PACIFICNET INC
Form 10-K/A
March 13, 2008

U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K/A
(Amendment No. 2)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006

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: 000-24985

PACIFICNET INC.
(Exact name of registrant in its charter)

DELAWARE	91-2118007
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
23/F, TOWER A, TIMECOURT, NO.6 SHUGUANG XILI, CHAOYANG DISTRICT, BEIJING, CHINA 100028	N/A
(Address of principal executive offices)	(Zip Code)

Registrant's Telephone Number: 0086-10-59225000

601 New Bright Building, 11 Sheung Yuet Road, Kowloon Bay, Kowloon, Hong Kong.
(Former Name and Address)

Securities Registered under Section 12(b) of the Exchange Act: NONE

Securities Registered under Section 12(g) of the Exchange Act: Common Stock, par value $0.0001

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act YES o NO x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act YES o NO x

Indicate by check mark whether the registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days YES x NO o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K contained herein, and will not be contained, to the best of the registrant's knowledge in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark if the registrant is a large accelerated filer, an accelerated filer or a non- accelerated filer.

Large Accelerated Filer o Accelerated Filer o Non- Accelerated Filer x

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

The aggregate market value of the common stock held by non-affiliates of the registrant as of March 31, 2007 was approximately $44,400,866 based upon the closing sale price of $5.34 per share as reported by The NASDAQ Global Market on such date. There were 11,733,929 shares of the Company's common stock outstanding on March 31, 2007.

DOCUMENTS INCORPORATED BY REFERENCE - NONE

Explanatory Note:

This Annual Report on Form 10K/A ("Form 10K/A") is being filed as Amendment No. 2 to our Annual Report on Form 10K/A for the year ended December 31, 2006, which was originally filed with the Securities and Exchange Commission (the "SEC") on May 11, 2007. We are amending the following items in this Amendment No. 2:

(i) Part II. Item 9A. Controls and Procedures
(ii) Part III. Item 10. Directors and Executive Officers and Corporate Governance. Compliance withSection 16(a) of the Exchange Act (to update director information for our newly elected directors who are signing the Annual Report on Form 10-K/A).
(iii) Part IV. Item 15. Exhibits and Financial Statements

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This annual report contains forward-looking statements within the meaning of the federal securities laws. These include statements about our expectations, beliefs, intentions or strategies for the future, which we indicate by words or phrases such as "anticipate," "expect," "intend," "plan," "will," "we believe," "the Company believes," "management believes" and similar language. The forward-looking statements are based on our current expectations and are subject to certain risks, uncertainties and assumptions, including those set forth in the discussion under "Description of Business," including the "Risk Factors" described in that section, and "Management's Discussion and Analysis or Plan of Operation." Our actual results may differ materially from results anticipated in these forward-looking statements. We base our forward-looking statements on information currently available to us, and we assume no obligation to update them.

ITEM 9A. CONTROLS AND PROCEDURES

We maintain controls and procedures designed to ensure that information required to be disclosed in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission. Certain internal audit tests performed at the fiscal year-end of 2006 revealed that there were weaknesses inherent in the Company's internal control system. Among which it was noted that there were insufficient checks and balances in place for controlling the company's non-routine transactions, namely: accuracy and completeness of stock option expense calculation. Such weaknesses in our controls eventually led to prior period restatements for the years ended December 31, 2003, 2004, and 2005 respectively. As a result, our Chief Executive Officer and our former Chief Financial Officer concluded that there was a material weakness in our disclosure controls and procedures.

As of the end of the quarter covered by this report, the company had taken various steps to maintain the accuracy of our financial disclosures, and improve company internal control. An internal control SOX implementation team led by senior managers had been set up to uncover potential significant deficiencies inherent in the internal control systems of the company, including but not limited to risk identification, control procedure setup, staff training, segregation of incompatible job duties, design of management reporting system, definition and delegation of signing authority, establishment of documentation system and implementation of a company-wide SOX compliant ERP system. Absent systematic testing and documentation of the newly implemented controls, our chief executive officer and chief financial officer concluded that there was no evidence to prove that the material weakness in our disclosure controls and procedures discovered in the former years had been corrected for the quarter covered by this report.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

COMPLIANCE WITH SECTION 16(A) OF THE EXCHANGE ACT

Set forth below are the names of the directors, executive officers and significant employees of the Company as of March 3, 2008:

Name	Age	Title
Tony Tong	38	Chairman and Chief Executive Officer
Victor Tong	36	President, Secretary, and Director
Daniel Lui	43	Chief Financial Officer
ShaoJian (Sean) Wang	41	Director
Su Guo Jing	37	Independent Director (2) (3)
Jeremy Goodwin	33	Independent Director (1) (3)
Tao Jin	38	Independent Director (1) (2) (3)
Mike Fei	38	Company Secretary and General Counsel
Ho-Man Poon	34	Independent Director (1)
Herman Brenninkmeijer	43	Director

Stephen A. Crystal	43	Independent Director

(1) Member of Audit Committee
(2) Member of Nominating Committee
(3) Member of Compensation Committee

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Our executive officers are appointed at the discretion of our board of directors with no fixed term. There are no family relationships between or among any of our executive officers or our directors other than the relationship between Mr. Tony Tong and Mr. Victor Tong.

The following is a brief description of each board of director, key positions and brief biography:

MR. TONY TONG, age 38, is the Chairman, CEO, Executive Director, and co-founder of PacificNet since 1999. From 1995 to 1997, Mr. Tong served as the Chief Information Officer of DDS Inc., a leading SAP-ERP consulting company in the USA, which was later acquired by CIBER, Inc. (NYSE: CBR). From 1993 to 1994, Mr. Tong worked for Information Advantage, Inc. (NASDAQ:IACO), a leading business intelligence, Data-Mining and CRM technology provider serving Fortune 500 clients. IACO consummated an IPO on NASDAQ in 1997 and was later acquired by Sterling Software and Computer Associates (NYSE:CA). From 1992 to 1993, Mr. Tong worked as a Business Process Re-engineering Consultant at Andersen Consulting (now Accenture, NYSE:ACN). From 1990 to 1991, Mr. Tong worked for ADC Telecommunications (NASDAQ:ADCT), a global supplier of telecom equipment. Mr. Tong"s R&D achievements include being the inventor and patent holder of US Patent Number 6,012,066 (granted by US Patent and Trademark Office) titled “Computerized Work Flow System, an Internet-based workflow management system for automated web creation and process management.” Mr. Tong also serves on the board of advisors of Fortune Telecom (listed on Hong Kong Stock Exchange: 0110.HK), a leading distributor of mobile phones, PDAs, telecom services, and accessories in China and Hong Kong. Mr. Tong is a frequent speaker on technology investment in China, and was invited to present at the Fourth APEC International Finance & Technology Summit in 2001. Mr. Tong is the Vice Chairman (PRC) of Hong Kong Call Centre Association, a Fellow of Hong Kong Institute of Directors, a consultant on privatization and securitization for China’s State-owned Assets Supervision and Administration Commission (SASAC), and a frequent speaker for LexisNexis, a licensed Continued Professional Development (CPD) trainer, on China investment. Mr. Tong graduated with Bachelor of Mechanical/Industrial Engineering Degree from the University of Minnesota and served on the Computer Engineering Department Advisory Board and was an Adjunct Professor at the University of Minnesota, USA. Tony Tong is the brother of Victor Tong.

MR. VICTOR TONG, age 36, is the President, Secretary, and Director of PacificNet, and has served on our board as an Executive Director since 2002. Mr. Victor Tong gained his consulting, systems integration, and technical expertise through his experience at Andersen Consulting (now Accenture, NYSE:ACN), American Express Financial Advisors (IDS), 3M, and the Superconductivity Center at the University of Minnesota. In 1994, Victor co-founded Talent Information Management (“TIM”), a leading internet application development and consulting company in Minnesota. PacificNet.com was originally founded as an operating division of TIM. In 1997, Mr. Tong successfully sold GoWeb internet consulting division of TIM to Key Investment, a leading technology and media investment company owned by Vance Opperman, a billionaire in Minnesota who founded West Publishing. Mr. Tong became the President of KeyTech, a leading information technology consulting company based in Minnesota. In 1999, he was recognized in “City Business 40 Under 40” as one of the future business and community leaders in Minnesota. Mr. Tong won the Student Commencement Speaker Award and graduated with honors with a Bachelor of Science in Physics from the University of Minnesota. Mr. Tong was an adjunct professor at the College of Software of Beihang University, one of the top software colleges in China. Victor Tong is the brother of Tony Tong.

MR. DANIEL LUI, age 43, has served as Chief Financial Officer since March 1, 2007. Mr. Lui joined PacificNet with over 17 years of professional and commercial accounting experience, 7 years of which was in Mainland China. He carries the credentials of Chartered Accountant (Alberta, Canada) and CPA-inactive (Washington, USA). Mr. Lui was Vice President of Finance and Company Secretary of Fiberxon Inc., a leading communications subsystem maker, where he was in charge of Fiberxon’s Finance, Company Secretarial, and Information Technology departments from 2002 to 2007. Prior to joining Fiberxon, Mr. Lui was Chief Financial Officer of China Motion NetCom Ltd., a wholly owned subsidiary of China Motion Telecom International Limited, a Hong Kong Exchange listed company, engaged in long distance call resale business from 2000 to 2001. Prior to that, Mr. Lui was Financial Advisory Services

Manager of PricewaterhouseCoopers and Auditor at KPMG. Mr. Lui received his Bachelors of Business Administration degree from the University of Hawaii at Manoa in 1987 and Masters of Business Administration from University of Alberta in Canada in 1994.

MR. SHAOJIAN (SEAN) WANG, age 41, has served on our board as a Director since 2002. From 2002 to May 2006, Mr. Wang also served as Chief Financial Officer of PacificNet. Mr. Wang is now President and Chief Operating Officer of Hurray! Holding Co., Ltd. (NASDAQ:HRAY), a NASDAQ-listed Chinese VAS company. Previously, Mr. Sean Wang was COO and acting Chief Financial Officer (CFO) at GoVideo and Opta Corporation, a public listed consumer Electronics Company in the US controlled by TCL, a leading consumer electronics maker in China. From 1987 to 2002, he served as a country manager at Ecolab, Inc. and as the managing director at Thian Bing Investments PTE, Ltd. From 1993 to 2002, Mr. Wang served as managing director of Thian Bing Investments PTE, Ltd. Where he managed the Singapore-based company's multi-million dollar investment operations and identified strategic and investment opportunities. Mr. Sean Wang attended Peking University and received a BS in Economics from Hamline University and an MBA from Carlson School of Management, University of Minnesota.

MR. SU GUO JING, age 37, has served on our board as an independent director since February 5, 2008. Mr. Su is currently the Chief Executive Officer of Beijing Lottery International Information Technology Development Ltd., Chairman of the Board of Directors of Vindaway Trading Co., Ltd. and a member of the China IT Channel Committee as well as a member of the 9th Beijing Enterprise Committee of the China National Democratic Construction Association. In 2005, Mr. Su became a shareholder of Beijing Lottery International Information Technology Development Ltd. In the same year, the company cooperated with the China Center for Lottery Studies of Peking University to found the magazine "Gaming Industry and Public Welfare" where Mr. Su served as a Special Advisor. Mr. Su became the second largest shareholder of Hubei Bothwin Investment Ltd. the following year. From 2004 to 2005, Mr. Su was the General Manager of the Paperless Lottery Department at the Beijing Welfare Lottery Center, taking charge of the operations of Happy 8 (a gaming method) and paperless lottery. In 2001, Mr. Su established Vindaway Trading Co., Ltd, which acquired related technology and facilities from Silicon Valley-based Filanet and launched the Interjak hardware series between 2002 and 2004. Prior to that, Mr. Su served as a Project Director at China National Electronics Import and Export Corporation. He is also referred to by industry reporters as "China's Gaming Expert" because of his insights on gaming in China. Mr. Su graduated from the University of Shanghai where he studied Science and Technology from 1989 to 1992 and studied law at the Party School of the Central Committee of C.P.C. from 1998 to 2000.

MR. JEREMY GOODWIN, age 33, has served on our board as an Independent Director since December 24, 2004. Jeremy Goodwin is founder of China Diligizer and Managing Partner of 3G Capital Partners. He began his career in 1995 at Mees Pierson Investment Finance S.A. in Geneva, Switzerland where he supported the fund's private placement/private equity finance team. Noteworthy transactions executed by the group included assistance on the placements of the $1.2 Billion Carlyle Partners II Limited Partnership. In 1997 he went to work for the then parent institution, ABN Amro, in Beijing, China. In 1999, Mr. Goodwin was employed with ING Barings in London as an International Associate. Mr. Goodwin received his BS from Cornell University in 1996 in conjunction with the Institute of Higher International Studies in Geneva, Switzerland. He later pursued his advanced degree with Princeton University with a concentration in Chinese affairs which he completed at the prestigious Nanjing Chinese Studies Center of the Johns Hopkins School of Advanced International Studies. Jeremy is fluent in written and spoken Mandarin Chinese, French and has working knowledge of Dutch.

MR. TAO JIN, age 38, has served on our board as an Independent Director since January 6, 2005. Mr. Jin is a resident partner at Jun He Law Offices (www.JunHe.com), a leading Chinese law firm specializing in commercial legal practice with over 160 lawyers and offices in Beijing, Shanghai, Shenzhen, Dalian, Haikou and New York. Founded in April 1989, Jun He was one of the first private law firms formed in China, and has been a pioneer in the re-established Chinese legal profession with a focus in representing foreign clients in business activities throughout China. Over the past few years, Jun He has been honored a number of times as one of the best law firms in China by the Ministry of Justice of China. With a team of more than 160 well-trained lawyers, Jun He is one of the largest and most established law firms in China. Prior to joining Jun He, Mr. Jin served as Vice President and Assistant General Counsel of J.P. Morgan Chase Bank, as the head legal counsel for capital markets transactions in Asia, and for JPMorgan's M&A transactions in China. Mr. Jin joined Jun He as a partner in 2005. From 1999 to 2002, Mr. Jin served as a Senior New York Qualified Lawyer for Sullivan & Cromwell, which represented China Unicom, PetroChina and China Telecom in their IPO's and dual listings in New York and Hong Kong. From 1996 to 1999, Mr. Jin served as Associate Lawyer for Cleary, Gottlieb Steen & Hamilton, which represented various Fortune 500 companies and investment banks in public and private securities offerings and M&A activities. Mr. Jin received his Juris Doctor in 1996 with high honors from Columbia University, and received B.S. in Psychology in 1990 from Beijing University.

MR. MIKE FEI, age 38, is the Company Secretary and General Counsel for PacificNet. Mr. Fei joined PacificNet in 2004 as in-house PRC Chief Legal Counsel for PacificNet's China Operations. Mr. Fei is a Member of the All-China Bar Association and holds a Master of Law degree from the University of New South Wales of Australia. Mr. Fei has 8 years of experience in the legal profession and dealt with more than 200 cases of litigation and arbitration which related to the issues of foreign investment, bankruptcy, merging, commercial contract and debt disputes.

MR. HO-MAN (MIKE) POON, age 34, has been an independent director of PacificNet since October 17, 2007. Mr. Poon is a Chartered Financial Analyst (CFA). He is the first session graduate of the EMBA course of the Tsinghua University and holds a Bachelor degree from the University of Hong Kong. He has been registered as dealing director and investment advisor since 2002. He has over 11 years experience in the equity and capital markets of the Greater China Region, ranging from direct investment, fund management, securities brokerage and financial advisory. He is experienced in deal structuring, especially in relation to transactions of the listed companies in Hong Kong. Since 2002, he has served as the Chairman and the Chief Executive Officer of the Friedmann Pacific group of companies, which is a private financial groups covering investment, securities brokerage and financial services. He is a member of the Hong Kong Society of Financial Analyst and the member of the Hong Kong Institute of Directors.

MR. HARMEN BRENNINKMEIJER, age 43, has served on our board as a director since February 5, 2008. Mr. Brenninkmeijer is the Chief Executive Officer of Octavian International Ltd., a recently- acquired subsidiary of the Company (the "Octavian"). Mr. Brenninkmeijer founded Octavian in September 2001 to focus on the commercial opportunities presented by the market developing in Russia and to export gaming system technologies from Russia. Today, Octavian is a leading and innovative global developer of networked games and systems for the casino, AWP and lottery markets, and also a leading supplier of third party equipment from many of the gaming world's leading manufacturers. Prior to founding Octavian, Mr. Brenninkmeijer established a casino gaming division for the Gauselmann Group. During this period he opened and operated a number of casinos, including the Playboy Casino on the island of Rhodes. Prior to that he worked for Mikohn, where he was responsible for establishing the company's presence first in Europe, then in South Africa and Asia; traveling extensively, creating a worldwide network within the gaming industry. Having established a leadership role in the industry, he was elected the first chairman of the European Gaming Organization, a position he held for three years. He currently sits on the Advisory Board for the Global Gaming Expo ("G2E"), the world's leading gaming industry expo, and is a regular speaker and moderator at G2E and other international gaming industry events. Mr. Brenninkmeijer graduated from the Inter College School in Netherlands with a Bachelor degree in Business.

MR. STEPHEN A. CRYSTAL, age 43, has served on our board as an Independent Director since March 3, 2008. Mr. Crystal has been the Chief Executive Officer and President of TableMAX Holdings, LLC, a leading provider of electronic table games, since August 2007. Mr. Crystal is also a former board member of Las Vegas Gaming, Inc., a game management system operator as well as founder and managing member of JMC Investments, LLC, an investment company whose portfolio includes gaming real estate and operations, gaming technology, hospitality and entertainment, and franchise assets. Prior to that, Mr. Crystal co-founded Barrick Gaming Corporation, which owned and operated six hotel casinos in Las Vegas. Prior to entering the gaming world, Mr. Crystal practiced law at Armstrong Teasdale, LLP, Gage & Tucker L.C, and Wirken & King, P.C. Mr. Crystal also served as an Equal Opportunity Specialist for the United States Department of Labor from May 1990 to May 1992 and served in the New Hampshire House of Representatives from December 1988 to August 1989. Mr. Crystal received his law degree from the American University, Washington College of Law in 1992 and his Bachelor degree from Dartmouth College in Political Science in 1986.

CORPORATE GOVERNANCE

BOARD OF DIRECTORS

We have six members serving on our Board of Directors. Each board member is nominated for election at our annual meeting to serve until the next annual meeting of stockholders and until their successors are duly elected and qualified.

BOARD COMMITTEES

The Board of Directors has a Nominating Committee, Compensation Committee and an Audit Committee.

