ALTERNET SYSTEMS INC
Form 10QSB
May 17, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-QSB

(Mark One)

x QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2004

¨ TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM ___________ TO __________

COMMISSION FILE NUMBER: 000-31909

ALTERNET SYSTEMS, INC.

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

NEVADA	**88-0473897**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

#610 815 West Hastings Street Vancouver, British Columbia V6C 1B4
(Registrant s Address)

(604) 608-2540
(Registrant s telephone number)

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

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: Common Stock, $0.001 Par Value

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or 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 ¨

As of March 31, 2004, the Registrant had 19,185,029 shares of common stock issued and outstanding.

Transitional Small Business Disclosure Format (check one) Yes ¨ No **x**

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MARCH 31, 2004

(Unaudited)

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ALTERNET SYSTEMS INC.
(A Development Stage Company)
CONSOLIDATED BALANCE SHEETS
As at March 31, 2004

		March 31, 2004 (Unaudited)		December 31, 2003
ASSETS				
Current Assets				
Cash	$	129,022	$	113,161
Prepaid expenses		10,301		8,633
Total Current Assets		139,323		121,794
Fixed Assets - net of depreciation		12,108		5,121
TOTAL ASSETS	**$**	**151,431**	**$**	**126,915**
LIABILITIES				
Current Liabilities				
Accounts payable & accrued liabilities (Note 5)	$	583,922	$	596,605
Deferred license revenue		17,027		19,874
Due to related parties (Note 6)		5,118		34,069
TOTAL LIABILITIES		606,067		650,548
Commitments and contingencies (Notes 1, 3 and 6)				
STOCKHOLDERS' EQUITY (CAPITAL DEFICIENCY)				
Capital Stock (Note 5)				
Common stock, $0.00001 par value, 100,000,000 shares		193		175
authorized 19,185,029 (2003 17,400,029) issued and outstanding				
Additional paid-in capital		1,510,595		1,044,293
Private placement subscriptions		621,884		365,921
Obligation to issue shares		198,360		553,720
Accumulated other comprehensive income (loss)		(6,101)		(6,469)
Deficit accumulated during development stage		(2,779,567)		(2,481,273)
TOTAL STOCKHOLDERS' EQUITY		(454,636)		(523,633)
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	**$**	**151,431**	**$**	**126,915**

ALTERNET SYSTEMS INC
(A Development Stage Company)
INTERIM CONSOLIDATED STATEMENTS OF LOSS AND DEFICIT
(Unaudited)

	Three months Ended March 31, 2004	Three months Ended March 31, 2003	October 13, 2000 (inception) to March 31, 2004
REVENUE			
License fees and hardware sales	$ 7,423	$ 6,448	$ 157,545
COST OF SALES			
Installation costs and other	2,426	790	55,760
Royalties	4,720	-	15,813
	7,146	790	71,573
GROSS PROFIT	277	5,658	85,972
OPERATING EXPENSES			
Advertising and promotion	8,030	-	110,753
Bad debt	-	-	15,344
Commissions	-	-	13,439
Depreciation and amortization	646	1,555	33,356
License fees	-	84,000	696,000
Management and consulting	100,461	84,274	687,190
Marketing	127,961	159,799	801,965
Office and general	13,226	12,518	145,147
Professional fees	11,139	26,261	133,264
Rent	9,002	6,795	58,842
Telephone and utilities	936	-	16,828
Training and documentation	17,848	26,296	132,329
Travel	10,258	-	37,910
	298,571	401,498	2,865,539
NET LOSS FOR THE PERIOD	$ (298,294)	$ (395,840)	$ (2,779,567)
BASIC NET LOSS PER SHARE	$ (0.02)	$ (0.02)	
WEIGHTED COMMON SHARES OUTSTANDING	19,086,952	16,164,367	

