

CHINA FIRE & SECURITY GROUP, INC.  
Form 10-Q  
August 09, 2010

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

FORM 10-Q

(Mark one)

Quarterly Report Under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Quarterly Period Ended June 30, 2010

or

Transition Report Under Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File Number 000-50491

China Fire & Security Group, Inc.

(Name of small business issuer in its charter)

Florida  
(State or other jurisdiction  
of incorporation or organization)

65-1193022  
(I.R.S. Employer  
Identification No.)

B-2508 TYG Center, C2  
Dongsanhuanbeilu,  
Chaoyang District, Beijing 100027,  
People's Republic of China  
(Address of principal executive offices)

100027  
(Zip Code)

Issuer's telephone number: (86-10) 8441 7400.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

(Do not check if smaller reporting company)

Smaller reporting company

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

As of August 9, 2010, the registrant had 27,595,541 shares of common stock outstanding.

---

## China Fire &amp; Security Group, Inc.

## Table of Contents

	Page
<b>PART I - FINANCIAL INFORMATION</b>	
<b>Item 1. Financial Statements (unaudited):</b>	
Consolidated Balance Sheets as of June 30, 2010 (unaudited) and December 31, 2009	3
Consolidated Statements of Income and Other Comprehensive Income For the Three and Six Months Ended June 30, 2010 and 2009 (unaudited)	4
Consolidated Statements of Changes in Equity	5
Consolidated Statements of Cash Flows For the Six Months Ended June 30, 2010 and 2009 (unaudited)	6
Notes to Consolidated Financial Statements (unaudited)	7
<b>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</b>	<b>33</b>
<b>Item 3. Quantitative and Qualitative Disclosures About Market Risk</b>	<b>42</b>
<b>Item 4. Controls and Procedures</b>	<b>43</b>
<b>PART II - OTHER INFORMATION</b>	
<b>Item 1. Legal Proceedings</b>	<b>43</b>
<b>Item 1A. Risk Factors</b>	<b>43</b>
<b>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</b>	<b>43</b>
<b>Item 3. Defaults Upon Senior Securities</b>	<b>43</b>
<b>Item 4. (Removed and Reserved)</b>	<b>43</b>
<b>Item 5. Other Information</b>	<b>43</b>
<b>Item 6. Exhibits</b>	<b>44</b>

## Item 1. Financial Statements

## CHINA FIRE &amp; SECURITY GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS  
AS OF JUNE 30, 2010 AND DECEMBER 31, 2009

	June 30, 2010 (Unaudited)	December 31, 2009
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 27,773,889	\$ 34,976,880
Restricted cash	4,324,670	1,837,134
Notes receivable	2,836,706	4,274,268
Accounts receivable, net of allowance for doubtful accounts of \$7,274,109 and \$6,539,787 as of June 30, 2010 and December 31, 2009, respectively	34,350,836	30,989,569
Receivables from related parties	156,069	156,599
Other receivables	616,311	368,679
Other receivables from related parties	1,217,736	395,193
Refundable bidding and system contracting project deposits	1,596,790	1,774,330
Inventories	5,528,866	5,360,520
Costs and estimated earnings in excess of billings	55,302,042	36,562,573
Employee advances	1,407,024	953,625
Prepayments and deferred expenses	3,667,230	3,397,358
Total current assets	138,778,169	121,046,728
PLANT AND EQUIPMENT, net	8,887,674	8,617,521
<b>OTHER ASSETS:</b>		
Restricted cash - non current	3,566,050	3,602,906
Accounts receivable – retentions	2,941,189	3,463,998
Deferred expenses - non current	116,519	116,045
Investment in joint ventures	482,502	477,837
Intangible assets, net	1,005,912	1,041,156
Total other assets	8,112,172	8,701,942
Total assets	\$ 155,778,015	\$ 138,366,191
<b>LIABILITIES AND EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 8,769,594	\$ 6,903,961
Accounts payable to related party	-	272,994
Customer deposits	2,476,834	2,182,790
Billings in excess of costs and estimated earnings	1,488,334	1,429,999
Other payables	472,175	333,121
Accrued liabilities	15,861,264	13,841,300