NOMINATING COMMITTEE

The purpose of the Nominating Committee is to assist the Board of Directors in identifying qualified individuals to become board members, in determining the composition of the Board of Directors and in monitoring the process to assess Board effectiveness. Michael Ha and Tao Jin are members of the Nominating Committee. There have been no changes to the procedures by which the stockholders of the Company may recommend nominees to the Board of Directors since the filing of the Company's Definitive Proxy Statement on October 1, 2006, for its Annual Meeting of Stockholders, which was held on December 15, 2006. The Nominating Committee Charter is not available on the Company's website. A copy of the Nominating Committee Charter was included in the proxy statement for the Annual Meeting held on December 30, 2005.

COMPENSATION COMMITTEE

As of December 31, 2006, our Compensation Committee consisted of Messrs. Jeremy Goodwin, Michael Chun Ha, Tao Jin, and Peter Wang, who are all independent directors. Our Compensation Committee currently consists of Messrs. Su Guo Jing, Jeremy Goodwin and Tao Jin. The Compensation Committee has a charter which states that it is the responsibility of the Compensation Committee to make recommendations to the Board of Directors with respect to all forms of compensation paid to our executive officers and to such other officers as directed by the Board and any other compensation matters as from time to time directed by the Board. The goal of the Compensation Committee's policies on executive compensation is to ensure that an appropriate relationship exists between executive compensation and the creation of stockholder value, while at the same time attracting, motivating and retaining executives.

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

Members of our Compensation Committee of the Board of Directors were Messrs. Goodwin, Ha, Tao and Wang. No member of our Compensation Committee was, or has been, an officer or employee of the Company or any of our subsidiaries. No member of the Compensation Committee has a relationship that would constitute an interlocking relationship with executive officers or directors of the Company or another entity.

AUDIT COMMITTEE OF THE BOARD OF DIRECTORS

The board of directors has established an audit committee in accordance with Section 3(a)(58)(A) of the Securities Exchange Act of 1934, as amended. The members of the Audit Committee are Messrs. Tao Jin (Chairman of Audit Committee), Jeremy Goodwin, and Peter Wang, each of whom are considered "independent" under the NASDAQ Stock Market listing standards currently in effect. The board of directors has determined that each of the members of the audit committee qualify as an "audit committee financial expert" under the Securities and Exchange Commission's definition.

The Audit Committee is responsible for nominating the Company's independent auditors and reviewing any matters that might impact the auditors' independence from the Company; reviewing plans for audits and related services; reviewing audit results and financial statements; reviewing with management the adequacy of the Company's system of internal accounting controls, including obtaining from independent auditors management letters or summaries on such internal accounting controls; determining the necessity and overseeing the effectiveness of the internal audit function; reviewing compliance with the U.S. Foreign Corrupt Practices Act and the Company's internal policy prohibiting insider trading in its Common Stock; reviewing compliance with the SEC requirements for financial reporting and disclosure of auditors' services and audit committee members and activities; reviewing related-party transactions for potential conflicts of interest; and reviewing with corporate management and internal and independent auditors the policies and procedures with respect to corporate officers' expense accounts and perquisites, including their use of corporate assets.

CODE OF ETHICS

On May 14, 2003, we adopted a code of ethics that applies to our Chief Executive Officer and Chief Financial Officer, and other persons who perform similar functions. A copy of our Code of Ethics was filed as an exhibit to our Annual Report on Form 10-KSB filed on April 2, 2004. Our Code of Ethics is intended to be a codification of the business and ethical principles which guide us, and to deter wrongdoing, to promote honest and ethical conduct, to avoid conflicts of interest, and to foster full, fair, accurate, timely and understandable disclosures, compliance with applicable governmental laws, rules and regulations, the prompt internal reporting of violations and accountability for adherence to this Code.

COMPLIANCE WITH SECTION 16(A) OF EXCHANGE ACT

Section 16(a) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), requires our executive officers, directors and persons who beneficially own more than 10% of a registered class of our equity securities to file with the Securities and Exchange Commission initial reports of ownership and reports of changes in ownership of our common stock and other equity securities. Such executive officers, directors, and greater than 10% beneficial owners are required by SEC regulation to furnish us with copies of all Section 16(a) forms filed by such reporting persons.

Based solely on our review of such forms furnished to us and written representations from certain reporting persons, we believe that the following executive officers and directors failed to timely file Form 4's: Tony Tong failed to timely file Form 4's, one Form 4 reporting the exercise of a stock option and three Form 4's each reporting the grant of stock options; Victor Tong failed to timely file Form 4's, one Form 4 reporting the exercise of a stock option and four Form 4's each reporting the grant of stock options; Shaojian Wang failed to timely file Form 4's, two Form 4's each reporting the exercise of stock options and three Form 4's each reporting the grant of stock options; Michael Chun Ha failed to timely file Form 4's, one Form 4 reporting the exercise of an option and three Form 4's each reporting the grant of stock options; Peter Wang failed to timely file three Form 4's each reporting the grant of stock options; Jeremy Goodwin failed to timely file three Form 4's each reporting the grant of stock options and Tao Jin failed to timely file three Form 4's each reporting the grant of stock options.

SIGNATURES

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

	PACIFICNET INC.
Date: March 13, 2008	BY: /S/ TONY TONG Tony Tong Chief Executive Officer (Principal Executive Officer)
Date: March 13, 2008	BY: /S/ DANIEL LUI Daniel Lui Chief Financial Officer (Principal Financial Officer)

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

Name	Title	Date
/s/ TONY TONG Tony Tong	Director, Chairman and CEO	March 13, 2008
/s/ VICTOR TONG Victor Tong	Director, President and	March 13, 2008
/s/ DANIEL LUI Daniel Lui	Chief Financial Officer	March 13, 2008
Shao Jian Wang	Director	March 13, 2008
Su Guo Jing	Director	March 13, 2008
Tao Jin	Director	March 13, 2008
/s/ JEREMY GOODWIN Jeremy Goodwin	Director	March 13, 2008
Ho-Man Poon	Director	March 13, 2008
/s/ HARMEN BRENNINKMEIJER	Director	March 13, 2008

Harmen Brenninkmeijer

/s/ STEPHEN A. CRYSTAL Stephen A. Crystal	Director	March 13, 2008

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Pacific Net Inc.

We have audited the accompanying consolidated balance sheets of PacificNet Inc. (a Delaware Corporation) and Subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of operations, changes in stockholders' equity and cash flows for each of the three years in the period ended December 31, 2006. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards established by 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 consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of PacificNet Inc. and Subsidiaries as of December 31, 2006 and 2005, and the results of their consolidated operations and cash flows for each of the three years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. During the year ended December 31, 2006, the Company incurred net losses of $12,415,000. In addition, the Company had a negative cash flow in operating activities amounting to negative $8,190,000 in the year ended December 31, 2006, and the Company's accumulated deficit was $51,090,000 as of December 31, 2006. In addition, the Company is in default on its convertible debenture obligation. These factors, among others, as discussed in Note 1 to the consolidated financial statements, raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 1. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

As discussed in Note 18, the financial statements for the years ended December 31, 2006 and 2005 have been restated.

/s/ KABANI & COMPANY, INC.

LOS ANGELES, CA
March 30, 2007, except for notes 1, 2, 4, 6, 9, 10, 11, 12, 13, 14, 16, & 18 are as of November 5, 2007

PACIFICNET INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS–RESTATED
AS AT DECEMBER 31, 2006 AND 2005
(In thousands of United States dollars, except par values and share numbers)

	As at December 31, 2006 Restated	As at December 31, 2005 Restated
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 1,900	$ 3,486
Restricted cash - pledged bank deposit	234	163
Accounts receivables, net of allowances for doubtful accounts	8,141	3,841
Inventories	201	203
Loan receivable from related parties	1,706	2,328
Loan receivable from third parties	128	1,062
Marketable equity securities - available for sale	558	539
Other current assets	4,173	1,375
Total Current Assets	17,041	12,997
Property and equipment, net	4,711	958
Intangible assets, net	323	0
Investments in affiliated companies and subsidiaries	115	1,161
Goodwill	5,601	3,964
Net assets held for disposition	8,664	8,854
Other assets	471	-
TOTAL ASSETS	$ 36,926	$ 27,934
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Bank line of Credit	$ 855	$ 1,059
Bank loans-current portion	576	188
Capital lease obligations - current portion	120	126
Accounts payable	1,266	628
Accrued expenses and other payables	1,828	704
Customer deposits	352	335
Convertible debenture	8,000	-
Warrant liability	904	-
Liquidated damages liability	2,837	-
Loan payable to related party	638	759
Total Current Liabilities	17,376	3,799
Bank loans - noncurrent portion	1,635	6
Capital lease obligations - noncurrent portion	124	78
Convertible debenture - non current portion	945	-
Total long-term liabilities	2,704	84
Total liabilities	20,080	3,883

Minority interest		2,869		846
Commitments and contingencies		-		-
Stockholders' Equity:				
Preferred stock, par value $0.0001, Authorized 5,000,000 shares				
Issued and outstanding - none		-		-
Common stock, par value $0.0001, Authorized 125,000,000 shares				
Issued and outstanding:				
December 31, 2006 - 14,155,597 issued; 11,541,202 outstanding; December 31, 2005: 12,000,687 issued, 10,809,562 outstanding		1		1
Treasury stock, at cost (2006: 2,614,395 Shares, 2005: 1,191,125 shares)		(272)		(134)
Additional paid-in capital		65,757		61,979
Cumulative other comprehensive income		(42)		(15)
Accumulated deficit		(51,090)		(38,627)
Less: stock subscription receivable		(377)		-
Total Stockholders' Equity		13,977		23,204
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$	36,926	$	27,934

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

PACIFICNET INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS - RESTATED
FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004
(In thousands of United States dollars, except loss per share and share amounts)

	For the Years Ended December 31,		
	2006 Restated	2005 Restated	2004 Restated
Net Revenues			
Services	$ 16,790	$ 14,091	$ 10,008
Product sales	25,948	3,216	849
Total net revenue	42,738	17,307	10,857
Cost of Revenues			
Services	(12,155)	(10,380)	(7,046)
Product sales	(24,062)	(2,841)	(841)
Total cost of revenue	(36,217)	(13,221)	(7,887)
Gross Profit	6,521	4,086	2,970
Operating expenses:			
Selling, General and Administrative expenses	(11,126)	(5,447)	(5,244)
Stock-based compensation expenses	(242)	(282)	(1,246)
Depreciation and amortization	(1,463)	(276)	(94)
Impairment of goodwill	-	(3,689)	(2,628)
Impairment of investment	(1,233)	-	-
Total Operating expenses	(14,064)	(9,694)	(9,212)
Loss from operations	(7,533)	(5,608)	(6,242)
Other income (expenses):			
Interest income/(expense), net	(1,192)	100	(57)
Gain/(loss) in change in fair value of derivatives	(214)	-	-
Liquidated damages expense	(3,817)	-	-
Sundry income, net	105	289	176
Total other income (expense)	(5,118)	389	119
Loss from operations before Income Taxes and Minority Interests	(12,661)	(5,219)	(6,123)
Provision for income taxes	(63)	(55)	(106)
Share of earnings from investment on equity method	17	855	87
Minority Interests	153	(1,461)	(296)
Loss from continued operations	(12,554)	(5,880)	(6,438)
Income/(loss) from discontinued operations:			
Gain on disposal	530	-	-
Loss on disposal	(504)	-	-
Income from discontinued operations	113	735	1,014
Total income/(loss) from discontinued operations	139	735	1,014

NET LOSS		(12,415)		(5,145)		(5,424)
Other comprehensive income (loss):						
Foreign exchange gain (loss)		(27)		7		(22)
Net comprehensive loss	$	(12,442)	$	(5,138)	$	(5,446)
BASIC & DILUTED LOSS PER COMMON SHARE:						
Loss per common share continued operations	$	(1.08)	$	(0.58)	$	(0.92)
Earnings per common share discontinued operations	$	0.00	$	0.07	$	0.14
Loss per common share - basic & diluted	$	(1.08)	$	(0.51)	$	(0.78)
*Weighted average number of shares - basic & diluted		11,538,664		10,156,809		7,015,907

*Weighted average number of shares used to calculate basic and diluted loss per share is considered same as the effect of dilutive shares is anti-dilutive.

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

PACIFICNET INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY – RESTATED
(In thousands of United States dollars, except number of shares)

	Common Stock Outstanding Shares	Common Stock Amount	Additional Paid-in Capital	Cumulative Other Comprehensive Income/(loss)	Accumulated Deficit (Restated)	Treasury Stock Shares	Treasury Stock Amount	Stock Subscription Receivable	Total Stockholders' Equity (Restated)
Balance at December 31, 2003, as restated	5,363,977	$ 1	$ 31,790	$ (24)	$ (28,056)	800,000	$ (5)	$ -	$ 3,706
Issuance of common stock for acquisition of subsidiaries	1,756,240	-	9,938	-	-	-	-	-	9,938
Proceeds from the sale of common stock, net of related costs	2,205,697	-	12,330	-	-	-	-	-	12,330
PIPE related Expenses	-	-	(205)	-	-	-	-	-	(205)
Issuance of common stock for acquisition of affiliate	149,459	-	1,547	-	-	-	-	-	1,547
Repurchase of common stock	(33,616)	-	-	-	-	33,616	(114)	-	(114)
Stock issued for services	50,000	-	132	-		-	-	-	132
Stock issued in error	83,000	-	-	-	-	-	-	-	-
Stock options expense	-	-	1,246	-	-	-	-	-	1,246
Exercise of stock options and warrants for cash	219,364	-	606	-	-	-	-	-	606
Foreign currency translation gain	-	-	-	2	-	-	-	-	2
Excess finders fee charged adjusted	-	-	345	-	-	-	-	-	345
Net loss	-	-	-	-	(5,425)	-	-	-	(5,425)
Balance at December 31, 2004	9,794,121	1	57,730	(22)	(33,482)	833,616	(119)	-	24,108
Issuance of common stock for acquisition of subsidiaries	515,900	-	3,971	-	-	-	-	-	3,971
Stock issued for services	20,000	-	63	-	-	-	-	-	63
Repurchase of common stock for acquisition of	(149,459)	-	(1,547)	-	-	149,459	-	-	(1,547)

affiliate									
Cancellation of common stock	(45,000)	-	-	-	-	45,000	-	-	-
Repurchase of common shares	(2,000)	-	-	-	-	2,000	(15)		(15)
Stock options expense	-	-	282	-	-	-	-		282
Exercise of stock options and warrants for cash	676,000	-	966	-	-	-	-		966
Holdback shares as contingent consideration due to performance targets not yet met	-	-	-	-	-	298,550	-		-
Share consideration for acquisition of subsidiary deemed issued under S&P	-	-	-	-	-	(137,500)	-		-
Excess finders fee charged adjusted	-	-	455	-	-	-	-		455
Option exercise price adjusted	-	-	60	-	-	-	-		60
Foreign currency translation gain	-	-	-	7	-	-	-		7
Net loss	-	-		-	(5,145)	-	-		(5,145)
BALANCE AT DECEMBER 31, 2005	10,809,562	1	61,979	(15)	(38,627)	1,191,125	(134)		23,204
Exercise of stock options for cash and receivable	418,000	-	834	-	-	(24,000)	-	-	834
Issuance of common stock for acquisition of subsidiaries	618,112	-	4,346	-	-	1,142,798	-	-	4,346
Cancellation of common stock	(275,000)	-	(1,672)	-	-	275,000	-	-	(1,672)
Repurchase of common shares (Treasury shares)	(29,472)	-	-	-	-	29,472	(138)	-	(138)
Foreign currency translation loss	-	-	-	(27)	-	-	-	-	(27)
Stock options expense	-	-	242	-	-	-	-	-	242
Goodwill opening balance adjustment	-	-	-	-	(48)	-	-	-	(48)
Issuance of warrants for issuing fee of convertible debts	-	-	28	-	-	-	-	-	28

Stock subscription receivable	-	-	-	-	-	-	-	(377)	(377)
Net loss	-	-	-	-	(12,415)	-	-	-	(12,415)
BALANCE AT DECEMBER 31, 2006	11,541,202	$ 1	$ 65,757	$ (42)	$ (51,090)	2,614,395	$ (272)	$ (377)	$ 13,977

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

PACIFICNET INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS –RESTATED
(In thousands of United States dollars)

Cash Flows from operating activities	For the Years Ended December 31,		
	2006 Restated	2005 Restated	2004 Restated
Net loss	$ (12,415)	$ (5,145)	$ (5,424)
Adjustment to reconcile net loss to net cash provided by (used in) operating activities:			
Provision for allowance for doubtful accounts	6,173	3,425	777
Minority Interest	(153)	1,461	296
Depreciation and amortization	1,463	276	94
Goodwill/Investment impairment	1,233	3,689	2,628
Stock-based compensation	242	282	1,246
Issuance of shares for services	-	63	132
Change in fair value of derivatives	214	-	-
Amortization of interest discount	690	-	-
Liquidated damages expense	3,817	-	-
Changes in current assets & liabilities net of effects from purchase of subsidiaries:			
Accounts receivable and other current assets	(7,098)	(297)	(2,743)
Inventories	2	(55)	(72)
Accounts payable and accrued expenses	(2,219)	2,671	1,098
Net cash provided by (used in) operating activities of continued operations	(8,051)	6,370	(1,968)
Net cash provided by (used in) operating activities of discontinued operations	(139)	(735)	(1,014)
Net cash provided by (used in) operating activities	(8,190)	5,635	(2,982)
Cash flows from investing activities			
Increase in restricted cash	(71)	49	-
Increase in purchase of marketable securities	(19)	(510)	(29)
Acquisition of property and equipment	(2,608)	(2,966)	(477)
Acquisition of subsidiaries and affiliated companies	(667)	(3,958)	(991)
Net increase (decrease) in assets held for disposition	190	(3,493)	264
Acquisition of subsidiaries and affiliated companies	(667)	(3,958)	(991)
Repurchase of treasury shares	(138)	(15)	(114)
Net cash used in investing activities of continued operations	(3,503)	(7,400)	(1,611)
Net cash provided by (used in) investing activities of discontinued operations	190	(3,493)	264
Net cash used in investing activities	(3,313)	(10,893)	(1,347)
CASH FLOWS PROVIDED BY FINANCING ACTIVITIES:			
Loans receivable from third parties	934	(1,024)	(38)
Loans receivable from related parties	622	(868)	(1,460)
Loans payable to related party	(121)	575	184
Advances (repayments) under bank line of credit	(204)	1,113	(1,253)
Repayment of amount borrowed under capital lease obligations	40	(5)	(92)
Proceeds from exercise of stock options and warrants	237	966	606

Advances under bank loans	935	(1,453)	(135)
Net proceeds from issuance of convertible debenture	7,500	-	-
Payment of certain PIPE related expenses	-	-	(205)
Proceeds from sale of common stock for cash	-	-	12,330
Net cash provided by(used in) financing activities of continued operations	9,943	(696)	9,937
Net cash provided by (used in) financing activities of discontinued operations	-	-	-
Net cash provided by (used in) financing activities	9,934	(696)	9,937
Effect of exchange rate change on cash and cash equivalents	(27)	7	2
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(1,586)	(5,947)	5,610
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	3,486	9,433	3,823
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 1,900	$ 3,486	$ 9,433
SUPPLEMENTAL CASH FLOW INFORMATION:			
Interest paid	$ 664	$ 229	$ 178
Income taxes paid	$ 5	$ (53)	$ 3
NONCASH INVESTING AND FINANCING ACTIVITIES:			
Investment in subsidiaries and affiliate through issuance of common stock	$ 4,346	$ 3,971	$ 9,938
Investment in affiliate through issuance of common stock	$ -	$ -	$ 1,547
Property & equipment acquired under bank loans	$ 1,082	$ -	$ -

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

PACIFICNET INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – RESTATED
(Amounts expressed in United States dollars unless otherwise stated)

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

NATURE OF OPERATIONS

PacificNet Inc. (referred to herein as "PacificNet" or the "Company") was originally incorporated in the State of Delaware on April 8, 1987. Through our subsidiaries we provide outsourcing services, value-added telecom services (VAS) and products (telecom and gaming) services. Our business process outsourcing (BPO) services include call centers, providing customer relationship management (CRM), and telemarketing services, and our information technology outsourcing (ITO) includes software programming and development. We are value-added resellers and providers of telecom VAS, which is comprised of interactive voice response (IVR) systems, call center management systems, and voice over Internet protocol (VOIP), as well as mobile phone VAS, such as short messaging services (SMS) and multimedia messaging services (MMS). Our products (telecom and gaming) include gaming technology and communication products distribution. The Company's operations are primarily targeted in Greater China and certain Asian country markets.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION AND BASIS OF PRESENTATION

The consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States of America and present the financial statements of the Company and its wholly owned and majority-owned subsidiaries including variable interest entities ("VIEs") for which the Company is the primary beneficiary. All significant inter-company accounts and transactions have been eliminated. Investments in entities in which the Company can exercise significant influence, but which are less than majority owned and not otherwise controlled by the Company, are accounted for under the equity method.