ALTERNET SYSTEMS INC
(A Development Stage Company)
INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Three months ended March 31, 2004	Three months Ended March 31, 2003	October 13, 2000 (inception) to March 31, 2004
OPERATING ACTIVITIES			
Net loss for the period	$ (298,294)	$ (395,840)	$ (2,779,567)
Add: items not affecting cash			
Depreciation and amortization	646	1,555	33,356
Gain on disposal of assets	-	-	(215)
Issuance of shares for services rendered		223,553	326,559
Obligation to issue shares for services rendered	110,960	-	664,680
Changes In Non-Cash Working Capital:			
Accounts receivable	-	3,150	-
Changes in prepaids	(1,668)	-	(10,301)
Changes in deferred license revenue	(2,847)	(715)	17,027
Accounts payable and accrued charges	(12,683)	94,373	659,782
Net cash flows used in operating activities	(203,886)	(73,942)	(1,088,679)
INVESTING ACTIVITIES			
Acquisition of fixed assets	(7,633)	-	(15,249)
Cash acquired on reverse acquisition of SchoolWeb	-	-	74
Net cash flows used in investing activities	(7,633)	-	(15,175)
FINANCING ACTIVITIES			
Advances (to) from related parties	(28,951)	(894)	1,280
Net proceeds on sale of common stock and subscriptions	255,963	82,243	1,237,694
Net cash flows from financing activities	227,012	81,349	1,238,974
EFFECT OF EXCHANGE RATE CHANGES ON CASH	368	(5,924)	(6,101)
INCREASE IN CASH DURING THE PERIOD	15,861	1,501	129,019
CASH, BEGINNING OF PERIOD	113,161	203	3
CASH, END OF PERIOD	$ 129,022	$ 1,704	$ 129,022

OTHER SIGNIFICANT NON-CASH TRANSACTIONS

During the quarter ended March 31, 2004 the Company issued 1,785,000 shares for services valued at $466,320.

NOTE 1 NATURE OF OPERATIONS AND BASIS OF PRESENTATION

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

By agreement dated July 2, 2001 and completed September 10, 2001, Alternet issued 12,343,000 shares of restricted common stock to the shareholders of Schoolweb Holdings Inc. (SW Holdings), a development stage company incorporated October 13, 2000 in the State of Nevada, in exchange for all of the issued and outstanding shares of SW Holdings. On June 26, 2002 SW Holdings changed its name to AI Systems Group, Inc. (AI Systems).

The acquisition resulted in the former shareholders of SW Holdings acquiring 90.1% of the then outstanding shares of the Company and has been accounted for as a reverse merger with SW Holdings being treated as the accounting parent and Alternet, the legal parent, being treated as the accounting subsidiary. Accordingly, the consolidated results of operations of the Company include those of SW Holdings for all periods shown and those of the Alternet since the date of the reverse acquisition. The results of operations of SW Holdings are from its inception, October 13, 2000 and include the results of its wholly-owned subsidiary, AI Systems Group (Canada) Ltd. (formerly SchoolWeb Systems (Canada) Ltd.), a company incorporated April 17, 2001 in the Province of British Columbia.

SW Holdings distributes, markets, sells and licenses in the United States and Canada, certain proprietary software and hardware systems technology known as SchoolWeb used for caching Internet and multimedia files on special servers.

The consolidated financial statements have been prepared on the basis of a going concern, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. At March 31, 2004 the Company had a working capital deficiency of $466,744 (2003 - $223,346). The Company has incurred losses since inception and further losses are anticipated in the development of its products raising substantial doubt as to the Company s ability to continue as a going concern. The Company s continued operations are dependent on the successful implementation of its business plan, its ability to obtain additional financing as needed, continued support from creditors, settling its outstanding debts and ultimately attaining profitable operations. It is management's intention to continue to pursue market acceptance for its proprietary software and hardware systems technology, to settle its outstanding debts and to identify funding sources until such time that there is sufficient operating cash flow to fund operating requirements. Funding for continuing operations will be pursued on a private placement basis with qualified investors in applicable US states and Canada.