Taxes payable	8,181,622	9,002,470
Total current liabilities	37,249,823	33,966,635

#### COMMITMENTS AND CONTINGENCIES

#### EQUITY:

Common stock, \$0.001 par value, 65,000,000 shares authorized, 27,595,541 shares issued and outstanding as of June 30, 2010 and December 31, 2009, respectively	27,595	27,595
Additional paid-in-capital	22,672,485	20,601,138
Statutory reserves	7,147,795	7,147,795
Retained earnings	80,846,934	69,266,049
Accumulated other comprehensive income	7,791,584	7,324,237
Total shareholders' equity	118,486,393	104,366,814
Noncontrolling interest	41,799	32,742
Total equity	118,528,192	104,399,556
Total liabilities and equity	\$ 155,778,015	\$ 138,366,191

See report of independent registered public accounting firm.

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

## CHINA FIRE &amp; SECURITY GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME AND OTHER COMPREHENSIVE INCOME  
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2010 AND 2009  
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
<b>REVENUES</b>				
System contracting projects	\$ 18,267,248	\$ 18,290,930	\$ 33,788,996	\$ 31,294,114
Products	3,556,422	3,791,491	8,087,021	6,915,813
Maintenance services	1,009,761	649,447	1,901,140	1,234,152
Total revenues	22,833,431	22,731,868	43,777,157	39,444,079
<b>COST OF REVENUES</b>				
System contracting projects	7,876,558	6,970,283	15,187,843	11,777,541
Products	1,856,133	865,395	3,310,200	2,077,048
Maintenance services	705,688	395,619	1,251,906	792,160
Total cost of revenues	10,438,379	8,231,297	19,749,949	14,646,749
<b>GROSS PROFIT</b>	<b>12,395,052</b>	<b>14,500,571</b>	<b>24,027,208</b>	<b>24,797,330</b>
<b>OPERATING EXPENSES</b>				
Selling and marketing	2,209,162	2,237,873	4,205,360	4,140,191
General and administrative	2,618,664	1,983,443	5,558,741	3,664,082
Depreciation and amortization	202,055	183,456	402,161	376,850
Research and development	399,701	519,987	796,597	834,017
Total operating expenses	5,429,582	4,924,759	10,962,859	9,015,140
<b>INCOME FROM OPERATIONS</b>	<b>6,965,470</b>	<b>9,575,812</b>	<b>13,064,349</b>	<b>15,782,190</b>
<b>OTHER INCOME</b>				
Other income, net	302,269	110,301	337,532	220,997
Interest income	99,548	7,206	183,348	129,302
Total other income, net	401,817	117,507	520,880	350,299
<b>INCOME BEFORE PROVISION FOR INCOME TAXES AND NONCONTROLLING INTEREST</b>	<b>7,367,287</b>	<b>9,693,319</b>	<b>13,585,229</b>	<b>16,132,489</b>
<b>PROVISION FOR INCOME TAXES</b>	<b>1,051,259</b>	<b>1,357,097</b>	<b>2,054,133</b>	<b>2,150,664</b>
<b>NET INCOME BEFORE NONCONTROLLING INTEREST</b>	<b>6,316,028</b>	<b>8,336,222</b>	<b>11,531,096</b>	<b>13,981,825</b>
Less: Net loss attributable to noncontrolling interest	(17,632)	-	(49,789)	-
<b>NET INCOME ATTRIBUTABLE TO CONTROLLING INTEREST</b>	<b>6,333,660</b>	<b>8,336,222</b>	<b>11,580,885</b>	<b>13,981,825</b>

<b>OTHER COMPREHENSIVE INCOME</b>				
Foreign currency translation adjustment	487,820	69,294	467,347	(108,923)
<b>COMPREHENSIVE INCOME</b>	<b>\$ 6,821,480</b>	<b>\$ 8,405,516</b>	<b>\$ 12,048,232</b>	<b>\$ 13,872,902</b>
<b>BASIC EARNINGS PER SHARE</b>				
Weighted average number of shares	27,595,541	27,588,598	27,595,541	27,587,595
Earnings per share	\$ 0.23	\$ 0.30	\$ 0.42	\$ 0.51
<b>DILUTED EARNINGS PER SHARE</b>				
Weighted average number of shares	28,405,959	28,298,850	28,402,599	28,258,225
Earnings per share	\$ 0.22	\$ 0.29	\$ 0.41	\$ 0.49