The Company has adopted FASB Interpretation No. 46R "Consolidation of Variable Interest Entities" ("FIN 46R"), an Interpretation of Accounting Research Bulletin No. 51. FIN 46R requires a Variable Interest Entity (VIE) to be consolidated by a company if that company is subject to a majority of the risk of loss for the VIE or is entitled to receive a majority of the VIE's residual returns. VIEs are those entities in which the Company, through contractual arrangements, bears the risks of, and enjoys the rewards normally associated with ownership of the entities, and therefore the company is the primary beneficiary of these entities. Acquisitions of subsidiaries or variable interest entities are accounted for using the purchase method of accounting. The results of subsidiaries or variable interest entities acquired during the year are included in the consolidated income statements from the effective date of acquisition.

INITIAL MEASUREMENT OF VIE- The Company initially measures the assets, liabilities, and non-controlling interests of the VIEs at their fair values at the date of the acquisitions. Goodwill is recorded for the excess of the fair value of the newly consolidated assets and the reported amount of assets transferred by the primary beneficiary to the VIE over the sum of the fair value of the consideration paid, the reported amount of any previously held interests, and the fair value of the newly consolidated liabilities and non-controlling interests are allocated and reported as a pro rata adjustment of the amounts that would have been assigned to all of the newly consolidated assets as if the initial consolidation had resulted from a business combination.

ACCOUNTING AFTER INITIAL MEASUREMENT OF VIE – Subsequent accounting for the assets, liabilities, and non-controlling interest of a consolidated variable interest entity are accounted for as if the entity were consolidated based on voting interests and the usual accounting rules for which the VIE operates are applied as they would to a consolidated subsidiary as follows:

Carrying amounts of the VIE are consolidated into the financial statements of PacificNet as the primary beneficiary (referred as “Primary Beneficiary” or “PB”)

Inter-company transactions and balances, such as revenues and costs, receivables and payables between or among the Primary Beneficiary and the VIE(s) are eliminated in their entirety

There is no direct ownership interest by the Primary Beneficiary in the VIE, equity of the VIE is eliminated with an offsetting credit to minority interest

PRC laws and regulations restrict us, as a foreign entity, from having a direct controlling interest in entities such as Beijing Xing Chang Xin Sci –tech Development Co. Ltd (IMOBILE-DE) and Guangzhou Sunroom Information Industry Co., Ltd. (Sunroom-DE) that hold operating licenses to engage in domestic online ecommerce and telecom value-added services in China. As a result, we conduct substantially all of our operations through Beijing PacificNet IMOBILE Technology Co., Ltd (WOFE) and Technology Ltd. And Guangzhou 3G Information Technology Co., Ltd. (WOFE). We own 51% of the shares in each of the WOFEs and each WOFE signed Consulting and Services Agreements with IMOBILE-DE and Sunroom-DE (the entities that actually carry out the operating activities). These agreements provide that all of the DE profits will flow through to the respective WOFEs. Pursuant to these agreements, the Company guarantees any obligations undertaken by these companies under their contractual agreements with third parties, and the Company is entitled to receive service fees in an amount equal to 51% of the net income of these companies. Accordingly, we bear the risks of and enjoy the rewards associated with the investments in the WOFEs.

The operations of Des are managed by their original management teams, however, the Company has the power to appoint or change directors and senior management because it indirectly ultimately controls the voting power of the shareholders of each DE through the Power of Attorney given to PacificNet's President according to the operating agreements between the Des and WOFEs. Pursuant to the Consulting and Service Agreements signed between each WOFE and their respective DE, the WOFE ("Party A") agrees to be the exclusive provider of telecom consulting services to the DE ("Party B"). During the term of the agreement, Party B shall not accept technical and consulting services provided by any third party. Party B agrees to pay a fee to Party A equal to 100% of its monthly net income for the services provided. Payment of the service fees has been secured through a share pledge agreement with the shareholders of each of the Des, whereby they pledged all of their shares to the respective WOFE.

(1) Each of the Des, by design, is thinly capitalized because a substantial portion of PacificNet's invested amounts or consideration were paid or payable directly to previous owners of Sunroom-DE and Imobile-DE for entering into the acquisition transactions while none of the investment consideration was injected into the Des. Therefore, additional funding from PacificNet is needed to support the Des' business development and working capital.

(2) Fees from Service Contracts are substantial, but are not commensurate with the level of service provided by the WOFEs to the Des. The contractual and funding arrangements with the Des evidence that PacificNet has closely participated in the majority of the Des' economics. PacificNet is the primary beneficiary through its WOFE subsidiaries since PacificNet is the only enterprise with a sufficiently large interest in the VIEs. In compliance with PRC's foreign investment restrictions on Internet Content Provider and Value Added Telecom Services Provider's laws and regulations, the Company conducts all of its value-added services for telecom in China via the following significant domestic VIEs below. The respective management agreements between the VIE's and WOFE's create a variable interest and accordingly, these two Vies are consolidated as VIE through their respective WOFEs from the date of acquisition.

The following is a summary of all the VIEs of the Company:

Beijing Xing Chang Xin Sci –tech Development Co. Ltd (the "Imobile-VIE"), a China company controlled through business agreement. Through Imobile-VIE, a variable interest entity, PacificNet is able to engage in the business of ICP, and operates mobile distribution and value-added service in the PRC. The business of the VIE is managed by their original management teams. Imobile-VIE is owned by Gao Chunhui, CEO 51% and Liu Lei, COO 49%, of the Company. The registered capital of the VIE is RMB 2,000,000. The VIE's board of directors has the power to appoint the General Manager of the VIE who in turn has the power to appoint other members of the management. PacificNet does not directly participate in the daily operation of the VIE. It however has the power to change the management, if needed, because PacificNet is directly or indirectly controlling the board of this VIE.

Guangzhou Sunroom Information Industrial Co., Ltd. ("Sunroom-VIE"), a PRC registered domestic enterprise, controlled by PacificNet through a series of contractual agreements. It is responsible for VAS in China under its ICP and VAS licenses. It is 31% owned by Mr. Wang Yongchao (CEO), 41.4% owned by Mr. Liao Mengjiang (COO) and 27.6% owned by non-participating shareholder, Mr. Sun Zhengquan. The registered capital of the VIE Company is $4.0 million. Sunroom-VIE is required to transfer their ownership in these entities to our subsidiaries when permitted by PRC laws and regulations and all voting rights are assigned to us. As of December 31, 2005, Sunroom-VIE's revenues and net loss accounted for approximately 17% and (96) % of our consolidated revenues and net earnings before minority interests, respectively.

The initial capital investments in these VIEs were not funded by us but we have provided loans to these VIEs to fund their R&D and expansion plans. As of December 31, 2005, the amount of loans to Clickcom VIE and Sunroom VIE were approximately US$262,695 (low interest at 2%) and US$246,216 (interest free) respectively. None of the VIEs' assets were collateralized for our loans. Given the fact that we do not have direct ownership interests in these VIEs, the creditors of these VIEs will not have recourse to the general credit of our group being the primary beneficiary.

Under various contractual agreements, employee shareholders of the VIEs are required to transfer their ownership in these entities to our subsidiaries in China when permitted by PRC laws and regulations or to our designees at any time for the amount of the outstanding loans. All voting rights of the VIEs are then assigned to us. We have the power to appoint all directors and senior management personnel of the VIEs. Through our wholly owned subsidiaries in China, we have also entered into exclusive technical agreements and other service agreements with the VIEs, under which these subsidiaries provide technical services.

BUSINESS COMBINATIONS

The Company accounts for its business combinations using the purchase method of accounting. This method requires that the acquisition cost to be allocated to the assets and liabilities the Company acquired based on their fair values. The Company makes estimates and judgments in determining the fair value of the acquired assets and liabilities, based on valuations using management's estimates and assumptions including its experience with similar assets and liabilities in similar industries. If different judgments or assumptions were used, the amounts assigned to the individual acquired assets or liabilities could be materially different.

GOODWILL AND PURCHASED INTANGIBLE ASSETS

Goodwill represents the excess of the purchase price over the fair value of the identifiable assets and liabilities acquired as a result of the Company's acquisitions of interests in its subsidiaries and VIEs. Fair market value of the identifiable assets and liabilities, including tangible and intangible, is primarily ascertained with replacement cost method. At time of acquisition, based on market research and discussion with management, a benchmark is established with reference to comparable replacement cost in open market. Occasionally, net book value is used as a fair market value equivalent if the assets and liabilities of the newly acquired subsidiaries and/or VIEs were either current in nature or newly established.

Under Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets ("SFAS 142")," goodwill is no longer amortized, but tested for impairment upon first adoption and annually, thereafter, or more frequently if events or changes in circumstances indicate that it might be impaired. The Company assesses goodwill for impairment annually in accordance with SFAS 142. The assessment includes first comparing implied P/E valuation of the goodwill carrying subsidiaries (adjusted by R&D expenses written off) to benchmarks as found in comparable publicly traded companies. If a comfortable buffer over the public benchmark does not exist, more sophisticated DCF analysis, based on 5 year cash flows forecasts, will follow to ascertain if goodwill impairment is warranted.

The Company applies the criteria specified in SFAS No. 141, "Business Combinations" to determine whether an intangible asset should be recognized separately from goodwill. Intangible assets acquired through business acquisitions are recognized as assets separate from goodwill if they satisfy either the "contractual-legal" or "separability" criterion. Per SFAS 142, intangible assets with definite lives are amortized over their estimated useful life and reviewed for impairment in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-lived Assets." Intangible assets, such as purchased technology, trademark, customer list, user base and non-compete agreements, arising from the acquisitions of subsidiaries and variable interest entities are recognized and measured at fair value upon acquisition. Intangible assets are amortized over their estimated useful lives from one to ten years. The Company reviews the amortization methods and estimated useful lives of intangible assets at least annually or when events or changes in circumstances indicate that it might be impaired. The recoverability of an intangible asset to be held and used is evaluated by comparing the carrying amount of the intangible asset to its future net undiscounted cash flows. If the intangible asset is considered to be impaired, the impairment loss is measured as the amount by which the carrying amount of the intangible asset exceeds the fair value of the intangible asset, calculated using a discounted future cash flow analysis. The Company uses estimates and judgments in its impairment tests, and if different estimates or judgments had been utilized, the timing or the amount of the impairment charges could be different.

We currently have nine reporting units: EPRO, Smartime/Soluteck, Guangzhou 3G-WOFE (assets held for disposition), iMobile-WOFE, Shanghai Classic (including discontinued subsidiary – Yueshen), Wangrong, Clickcom (discontinued operation), PacificNet Games, Linkhead (discontinued operation), but those that are marked either assets held for disposition or discontinued are excluded for the purposes of goodwill assessment. We determined our reporting units if the entity constituted a business, financial information was available, and segment management can regularly review the operating results of that component. Excluding investment holding vehicles and self-developed units, reporting units only include those operating units that PacificNet holds 50% or more through acquisition and maintain effective control. Units such as PacificNet Solution, PacificNet Limited, and PacificNet Communication are 100% owned by PacificNet through self-development and not through acquisition. Therefore, there is no goodwill allocation to these self-developed units.

We allocated goodwill amongst the reporting units based on the consideration paid in shares and cash minus the proportional share of the fair value of net assets and liabilities at the time of acquisition specific to each reporting unit. The fair value of each reporting unit represents the amount at which the unit as a whole could be bought or sold in a current transaction between willing parties in an open marketplace. At the time of acquisition, the fair value of assets and liabilities was determined based on book value minus any potential write-down, if any, to reflect the fair value of the assets and liabilities acquired in the transaction. The Company has one class of goodwill arising from business combination resulting from the acquisitions of our subsidiaries. Goodwill has been revised to reflect certain expenses that should have been written off prior to certain acquisitions, not subsequent to the acquisitions, to better reflect the assets acquired and liabilities assumed in certain business combinations during 2003 in accordance with SFAS No. 141, “Business Combinations”. Originally, the Company had acquired certain intangible assets such as research and development costs and related party receivables that were considered as part of the purchase price allocation, then subsequently expensed them at year end.

The total carrying amount of goodwill recorded on the balance sheets at December 31, 2006 is $5,601,000 and the changes in the carrying amount of goodwill for the following reporting periods are summarized below:

(US$'000s)	Group 1. Outsourcing Services	Group 2. Telecom Value-Added Services	Group 3. Products (Telecom & Gaming)	Total goodwill on the restated balance sheet
Balance as of December 31, 2003	$ 420	$ -	$ -	$ 420
Goodwill acquired during the year	3,575	4,831	1,438	9,844
Goodwill reclassified to net assets held for disposition	-	(3,672)	-	(3,672)
Goodwill impaired during the year	(31)	(1,159)	(1,438)	(2,628)
Balance as of December 31, 2004-Restated	3,964	-	-	3,964
Goodwill acquired during the year	-	5,183	-	5,183
Goodwill reclassified to net assets held for disposition	-	(1,494)	-	(1,494)
Goodwill impaired during the year	-	(3,689)	-	(3,689)
Balance as of December 31, 2005-Restated	3,964	-	-	3,964
Goodwill acquired during the year	-	1,694	1,176	2,870
Balance as of December 31, 2006-Restated	$ 3,964	$ 461	$ 1,176	$ 5,601

The Company assesses the need to record impairment losses on our goodwill assets at least annually or when an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The assessment includes using a combination of qualitative and quantitative analyses such as DCF/PE multiples based on 5 year profit forecasts, and published comparables, where applicable. The Company concluded that there have been no material adverse changes on the operating environments during the reporting periods that would have otherwise affected the carrying value of the goodwill. In addition, there has been no disposal of any reporting subsidiaries and, as a result, no gain or loss is recognized during those reporting periods.

The following table summarizes goodwill from the Company's acquisitions during 2006 and 2005:

	For the years ended December 31	
(USD$'000s)	2006 Restated	2005 Restated
Epro	$ 3,949	$ 3,949
Smartime (Soluteck)	15	15
iMobile	430	-
Wanrong	461	-
PacificNet Games	746	-
Total	$ 5,601	$ 3,964

The following table summarizes the intangible assets acquired from PacificNet Games:

(USD000s)	December 31, 2006
Technology	$ 353
Less: Accumulated amortization	(30)
Net	$ 323

Amortization expense related to intangible assets was $30,000 in the year ended December 31, 2006.

IMPAIRMENT OF LONG-LIVED ASSETS

The Company periodically assesses the need to record impairment losses on long-lived assets, such as property, plant and equipment, and purchased intangible assets, used in operations and its investments when indicators of impairment are present indicating the carrying value may not be recoverable. An impairment loss is recognized when estimated undiscounted future cash flows expected to result from the use of the asset plus net proceeds expected from disposition of the asset (if any) are less than the carrying value of the asset. When impairment is identified, the carrying amount of the asset is reduced to its estimated fair value. All goodwill will no longer be amortized and potential impairment of goodwill and purchased intangible assets with indefinite useful lives will be evaluated using the specific guidance provided by SFAS No. 142 and SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets."

This impairment analysis is performed at least annually. For investments in affiliated companies that are not majority-owned or controlled, indicators or value generally include revenue growth, operating results, cash flows and other measures. Management then determines whether there has been a permanent impairment of value based upon events and circumstances that have occurred since acquisition. It is reasonably possible that the impairment factors evaluated by management will change in subsequent periods, given that the Company operates in a volatile environment. This could result in material impairment charges in future periods.

During the year ended December 31, 2005 the Company impaired goodwill as follows:

(USD$'000s)	2005 Restated
Linkhead	$ 3,423
Clickom	266
GZ3G(Sunroom)	-
Lion Zone (ChinaGoHi)	-
Total	$ 3,689

There was no impairment of goodwill in the year ended December 31, 2006.

INVESTMENTS IN AFFILIATED COMPANIES

The Company's investments in affiliated companies for which its ownership exceeds 20%, but is not majority-owned or controlled, are accounted for using the equity method. The Company's investments in affiliated companies for which its ownership is less than 20% are accounted for using the cost method.

COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) consists of net earnings and other gains (losses) affecting stockholders' equity that, under generally accepted accounting principles are excluded from net earnings in accordance with Statement of Financial Accounting Standards ("SFAS") 130, Reporting Comprehensive Income.

REVENUE RECOGNITION

Revenues are derived from the following categories as classified by our operating segments (see Note 15): (1) outsourcing services including Business Process Outsourcing (BPO), call center, IT Outsourcing (ITO) and software development services; (2) Telecom Value-Added Telecom Services (VAS) including Content Providing (CP), Interactive Voice Response (IVR), Platform Providing (PP) and Service Providing (SP); and (3) Products (telecom & gaming) Services, including calling cards, GSM/ CDMA/ XiaoLingTong products, and multimedia self-service kiosks.

Revenues from outsourcing services are recognized when the services are rendered. Revenues from license agreements are recognized when a signed non-cancelable software license exists, delivery has occurred, the Company's fee is fixed or determinable, and collectability is probable at the date of sale. Revenues from software development services are recognized when the customer accepts the installation and no significant modification or customization work is involved, in accordance with SOP 97-2 "Software Revenue Recognition." Revenues from support services such as consulting, implementation and training services are recognized when the services are performed, collectability is probable and such revenues are contractually nonrefundable.

Revenues from value-added telecom services are derived principally from providing mobile phone users with short messaging service ("SMS"), multimedia messaging service ("MMS"), color ring back tone ("CRBT"), wireless application protocol ("WAP") and interactive voice response system ("IVR"). These services include news and other content subscriptions, mobile dating service, picture and logo download, ring tones, ring back tones, mobile games, chat rooms and access to music files. These revenues from are charged on a monthly or per-usage basis and are recognized in the period in which the service is performed, provided that no significant Company obligations remain, collection of the receivables is reasonably assured and the amounts can be accurately estimated. In accordance with EITF No. 99-19, "Reporting Revenues Gross as a Principal Versus Net as an Agent," revenues are recorded on a gross basis when the Company is considered the primary obligor to the VAS users. Under the gross method, the amounts billed to VAS users are recognized as revenues and the fees charged or retained by the third-party operators are recognized as cost of revenues.

Revenues from the sale of products and systems are recognized when the product and system is completed, shipped, and the risks and rewards of ownership have transferred.

Revenues from the distribution of all types of calling cards and product sales is recognized in accordance with EITF No. 99-19, "Reporting Revenues Gross as a Principal Versus Net as an Agent," where revenues are recorded on a gross basis when the Company is considered the primary obligor to the users, maintains an inventory of products before the products are ordered by customers, has latitude in establishing the pricing power of products, is subject to physical inventory loss risk, and has credit risk as it is responsible for collecting the sales price from the customer and is responsible for paying the supplier regardless of whether or not the sales price is fully collectible.

The effect of post-shipment/delivery obligations, such as customer acceptance, product returns, etc. on our revenue recognition policy is as follows: (a) there is no effect on outsourcing services as revenue is recognized as the services are performed; however product sale revenue is recognized when contracts are approximately 80% completed for revenue recognition and fully when the customer signs the UAT, (i.e., "User Acceptance Form"); (b) there is no effect on telecom value-added services revenue as the product sales mainly involve IVR hardware that are from mature and stable products of multi-national vendors and there have been minimal returns historically; and (c) there is no effect on product (telecom & gaming) since the transactions are conducted on cash basis and revenue is recognized at the time the sale is transacted.

ALLOWANCE FOR DOUBTFUL ACCOUNTS

The Company presents accounts receivable, net of allowances for doubtful accounts and returns. The allowances are calculated based on a detailed review of certain individual customer accounts, historical rates and an estimate of the overall economic conditions affecting the Company's customer base. The Company frequently monitors its customers' financial condition and credit worthiness and only sells products, licenses or services to customers where, at the time of the sale, collection is reasonably assured. If the financial condition of its customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. The Company also records reserves for doubtful accounts for all other customers based on a variety of factors including the length of time the receivables are past due, the financial health of the customer, macroeconomic considerations and historical experience. If circumstances related to specific customers change, the Company's estimates of the recoverability of receivables could be further adjusted. Allowance for doubtful accounts at December 31, 2006 was approximately $3,400,000 (2005: $168,000).

PROPERTY AND EQUIPMENT

Property and equipment is stated at cost and depreciated using the straight-line method over the shorter of the estimated useful life of the asset or the lease term, ranging from three to five years. Significant improvements and betterments are capitalized. Routine repairs and maintenance are expensed when incurred. When property and equipment is sold or otherwise disposed of, the asset account and related accumulated depreciation account are relieved, and any gain or loss is included in operations.

INVENTORIES

Inventories consist of finished goods and are stated at the lower of cost or market value. Cost is computed using the first-in, first-out method and includes all costs of purchase and other costs incurred in bringing the inventories to their present location and condition. Market value is determined by reference to the sales proceeds of items sold in the ordinary course of business after the balance sheet date or management estimates based on prevailing market conditions. The inventories consist of finished goods and represent telecommunication products such as mobile phone, rechargeable phone cards, smart chip, and interactive voice response cards.

INCOME TAXES

Income taxes are accounted for using an asset and liability approach, which requires the recognition of income taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in the Company's consolidated financial statements or tax returns. The measurement of current and deferred tax liabilities and assets is based on provisions of the enacted tax laws; the effects of future changes in tax laws or rates are not anticipated. The measurement of deferred tax assets is reduced, if necessary, by the amount of any tax benefits that, based on available evidence assessed using the criteria in SFAS No. 109, "Accounting for Income Taxes," will not more-likely-than-not be realized.

The Company records a valuation allowance for deferred tax assets, if any, based on estimates of its future taxable income as well as its tax planning strategies when it is more likely than not that a portion or all of its deferred tax assets will not be realized. If the Company is able to utilize more of its deferred tax assets than the net amount previously recorded when unanticipated events occur, an adjustment to deferred tax assets would be reflected in income when those events occur.

CONTINGENCIES

The Company accounts for contingency using SFAS 5 ‘Accounting for Contingencies’. This statement requires accrual by a charge to income (and disclosure) for an estimated loss from a loss contingency if two conditions are met: (a) information available prior to issuance of the financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements, and (b) the amount of loss can be reasonably estimated. Accruals for general or unspecified business risks ("reserves for general contingencies") are no longer permitted. As at December 31, 2006 the Company recorded ‘Liquidated Damages’ liability on suspension of use of registration statement as an ‘Event of default’ under this statement.

RESEARCH AND DEVELOPMENT COSTS AND CAPITALIZED SOFTWARE COSTS

Expenditures related to the research and development of new products and processes, including significant improvements and refinements to existing products are expensed as incurred, unless they are required to be capitalized.

Software development costs are required to be capitalized when a product's technological feasibility has been established by completion of a detailed program design or working model of the product, and ending when a product is available for release to customers. For the years ended December 31, 2006 and 2005, the Company did not capitalize any costs related to the purchase of software and related technologies and content.

EARNINGS PER SHARE (EPS)

Basic and diluted earnings or loss per share (EPS) amounts in the financial statements are computed in accordance with SFAS No. 128, "Earnings Per Share." Basic EPS is based on the weighted average number of common shares outstanding. Diluted EPS is based on the weighted average number of common shares outstanding and dilutive common stock equivalents. Basic EPS is computed by dividing net income/loss available to common stockholders (numerator) by the weighted average number of common shares outstanding (denominator) during the period. Weighted average number of shares used to calculate basic and diluted loss per share is considered same as the effect of dilutive shares is anti-dilutive.

The reconciliation of the numerators and denominators of the basic and diluted EPS calculations was as follows:

(In thousands of US Dollars, except weighted shares and per share amounts)	FY 2006 Restated	FY 2005 Restated
Numerator: Net loss	$ (12,415)	$ (5,145)
Denominator:		
Weighted-average shares used to compute basic & diluted loss per share	11,538,664	10,156,809
Basic & Diluted loss per common share:	$ (1.08)	$ (0.51)

STOCK-BASED COMPENSATION PLANS

Prior to January 1, 2006, PacificNet accounted for awards granted under stock-based compensation plans following the recognition and measurement principles of APB 25, Accounting for Stock Issued to Employees, and related interpretations. Compensation expense, if any, is recognized for awards granted at an exercise price less than fair market value of the underlying common stock on the date of grant.

Effective January 1, 2006, PacificNet adopted the fair value recognition provisions of SFAS 123(R). See Item 6 for a description of the Company’s adoption of SFAS 123R.The fair value of stock options is determined using the Black-Scholes option pricing model, which is consistent with the valuation techniques previously utilized for options in footnote disclosures required under SFAS 123,as amended by FASB Statement No. 148, “Accounting for Stock-Based Compensation - Transition and Disclosure.” The determination of the fair value of stock-based compensation awards on the date of grant using an option-pricing model is affected by the Company’s stock price as well as assumptions regarding a number of complex and subjective variables, including the expected volatility of the Company’s stock price over the term of the awards, actual and projected employee stock option exercise behaviors, risk-free interest rate and expected dividends. The compensation costs, which approximated $242,473 for year 2006, are recognized on a straight-line base over the option vesting term and the amortized cost is included in selling, general and administrative expenses. The valuation provisions of SFAS 123(R) apply to new grants and unvested grants that were outstanding as of the effective date.

During year 2006, we had 370,500 stock options exercisable, 394,000 options were exercised, and 680,000 options granted in year 2005 were cancelled. The board also authorized to issue 500,000 options on September 21, 2006. However due to the increasing cost of option administration, the board of directors decided to cancel all options authorized during year 2005 and 2006, and plan to issue restricted stock or stock appreciation right (SAR) for future executive and employee incentive compensation. See note 12 b) for the status of the Company's stock option plan.

Additional information on options outstanding as of December 31, 2006 is as follows:

	WEIGHTED AVERAGE EXERCISE PRICE	OPTIONS	WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE
Options outstanding	$2.00	370,500	0.57 years
Options exercisable	$2.00	370,500	0.57 year

CONVERTIBLE DEBENTURES

On March 13, 2006, we completed a private placement in which we sold $8,000,000 in convertible debentures and issued warrants to purchase up to an aggregate of 400,000 shares of common stock. The debentures are convertible at any time into shares of our common stock at an initial fixed conversion price of $10.00 per share, subject to adjustments for certain dilutive events. The debentures are due March 13, 2009. The warrants are exercisable for a period of five years at an exercise price of $12.20 per share. At the closing of the private placement, we prepaid the first year's interest on debentures equal to 5% of the aggregate principal amount of debentures. We will pay interest in cash or shares, provided that certain conditions are met, at the rate of 6% for the second year the debentures are outstanding and then 7% for the third. Beginning January 1, 2007, we are obligated to redeem up to $320,000 every month, plus accrued, but unpaid interest, liquidated damages and penalties. We also have the option to prepay the debentures at any time, provided that certain conditions have been met, after the 12 month anniversary of the effective date of the registration statement that has been filed with the Securities and Exchange Commission with respect to the common stock issuable upon conversion of the debentures, some or all of the outstanding debentures for cash in an amount equal to 120% of the principal amount outstanding, plus accrued, but unpaid interest, liquidated damages and penalties outstanding. At any time after the six month anniversary of the effective date of the registration statement, we may force the holders to convert up to 50% of the then outstanding principal amount of the debentures, subject to certain trading conditions being met. If any event of default occurs under the debentures or other related documents, the holders may elect to accelerate the payment of the outstanding principal amount of the debenture, plus accrued, but unpaid interest, liquidated damages and penalties, which shall become immediately due and payable.

Under the terms of a registration rights agreement entered into at the time of the private placement, the Company was obligated to file a registration statement with respect to the shares issuable under the debenture and the warrants by April 30, 2006, and have the registration statement declared effective by the SEC no later than June 28, 2006. Due to various factors, the Company did not file the registration statement until May 15, 2006, and it was not declared effective until December 8, 2006. Therefore, under the terms of the registration rights agreement, the Company was obligated to pay liquidated damages to the investors at the rate of 2% of the principal amount of the debenture each month beginning on June 28, 2006 until the effectiveness of the registration statement, which was equal to $1,120,000, in the aggregate.

In February 2007, upon reaching an agreement on the amount and payment of accrued liquidated damages, the Company signed a Settlement and Release Agreement with each of the investors. Under the terms of the Settlement and Release Agreements, the Company paid an aggregate $140,000 in cash as satisfaction in full of liquidated damages owed to Basso Fund Ltd., Basso Multi-Strategy Holding Fund Ltd. and Basso Private Opportunities Holding Fund Ltd.. Partial liquidated damages owed to Whalehaven Capital Fund Ltd. were paid in the amount of $35,000 in cash, with the remaining liquidated damages in the amount of $105,000 paid in the form of a new convertible debenture due February 2009, on substantially the same terms as the original debentures, except that interest only is paid on the new debentures until October 2008 and beginning in November 2008 until February 2009, when the new debentures are due, the monthly redemption amount under the new debentures shall be equal to $315,000. The remaining investors also agreed to accept the aggregate $840,000 in liquidated damages owed to them in the form of the new convertible debentures for the amount of their respective portion of the liquidated damages. The Company also agreed to amend the original debentures to shorten the term for payment of the original principal amount to a 22 month term. As a result the monthly redemption amount for the original debenture increased from $320,000 to $ 363,638. All other terms and conditions of the original debenture remains in full force and effect.

C.E. Unterberg, Towbin L.L.C. acted as placement agent and received a negotiated cash fee in the amount of $449,500 and a warrant to purchase up to 16,000 shares at an exercise price of $12.20 per share, which expire five years from the date of issuance. The fair value of these warrants totaled $28,141. Such amount was charged to other assets, net, and credited to additional paid-in capital and will be amortized over the life of the debentures. Maxim Group also acted as Placement Agent and received a cash fee in the amount of $50,000.

In connection with the issuance of the debentures, the Company incurred $1,106,135 of issuance costs, which primarily consisted of investment banker fees, legal and other professional fees. These costs have been recorded as additional expense during year 2006.

The gross proceeds of $8,000,000 are recorded as a current debenture liability. In addition, fair values attributed to the Investors' warrants in accordance with EITF issue No. 00-19 "Accounting for Derivative Financial Instruments Indexed to and Potentially Settled in a Company's Own Stock" are recorded as liabilities. The initial value related to the Investors' warrants is $690,642. An aggregate loss of $213,692 representing the change in fair value of warrants was recognized during the twelve months ended December 31, 2006.

The Company reassesses the classification at each balance sheet date. If the classification required under EITF No. 00-19 changes as a result of events during the period, the contract should be reclassified as of the date of the event that caused the reclassification.

EVENT OF DEFAULT

On March 16, 2007, the predecessor auditor withdrew their opinion on our previously filed financial statements for the years ended December 31, 2005, December 31, 2004 and December 31, 2003. As a result, on March 27, 2007, we notified the holders of the outstanding convertible debenture that we suspended use of the prospectus contained in our Registration Statement on Form S-1 (File No. 333-134127) that was declared effective on December 8, 2006, due to the lack of fiscal year end 2005 and 2004 audited financial statements and that they must cease selling under the prospectus. The suspension of the use of the prospectus after April 17, 2007, triggered an event of default under the registration rights agreement and the convertible debentures, and if any of the holders so elect, they can accelerate and demand payment under the debentures, in accordance with the registration rights agreement based on the following provisions.

a) If, during the Effectiveness Period, either the effectiveness of the Registration Statement lapses for any reason or the Holder shall not be permitted to resell Registrable Securities under the Registration Statement for a period of more than 20 consecutive Trading Days or 60 non-consecutive Trading Days during any 12 month period, the Company has to pay 'Mandatory Default Amount' as

the sum of (i) the greater of (A) 130% of the outstanding principal amount of this Debenture, plus all accrued and unpaid interest hereon, or (B) the outstanding principal amount of this Debenture, plus all accrued and unpaid interest hereon, divided by the Conversion Price on the date the Mandatory Default Amount is either (a) demanded (if demand or notice is required to create an Event of Default) or otherwise due or (b) paid in full, whichever has a lower Conversion Price, multiplied by the VWAP on the date the Mandatory Default Amount is either (x) demanded or otherwise due or (y) paid in full, whichever has a higher VWAP, and (ii) all other amounts, costs, expenses and liquidated damages due in respect of this Debenture."

b) If any Event of Default occurs, the outstanding principal amount of this Debenture plus accrued but unpaid interest, liquidated damages and other amounts owing in respect thereof through the date of acceleration, shall become, at the Holder's selection, immediately due and payable in cash at the Mandatory Default Amount. Commencing 5 days after the occurrence of any Event of Default that results in the eventual acceleration of this Debenture, the interest rate on this Debenture shall accrue at an interest rate equal to the lesser of 18% per annum or the maximum rate permitted under applicable law.

The provisions mentioned above and as per the terms of the Debenture, the Company has reclassified the principal amount of the Debenture of $8,000,000 and the principal amount of the new Debenture of $945,000 and the interest accrued thereon to the current liability.

The Company accrued 2% as liquidated damages and 30% as mandatory default amount from the date of ineffectiveness of registration statement as follows:

($,000)			2006
Liquidated damages	2%	$	450
Mandatory default	30%		2,247
Total		$	2,697

The Company also expensed the unamortized discount of $691,000 to expense for the year ended December 31, 2006.

ADVERTISING EXPENSES

Advertising expenses consist primarily of costs of promotion for corporate image and product marketing and costs of direct advertising. The Company expenses all advertising costs as incurred and classify these costs under selling, general and administrative expenses, which amounted to $31,052 in 2006 (2005: $129,000).

CASH EQUIVALENTS

Cash and cash equivalents comprise cash at bank and on hand, demand deposits with banks and other financial institutions, and short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Bank overdrafts that are repayable on demand and form an integral part of the PacificNet's cash management are also included as a component of cash and cash equivalents for the purpose of the cash flow statement. Highly liquid investments with original maturities of three months or less are considered cash equivalents.

RELATED PARTY TRANSACTIONS

A related party is generally defined as (i) any person that holds 10% or more of the Company's securities including such person's immediate families, (ii) the Company's management, (iii) someone that directly or indirectly controls, is controlled by or is under common control with the Company, or (iv) anyone who can significantly influence the financial and operating decisions of the Company. A transaction is considered to be a related party transaction when there is a transfer of resources or obligations between related parties. (See Note 14)

RECLASSIFICATION

Certain prior period amounts have been reclassified to conform to the current year presentation. These changes had no effect on previously reported results of operations or total stockholders' equity.

FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is described as the amount at which the instrument could be exchanged in a current transaction between informed willing parties, other than a forced liquidation. Cash and cash equivalents, accounts receivable and payable, accrued expenses and other current liabilities are reported on the consolidated balance sheets at carrying value which approximates fair value due to the short-term maturities of these instruments. The Company does not have any off balance sheet financial instruments.

CONCENTRATION OF CREDIT RISK

CASH HELD IN BANKS. For those financial institutions that the Company maintains cash balances in the United States, the amounts are insured by the Federal Deposit Insurance Corporation up to $100,000.

GEOGRAPHIC RISK. All of the Company's revenues are derived in Asia and Greater China and its operations are governed by Chinese laws and regulations. The operations in China are carried out by the subsidiaries and VIEs. If the Company was unable to derive any revenue from Asia and Greater China, it would have a significant, financially disruptive effect on the normal operations of the Company.

SIGNIFICANT RELATIONSHIPS. A substantial portion of the operations of the Company's VIEs (Dianxun-DE and Sunroom-DE) business operations depend on mobile telecommunications operators (operators) in China and any loss or deterioration of such relationship may result in severe disruptions to their business operations and the loss of a significant portion of the Company's revenue. The VIEs rely entirely on the networks and gateways of these operators to provide its wireless value-added services. Specifically these operators are the only entities in China that have platforms for wireless value-added services. The Company's agreements with these operators are generally for a period of less than one year and generally do not have automatic renewal provisions. If neither of them is willing to continue to cooperate with the Company, it would severely affect the Company's ability to conduct its existing wireless value-added services business.

MARKETABLE EQUITY SECURITIES

Marketable equity securities are classified as available-for-sale and are recorded at fair value in other assets on the balance sheet, with the change in fair value during the period excluded from earnings and recorded net of tax as a component of other comprehensive income. Realized gains or losses are charged to the income statement during the period in which the gain or loss is realized. Investments classified as available-for-sale securities include marketable equity securities of Unit Trust Funds and are based primarily on quoted market prices at December 31, 2006. The component costs of these securities are summarized as follows: cost of $559,000, gross unrealized losses of $1,000 and estimated fair value of $558,000 as at December 31, 2006 and cost of $586,000, gross unrealized losses of $47,000 and estimated fair value of $539,000 as at December 31, 2005. The acquisition of marketable securities and unrealized losses on marketable equity securities are recorded on consolidated statements of cash flows.

FOREIGN CURRENCY

The Company's reporting currency is the U.S. dollar. The Company's operations in China and Hong Kong use their respective currencies as their functional currencies. The financial statements of these subsidiaries are translated into U.S. dollars using period-end rates of exchange for assets and liabilities and average rates of exchange in the period for revenue and expenses. Translation gains and losses are recorded in accumulated other comprehensive income or loss as a component of shareholders' equity. Net gains and losses resulting from foreign exchange transactions are included in General and Administrative Expenses an amount of US $16,000. During the year ended December 31, 2006, the foreign currency translation adjustments to the Company's comprehensive income was $27,000 and the currency translation gain was approximately $72,000, primarily as a result of the Hong Kong dollars appreciating against the U.S. dollar.

SEGMENT INFORMATION

The Company determines and classified its operating segments in accordance with SFAS No. 131 "DISCLOSURES ABOUT SEGMENTS OF AN ENTERPRISE AND RELATED INFORMATION" based on the following considerations: (a) each of the Company's operating segments is a discrete business unit that earns revenues and incurs expenses; (b) the operating results are regularly reviewed by PacificNet's chief operating decision makers for the purposes of fine-tuning its strategies going forward, making resource allocation decisions such as whether further working capital advances are required and assessing individual performance; and (c) discrete financial information for each subsidiary within each operating segment is available. The chief operating decision makers are the Company's President and CEO and its Chairman, and their decisions are based on discussions with each segment's senior management and financial controllers regarding non-financial indicators such as customer satisfaction, loyalty and new marketplace competition as well as financial indicators such as internally generated financial statements, to assess overall financial performance.

GOING CONCERN

As shown in the accompanying consolidated financial statements, the Company incurred accumulated losses of $51.1 million and $38.6 million as of December 31, 2006 and December 31, 2005, respectively. Negative cash flows from the operations of $8.2 million were noted for the year ended December 31, 2006. These matters raise substantial doubt about the Company’s ability to continue as a going concern.

In view of the matters described in the preceding paragraph, recoverability of a major portion of the recorded asset amounts shown in the accompanying balance sheet is dependent upon continued operations of the Company, which in turn is dependent upon the Company’s ability to raise additional capital, obtain financing and to succeed in its future operations. The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern.

The Company has taken certain restructuring steps to provide the necessary capital to continue its operations. These steps included, but not limited to: 1) accelerate disposal and spin-off of unprofitable or unfavorable return-on-investment non-gaming operations. On April 30, 2007, the Company entered into a sale and purchase agreement to dispose of its interest in Guangzhou3G for a consideration of US$6 million. On May 5, 2007, the Company also entered into a sale and purchase agreement to dispose of the real estate in HK for approximately US$1 million; 2) focus on execution of the new high potential gaming business initiatives; 3) acquisition of profitable and/or strategic operations through issuance of equity instruments; 4) formation of strategic relationship with key gaming operators in Asia; 5) issuance and/or restructure of new long-term convertible debentures.

Recent Pronouncements

In February 2007, FASB issued FASB Statement No. 159, The Fair Value Option for Financial Assets and Financial Liabilities. FAS 159 is effective for fiscal years beginning after November 15, 2007. Early adoption is permitted subject to specific requirements outlined in the new Statement. Therefore, calendar-year companies may be able to adopt FAS 159 for their first quarter 2007 financial statements.

The new Statement allows entities to choose, at specified election dates, to measure eligible financial assets and liabilities at fair value that are not otherwise required to be measured at fair value. If a company elects the fair value option for an eligible item, changes in that item's fair value in subsequent reporting periods must be recognized in current earnings. FAS 159 also establishes presentation and disclosure requirements designed to draw comparison between entities that elect different measurement attributes for similar assets and liabilities. The management is currently evaluating the effect of this pronouncement on financial statements.

In September 2006, FASB issued SFAS 158 ‘Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)’ This Statement improves financial reporting by requiring an employer to recognize the over funded or underfunded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income of a business entity or changes in unrestricted net assets of a not-for-profit organization. The Company currently does not have any defined benefit plan and so FAS 158 will not affect the financial statements.

In September 2006, FASB issued SFAS 157 ‘Fair Value Measurements’. This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the Board having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements.

However, for some entities, the application of this Statement will change current practice. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The management is currently evaluating the effect of this pronouncement on financial statements.

In March 2006 FASB issued SFAS 156 “Accounting for Servicing of Financial Assets.” This Statement amends FASB Statement No. 140, “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities,” with respect to the accounting for separately recognized servicing assets and servicing liabilities. The Company does not have any servicing assets and therefore the statement will not have any impact on the financial statements.

In February 2006, FASB issued SFAS No. 155, “Accounting for Certain Hybrid Financial Instruments.” SFAS No. 155 amends SFAS No 133, “Accounting for Derivative Instruments and Hedging Activities,” and SFAF No. 140, “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.” SFAS No. 155, permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS No. 133, establishes a requirement to evaluate interest in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives, and amends SFAS No. 140 to eliminate the prohibition on the qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. The management is currently evaluating the effect of this pronouncement on financial statements.

In July 2006, the FASB released FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 (FIN 48) FIN 48 clarifies the accounting and reporting for uncertainties in income tax law. This interpretation prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of uncertain tax positions taken or expected to be taken in income tax returns. This statement is effective for fiscal years beginning after December 15, 2006. The Company believes that the adoption of FIN 48 will not have a material impact on its results of operations and financial position.

2. BUSINESS ACQUISITIONS

During 2006 and 2005, PacificNet acquired various entities in accordance with the Company's strategy to grow via mergers and acquisitions. The entities acquired met various PacificNet acquisition criteria, which include reasonable expectations for positive earnings and cash flow within two years of acquisition and reputation for high quality and performance in the customer relationship management, brand name recognition, and well-established relationships with clients. Several factors contributed to the determination of the negotiated purchase price and deal structure. Among them were the value of assets acquired and liabilities assumed, historical EBITDA and projected EBITDA. The assets acquired and liabilities assumed were recorded at estimated fair values as determined by the Company's management based on information currently available and on current assumptions as to future operations

A summary of business acquisitions for the periods presented follows:

GUANGZHOU WANRONG INFORMATION TECHNOLOGY CO., LIMITED (INCORPORATED IN THE PRC)

On January 31, 2006, the Company, through its subsidiary PacificNet Strategic Investment Holdings Limited, consummated the acquisition of a 51% controlling interest in Guangzhou Wanrong Information Technology Co. Limited (Guangzhou Wanrong), one of the leading value-added telecom service providers in China, located in PRC Guangzhou. Since its inception in 2003, Guangzhou Wanrong has achieved strong growth in its VAS including SMS, WAP, JAVA, MMS, IVR, multimedia entertainment download services, media interactive products, mobile email services, life, sports, entertainment, and business information services. Guangzhou Wanrong was granted nationwide SMS service numbers "2388" for China Mobile and "9928" for China Unicom. Wanrong's integrated value-added mobile services system is valuable for the implementation of PacificNet's "iPACT program", a standard service-mark for PacificNet's VAS profit-sharing alliance partnership program.

The consideration was paid as follows:

(i) The purchase consideration for 51% of the equity interest of Guangzhou Wanrong was approximately US $1.75million, payable 21% in cash and 79% in restricted shares of PacificNet common stock valued at $8 per share, or about 173,000 restricted shares.

(ii) Under the purchase agreement, Guangzhou Wanrong has made a guarantee to generate US $500,000 in annual net income. In the event of a shortfall, the purchase price will be adjusted accordingly.

(iii) PacificNet will also invest approximately RMB 3 million (or about US $370,000) in Guangzhou Wanrong for general corporate purposes. The purchase price is payable upon achievement of certain quarterly earn-out targets based on net income.

The cash portion of the purchase consideration was paid from working capital of the Company. The value of the common shares issued was determined based on the average market price of PacificNet's common shares over a reasonable period before and after the terms of the acquisition were agreed to and announced.

A summary of the assets acquired and liabilities for Guangzhou Wangrong assumed in the acquisition follows:

Estimated fair values:	Restated
Current Assets	$ 185,050
Property Plan and equipment	-
Current Liabilities assumed	-
Net asset acquired	185,050
Consideration paid:	646,158

Shares		-
Cash paid		-
Goodwill	$	461,108

As of December 31, 2006, goodwill of $461,108 represents the excess of the purchase price over the fair value of the assets acquired and is not deductible for tax purposes. The total amount of goodwill by reportable segment for Telecom Value-added Services was $461,000 (see Note 15).

In accordance with SFAS 142, goodwill is not amortized but is tested for impairment at least annually. The purchase price allocation for Guangzhou Wanrong acquisition is based on a management's estimates and overall industry experience. Immediately after the signing of the definitive agreement, the Company obtained effective control over Guangzhou Wanrong. Accordingly, the operating results of Guangzhou Wanrong have been consolidated with those of the Company starting January 31, 2006. Pursuant to SFAS 141 "Business Combinations", the earn-out consideration was considered contingent consideration and after the audited combined after-tax profit of US $500,000 for the 12 months ended December 31, 2006 is available. Accordingly, the contingent consideration of 138,348 shares has not been reflected in the consolidated financial statements of the Company as of December 31, 2006.

UNAUDITED PRO FORMA CONSOLIDATED FINANCIAL INFORMATION DISCLOSURE FOR THE YEAR ENDED DECEMBER 31, 2006 AND 2005

The following un-audited pro forma consolidated financial information for the years ended December 31, 2006 and 2005, as presented below, reflects the results of operations of the Company assuming the acquisition occurred on January 1, 2005 and 2006 respectively, and after giving effect to the purchase accounting adjustments. These pro forma results have been prepared for information purposes only and do not purport to be indicative of what operating results would have been had the acquisitions actually taken place on January 1, 2005 and 2006 respectively, and may not be indicative of future operating results.

Guangzhou Wanrong	Years ended December 31		
	2006	2005	2004
	Restated	Restated	Restated
(In thousands of U.S Dollars, except for earnings per share)	(Unaudited)	(Unaudited)	(Unaudited)
Revenues	$ 43,692	$ 18,271	$ 11,598
Operating loss	(6,354)	(5,610)	(6,547)
Net loss attributable to shareholders	(12,437)	(5,145)	(5,581)
Loss per share – basic & diluted	$ (1.08)	$ (0.51)	$ (0.80)

PacificNet included the financial results of Guangzhou Wanrong in its consolidated 2006 financial results from the date of the purchase, January 31, 2006 through December 31, 2006.

PACIFICNET IMOBILE (BEIJING) TECHNOLOGY CO., LIMITED (INCORPORATED IN THE PRC)

On February 26, 2006, PacificNet acquired a 51% majority interest in PacificNet iMobile (Beijing) Technology Co., Ltd ("iMobile"), one of the leading Internet information portal and e-commerce distributors for mobile phone and accessories and mobile related value-added service providers in China. iMobile operates its e-commerce business via two Internet portals, "http://www.iMobile.com.cn" and "http://www.18900.com" and one WAP portal "17wap.com" for mobile phone browsing. In addition, iMobile's 18900.com operation is the designated Internet distributor for Motorola, Nokia, and NEC's mobile products in China. iMobile's Internet portal has been one of the top ranked traffic sites and has achieved about 5.4 million registered online users and over 1,200,000 active users, with 10 million daily page views and 40,000 blog postings per day, which makes iMobile the top ranked site in its category in China. This acquisition was structured in the same manner as our other acquisitions, that are classified and accounted for as variable interest entities in accordance with FASB Interpretation No. 46R "Consolidation of Variable Interest Entities" ("FIN 46R"), an Interpretation of Accounting Research Bulletin No. 51.), with operation and services agreements between Beijing Xing Chang Xin Science and Technology Development Co. Limited Incorporated DE and PacificNet Imobile (Beijing) Technology, Co. Ltd. WOFE. The results of variable interest entities acquired during the period are included in the consolidated income statements from the effective date of the acquisition.

The consideration was paid as follows:

(i) The purchase consideration for 51% of the equity interest of iMobile is approximately US $1.8 million, which represents approximately seven times the anticipated future annual net income of iMobile.

(ii) The purchase consideration is payable 14% in cash and 86% in restricted shares of PacificNet valued at $8 per share, or about 191,875 restricted shares The purchase price is payable upon achievement of certain quarterly earn-out targets based on net income.

(iii) Under the purchase agreement, iMobile has committed to generate US $500,000 in annual net income. In the event of a shortfall, the purchase price will be adjusted accordingly.

(iv) PacificNet will also invest approximately RMB 2 million (about US $250,000) in iMobile for general corporate and working capital purposes to support growth. The purchase price is payable upon achievement of certain quarterly earn-out targets based on net income.

The cash portion of the purchase consideration was paid from working capital of the Company. The value of the common shares issued was determined based on the average market price of PacificNet's common shares over a reasonable period before and after the terms of the acquisition were agreed to and announced.

A summary of the assets acquired and liabilities for iMobile assumed in the acquisition follows:

	Restated
Estimated fair values:	
Current Assets	$ 127,500
Property Plan and equipment	-
Current Liabilities assumed	-
Net asset acquired	127,500
Consideration paid:	557,000
Goodwill	$ 429,500

At December 31, 2006, goodwill of $429,500 represents the excess of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired and is not deductible for tax purposes and the total amount of goodwill by reportable segment for Products (Telecom & Gaming) was $2,155,000. (See Note 15)

In accordance with SFAS 142, goodwill is not amortized but is tested for impairment at least annually. The purchase price allocation for iMobile acquisition is based on a management's estimates and overall industry experience. Immediately after the signing of the definitive agreement, the Company obtained effective control over iMobile. Accordingly, the operating results of iMobile have been consolidated with those of the Company starting February 26, 2006. Pursuant to SFAS 141 "Business Combinations", the earn-out consideration is considered contingent consideration, which will not become certain until the audited combined after-tax profit of US $500,000 for the 12 months ended December 31, 2006 is available. Accordingly, the contingent consideration of 153,500 shares has not been reflected in the consolidated financial statements of the Company as of December 31, 2006.

UNAUDITED PRO FORMA CONSOLIDATED FINANCIAL INFORMATION DISCLOSURE FOR THE YEAR ENDED DECEMBER 31, 2006 AND 2005

The following un-audited pro forma consolidated financial information for the years ended December 31, 2005 and 2006, as presented below, reflects the results of operations of the Company assuming the acquisition occurred on January 1, 2005 and 2006 respectively, and after giving effect to the purchase accounting adjustments. These pro forma results have been prepared for information purposes only and do not purport to be indicative of what operating results would have been had the acquisitions actually taken place on January 1, 2005 and 2006 respectively, and may not be indicative of future operating results.

iMobile	Years ended December 31		
	2006	2005	2004
	Restated	Restated	Restated
(In thousands of U.S Dollars, except for earnings per share)	(Unaudited)	(Unaudited)	(Unaudited)
Revenues	$ 43,285	$ 24,201	$ 16,303
Operating loss	(6,221)	(5,695)	(6,221)
Net loss attributable to shareholders	(12,407)	(5,181)	(5,413)
Loss per share – basic & diluted	$ (1.08)	$ (0.51)	$ (0.77)

PacificNet included the financial results of iMobile in its consolidated 2006 financial results from the date of the purchase, February 26, 2006 through December 31, 2006.

PACIFICNET GAMES LIMITED

On August 3, 2006, PacificNet's wholly owned subsidiary PacificNet Games Limited ("PacGames", [ ]) cor acquisition of 100% of Able Entertainment Technology Ltd., a leading gaming technology provider based in the Macau Special Administrative Region of China. Upon completion of this transaction, the Company owned 35% of

PacificNet Games Limited. Under the purchase agreement, Able Entertainment Technology Ltd represented that is expects to generate an annual profit of USD $1,600,000 and will provide for an adjustment to the purchase price if PacGames does not achieve an annual net profit of USD $1,600,000 during the first 12-month period ended June 30, 2007, and USD $3,000,000 during the second 12-month period ended June 30, 2008.

The purchase price consideration is 200,000 restricted PACT shares in exchange for 100% of the issued and outstanding shares of Able Entertainment Technology Ltd. or a 35% ownership interest in PacGames. As of December 31, 2006, 40,000 total restricted shares of PacificNet had been issued for the acquisition and 160,000 shares were held back as contingent consideration payable upon completion of certain earnings criteria pursuant to the purchase agreement.