Unaudited Interim Financial Statements

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-QSB of Regulation S-B. They do not include all information and footnotes required by generally accepted accounting principles for complete financial statements. However, except as disclosed herein, there has been no material changes in the information disclosed in the notes to the financial statements for the year ended December 31, 2003 included in the Company s Annual Report on Form 10-KSB filed with the Securities and Exchange Commission. The interim unaudited financial statements should be read in conjunction with those financial statements included in the Form 10-KSB. In the opinion of Management, all adjustments considered necessary for a fair presentation, consisting solely of normal recurring adjustments, have been made. Operating results for the three months ended March 31, 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2004.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, AI Systems Group, Inc. and AI Systems Group (Canada) Ltd. All significant intercompany transactions and account balances have been eliminated.

Use of Estimates and Assumptions

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

Cash and Cash Equivalents

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

License Rights

The Company amortizes the cost of acquiring license rights on a straight-line basis over the term of the license. The Company evaluates the carrying amount of its unamortized license rights against the undiscounted future anticipated cash flows associated with them. If the evaluation indicates that the future undiscounted cash flows are not sufficient to recover the carrying value, an impairment provision is recorded to adjust the carrying value of the license rights to their fair value. During 2003 management determined that based on evaluation there was no reliable basis for estimating new cash flows from the license and the Company wrote off the carrying balance of the AII license.

Furniture and Equipment

Furniture and equipment are recorded at cost and depreciated on a declining balance basis at a rate of 30% per annum.

Impairment of long lived assets

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

Revenue recognition

The Company licenses its SchoolWeb system on a prepaid basis for terms ranging from one to three years. The Company recognizes license revenues on a straight-line basis over the license term upon completion of the required hardware and software installations and upon acceptance by the purchasers, subject to collection being reasonably assured. License fees paid in advance are recorded as deferred revenue.

The Company has generated revenues from hardware sales in connection with the testing of the SchoolWeb system. Hardware sales are recognized upon completion and acceptance of installation by the purchasers and collection is reasonably assured.

Foreign Currency Translation

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

Fair Value of Financial Instruments

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

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Stock-Based Compensation

In December 2002, the Financial Accounting Standards Board issued Financial Accounting Standard No. 148, Accounting for Stock-Based Compensation Transition and Disclosure (SFAS No. 148), an amendment of Financial Accounting Standard No. 123 Accounting for Stock-Based Compensation (SFAS No. 123). The purpose of SFAS No. 148 is to: (1) provide alternative methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock-based employee compensation, (2) amend the disclosure provisions to require prominent disclosure about the effects on reported net income of an entity s accounting policy decisions with respect to stock-based employee compensation, and (3) to require disclosure of those effects in interim financial information. The disclosure provisions of SFAS No. 148 were effective for the Company commencing for the year ended December 31, 2003. As no options have been granted to March 31, 2004, no pro-forma disclosures are required.

The Company has elected to continue to account for stock options granted to employees and officers using the intrinsic value based method in accordance with the provisions of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees , (APB No. 25) and comply with the disclosure provisions of SFAS No. 123 as amended by SFAS No. 148 as described above. Under APB No. 25, compensation expense is recognized based on the difference, if any, on the date of grant between the estimated fair value of the Company s stock and the amount an employee must pay to acquire the stock. Compensation expense is recognized immediately for past services and pro-rata for future services over the option-vesting period. In addition, with respect to stock options granted to employees, the Company provides pro-forma information as required by SFAS No. 123 showing the results of applying the fair value method using the Black-Scholes option pricing model. In accordance with SFAS No. 123, the Company applies the fair value method using the Black-Scholes option-pricing model in accounting for options granted to consultants.

The Company accounts for equity instruments issued in exchange for the receipt of goods or services from other than employees in accordance with SFAS No. 123 and the conclusions reached by the Emerging Issues Task Force in Issue No. 96-18. Costs are measured at the estimated fair market value of the consideration received or the estimated fair value of the equity instruments issued, whichever is more reliably measurable. The value of equity instruments issued for consideration other than employee services is determined on the earliest of a performance commitment or completion of performance by the provider of goods or services as defined by EITF 96-18.

