located in Asia. The Company actively evaluates the creditworthiness of the customers with which it conducts business through credit approvals, credit limits and monitoring procedures.

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RESTATED  
CITY NETWORK, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
MARCH 31, 2005 AND 2004

## NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Impairment of Long-Lived Assets - On January 1, 2002 the Company adopted SFAS No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets". The Company evaluates long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. If the estimated future cash flows (undiscounted and without interest charges) from the use of an asset are less than the carrying value, a write-down would be recorded to reduce the related asset to its estimated fair value. There have been no such impairments to date.

Earnings Per Share - Earnings per share are based on the weighted average number of shares of common stock and common stock equivalents outstanding during each period. Earnings per share are computed using the treasury stock method. The options to purchase common shares are considered to be outstanding for all periods presented, but are not calculated as part of the earnings per share.

Income Taxes - Income taxes have been provided based upon the tax laws and rates in the countries in which operations are conducted and income is earned. The income tax rates imposed by the taxing authorities vary. Taxable income may vary from pre-tax income for financial accounting purposes. There is no expected relationship between the provision for income taxes and income before income taxes, because the countries have different taxation rules, which vary not only to nominal rates but also in terms of available deductions, credits and other benefits. Deferred tax assets and liabilities are recognized for the anticipated future tax effects of temporary differences between the financial statement basis and the tax basis of the Company's assets and liabilities using the applicable tax rates in effect at year end as prescribed by SFAS No. 109 "Accounting for Income Taxes".

Exchange Gain (Loss) - As of March 31, 2005 and 2004, the transactions of City Network, Inc. - Taiwan and City Construction Co., Ltd. were denominated in a foreign currency and are recorded in New Taiwan Dollars ("NTD") 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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RESTATED  
CITY NETWORK, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
MARCH 31, 2005 AND 2004

## NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Translation Adjustment - As of March 31, 2005 and 2004, the accounts of City Network, Inc. - Taiwan and City Construction Co., Ltd. were maintained, and their financial statements were expressed, in NTD. Such financial statements were translated into U.S. Dollars (USD) in accordance with SFAS No. 52, "Foreign Currency Translation", with the NTD as the functional currency. According to SFAS No. 52, all assets and liabilities were translated at the current exchange rate, stockholder's equity are translated at the historical rates and income

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statement items are 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 March 31, 2005 and 2004 the exchange rates between NTD and the USD was NTD\$1=USD\$0.03149 and NTD\$1=USD\$0.03149, respectively. The weighted-average rate of exchange between NTD and USD was NTD\$1 = USD\$0.02979 and NTD\$1=USD\$0.03149, respectively. Total translation adjustment recognized for the period ended March 31, 2005 is \$194,658.

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") 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.

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### RESTATED CITY NETWORK, INC. AND SUBSIDIARIES

#### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS MARCH 31, 2005 AND 2004

##### NOTE 3 - CONCENTRATION

The Company had ten major customers during the three months ended March 31, 2005. Those customers comprise 85.3% of the total sales during the three months ended March 31, 2005. Sales to these customers were approximately \$1,033,596. Included in accounts receivable is \$395,939 from these customers as of March 31, 2005.

##### NOTE 4 - 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 March 31, 2005 and 2004, there were no uninsured portions of the balances held at the bank.

##### NOTE 5 - FIXED ASSETS

Fixed assets consist of the following:

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	March 31, 2005	December 31, 2004
	-----	-----
Land	\$ 1,774,623	\$ 1,916,328
Building	--	283,977
Machinery and equipment	372,189	430,880
Furniture and fixtures	143,655	143,655
	-----	-----
	\$ 2,290,467	\$ 2,774,840
Accumulated depreciation	(162,698)	(187,968)
	-----	-----
	\$ 2,127,769	\$ 2,586,872
	=====	=====

Note 6 - INTANGIBLE ASSETS

Intangible assets consist of the following:

	March 31, 2005	December 31, 2004
	-----	-----
Trademarks	\$ 2,150	\$ 2,150
Intangible asset	1,000,000	1,000,000
	-----	-----
	\$ 1,002,150	\$ 1,002,150
Accumulated depreciation	(56,482)	(39,285)
	-----	-----
	\$ 945,668	\$ 962,865
	=====	=====

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RESTATE  
CITY NETWORK, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
MARCH 31, 2005 AND 2004

NOTE 7 - 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. At termination, employees are paid for any accumulated annual vacation leave. As of March 31, 2005 vacation liability exists in the amount of \$3,293.

NOTE 8 - COMMITMENTS

A Best Information Technology, Inc. - City Network, Inc. - Taiwan, signed an agreement with A Best Information Technology, Inc. in 2002 for the exclusive right to sell A Best Information's products. The rights are perpetual and transferable. 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.

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Co-Construction Agreements - In April 2004, City Construction Co., Ltd. placed a refundable performance bond in the amount of \$227,240 with the court in Taiwan for the rights to complete an unfinished building in Keelung, Taiwan with the owner of the land. The Company is currently in discussion with the land owner regarding the terms of the project.

In March 2005, City Construction Co., Ltd. entered into a Co-Construction Agreement with three individuals which own a tract of land in Keelung, Taiwan. Under the agreement, the Company will finance, construct and own 60% of the completed building project. The Company has agreed to a refundable security deposit totaling approximately \$95,500 dollars payable at various agreed upon phases of the construction. The deposits will be returned within 2 years after the construction is completed. As of March 31, 2005, the Company has paid \$31,490 as part of the refundable security deposit.

Operating Leases - The Company leases s office facilities under operating leases that terminate on various dates. Rental expense for these leases consisted of \$12,116 for the three months ended March 31, 2005. The Company has future minimum lease obligations as follows:

2005	\$21,452
------	----------

### NOTE 9 - LONG-TERM INVESTMENT

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 March 31, 2005 the Company recognized a \$10,654 loss from their acquisition.

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### RESTATED CITY NETWORK, INC. AND SUBSIDIARIES

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS MARCH 31, 2005

### NOTE 10 - DEBTS

At of March 31, 2005 the Company had three separate revolving secured lines of credit agreements, renewable annually, with three banks in Taiwan. The lines of credit are secured either by the Company's bank accounts and accounts receivable or by an officer of the Company.

At March 31, 2005, the Company had borrowings outstanding in the aggregate amount of \$3,388,219, of which \$3,205,577 is against these lines of credit.

Note payable to a bank in Taiwan, interest at 3.708% per annum, due by April 9, 2005	\$ 595,161
Note payable to a bank in Taiwan, interest at 3.708% per annum, due by April 9, 2005	59,920
Note payable to a bank in Taiwan, interest at 4.48% per annum, due by April 10, 2005	55,364

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Note payable to a bank in Taiwan, interest at 4.48% per annum, due by April 11, 2005	77,061
Note payable to a bank in Taiwan, interest at 3.35% per annum, due by April 22, 2005	122,684
Note payable to a bank in Taiwan, interest at 3.708% per annum, due by May 3, 2005	13,736
Note payable to a bank in Taiwan, interest at 4.48% per annum, due by May 29, 2005	235,060

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RESTATED  
CITY NETWORK, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
MARCH 31, 2005

Note 10 - DEBT (CONTINUED)

Note payable to a bank in Taiwan, interest at 3.35% per annum, due by June 24, 2005	39,687
Note payable to a bank in Taiwan, interest at 3.35% per annum, due by June 24, 2005	264,649
Note payable to a bank in Taiwan, interest at 3.708% per annum, due by June 29, 2005	859,677
Note payable to a bank in Taiwan, interest at 3.35% per annum, due by July 11, 2005	96,912
Note payable to a bank in Taiwan, interest at 3.708% per annum, due by July 15, 2005	44,783
Note payable to a bank in Taiwan, interest at 3.708% per annum, due by July 27, 2005	31,027
Note payable to a bank in Taiwan, interest at 3.708% per annum, due by October 5, 2005	503,840
Note payable to a bank in Taiwan, interest at 3.708% per annum, due by February 13, 2006	125,960
Note payable to a corporation in Taiwan, interest at 6.265% per annum, due by	