On September 22, 2006, PACT acquired another 10% of PacGames in exchange for 57,100 restricted shares of the Company’s common stock. Those shares have been issued out according to sale and purchase agreement.

On November 9, 2006, we acquired an additional 6% interest in PacificNet Games Limited (PacGames) for a consideration of $504,000 (paid entirely with shares of PacificNet: 90,000 PACT Shares, valued at $5.60 per share, price on the day of transaction). Those shares have been issued out according to sale and purchase agreement. The company currently owns 51% of PacGames.

The cash portion of the purchase consideration was paid from working capital of the Company. The value of the common shares issued was determined based on the average market price of PacificNet's common shares over a reasonable period before and after the terms of the acquisition were agreed to and announced.

A summary of the assets acquired and liabilities for PacGames assumed in the acquisition follows:

Estimated fair values:	Restated
Current Assets	$ 642,111
Property Plan and equipment	25,051
Intangible asset	179,858
Current Liabilities assumed	(291,598)
Net asset acquired	555,422
Consideration paid:	1,301,811
Goodwill	$ 746,389

At December 31, 2006, goodwill of $746,389 represents the excess of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired and is not deductible for tax purposes and the total amount of goodwill by reportable segment for Products (Telecom & Gaming) was $2,155,000.

In accordance with SFAS 142, goodwill is not amortized but is tested for impairment at least annually. The purchase price allocation for PacGames acquisition is based on a management's estimates and overall industry experience. Immediately after the signing of the definitive agreement, the Company obtained effective control over PacGames. Accordingly, the operating results of PacGames have been consolidated with those of the Company starting March 30, 2006. Pursuant to SFAS 141 "Business Combinations", the earn-out consideration is considered contingent consideration, which will not become certain until the audited combined after-tax profit of US $700,000 for the year ended December 31, 2006 is available. Accordingly, the contingent consideration of 160,000 shares has not been reflected in the consolidated financial statements of the Company as of December 31, 2006.

The following table summarizes the intangible assets acquired from PacificNet Games:

(USD000s)	December 31, 2006	December 31, 2005
Technology	$ 353	$ -
Less: Accumulated amortization	(30)	-
Net	$ 323	$ -

Amortization expense related to intangible assets was $30,000 in the year ended December 31, 2006.

UNAUDITED PRO FORMA CONSOLIDATED FINANCIAL INFORMATION DISCLOSURE FOR THE YEAR ENDED DECEMBER 31, 2006 AND 2005

The following un-audited pro forma consolidated financial information for the years ended December 31, 2005 and 2006, as presented below, reflects the results of operations of the Company assuming the acquisition occurred on January 1, 2005 and 2006 respectively, and after giving effect to the purchase accounting adjustments. These pro forma results have been prepared for information purposes only and do not purport to be indicative of what operating results would have been had the acquisitions actually taken place on January 1, 2005 and 2006 respectively, and may not be indicative of future operating results.

PACT Games	Years ended December 31

(In thousands of U.S Dollars, except for earnings per share)	2006 Restated (Unaudited)	2005 Restated (Unaudited)	2004 Restated (Unaudited)
Revenues	$ 44,176	$ 17,307	$ 10,857
Operating loss	(5,585)	(5,608)	(6,242)
Net loss attributable to shareholders	(12,381)	(5,145)	(5,424)
Loss per share – basic & diluted	$ (1.07)	$ (0.51)	$ (0.77)

Accordingly, PacificNet included the financial results of PacGames in its consolidated 2006 financial results from August 3, 2006 through December 31, 2006.

3. INVESTMENT IN AFFILIATED COMPANIES

Investments

Investments in affiliated companies consist of the following as of December 31, 2006 (in thousands):

(USD000s)	COLLATERAL/OWNERSHIP % AND BUSINESS DESCRIPTION AMOUNT	DESCRIPTION
INVESTMENTS IN AFFILIATED COMPANIES:		
Take1 (Cheer Era Limited) [1]	$ 100	2 20% ownership interest; trader of vending machine located in Hong Kong
MOABC	(19)	20% ownership interest
Glad Smart	30	15% ownership interest
Community media co.	4	5% ownership interest
Total	$ 115	

TAKE 1 TECHNOLOGIES GROUP LIMITED (FORMERLY KNOWN AS: CHEER ERA LIMITED "CHEERERA")

On January 05, 2007, we entered into an agreement for PacificNet to exercise the option to acquire an additional 31% interest in Take 1. The completion date for the new Securities Subscription Agreement was March 5, 2007, with a consideration of $721,887 (paid entirely with shares of PacificNet: 149,459 PACT Shares, valued at $4.83 per share). As a result, PacificNet has become the majority and controlling shareholder of Take1 with our ownership percentage increased from 20% to 51%.

Initial equity investment of 30% in Take 1 was made in April 2004 by the Company, through its subsidiary PacificNet Strategic Investment Holdings Limited for an aggregate consideration of $385,604 in cash and 149,459 PacificNet shares. PacificNet's interest in Take 1 was reduced to 20% in the year 2005 from 30% as a result of PacificNet repurchasing an aggregate of 149,459 at nominal value.

As of December 31, 2006, there was an outstanding inter-company convertible loan of $1,026,000 due from Take 1. The Convertible Loan, expiring on October 17, 2008, is guaranteed personally and jointly by the two minority shareholders of Take 1, and bears an interest rate of 8% per annum or 6-month Prime Rate of Hong Kong.

4. PROPERTY AND EQUIPMENT, NET

Property and equipment consists of the following as of December 31 (in thousands of US Dollars):

	2006 Restated	2005 Restated
Office furniture, fixtures and leasehold improvements	$ 908	$ 1,259
Computers and office equipment	1,720	2,691
Motor Vehicles	130	97
Software	395	747
Electronic Equipment	68	1,174

Land and buildings		2,805		68
Less: Accumulated depreciation		(1,315)		(5,078)
Property and Equipment, Net	$	4,711	$	958

For the years ended December 31, 2006 and 2005, the total depreciation and amortization expenses were $2,521,000 and $1,126,000, of which $1,058,000 and $872,000 was included in the cost of revenues, respectively.

The significant increase of the office furniture, fixtures and leasehold improvements was mainly due to most of the computers and office equipment in 2006 are derived from the expansion of our business including Epro ($200,000). Additionally, Beijing office purchased through Inc ($1,617,000) during 2006 and the real estate in Hong Kong recorded in PacCom ($1,053,000) are accounted under Land and Buildings.

OPERATING LEASES - The Company leases warehouse and office space under operating leases with fixed monthly rentals. None of the leases included contingent rentals. Lease expense charged to operations for 2006 amounted to $571,000 (2005: $516,000). Future minimum lease payments under non-cancelable operating leases are $680,000 for 2007, $764,000 for 2008 through 2011

RESTRICTED CASH - The Company has a $234,000 and $163,000 pledged bank deposit for Epro for the years ended December 31, 2006 and 2005 respectively, which represents overdraft protections with certain financial institutions.

BANK LINE OF CREDIT (2006): As of December 31, 2006, the Company's outstanding bank lines of credit were as follows:

(i) Epro has an overdraft banking facility with certain major financial institutions in the aggregate amount of $744,000, which is secured by a pledge of its fixed deposits of $234,000, pursuant to the following terms: interest will be charged at the Hong Kong Prime Rate per annum and payable at the end of each calendar month or the date of settlement, whichever is earlier.
(ii) Smartime has an overdraft banking facility with a large Hong Kong bank in the aggregate amount of $111,000. This overdraft facility is personally pledged by the deposit account of a director of Smartime.

BANK LINE OF CREDIT (2005): As of December 31, 2005, the Company utilized $1,059,000 of the banking facility including $944,000 from Epro and $115,000 from Smartime. Epro has an overdraft banking facility with certain major financial institutions in the aggregate amount of $1,218,000, which is secured by a pledge of its fixed deposits of $163,000, pursuant to the following terms: interest will be charged at the Hong Kong Prime Rate per annum and payable at the end of each calendar month or the date of settlement, whichever is earlier. For Smartime, there is no due date payment stipulated by Hong Kong Hang Seng Bank because its overdraft banking facility was borrowed directly from one of its directors personal fixed deposit account as a mortgage. The detailed payment period is based on its funding condition.

CONTINGENT CONSIDERATION: Warrants have not been included as part of the acquisition price of various S&P Agreements (Note 2) and are no longer considered as part of the purchase consideration due to (i) the ambiguity of the S&P Agreements with respect to the issuance of the warrants and (ii) the lack of actual instruments to transfer the warrants, such as a warrant agreement that is signed and sealed by the Company and property registered at the Company Registrar of securities in Hong Kong, and accordingly, there is no irrevocable obligation by the Company to issue the warrants. Furthermore, the net income milestones were not achieved as required under the S&P Agreements according to Hong Kong law. Based on the opinion of the Company's legal counsel in Hong Kong, the Company does not have an irrevocable obligation to issue the warrants and therefore the warrants are not considered issued and outstanding. The offer to issue the warrants is no longer part of the purchase price in the S&P Agreements due to the failure by the Sellers to satisfy their warranties in the S&P Agreements. Accordingly, the warrants have not been valued.

6. OTHER CURRENT ASSETS

Other current assets comprises of the following as at December 31 (in thousands of US Dollars):

Other current assets	2006 Restated	2005 Restated
Prepayment	$ 1,048	$ 655
Utilities deposit	1,292	-
Receivable from Lion Zone Holdings Ltd (See note 14)	485	-
Loans to employees	412	-
Prepaid expenses	408	204
Others receivable	170	1,504

Advances to sales reps		358		-
Provision for doubtful account of other receivables		-		(988)
Total	$	4,173	$	1,375

7. BANK LOANS

Bank loans represent the following at December 31 (in thousands):

	2006	2005
Secured [1]	$ 1,668	$ 108
Unsecured	543	86
Less: current portion	(576)	(188)
Noncurrent portion	$ 1,635	$ 6

Bank Loans are generated by two of the Company's subsidiaries. One of the subsidiaries is PacificNet Epro Holdings Limited, a company incorporated in the Hong Kong Special Administrative Region of the PRC, primarily engaged in the business of providing call center and customer relationship management (CRM) services as well as other business outsourcing services.

[1] The loans were secured by the following: joint and several personal guarantees executed by certain directors of the subsidiary of the Company; corporate guarantee executed by a subsidiary of the Company; second legal charge over a property owned by a subsidiary of the Company; and pledged bank deposits of $234,000 (2005: $163,000) of a subsidiary of the Company.

Aggregate future maturities of borrowing for the next five years are as follows: 2007: $526,000, 2008: $424,000 and 2009: $213,000, thereafter: none.)

The remaining bank loans of $1,048,000 are generated by PacificNet Inc. relating to a fixed asset bought during the first quarter with total cost of $1,648,000. The repayment of the bank loan was $69,000. (Aggregate future maturities of borrowing for the following period are as follows: Less than 1 year: $50,000, 1-5 year: $229,000 and after 5 years: $769,000)

8. CAPITAL LEASE OBLIGATIONS

The Company leases various equipments under capital leases expiring in various years through 2008. The assets and liabilities under capital leases are recorded at the lower of the present value of the minimum lease payments or the fair value of the asset. The assets are depreciated over the lesser of their related lease terms or their estimated productive lives and are secured by the assets themselves. Depreciation of assets under capital leases is included in depreciation expense for 2006 and 2005

Aggregate minimum future lease payments under capital leases as of December 31, 2006 for each of the next five years are as follows: (2007: $132,000; 2008: $89,000; and 2009: $42,000, and thereafter: none.)

Capital lease obligations represent the following at December 31 (in thousands of US Dollars):

	2006	2005
Total minimum lease payments	$ 263	$ 216
Interest expense relating to future periods	(19)	(12)
Present value of the minimum lease payments	244	204
Less: current portion	(120)	(126)
Noncurrent portion	$ 124	$ 78

Following is a summary of fixed assets held under capital leases at December 31 (in thousands of US Dollars):

	2006	2005
Computers and office equipment	$ 630	$ 441
Less: accumulated depreciation	(391)	(286)
Net	$ 239	$ 155

9. ACCRUED EXPENSES & OTHER PAYABLES

Accrued expenses consist of the following at December 31 (in thousands of US Dollars):

	2006 Restated	2005 Restated
Professional fee	321	486
Director fee	100	
Salaries and benefit payable	792	109
Marketing expense	389	-
Others	226	109
Total	$ 1,828	$ 704

10. STOCKHOLDERS' EQUITY

a) COMMON STOCK

During the year ended December 31, 2006, the Company had the following equity transactions (i) 394,000 shares as a result of exercise of stock options with cash consideration of $237,000; (ii) 618,112 shares for acquisition of subsidiaries valued at $4,346,000; and (iii) 275,000 shares returned by ChinaGoHi valued at $1,672,000, due to a termination agreement signed with ChinaGoHi in November 2006 (as filed in an 8K dated Nov 28, 2006); (iv) repurchase of 24,200 shares from Yueshen with a market value of $124,223.

For the year ended December 31, 2005, the Company had the following equity transactions (i) 676,000 shares as a result of exercise of stock options and warrants with cash consideration of $966,000; (ii) 515,900 shares for acquisition of subsidiaries valued at $3,971,000;(iii) 20,000 shares at $63,000 for investor relations services rendered based on the fair market value of the services rendered; (iv) repurchase of 45,000 shares fraudulently issued by the former financial controller of the company in 2004 to herself at par value; and (v) repurchase of 149,459 shares with a market value of $1,547,000 related to affiliated company (see Note 3 for details).

For the year ended December 31, 2004, the Company had the following equity transactions (i) 219,364 shares as a result of exercise of stock options and warrants with cash consideration of $606,000; (ii) 1,756,240 shares for acquisition of subsidiaries valued at $9,938,000; and (iii) 2,205,697 shares for cash proceeds of $12,330,000 (net of offering costs); (iv) 50,000 shares at $2.64 per share, or $132,000 for investor relations services rendered; (v) 83,000 shares were fraudulently issued by the former financial controller of the company to herself out of which 38,000 could not be cancelled as they had been resold and the balance were cancelled in 2005 by the company; and (vi) 149,459 shares with a market value of $1,547,000 for acquisition of affiliated company (see Note 3 for details)

b) STOCK OPTION PLAN

On December 23, 2003, stockholders of the Company adopted an amendment to the Stock Option Plan (the "Plan") to increase the number of shares reserved under the Plan from 1,666,667 to 2,000,000. On December 30, 2004, stockholders of the Company approved the new 2005 Stock Option Plan (the "2005 Option Plan"). The 2005 Option Plan provide for the grant to directors, officers, employees and consultants of the Company (including its subsidiaries) of options to purchase up to an aggregate of 2,000,000 shares of Common Stock. The 2005 Plan is administered by the Board of Directors or a committee of the Board of Directors (in either case, the "Committee"), which has complete discretion to select the optionees and to establish the terms and conditions of each option, subject to the provisions of the 2005 Option Plan. Options granted under the 2005 Plan are "incentive stock options" as defined in Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"), or nonqualified options.

The purpose of the Plan is to attract and retain the best available personnel for positions of responsibility and to provide incentives to such personnel to promote the success of the business. The Plan provides for the grant to directors, officers, employees and consultants of the Company (including its subsidiaries) of options to purchase shares of common stock. Options granted under the Plan may be "incentive stock options" as defined in Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"), or non-qualified options. To date, all options granted have been nonqualified options. The exercise price of incentive stock options may not be less than 100% of the fair market value of the common stock as of the date of grant. The number of options outstanding and the exercise price thereof are subject to adjustment in the case of certain transactions such as mergers, recapitalizations, stock splits or stock dividends. Options granted under the Plan fully vest through June 2006.

The status of the Stock Option Plan as of December 31, 2006, is as follows:

	Options outstanding		WEIGHTED AVERAGE EXERCISE PRICE
OUTSTANDING, DECEMBER 31, 2003	550,600	$	2.87
Granted	870,000	$	3.03
Cancelled	(400,000)	$	4.25
Exercised	(188,500)	$	2.04
OUTSTANDING, DECEMBER 31, 2004	832,100	$	1.90
Granted	680,000	$	6.57
Cancelled	(680,000	$	6.57
Exercised	(76,000)	$	2.05
OUTSTANDING, DECEMBER 31, 2005	756,100	$	3.99
Granted	500,000	$	4.75
Cancelled	(491,600)	$	4.75
Exercised	(394,000)	$	2.12
OUTSTANDING, DECEMBER 31, 2006	370,500	$	2.00

Following is a summary of the status of options outstanding at December 31, 2006:

Grant Date	Total Options Outstanding	Aggregate Intrinsic Value	Weighted Average Remaining Life (Years)	Total Weighted Average Exercise Price	Option Exercisable	Weighted Average Exercise Price
2004-7-26	370,500	$1,548,690	0.57	$2.00	370,500	$2.00

There are 370,500 options, which granted during year 2004, were outstanding and vested in year 2006. Those options have a term of three years and 0.83 year vesting period. The weighted-average fair value of such options was $1.42.The assumptions used in calculating the fair value of options granted using the Black-Scholes option- pricing model are as follows:

Risk-free interest rate	2.75%
Expected life of the options	1.65 years
Expected volatility	61.33%
Expected dividend yield	0%

There were 500,000 options authorized on September 21 of 2006 with a $4.75 exercise price. Such options have a term of 5 years and will be vested 5% per quarter commencing from January 1st 2007. On December 15, 2006, the board of directors decided to cancel all options previously granted in 2005 and 2006 due to the increasing cost of option administration. The board of directors plan to issue restricted stock or stock appreciation right (SAR) for future executive and employee incentive compensation.

c) WARRANTS

At December 31, 2006, the Company had outstanding and exercisable warrants to purchase an aggregate of 1,007,138 shares of common stock. The weighted average remaining life is 3.34 years and the weighted average price per share is $10.61.