The Company has also adopted the provisions of the Financial Accounting Standards Board Interpretation No.44, Accounting for Certain Transactions Involving Stock Compensation An Interpretation of APB Opinion No. 25 (FIN 44), which provides guidance as to certain applications of APB 25. FIN 44 is generally effective July 1, 2000 with the exception of certain events occurring after December 15, 1998.

The Company accounts for direct awards of share for services at the fair value of the shares awarded. The Company records the obligation to issue the shares at such time as performance of the service is complete.

Income taxes

The Company follows the liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax balances. Deferred tax assets and liabilities are measured using enacted or substantially enacted tax rates expected to apply to the taxable income in the years in which those differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the date of enactment or substantive enactment. As at March 31, 2004 the Company had net operating loss carryforwards; however, due to the uncertainty of realization the Company has provided a full valuation allowance for the deferred tax assets resulting from these loss carryforwards.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Loss per share

Basic earnings (loss) per share includes no dilution and is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period. Dilutive loss per share reflects the potential dilution of securities that could share in the earnings of the Company. Fully diluted loss per share has not been presented as the effects of warrants have been excluded as they are anti-dilutive.

NOTE 3 - LICENSE RIGHTS

By agreement dated January 1, 2001, SW Holdings entered into an agreement with Advanced Interactive Inc. (AII) and Advanced Interactive (Canada) Inc. (AIC) whereby SW Holdings acquired exclusive and non-exclusive rights and licenses to commercialise, distribute and market AII and AIC technology, products and services in the United States and Canada for a period of five years renewable for a further five years at SW Holdings option. SW Holdings issued 2,500,000 shares on June 29, 2001 valued at $.01 per share or $25,000 to acquire the license. SW Holdings must pay royalties equal to 40% of net revenue received plus a fixed amount of $10,000 per month in the first year, $20,000 per month in year two, and increasing by $8,000 per month in each of the subsequent years to a maximum of $84,000 per month in year ten. After year three, the fixed monthly payment is reduced by the amount of royalties otherwise payable.

Effective September 10, 2001 SW Holdings, AII and AIC amended the original agreement such that AI and AIC received an additional 500,000 shares valued at $5,000 which Alternet issued on September 10, 2001. Also effective September 10, 2001 the President and director of AII and AIC became a director of the Company until May 16, 2003 when this director resigned.

A total of $386,162 in unpaid monthly license fees accrued to December 31, 2003 and related costs owing to AII is included in accounts payable.

On October 14, 2003, AI Systems terminated its software license agreement (the "License Agreement") with AII. The License Agreement was terminated for a number of reasons including the failure by AII to grant to AI Systems North American exclusivity for technologies and software licensed under the License Agreement.

AI Systems has advised AII that it does not intend to pay the $386,162 in unpaid monthly license fees and other costs. AI Systems has also advised AII that it intends to cancel the 3,000,000 common shares issued to AII under the terms of the License Agreement.

AII has advised AI Systems, in writing, that it considers the agreement now to be a non-exclusive license that is still in effect and that unpaid monthly license fees and related costs are still due to AII. The software licensed under the License Agreement is no longer used in any products sold by the Company.

The terms of the License Agreement state that if either party has a dispute with the other party the dispute should be submitted to arbitration for settlement. If this were to occur, or if other proceedings including court proceedings were to be commenced, such arbitration or other proceedings could involve claims for monetary or other damages, recovery of the unpaid monthly license payments, royalty payments or other claims and would likely be significant and material to the business of Alternet Systems and to its liquidity and capital resources.