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

## CHINA FIRE &amp; SECURITY GROUP, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

	Common Stock Shares	Par value	Additional paid-in-capital	Retained Earnings Statutory reserves	Unrestricted	Accumulated other comprehensive income	Noncontrolling interest	Totals
BALANCE, December 31, 2008	27,586,593	\$ 27,586	\$ 19,357,409	\$ 7,148,827	\$ 44,850,181	\$ 7,305,144	\$ -	\$ 78,689,147
Capital received from non-controlling interest							87,900	87,900
Net income (loss)					13,981,825			13,981,825
Warrants exercised	6,682	7	(7)					
Options issued to employees			490,097					490,097
Foreign currency translation adjustment						(108,923)		(108,923)
BALANCE, June 30, 2009, (Unaudited)	27,593,275	27,593	19,847,499	7,148,827	58,832,006	7,196,221	87,900	93,140,046
Net income (loss)					10,433,011		(55,244)	10,377,767
Options exercised	2,266	2	(2)					-
Options issued to employees			490,099					490,099
Stock based compensation for services			263,542					263,542
Deconsolidation of statutory reserves held in Tianjin Tianxiao Fire Safety Equipment Co., Ltd.				(1,032)	1,032			-
						128,016	86	128,102



Foreign  
currency  
translation  
adjustment

BALANCE,  
December 31,  
2009

27,595,541	27,595	20,601,138	7,147,795	69,266,049	7,324,237	32,742	104,399,556
------------	--------	------------	-----------	------------	-----------	--------	-------------

Capital received  
from  
non-controlling  
interest

58,920	58,920
--------	--------

Net income  
(loss)

11,580,885	(49,789)	11,531,096
------------	----------	------------

Options issued  
to employees

490,097	490,097
---------	---------

Stock based  
compensation  
for services

1,581,250	1,581,250
-----------	-----------

Foreign  
currency  
translation  
adjustment

467,347	(74)	467,273
---------	------	---------

BALANCE,  
June 30, 2010,  
(Unaudited)

27,595,541	27,595	22,672,485	7,147,795	80,846,934	7,791,584	41,799	118,528,192
------------	--------	------------	-----------	------------	-----------	--------	-------------

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

## CHINA FIRE &amp; SECURITY GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE SIX MONTHS ENDED JUNE 30, 2010 AND 2009

	Six Months Ended June 30,	
	2010	2009
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income attributable to controlling interest	\$ 11,580,885	\$ 13,981,825
Net loss attributable to noncontrolling interest	(49,789)	-
Consolidated net income	11,531,096	13,981,825
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation	394,351	410,521
Amortization	37,646	37,641
Provision for doubtful accounts	704,645	662,143
(Gain) Loss on disposal of equipment	(485)	8,512
Options issued to employees	490,097	490,097
Stock based compensation for services	1,581,250	-
Provision for estimated warranty claims	-	62,973
Change in operating assets and liabilities		
Notes receivable	1,449,019	292,739
Accounts receivable	(3,391,203)	(4,749,389)
Other Receivable from related parties	(816,955)	(37,975)
Other receivables	(296,747)	(509,019)
Refundable bidding and system contracting project deposits	235,653	-
Inventories	(146,087)	257,998
Costs and estimated earnings in excess of billings	(18,512,944)	(11,713,121)
Employee advances	(447,637)	(333,729)
Prepayments and deferred expenses	(255,015)	(183,819)
Accounts payable	2,050,026	314,470
Accounts payable related party	(272,994)	-
Customer deposits	283,929	(3,030,801)
Billings in excess of costs and estimated earnings	52,268	(2,198,063)
Other payables	137,125	277,696
Accrued liabilities	1,735,497	4,505,900
Taxes payable	(853,848)	4,307,424
Net cash (used in) provided by operating activities	(4,311,313)	2,854,023
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchase of plant and equipment	(642,178)	(962,362)
Proceeds from sale of equipment	14,376	9,827
Payments for long term investments	(4,648)	-
Net cash used in investing activities	(632,450)	(952,535)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Change in restricted cash	(2,418,374)	(818,891)
Capital contributed by noncontrolling interest shareholder	60,891	87,942
Net cash used in financing activities	(2,357,483)	(730,949)