Following is a summary of the warrant activity:

		WEIGHTED AVERAGE EXERCISE PRICE
OUTSTANDING, DECEMBER 31, 2003	800,000	$ 1.53
Granted	622,002	-
Expired	-	-
Exercised	(30,864)	-
OUTSTANDING, DECEMBER 31, 2004	1,391,138	4.93
Granted	-	-
Expired	(200,000)	-
Exercised	(600,000	-
OUTSTANDING, DECEMBER 31, 2005	591,138	9.5
Granted	416,000	-
Expired	-	-
Exercised	-	-
OUTSTANDING, DECEMBER 31, 2006	1,007,138	$ 10.61

Following is a summary of the status of warrants outstanding at December 31, 2006:

Grant Date	Total warrants Outstanding	Weighted Average Remaining Life (Years)	Total Weighted Average Exercise Price	Warrants Exercisable	Weighted Average Exercise Price
2004-1-15	123,456	3.04	$7.15	123,456	$7.15
2004-11-15	117,682	3.88	$3.89	117,682	$3.89
2004-12-9	350,000	3.94	$12.21	350,000	$12.21
2006-3-13	416,000	4.20	$12.20	416,000	$12.20

On March 13, 2006, we issued 400,000 warrants to several institutional investors in connection with a private placement of $8 million in convertible debentures. On the same day we issued another 16,000 warrants to our placement agent for the transaction. See Note 1 for further details. Those warrants have a term of 5 years and immediately vesting. The assumptions used in calculating the fair value of such warrants granted using the Black-Scholes option- pricing model are as follows:

Risk-free interest rate	4.78%
Expected life of the options	5.00 years
Expected volatility	37.08%
Expected dividend yield	0%

d) TREASURY STOCK

The following is a summary of the movement of the Company's shares held as treasury stock for the years ended December 31, 2006:

	Number of shares	Remarks
Escrowed shares returned to treasury in 2003	800,000	
Shares purchased in the open market	40,888	
Repurchase of shares from Take 1	149,459	
Repurchase of shares from Yueshen	24,200	
Cancellation of former employee shares	45,000	
Termination with ChinaGoHi	825,000	Returned shares plus Escrow shares
Incomplete acquisition of Allink	200,000	
Holdback shares as contingent consideration due to performance targets not yet met	529,848	Includes shares related to Clickcom (78,000); Guangzhou(Wanrong (138,348); iMobile (153,500); Games (160,000);
Balance, December 31, 2006	2,614,395	
Shares outstanding at December 31, 2006	11,541,202	
Shares issued at December 31, 2006	14,155,597	

11. INCOME TAXES

The Company is registered in the State of Delaware and has operations in primarily three tax jurisdictions - the PRC, Hong Kong and the United States.

The components of income before income taxes are as follows:

(USD000s)	2006	2005	2004
Income subject to PRC	$ 1,662	$ 1,308	$ 1,923
Loss subject to Hong Kong	(8,053)	(4,451)	(3,629)
Loss subject to United States	(5,961)	(1,947)	(3,612)
Income (loss) before taxes	(12,352)	(5,090)	(5,318)
Less: income taxes	(63)	(55)	(106)
Net income available to common stockholders	$ (12,415)	$ (5,145)	$ (5,424)

United States of America

For operations in the USA, the Company is subject to United States federal income tax at a rate of 34%. The Company has incurred net accumulated operating losses for income tax purposes and there is no provision for U.S. federal income tax for 2006, 2005 and 2004 due to the Company's loss position. The Company believes that it is more likely than not that these net accumulated operating losses will not be utilized in the future because the Parent company is a holding company with foreign subsidiaries and does not generate income. Therefore, the Company has provided full valuation allowance for the deferred tax assets arising from the losses as of December 31, 2006, 2005 and 2004.

The following table sets forth the significant components of the deferred tax assets for operation in the United States of America as of December 31, 2006, 2005 and 2004.

	2006	2005	2004
Deferred tax asset credit:			
Federal	34%	34%	34%
State	6%	6%	6%
Valuation allowance	(40)%	(40)%	(40)%
	0%	0%	0%

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Hong Kong

Hong Kong profits tax has been provided at a rate of 17.5% on the estimated assessable profits arising in Hong Kong for each of the years ended December 31, 2006, 2005 and 2004. Provision for Hong Kong profits tax for 2006, 2005 and 2004 was approximately $63,000, $40,000 and $36,000.

PEOPLE'S REPUBLIC OF CHINA (PRC)

Pursuant to the PRC Income Tax Laws, the Company's subsidiaries and VIEs are generally subject to Enterprise Income Taxes ("EIT") at a statutory rate of 33%, which comprises 30% national income tax and 3% local income tax. Some of these subsidiaries and VIEs are qualified new technology enterprises and under PRC Income Tax Laws, they are subject to a preferential tax rate of 15%. In addition, some of the Company's subsidiaries are Foreign Investment Enterprises and under PRC Income Tax Laws, they are entitled to either a three-year tax exemption followed by three years with a 50% reduction in the tax rate, commencing the first operating year, or a two-year tax exemption followed by three years with a 50% reduction in the tax rate, commencing the first profitable year. Provision for PRC business tax expense for 2006 was $257,000 (reclassified to discontinued operations), 2005 was $15,000 ($217,000 reclassified to discontinued operations) and 2004 was $70,000.

No provision for deferred tax liabilities has been made, since the Company had no material temporary differences between the tax bases of assets and liabilities and their carrying amounts.

12. RELATED PARTY TRANSACTIONS

LEASE AGREEMENT

In November 2004, the Company entered a lease agreement with EPRO for rental space in the amount of $1,923 per month. The term of the lease was one year and renewable by either party.

LOAN DUE TO AND FROM RELATED PARTIES

As at the years ended December 31, 2006 and 2005, there was a total loan receivable of approximately $1,706,000 and $2,328,00 respectively due from related parties while the loan due to related party was $638,000 and $759,000.

As at the year ended December 31, 2005 the related party loans receivable included $769,000 due from Take 1, an affiliated company that is 20% owned by PacificNet Strategic Limited. The loans receivable from shareholders and directors of PacificNet’s subsidiaries comprised of $1,559,000 due from a shareholder of Smartim and Yueshen.

As at the year ended December 31, 2006, the related party loan receivables included $1,026,000 due from Take 1, an affiliated company that is 20% owned by PacificNet, $196,000 due from MOABC, an affiliated company that is 20% owned by PacificNet, and $384,000 due from shareholders and directors of certain of the Company’s subsidiaries in connection with the acquisition of these subsidiaries. The loans receivable from shareholders and directors of these subsidiaries is comprised of $256,000 due from a shareholder of Yueshen and $128,000 due from a director of Soluteck.

The terms of these related parties loan receivables and payables are summarized below:

LOAN TO TAKE 1

Take 1 is an affiliated company and is 20% owned by PacificNet as of December 31, 2006. A convertible loan of $1,026,000 and $769,000 respectively is outstanding from Take 1 as of December 31, 2006 and 2005. Conversion terms of the convertible loan provide PacificNet an option at any time during the Term to convert in part or in whole of the then outstanding loan principle up to $1,026,000 (or HKD $8,000,000) into shares of Take 1 to reach 51% ownership of Take 1. The loan was extended as a working capital loan to finance the expansion of Take 1's business in Europe and North America.

LOAN TO MOABC

MOABC is an affiliated company and is 20% owned by PacificNet as of December 31, 2006. A convertible loan of $196,000 is outstanding from MOABC as of December 31, 2006. Conversion terms of the convertible loan provide PacificNet an option at any time during the Term to convert in part or in whole of the then outstanding loan principle by using the price of $23,160 (1% of shares). The provision for doubtful debts of $293,000 for the loan to MOABC was recorded in 2006.

LOAN TO GLAD SMART

Glad Smart is an affiliated company and is 15% owned by PacificNet as of December 31, 2006. A loan of $100,000 is outstanding from Glad Smart as of December 31, 2006. The loan was extended as a working capital loan to finance the expansion of Glad Smart’s voice card business operation.

LOAN TO YUESHEN’S SHAREHOLDER

As at the year ended December 31, 2006, there was a loan outstanding of $256,000 receivable from the shareholder of Yueshen. This loan is collateralized with 106,240 PacificNet shares owned by the shareholder of Yueshen. Further discussion of the outcome of our legal dispute with Yueshen is found under Part II of this 10Q document - Item1: Legal Proceedings.

As at the year ended December 31, 2005 there was an unsecured loan of $1,367,000 due from Ms. Li Yan-Kuan, shareholder of Yueshen.

LOAN TO SMARTIME’S SHAREHOLDER

As at the year ended December 31, 2005, there was $192,000 loan receivable due from the shareholder of PacificNet Smartime.

LOAN TO SOLUTECK’S DIRECTOR

As at the year ended December 31, 2006, there was a loan outstanding of $128,000 receivable from a director of Soluteck, due on December 14 for three consecutive years ending 2007. The interest rate for the loan is 8% per annum plus 5% penalty interest in case it has not been timely paid. The loan is collateralized with 100,000 PacificNet’s shares owned by the borrowing director and Ms Iris Lo, and the remaining assets of Smartime Holding Ltd.

LOAN PAYABLE TO RELATED PARTY

As at the year ended December 31, 2006, a loan of $356,000 was payable to a shareholder of EPRO. The loan was advanced to Epro for working capital purposes. The loan is due on August 4, 2010. Interest being charged per annum is at Hong Kong Prime lending rate, which was approximately 6.5% per annum in 2005 and 8% in 2006.

As at the year ended December 31, 2006, a loan of $282,000 was payable to a shareholder of Smartime. The loan was advanced to Smartime for working capital purposes.

As at the year ended December 31, 2005, a loan of $513,000 was payable to a shareholder of EPRO. The loan was advanced to Epro for working capital purpose expiring by August 4, 2010 at Hong Kong Prime lending rate approximately 6.5% interest per annum prevailing in the year 2005.

As at the year ended December 31, 2005, a loan of $246,000 was payable to a shareholder of Yueshen.

13. SEGMENT INFORMATION

SFAS No. 131, DISCLOSURE ABOUT SEGMENTS OF AN ENTERPRISE AND RELATED INFORMATION ("SFAS 131"), establishes standards for reporting information about operating segments and for related disclosures about products, services and geographic areas. Operating segments are identified as components of an enterprise about which separate discrete financial information is available for evaluation by the chief operating decision-maker, or decision-making group, in making decisions regarding allocation of resources and assessing performance. PacificNet’s chief decision-makers, as defined under SFAS 131, are the Chief Executive Officer and Chairman. During 2006 and 2005, PacificNet had four operating segments.

The Company's reportable segments are operating units, which represent the operations of the Company's significant business operations. Summarized financial information concerning the Company's reportable segments is shown in the following table. The "Other" column includes the Company's other insignificant services and corporate related items, and, as it relates to segment profit (loss), income and expense not allocated to reportable segments.

For the year ended December 31, 2006 (in thousands of US Dollars, except percentages)	Group 1. Outsourcing Service ($) Restated	Group 2. Telecom Value-Added Services ($) Restated	Group 3. Products (Telecom & Gaming) ($) Restated	Group 4. Other Business ($) Restated	Total ($) Restated
Revenues	14,146	1,555	23,385	3,652	42,738
(% of Total Revenues)	33%	4%	55%	9%	100%
Earnings / (Loss) from Operations	677	(44)	(1,054)	(5,889)	(6,310)
(% of Total Profit)	(11)%	1%	17%	96%	100%
Total Assets	8,365	2,747	12,673	18,244	36,535
(% of Total Assets)	23%	(8)%	35%	50%	100%
Goodwill	3,964	461	1,176		5,601
Geographic Area	HK,PRC	HK, PRC	HK,PRC,Macau	HK,PRC	

For the year ended December 31, 2005 (in thousands of US Dollars, except percentages)	Group 1. Outsourcing Service ($) Restated	Group 2. Telecom Value-Added Services ($) Restated	Group 3. Products (Telecom & Gaming) ($) Restated	Group 4. Other Business ($) Restated	Total ($) Restated
Revenues	13,568	-	2,880	859	17,307
(% of Total Revenues)	78%	-	17%	5%	100%
Earnings / (Loss) from Operations	686	-	(106)	(6,188)	(5,608)
(% of Total Profit)	(12%)	-	2%	110%	100%
Total Assets	4,745	10,876	7,037	12,431	35,089
(% of Total Assets)	14%	31%	20%	35%	100%
Goodwill	3,964	-	-	-	3,964
Geographic Area	HK,PRC	HK, PRC	HK,PRC,Macau	HK,PRC	

The Company identifies and classifies its operating segments based on reporting entities that exhibit similar long-term financial performance based on the nature of the products and services with similar economic characteristics such as margins, business practices and target market. The operating segments are classified into four major segments which are summarized as follows:

(1) Outsourcing Services - involves human voice services such as Business Process Outsourcing, CRM, call center, IT Outsourcing and software development services. These types of services are conducted through our subsidiaries EPRO, Smartime/Soluteck and PacificNet Solution Ltd.

(2) Telecom Value-Added Services (VAS) - primarily involves machine voice services such as Interactive Voice Response, SMS and related VAS, which are conducted through our subsidiaries such as ChinaGoHi (discontinued), Linkhead (discontinued), Clickcom (discontinued) and Guangzhou 3G/Sunroom. For example, Linkhead is a master reseller of NMS hardware and software platforms in China, and its voice cards are used as an integral part of voice

hardware using CPCI industry control machines, and also by Media Servers to support access from PSTN and VoIP, Softswitch and 3G networks.

(3) Product (Telecom & Gaming) Services Group - involves communication and gaming products, GSM/CDMA/3G Products, Multimedia Communication Kiosks. This Group includes the following subsidiaries: PacificNet Communications Limited, iMobile, Allink, Take1 and PacificNet Games. PacificNet Games Limited (PacGames) is a leading developer of Asian electronic gaming machines, multi-player electronic gaming technology solutions and gaming related maintenance, IT, and distribution services for the leading hotel and casino operators based in the Macau and other Asian gaming markets.

(4) Other Business -other administrative, financial and investment services and non-core businesses such as PacificNet Power Limited (PacPower), Pacific Financial Services Limited, etc.

Product and service revenues classified by major geographic areas are as follows (in thousands of US Dollars):

For the year ended December 31, 2006	Hong Kong	PRC	Macau	United States	Total
Product revenues	$ 19,829	$ 5,755	$ 364	$ -	$ 25,948
Service revenues	$ 13,527	$ 3,263	$ -	$ -	$ 16,790

For the year ended December 31, 2005	Hong Kong	PRC	Macau	United States	Total
Product revenues	$ 3,216	$ -	$ -	$ -	$ 3,216
Service revenues	$ 10,413	$ 3,678	$ -	$ -	$ 14,091

14. DISCONTINUED OPERATIONS/ASSETS HELD FOR DISPOSITION

Financial Statements for the year ended December 31, 2003, 2004 & 2005 have been reclassified to account for the following discontinued operations and/or assets held for disposition.

1. Guangzhou Yueshen Taiyang Network Science and Technology Limited (“Yueshen”)

During the year ended December 31, 2004 the Company impaired its investment in Yueshen. As of December 31, 2006, the Company recorded disposal loss of $504,000.

On 12 August, 2006, to recover the loan advanced to Yueshen, we commenced a law suit in the High Court of the Hong Kong Special Administrative Region ("HKSAR") against i) Guangzhou Yueshen Taiyang Network Science and Technology Limited as borrower and both ii) Ms. Li Yan Kuan and iii) Mr. Yi Wen as guarantors for the loan sum of RMB 2,000,000 ("Debt Sum") together with the agreed interest rate calculated at 6% per annum all due on 15 November, 2005 according to the promissory note and guarantee entered into by the three defendants on 15 May, 2005.

2. Guangzhou Clickcom Digit-net Science and Technology Ltd. (“Clickcom”)

Operations of Clickcom were discontinued and became dormant during the year as a result of poor business and market prospects. Former staffs of Clickcom have been reassigned to MOABC. Nominal amount of fixed assets are subject to disposition. Accordingly, Clickcom has been classified as Asset Held for Disposition in 2006. Approximately $400,000 of goodwill carried for Clickcom has been charged to impairment by the Company at the year end of 2006.

3. Beijing Linkhead Technologies Company Limited (“Linkhead”)

Due to bleak industry prospects, board of directors of Linkhead had resolved a special board resolution in January 2007 to direct management to engage in active search for willing buyers to acquire or prepare to enter into liquidation process. Accordingly, Linkhead has been classified as Asset Held for Disposition in 2006. Approximately $4 million of goodwill carried for Linkhead has been charged to impairment by the Company at the year end of 2006.

4. Guangzhou 3G Information Technology Co. Ltd. (“GZ3G”)

On April 30, 2007, the Company entered into a definitive agreement with HeySpace International Limited to sell PacificNet's 51% equity ownership of GZ3G group of companies for a consideration of $6 million. Accordingly, GZ3G has been classified as Asset Held for Disposition in 2006. Approximately $2.1 million in goodwill being carried on the Company's books had been written down to level the Company's total carrying cost of GZ3G to the intended disposition value.

5. Lion Zone Holdings Ltd. ("Lion Zone")

On November 20, 2006, PacificNet executed an agreement ("Termination Agreement") to terminate the Sale and Purchase Agreement with Lion Zone, ChinaGoHi and Mr. Wang Wenming (collectively, the "Sellers"). The Termination Agreement was effective as of November 1, 2006. In the Termination Agreement, the Sellers agreed to pay an aggregate of HKD$3,000,000, comprising: USD$100,000 in cash and 275,000 in restricted shares of PACT, in exchange for 51% interest of Lion Zone, holding company of ChinaGoHi. Additionally, the Sellers agreed to waive PacificNet's obligations under the Sale and Purchase Agreement entered into between PacificNet and the Sellers in December 2005 to issue restricted shares and to provide certain loans to the Sellers. PacificNet, however, reserves the rights to re-purchase the said 51% interest of Lion Zone within 2 years of the date of signing the Termination Agreement for a consideration of 5 times audited net profit under US GAAP for the 12-month period subsequent to the year of signing.

The following is a summary of discontinued operations/ to be discontinued operations:

	Yueshen	ChinaGoHi	Linkhead	G3G	Clickcom	Total
Investment	$ -	$ 4,475	$ -	$ -	$ -	$ 4,475
Impairment of investment	-	(1,233)	-			(1,233)
Net earnings consolidated into PACT	-	175	-			175
Consideration received/receivable	-	3,947	-			3,947
Gain on disposal	-	530	-			530
Loss on disposal	(504)	-	-			(504)
Income/(loss) from discontinued operations	-	-	(1,089)	1,206	(4)	113
Net assets for disposal /to be sold	$ -	$ -	$ 1,142	$ 6,709	$ 813	$ 8,664

15. CURRENT VULNERABILITY DUE TO CERTAIN CONCENTRATIONS

The Company's operations are carried out in the PRC. Accordingly, the Company's business, financial condition and results of operations may be influenced by the political, economic and legal environments in the PRC, by the general state of the PRC's economy. The Company's business may be influenced by changes in governmental policies with respect to laws and regulations, anti-inflationary measures, currency conversion and remittance abroad, and rates and methods of taxation, among other things.