On March 13 2004, the Company filed a Writ of Summons and Statement of Claim in the Supreme Court of BC, Vancouver, BC. The writ alleges that the defendants, Advanced Interactive Inc., have breached the License Agreement as follows and damages are being sought in the amount of $1,804,709. The defendants have breached the Agreement as follows: failed to grant exclusivity to the Plaintiff as required by the License Agreement; failed to provide technical support and/or provide technical support at a reasonable price; and failed to provide usable and working software as is required by the License Agreement. The likelihood of any gain or loss as a result of the above lawsuit is not determinable at this time.

NOTE 3 - LICENSE RIGHTS (continued)

If the Company is successful in this action the excess of any damages awarded over the amount currently accrued totaling $386,162 will be recorded as a gain in the period in which it becomes determinable. In addition, to date, no costs have been accrued in connection with the continuation and completion of this action as they can not get be reasonably estimated.

NOTE 4 CAPITAL STOCK

To March 31, 2004, the Company has not granted any stock options.

During the three months ended March 31, 2004 the Company issued 1,785,000 shares for services valued at $466,320, all of which had been accrued in a prior period. Also during the three months ended March 31, 2004 the Company received an additional $255,963 towards future equity private placements which totaled $621,884 at March 31, 2004, the terms of which are being negotiated.

The Company is obligated to issue 690,000 common shares with a fair value of $172,360 in connection with direct stock awards under consulting, management and marketing contacts (refer to Note 6).

The Company is obligated to issue 100,000 common shares in settlement of debt of $26,000.

A summary of the Company s warrants at March 31, 2004 and the changes for the period is as follows:

	Warrants Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Life
Balance, December 31, 2003	1,348,458	$0.50	0.52 years
Granted	-	-	
Exercised	-	-	
Cancelled	-	-	
Expired	610,000	-	
Balance, March 31, 2004	738,458	$0.50	0.27 years

Effective March 1, 2003 the Company adopted a Retainer Stock Plan for Employees, Directors and Consultants (the Plan) for the purpose of providing the Company with the means to compensate employees, directors and consultants for their efforts in furthering the future success of the Company. The Plan allows for direct awards of common stock as a reward or incentive to employees or as consideration to directors or consultants for their services. A total of 5,000,000 shares may be awarded under this Plan. The Plan will terminate February 29, 2008. The Company filed a Registration Statement on Form S-8 during 2003 to cover the Plan. To date 3,665,000 shares valued at $991,240 relating to services provided in 2003 and 2004 have been awarded, of which 790,000 shares valued at $198,360 have not yet been issued.

NOTE 5 RELATED PARTY TRANSACTIONS

At March 31, 2004 a total of $1,676 (2003 - $11,888) is owing to directors. Amounts due to related parties are non-interest bearing and have no specific terms of repayment.

NOTE 5 RELATED PARTY TRANSACTIONS (continued)

The following amounts were incurred to directors, a company with a director in common and a company controlled by a shareholder of the Company.

		Three months ended March 31, 2004		Three months ended March 31, 2003
Consulting	$	50,200	$	24,584
License fees		-		84,000
Marketing		47,200		66,910
	$	97,400	$	175,494

Of the amounts incurred above, the license fees were incurred to AII and AIC. AII and AIC became related to the Company effective September 10, 2001 when the President and director of AII and AIC became a director of the Company until May 16, 2003 when this director resigned. Included in accounts payable are license fees totalling $386,162 owing to AII which are currently under dispute (refer to Note 3).

NOTE 6 COMMITMENTS

Effective February 1, 2003, March 1, 2003 and December 1, 2003 the Company entered into twenty-four month consulting, management and marketing agreements which require payment in cash and shares of the Company s common stock on a monthly basis. These contracts may be terminated with seven days notice at any time and with no further cost to the Company. The remaining future commitments are as follows:

		Cash	Number of shares
2004	$	229,500	1,368,000
2005		79,500	474,000
	$	309,000	1,842,000

Of the above amounts, $143,000 of cash and 880,000 in shares is due to directors of the Company.

During the period the Company expensed $187,460 (2003 - $247,553) in connection with these agreements.