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November 20, 2005, personally guaranteed by an office of the Company	182,642
Total	3,388,219
Current portion	----- \$3,388,219 -----
Long-term portion	\$        -- =====

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RESTATED  
CITY NETWORK, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
MARCH 31, 2005

NOTE 11 - 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.

As of March 31, 2005, the Company has a non interest-bearing loan from Tiao-Tsan Lai, the Company's Chief Executive Officer and Chairman, in the amount of \$73,790. Mr. Lai has also personally guaranteed a note payable of the Company in the amount of \$477,953. As of March 31, 2005, the balance for the note was approximately \$182,642.

NOTE 12 - LITIGATIONS

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. The Company has recorded a reserve against this account in the amount of \$695,280. 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 the following 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. - As of June 21, 2005, City Network Inc.-Taiwan settled a litigation with RPPI International Ltd. (or Rong-Dian), a vendor of the Company.

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

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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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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS

#### FORWARD-LOOKING STATEMENTS

The following discussion should be read in conjunction with the Consolidated Financial Statements and Notes thereto appearing elsewhere in this Form 10-QSB. The information in this discussion contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements involve risks and uncertainties, including statements regarding our capital needs, business strategy and expectations, including but not limited to the following:

- \* our ability to raise funds in the future through public or private financings;
- \* the timing of our introduction of products or product enhancements;
- \* our ability to manage costs associated with our product or technology acquisitions;
- \* our ability to keep pace with rapidly changing technology, evolving industry standards and new product and services in our industry;
- \* customers' acceptance of our product designs;
- \* our ability to integrate businesses, products and technologies and in joint ventures and strategic relationships with other companies;
- \* our business expenses being greater than anticipated due to competitive factors or unanticipated developments;
- \* changes in political and economic conditions in the Asian and European countries where we do business;
- \* our ability to retain management and key personnel;
- \* our ability to protect our developed technologies, know-how, trademarks and related intellectual properties; and
- \* our ability to comply with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002.

Any statements contained herein that are not statements of historical facts may be deemed to be forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as "may", "will", "should", "expect", "plan", "intend", "anticipate", "believe", "estimate", "predict", "potential" or "continue", the negative of such terms or other comparable terminology. Actual events or results may differ materially. We disclaim any



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obligation to publicly update these statements, or disclose any difference between its actual results and those reflected in these statements. The information constitutes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995.

### BACKGROUND OF THE COMPANY

City Network, Inc. ("City Network," "we," "our" or "us") was incorporated on August 8, 1996 as Investment Agents, Inc. under the laws of the State of Nevada. City Network Technology, Inc. ("CNT") was incorporated under the laws of

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the British Virgin Islands on March 1, 2002. On November 14, 2002, CNT became a wholly owned subsidiary of our company through an Exchange Agreement, dated November 14, 2002 and amended on December 11, 2002, whereby our company acquired all of the issued and outstanding capital stock of CNT in exchange for 12,000,000 shares of common stock of our company, which represented 49% of our issued and outstanding stock at that time. In connection with the exchange and change in control, the name of our company was changed from Investment Agents, Inc. to City Network, Inc. the officers and directors of City Network resigned and new officers and directors were appointed. Upon the effective date of the exchange and change in control, we ceased our relationship with the company for whom we previously acted as referral agent.

CNT owns all of the issued and outstanding common stock of City Network, Inc.-Taiwan, which was incorporated under the laws of the Republic of China on September 6, 1994, and all of the issued and outstanding common stock of company of City Construction Co., Ltd., which was incorporated under the laws of Republic of China on October, 10, 2003.