16. EVENTS SUBSEQUENT TO DECEMBER 31, 2006 (UNAUDITED)

1) SALE OF PACIFICNET TELECOM SOLUTIONS INC. ("PacTelso")

On May 20, 2007, the Company entered into a definitive agreement to sell its 36% equity interest in PacTelso, an intermediate holding company registered under the laws of British Virgin Islands, to Mr. Mu Yingliang, a resident of People’s Republic of China. Consideration for the 36% interest of PacTelso was RMB10,000 (or US$1,295), to be paid within 90 days after signing of the agreement The Company’s interest in PacTelso decreased from 51% to 15% after the transaction.

2) SALE OF MOABC.com ("MOABC")

On May 20, 2007, the Company entered into a definitive agreement to sell its 5% equity interest in MOABC, a PRC limited liability corporation engaged in the business of value-added services platform providing, to Mr. Jack Ou, a resident of People’s Republic of China. Consideration for the 5% interest of MOABC was RMB5,000 (or US$647), to be paid within 90 days after signing of the agreement. The Company’s interest in MOABC decreased from 20% to 15% after the transaction.

3) SALE OF PACIFICNET SOLUTIONS LIMITED ("PacSo")

On May 18, 2007, the Company entered into a definitive agreement to sell its 45% equity interest in PacSo, a company registered under the laws of Hong Kong SAR, China and engaged in systems integration, software application, and e-business solutions services, to Mr. Alex Au, a resident of Hong Kong SAR, China. Consideration for the 45% interest of PacSo was HK$4,500 (or US$583), to be paid within 90 days after signing of the agreement. The Company’s interest in PacSo decreased from 60% to 15% after the transaction.

4) SALE OF PACIFICNET POWER LIMITED ("PacPower")

On May 18, 2007, the Company entered into a definitive agreement to sell its 36% equity interest in PacPower, a company registered under the laws of Hong Kong SAR, China and engaged in air-conditioning contracting and consulting businesses, to Mr. Alex Au, a resident of Hong Kong SAR, China. Consideration for the 36% interest of PacPower was HK$3,600 (or US$466), to be paid within 90 days after signing of the agreement. The Company's interest in PacPower decreased from 51% to 15% after the transaction.

5) SALE OF GUANGZHOU 3G ("GZ3G")

As part of our strategy to move away from telecom VAS, on April 30,2007 our wholly-owned subsidiary, PacificNet Strategic Investment Holdings Limited, entered into a stock purchase and sale agreement with Heyspace International Limited to sell its 51% interest in Guangzhou 3G's parent company, Pacific 3G Information & Technology Co. Limited. The purchase price is $6,000,000 payable in installments over a six month period or earlier if Heyspace completes its initial public offering prior to October 31, 2007.

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6) SALE OF CONVERTIBLE DEBENTURES BY OUR SUBSIDIARY PACIFICNET GAMES LIMITED

On February 9, 2007, the Company through its subsidiary, PacificNet Games Limited (PacGames) entered into a definitive agreement for a $5 million financing in the form of a convertible secured note from Pope Asset Management, LLC (Pope), an institutional investor. Proceeds from the financing will be used to provide PacGames with additional working capital to expand its gaming technology operations, to make further synergistic acquisitions in China and for general corporate purposes.

The $5 million financing, evidenced by a convertible secured note issued by PacGames to Pope, matures on February 6, 2010, and may be converted into 26% to 32% ownership interest in PacGames based on reaching certain net income milestones during fiscal year 2007. The interest rate on the convertible debenture will initially be set at 8%, and shall increase to 15% if the note is not converted prior to maturity.

7) SALE OF BEIJING LINKHEAD TECHNOLOGIES COMPANY LIMITED (“Linkhead”)

Due to bleak industry prospects, board of directors of Linkhead had resolved a special board resolution in January 2007 to direct management to engage in active search for willing buyers to acquire or prepare to enter into liquidation process. Accordingly, Linkhead has been classified as Asset Held for Disposition in 2006. Approximately $4 million of goodwill carried for Linkhead has been charged to impairment by the Company at the year end of 2006.

8) ACQUISITION OF GUANGDONG POLY BLUE EXPRESS COMMUNICATIONS CO.LTD. ("Guangdong Poly")

On Sep 5, 2007, we have entered into an agreement to acquire 51% equity interest in Guangdong Poly Blue Express Communications Co., Ltd. (Guangdong Poly). The acquisition is expected to enable PacificNet, through its operating subsidiaries in China, to participate in China's rapidly growing state-sponsored legalized gaming and electronic lottery operations. Guangdong Poly is a leading operator approved by China's Welfare Lottery Center to develop and operate real-time electronic paperless lottery services in China, in accordance to the rules and regulations set by China's Welfare Lottery Center. The Company expects this acquisition to be accretive to 2008 earnings.

According to the agreement, PacificNet Technology (Shenzhen) Limited and PacificNet Games Limited will acquire 34% and 17% of Guangdong Poly Blue Express Communications Co., Ltd, respectively. The investment in Guangdong Poly is structured dependent on the achievement of certain profit milestones. The investment by PacificNet is subject to the successful completion of customary due diligence and final documentation. The financial terms of the deal were not disclosed.

9) ADDDITIONAL ACQUISITION OF TAKE1 TECHNOLOGIES IN Q1 2007

On January 05, 2007, we entered into an agreement for PacificNet to exercise the option to acquire an additional 31% interest in Take1 Technologies Limited (“Take1”) (formerly known as “CHEER ERA LIMITED”). The completion date for the new Securities Subscription Agreement was March 5, 2007, with a consideration of $721,887 (paid entirely with shares of PacificNet: 149,459 PACT Shares, valued at $4.83 per share). As a result, PacificNet has become the majority and controlling shareholder of Take1 with our ownership percentage increased from 20% to 51%. Take1 is a leading designer, developer and manufacturer of gaming, multimedia entertainment and communication kiosk products including casino-use electronic gaming tables, photo and video entertainment kiosks, digital camera photo development stations, multimedia messaging services (MMS) and mobile content download stations for mobile phones, and other coin-operated peripherals and consumables. Take1 Technologies is based in Hong Kong and markets and distributes its products around the world including the USA, Canada, Mexico, Europe, China, and Southeast Asia.

10) PACIFICNET INC., V/S IROQUOIS MASTER FUND, LTD.

On October 3, 2007 Iroquois Master Fund, Ltd. filed a complaint in the Supreme Court of the State of New York against PacificNet Inc., complaining against non-payment of mandatory default amount on convertible debentures of $3,000,000 and $420,000.

As of October 2, 2007, the outstanding principal amount of the $3,000,000 debenture is $2,045,452 and accrued but unpaid interest amount is $30,682.

The mandatory default amount due to Iroquois Master Fund, Ltd. pursuant to amended debenture (as amended in February 2007) is $2,698,974 on $3,000,000 convertible debenture.

As of October 2, 2007, the outstanding principal amount of the $420,000 debenture is $420,000 and accrued but unpaid interest amount is $6,300.

The mandatory default amount due to Iroquois Master Fund, Ltd. is $554,190 on $420,000 convertible debenture.

Iroquois Master Fund, Ltd. also demanded for the reimbursement of its attorney fees and other costs and expenses incurred together with costs and disbursements of this action and such other and further relief as to the court seems just and proper.

17. LEGAL PROCEEDINGS

1. Legal Proceeding and Judgment Against Guangzhou Yueshen Taiyang Network Science and Technology Limited, Ms. Li Yan Kuan, and Mr.Wu Yi Wen

On August 12, 2006, we commenced a law suit in the High Court of the Hong Kong Special Administrative Region ("HKSAR") against Guangzhou Yueshen Taiyang Network Science and Technology Limited, Ms. Li Yan Kuan, (PRC ID: 440112195706120967, Residential Address: Room G6-305, West Garden, FuLiHuanShi, HuanShi West Road, LiWan District, Guangzhou, Guangdong, China) and Mr.Wu Yi Wen, (PRC ID: 440106196412220919, Residential Address: Room 906, Number 15, SiHeng Road Number 2, TianHe YuanChun, Guangzhou, Guangdong, China) for failure to pay amounts owed under a promissory note. On May 15, 2005, we loaned RMB2,000,000 ("Debt Sum") to Yueshen to cover operating costs, evidenced by a promissory note due on November 15, 2005. Ms. Kuan and Mr. Wen guaranteed repayment of the note by Yueshen. The Debt Sum together with the agreed interest rate calculated at 6% per annum was due on November 15, 2005.

On March 28, 2007, the High Court of HKSAR had adjudged that the three defendants should pay us the Debt Sum together with interest sum at the rate of 6% per annum from May 15, 2005 to March 28, 2007, and additional interest charged at the rate of 5% per annum for the Debt Sum and accrued interest within 90 days overdue and thereafter at the judgment rate until payment and fixed costs of HK$3,405.

2. Lawsuit between PacificNet Power Limited and Johnson Controls Hong Kong Limited (JCHKL), a subsidiary of Johnson Controls Inc. (NYSE:JCI) (www.jci.com)

On January 19, 2007, Johnson Controls Hong Kong Limited filed a claim against PacificNet Power Limited (a 51% owned subsidiary of PacificNet) in the High Court of the Hong Kong Special Administrative Region seeking HK$4,800,000 as payment for services rendered to replace 3 sets of trane water-cooled chillers, together with energy saving performance (the "Chiller System"), at the Fortress Tower in Hong Kong.

In connection with the claim, PacificNet Power reviewed a letter from its client, China Weal Property Management Ltd., dated January 22, 2007 stating that the construction work by JCHKL had not been completed as of the date of the letter, and that certain violations itemized in a letter issued by the Hong Kong Environment Protection Department (EPD) (Noise Abatement Notice No. N806030) addressed to JCHKL with respect to acoustic problems with JCHKL's equipment had not been abated. Further, JCHKL was to pay penalties between HK$100,000 and HK$200,000 assessed by the JCHKL for failing to fix the noise problem on the roof of Fortress Tower.

The board of directors of PacificNet Power Limited has reviewed the case with its client, China Weal Property Management Ltd., and our Hong Kong legal counsel and it is our belief that the project work undertaken JCHKL is defective in numerous aspects, as evidenced by the letter from government letter issued by EPD. As a result, we believe the construction work was not been completed by JCHKL, and therefore, JCHKL is not entitled to payment for its services.

On February 7, 2007, we instructed our Hong Kong legal counsel to issue a Defense and Counterclaim to JCHKL to counter-claim that (i) JCHKL's construction work has not complied with the applicable rules and regulations of various government authorities in Hong Kong; (ii) the Chiller System provided by JCHKL was defective and merchantable unfit and JCHKL has failed and/or refused to rectify such defective works; and (iii) JCHKL shall return the work deposit in the amount of HK$1,500,000 to PacificNet Power Limited and shall compensate and keep PacificNet Power Limited indemnified against all the loss and damages suffered as a result of any claims from the China Weal Property Management Ltd, the employer and the potential tenants of Fortress Tower.

The case is under review by Hong Kong High Court and we have not received any judgment from the High Court of the Hong Kong Special Administrative Region as of date of this report. We are currently proceeding with discovery and counter-claims, and we intend to vigorously defend ourselves against the allegations. We are unable to predict the outcome of these actions, or a reasonable estimate of the range of possible loss, if any.

3. Lawsuit between PacificNet Power Limited and Johnson Controls Hong Kong Limited (JCHKL), a subsidiary of Johnson Controls Inc. (NYSE:JCI) (www.jci.com)

On or about December, 2005, Johnson Controls Hong Kong Limited approached PacificNet Power Limited (a 51% owned subsidiary of PacificNet) and made a representation that they had submitted a tender to “The Incorporated Owners of Nan Fung Centre, Tsuen Wan (“the Employer”) for the “construction and replacement works of existing air-cooled chiller plant by new water-cooled chiller plant for Tsuen Wan Nan Fung Centre and energy saving performance contract” (“the Construction and Replacement Works Contract”). JCHKL invited and induced PacificNet Power Limited to act as the main contractor for the Contract and it would then act as a sub-contractor.

PacificNet Power also expressly made known to JCHKL that the said construction and replacement works and the guaranteed energy saving should meet all the tender requirements if PacificNet Power accepted the invitation to act as the main contractor for the Contract, and PacificNet Power further said that if there should be any quality defects with the system and/ or the construction work, the Employer and/ or their prospective tenants would claim against JCHKL and JCHKL should compensate.

PacificNet Power however received some correspondences and complaints from the Employer and/ or their representatives about the poor and/ or sub-standard works done by JCHKL. PacificNet Power, after separate investigation, discovered the poor workmanship and sub-standard works done by JCHKL. Accordingly, the Employer and/ or their representatives have delayed the monthly installments payment to PacificNet Power.

On April 23, 2007, we instructed our lawyers issued a letter to the Defendant requesting and demanding them, being the sub-contractor of the Construction and Replacement Works Contract, to take immediate rectification action within seven days from the date of the said letter to (i) rectify and complete all outstanding defective works of the Construction and Replacement Works Contract; (ii) replace the water-cooled chiller plant and/or equipments which are not conformed with the requirements of the tender documents previously submitted by the Defendant to the Employer; and (iii) improve the poor performance of energy saving of the new water-cooled chiller plant so that it would conform with their guarantee made on 21 December, 2005 to PKL and the employer.

Despite the said letter, JCHKL had failed and/ or refused to rectify and complete all outstanding works and/ or replace the defective system. And therefore PacificNet Power claims against JCHKL for: (i) refund HK$6,414,300.00, being the Contract Price paid by PacificNet Power to JCHKL; (ii) costs and expenses incurred by Power to rectify all defective works of the Contract; (iii) all damage and loss suffered by PacificNet Power, and further and other relief.

On July 25, 2007, JCHKL issued a Defense and Counterclaim to PacificNet Power to counter-claim that: (i) a concrete base was discovered after the existing dismantled radiators was not indicated in tender drawings nor could it be revealed by site visit; (ii) JCHKL could not have carried out the works under the Contract without first demolishing the said concrete base; (iii) by a letter from JCHKL to PacificNet Power dated 22 May, 2007, PacificNet Power was informed additional works had been carried out by JCHKL; (iv) a sum of HK$30,000 is still due and owing by PacificNet Power to JCHKL.

The case is now proceeding to the stage of fixing a date for trial in the High Court of Hong Kong. We are unable to predict the outcome of these actions, or a reasonable estimate of the range of possible loss, if any.

18. RESTATEMENT

On March 19, 2007 the predecessor auditor withdrew their opinion on our previously filed financial statements for the years ended December 31, 2005 and 2004 due to uncertainties around certain option grants during the said period. Independent investigation in this connection commissioned by our Audit Committee resulted in extra stock-based compensation charges of approximately $0.3 million, $1.2 million and $0.1 million to each of the years ended December 31, 2005, 2004 and 2003, respectively.

In the course of the financial statements restatement for the year ended December 31, 2006, management has decreased total non-current assets by $1 million worth of goodwill as a result of the re-audit restatement to the ending goodwill balances as at December 31, 2005. Further, management has also decreased total selling, general and administrative expenses by an aggregate of $6.3 million. Said decrease comprises of extra goodwill impairment amounting to approximately $3.7 million and $2.6 million, respectively, already charged to the restated Selling, General and Administrative expenses for the years ended December 31, 2005 and 2004. An impairment of investment of $1.2 million was also recorded for the year ended December 31, 2006 for an entity disposed in 2006.

Below is the detailed effect of the restatement (In thousands of US Dollars):

	2006 As reported	2006 As restated	2005 As reported	2005 As restated
Consolidated Balance Sheets:				
ASSETS:				
Current assets	$ 17,041	$ 17,041	$ 31,130	$ 12,997
Non-current assets	24,841	19,885	20,073	14,937
Total assets	$ 41,882	$ 36,926	$ 51,203	$ 27,934
LIABILITIES				
Current liabilities	$ 17,376	$ 17,376	$ 10,620	$ 3,799
Non-current liabilities	2,704	2,704	84	84
Total liabilities	20,080	20,080	10,704	3,883
Minority interest	6,874	2,869	8,714	846
STOCKHOLDERS' EQUITY				
Common stock	1	1	1	1
Treasury stock	(257)	(272)	(119)	(134)
Additional paid-in capital	63,124	65,757	57,690	61,979
Cumulative other comprehensive income (loss)	220	(42)	247	(15)
Accumulated deficit	(47,739)	(51,090)	(25,990)	(38,627)
Stock subscription receivable	(421)	(377)	(44)	
TOTAL STOCKHOLDERS' EQUITY	14,928	13,977	31,785	23,204
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 41,882	$ 36,926	$ 51,203	$ 27,934
Consolidated Statements of Operations:				
Net revenue	$ 42,738	$ 42,738	$ 44,341	$ 17,307
Cost of sales	(36,217)	(36,217)	(33,439)	(13,221)
Gross profit	6,521	6,521	10,902	4,086
Selling, General and Administrative expenses	(5,810)	(11,126)	(6,333)	(5,447)
Stock-based compensation expenses	(242)	(242)	-	(282)
Income/(loss) from operations	(13,988)	(7,533)	4,569	(5,608)
Income/(loss) before income taxes, minority interest and discontinued operations	(19,106)	(12,661)	5,645	(5,219)
Income/(loss) before discontinued operations	(18,999)	(12,554)	2,498	(5,880)
Net income available to common stockholders	$ 20,093	$ (12,415)	$ 2,489	$ (5,145)
Earnings/(loss) per common share:				
Basic	$ (1.78)	$ (1.08)	$ 0.25	$ (0.51)
Diluted	$ (1.78)	$ (1.08)	$ 0.23	$ (0.51)
Shares used in computing earnings per share:				
Basic	11,258,547	11,538,664	10,154,271	10,156,809
Diluted	11,964,587	11,538,664	10,701,211	10,156,809
Consolidated Statements of Cash Flows				
Net income (loss)	$ 20,093	$ (12,415)	$ 2,489	$ (5,145)
Stock-based compensation	242	242	-	282
Net cash provided by (used in) operating activities	(8,885)	(8,190)	9,250	5,635
Net cash used in investing activities	(1,297)	(3,313)	(6,199)	(10,893)
Net cash provided by (used in) financing activities	8,638	9,943	24	(696)
Effect of exchange rate on cash & cash equivalent	(43)	(27)	(260)	7

NET INCREASE IN CASH AND CASH EQUIVALENTS	$	(1,587)	$	(1,586)	$	2,815	$	(5,947)

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