NOTE 7 INCOME TAXES

The Company and its subsidiaries have tax losses which may be available to reduce future year s taxable income, that result in deferred tax assets. Management believes that the realization of the benefits from these deferred tax assets appears uncertain due to the Company s limited operating history and losses to date. Accordingly a full, deferred tax asset valuation allowance has been provided and no deferred tax asset benefit has been recorded.

ITEM 2: MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL OPERATIONS AND FINANCIAL RESULTS

The following discussion should be read in conjunction with the Company s consolidated financial statements and the notes thereto. The discussion of results, causes and trends should not be construed to imply any conclusion that such results or trends will necessarily continue in the future.

The statements contained herein, other than historical information, are or may be deemed to be forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities and Exchange Act of 1934, as amended, and involve factors, risks and uncertainties that may cause the Company s actual results to differ materially from such statements. These factors, risks and uncertainties, include the relatively short operating history of the Company; market acceptance and availability of products and services; the impact of competitive products, services and pricing; possible delays in the shipment of new products; and the availability of sufficient financial resources to enable the Company to expand its operations.

Critical Accounting Policies

We believe that the estimates, assumptions and judgments involved in the accounting policies described below have the greatest impact on our financial statements, so we consider these to be our critical accounting policies. Because of the uncertainty inherent in these matters, actual results could differ from the estimates we used in applying the critical accounting policies. Within the context of these critical accounting policies, we are not currently aware of any reasonably likely event that would result in materially different amounts being reported.

Revenue Recognition

The Company licenses its SchoolWeb system on a prepaid basis for terms ranging from one to three years. The Company recognizes license revenues on a straight line basis over the license term upon completion of the required hardware and software installations and upon acceptance by the purchasers. License fees paid in advance are recorded as deferred revenue.

RESULTS OF OPERATIONS:

With the closing of the SchoolWeb Agreement in September of 2001, the Company s results, on a consolidated basis, reflected its own results consolidated with its subsidiary, AI Systems Group Inc. (formerly known as SchoolWeb Holdings Inc). For the remainder of this part, the term Company refers to both the Company and its wholly owned subsidiary, AI Systems Group Inc.

Net Sales

For the period ending March 31, 2004, the Company had sales of $7,423. During the corresponding period to March 31, 2003, the Company had sales of $6,448. Net sales were flat due to the fact that no sales of SchoolWeb could occur because the Company had to develop its own proprietary SchoolWeb software since canceling the software license agreement with Advanced Interactive Inc. in October 2003. Software development was completed in May 2004 and commercial roll-out is scheduled to commence in June 2004.

Net Loss

For the period ending March 31, 2004, the Company had a net loss of $298,294 or $(0.02) per share. The net loss for the corresponding period to March 31, 2003 was $ 395,840 or $(0.02) per share. The decreased loss was due primarily to: a decrease in marketing expenses, and no license fees payable, which was slightly offset by an increase in software development costs.

Gross Profit

Gross Profit was $ 277 compared to $ 5,658 for the period ended March 31, 2003.

Selling, General and Administrative Expenses

For the period ended March 31, 2004, the Company incurred office and general expenses of $13,226; marketing expenses of $127,961; management and consulting fees of $ 100,461; no fees payable under the License Agreement, and $ 11,139 in professional fees. Training and documentation fees were $ 17,848. For the corresponding period to March 31, 2003, the Company had office and general expenses of $ 12,518; marketing expenses of $ 159,799, management and consulting fees of $ 84,274, fees payable under the License Agreement of $89,000 and professional fees of $ 26,261. Accounts payable increased to $583,922 at March 31, 2004, of which $386,162 are license fees owing to Advanced Interactive Inc., which are currently in dispute. This compares to accounts payable of $596,605 at March 31, 2003.

The decrease in marketing expense this period, compared to the corresponding period to March 31, 2003, is a result of decreased activity in marketing the SchoolWeb and CommunityWeb products, due to the software development period incurred since October 2003.