On December 16, 2004, our board of directors determined to change our fiscal year end from February 28 to December 31.

### CRITICAL ACCOUNTING POLICIES

The discussion and analysis of our financial conditions and results of operations is based upon our financial statements, which have been prepared in accordance with generally accepted accounting principles in the United States of America ("GAAP"). The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. See "Summary of Significant Accounting Policies" in the Notes to Consolidated Financial Statements in Item to this Report for our critical accounting policies. No significant changes in our critical accounting policies have occurred since December 31, 2004.

### RESULTS OF OPERATIONS

THREE MONTHS ENDED MARCH 31, 2005 COMPARED WITH THREE MONTHS ENDED MARCH 31, 2004

NET SALES. Net sales for the three months ended March 31, 2005 were \$1,293,350 compared to \$6,287,093 for the three months ended March 31, 2004. The decrease in net sales for the three months ended March 31, 2005 was due to a decrease in demand for our old products. Our new products, introduced in 2004, are in the early stages of selling.

We design, manufacture and market a comprehensive line of broadband communication and wireless Internet access solutions, including home PNA and xDSL broadband access equipment and related accessories, which comprise our older, established products. In 2004 we introduced new products such as VoIP,

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GSP and wireless Internet access products.

We believe that an increase in competition over the market for our older products has contributed to a decline in the unit price of those products. Additionally, we believe that the introduction of more technologically advanced products to the marketplace have diminished consumer demand for our older products. We intend to continue upgrading our older products to meet customer expectations.

We believe that sales for our new products, such as VoIP and GSP products, can increase with improved brand name recognition and increased sales channels. We intend to promote and market our new products to improve brand name recognition as well as work on increasing sales channels.

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**COST OF SALES.** Cost of sales for the three months ended March 31, 2005 was \$1,255,040 or 97.0% of net sales, as compared to \$5,697,879 or 90.6% of net sales, during the three months ended March 31, 2004. The decrease in cost of sales is associated with the decrease in sales. The decrease in our cost of sales as a percentage of net sales is attributable to a decrease in the sale price of our old products, which we believe is due to an increase in competitors selling the old products, while the cost of producing such products has remained constant.

**GENERAL AND ADMINISTRATIVE EXPENSES.** General and administrative expenses were \$323,145, or 25.0% of net sales, for the three months ended March 31, 2005, as compared to \$382,440 or 6.1% of net sales, for the three months ended March 31, 2004. The decrease was due to the decrease in sales and an associated decrease in related expenses. The decrease in general and administrative expenses as a percentage of net sales is attributable to fixed overhead costs which remain constant for all levels of sales.

**INCOME (LOSS) FROM OPERATIONS.** Loss from operations for the three months ended March 31, 2005 was \$(284,835), compared to income from operations for the three months ended March 31, 2004 of \$206,774. The loss from operations for the three months ended March 31, 2005 compared with income from operations for the three months ended March 31, 2004 was due to a decrease in sales without a proportionate decrease in the cost of sales and general and administrative expenses.

**OTHER (INCOME) EXPENSE.** Other (income) expense was \$739,051 for the three months ended March 31, 2005, as compared to \$14,197 for the three months ended March 31, 2004. This increase in other expense was the result of additional reserves made on accounts receivable and losses we incurred on the sale of fixed assets in the three months ended March 31, 2005.

**NET INCOME (LOSS).** Net income (loss) for three months ended March 31, 2005 was \$(1,023,886) compared to income of \$192,577 for the three months ended March 31, 2004. The net loss for the three months ended March 31, 2005 compared with income for the three months ended March 31, 2004 was due to the reasons described above, including the additional reserves made on accounts receivable.

### LIQUIDITY AND CAPITAL RESOURCES

At March 31, 2005 and December 31, 2004, we had cash and cash equivalents of \$1,319,326 and \$2,010,644, respectively. Our current assets totaled \$5,390,306 at March 31, 2005 as compared to \$6,186,420 at December 31, 2004. Our total current liabilities were \$6,637,206 at March 31, 2005 as compared to \$6,656,116 at December 31, 2004. Working capital at March 31, 2005 was \$(1,246,900) and \$(469,696) at December 31, 2004. For the three months ended March 31, 2005, total cash used in operations was \$(969,775) as compared to net

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cash provided by operations of \$300,434 during the same period in 2004. Net cash used in financing activities was \$(90,585), which consisted of the payment on notes payable and issuance of short-term debt, as compared with net cash used in financing activities of \$(282,489) during the three months ended March 31, 2004.

We deployed a large amount of cash in the three months ended March 31, 2005 for developing new products. Therefore there is a deficiency in working capital at the end of such period. We have, however, begun selling our new products on a large scale since March 31, 2005.

Our operations and short term financing does not currently meet our cash needs. We believe we will be able to generate revenues from sales and raise capital through private placement offerings of its equity securities to provide the necessary cash flow to meet anticipated working capital requirements. Our actual working capital needs for the long and short term will depend upon numerous factors, including our operating results, competition, and the availability of credit facilities, none of which can be predicted with

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certainty. Our future expansion will depend on operating results and will be limited by its ability to enter into financings and raise capital.

We currently are engaged in discussions with a number of companies regarding strategic acquisitions or investments. Although these discussions are ongoing, there can be no assurance that any of these discussions will result in actual acquisitions or investment. Several potential investors have already shown their interest to invest in our company. As of March 31, 2005, the amount of committed funds was \$2,400,000. An additional \$1,800,000 is still required.

Our liquidity is currently dependent on our ability to strengthen our accounts receivable collection time period and our ability to continue to raise cash from financing sources to fund our expansion. Our short-term and long-term liquidity may be influenced by uncollected accounts receivables. If the amount of bad debt is high, it will severely affect our ability to continue operations. Therefore, we are taking precautions to manage this risk, including diversifying its customer base and controlling credit risk through credit approvals, credit limits and monitoring procedures. There can be no assurance that these measures will prove successful. Our inability to manage this risk will have a material adverse effect upon its business, financial condition and results of operations.

**CAPITAL EXPENDITURES.** Total capital expenditures during the three months ended March 31, 2005 were \$0 compared to \$22,093 for the three months ended March 31, 2004.

### OFF-BALANCE SHEET ARRANGEMENTS

We do not have any off-balance sheet arrangements.

### ITEM 3. CONTROLS AND PROCEDURES

We maintain "disclosure controls and procedures," as such term is defined under Exchange Act Rule 13a-15(e), that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures. In designing and evaluating the disclosure controls and procedures, our management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives and in reaching a reasonable level of assurance our management

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necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. We have carried out an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of March 31, 2005. Based upon their evaluation and subject to the foregoing, the Chief Executive Officer and Chief Financial Officer concluded that as of March 31, 2005 our disclosure controls and procedures were effective at the reasonable assurance level in ensuring that material information relating to us, is made known to the Chief Executive Officer and Chief Financial Officer by others within our company during the period in which this report was being prepared.

There were no changes in our internal controls or in other factors during the most recent quarter that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

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### PART II. OTHER INFORMATION

#### ITEM 1. 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 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

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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 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

None.

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

### ITEM 5. OTHER INFORMATION

None.

### ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

#### (a) Exhibits:

- 31.1 Certifications of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certifications of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certifications of the Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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### SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CITY NETWORK, INC.

Dated: January 27, 2006

By: /s/ Tiao-Tsan Lai

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Tiao-Tsan Lai  
Chief Executive Officer  
(Principal Executive Officer)

Dated: January 27, 2006

By: /s/ Yun-Yi Tseng

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Yun-Yi Tseng  
Chief Financial Officer  
(Principal Financial Officer)