During the period, a total of $187,460 was expensed by the Company in connection with management and sales and marketing agreements entered into by the Company. This amount includes the fair value of share consideration where shares were issued as compensation for services rendered. Readers should consult Note 6 to the financial statements for an explanation of this expense.

Interest and other expenses

The Company had no material interest expenses.

Liquidity and Capital Resources

As at March 31, 2004, the Company had $129,022 cash in the bank, accounts receivable of $ 0.00 and prepaid expenses of $10,301. This compares to $1,704 cash in the bank, accounts receivable of $ 13,975 and prepaid expenses of $3,758 as at March 31, 2003.

Audit Fees

During the period ended March 31, 2004, the Company incurred approximately $ 7,000 in fees to its principal independent accountant.

Inflation

Management does not believe that inflation had a material adverse affect on the financial statements for the periods presented.

Currency Risks and Fluctuations

The Company s revenues to date and for the foreseeable future are received in Canadian dollars. The Canadian dollar has, in the quarter ending March 31, 2004, depreciated against the US dollar in which the Company s financial statements are prepared. If this trend continues, and given that some major expenses of the Company are fixed in US dollars, the Company s results could be negatively affected by currency fluctuations.

PART II. - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

Other than as described below, the Registrant is not a party to any material pending legal proceedings and, to the best of its knowledge, no such action by or against the Registrant has been threatened.

In August of 2003, Karim Lakhani resigned as a director of the Registrant. Karim Lakhani remained President, Director and largest shareholder of Advanced Interactive Inc.

The Company had an agreement with Advanced Interactive Inc. (the "License Agreement") under which it licensed certain of its software products from Advanced Interactive Inc. ("AII")

The Company subsequently terminated the License Agreement.

The Company has commenced legal proceedings against AII and its subsidiary by way of filing a Writ of Summons and Statement of Claim in the Supreme Court of British Columbia, Canada, Vancouver Registry. The Writ states that the Defendants have breached the License Agreement and damages are being sought in the amount of Cdn $1,804,709.00.

The Writ alleges that the Defendants have breached the License Agreement primarily as follows: they have failed to grant exclusivity to the Company as required, failed to provide technical support and/or provide technical support at a reasonable price, failed to provide usable and workable software as is required under the terms of the License Agreement.

The Defendants have, subsequent to the filing of a Report on Form 8-K on April 22, 2004, counterclaimed against the Company.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

During the three month period ending March 31, 2004, the Registrant issued no securities and the number of issued and outstanding shares remained unchanged between December 31, 2003 and March 31, 2004.

Effective February 1, 2003 and March 1, 2003 the Company signed twenty-four month consulting, management and marketing agreements which require payment in cash and shares of the Company s common stock on a monthly basis. The remaining future commitments are as follows:

Fiscal year 2004:	1,944,000 common shares	$229,500
Fiscal year 2005:	314,000 common shares	$79,500

In addition, certain of these agreements required the issuance of a total of 1,133,000 common shares as signing bonuses. At March 31, 2004 and subsequent to the date of this filing, none of these common shares for this period have been issued. Under these agreements, the Company is obligated to issue a total of 690,000 common shares to March 31, 2004.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

Not Applicable

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

None.

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Reports on Form 8-K. The Registrant filed one report on Form 8K subsequent to the three months ending March 31, 2004. This report was filed on EDGAR on April 22, 2004.

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

EXHIBIT INDEX

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

SIGNATURES

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

ALTERNET SYSTEMS, INC.

Dated: May 14, 2004

By: /s/ Michael Dearden
Michael Dearden, President, CEO
and Director

By: /s/ Griffin Jones
Griffin Jones, Treasurer, Director,
Chief Financial Officer and Chief
Accounting Officer

By: /s/ Patrick Fitzsimmons
Patrick Fitzsimmons, Vice-President
Director

By: /s/ Greg Protti,
Greg Protti, Vice-President and Director