EFFECT OF EXCHANGE RATE CHANGES ON CASH	98,255	(33,637)
INCREASE (DECREASE) IN CASH	(7,202,991)	1,136,902
CASH and CASH EQUIVALENTS, beginning of periods	34,976,880	26,655,333
CASH and CASH EQUIVALENTS, end of periods	\$ 27,773,889	\$ 27,792,235
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>		
Income taxes paid	\$ 3,422,925	\$ 311,505
Interest paid	\$ -	\$ -
<b>NON-CASH TRANSACTIONS IN INVESTING ACTIVITIES:</b>		
Reclassification of advances on building and equipment purchase to plant and equipment upon receipt of purchase	\$ -	\$ 249,536

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

CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2010

(Unaudited)

Note 1 - Background

Principal Activities and Reorganization

China Fire & Security Group Inc. (the “Company” or “CFSG”), is a Florida corporation. The Company, through its subsidiaries, is engaged in the design, development, manufacture and sale of fire protection products and services for industrial customers in People’s Republic of China (“China”) and India.

Recent Developments

Investment of 5% interest in Sureland Fire & Security India Private Ltd (“Sureland India”)

Sureland India was incorporated in New Delhi, India with registered capital of \$51,398 (INR2,500,000). Sureland India engages in project design, consulting and construction services for the fire protection industry in India. In January 2010, Sureland India received approval from the India government to accept foreign investment of 5% equity from China Fire Protection Group, Inc. China Fire Protection Group, Inc. has completed the payment of \$2,710 (INR125,000) in January 2010. After the transaction, the Company became a minority interest holder of Sureland Indian and the investment was recorded under the cost accounting method. The Company made an advance payment to Sureland Fire & Security India Private Ltd. in amount of \$143,602 as of June 30, 2010 for services.

Acquisition of 100% interest in Zeetech System Private Ltd (“Zeetech”)

Zeetech was incorporated in New Delhi, India with registered capital of \$2,215 (INR101,000). On February 4, 2010, China Fire Protection Group, Inc. signed an agreement to acquire 100% ownership in Zeetech from the existing shareholders for the consideration price of \$2,215 (INR101,000) approximately equal to fair value of the net assets as of January 12, 2010, which was approximately \$1,938 (INR88,387). Thus, a loss of \$277 was recognized in this transaction. After the closing of the acquisition, Zeetech is 100% owned by China Fire Protection Group, Inc. Zeetech does not currently have any operations.

Restructuring of Sureland Industrial

During the first quarter of 2010, our wholly-owned subsidiary, CFPG entered into an agreement with Zeetech, our subsidiary in which we own 100%, pursuant to which CFPG’s entire interest (75%) in Sureland Industrial shall be transferred to Zeetech. On March 12, 2010, the restructuring transaction was approved by the Chinese Ministry of Commerce. Subsequent to the transfer, China Fire & Security Group, Inc. still holds 100% of the interest in Sureland Industrial through its subsidiaries.

CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2010  
(Unaudited)

### Restructuring of Tianxiao Equipment

On July 3, 2009, Sureland Industrial signed an agreement to transfer 83.3% ownership in Tianxiao Equipment to Tianjin Fire Protection Equipment Co., Ltd. for consideration approximately equal to the net assets of Tianxiao Equipment as of June 30, 2009, which was approximately \$1.6 million (RMB 10.6 million). Thus, a loss of \$913 was recognized in this transaction. The proceeds of \$1.6 million have been fully received by the Company as of December 31, 2009.

After the restructuring, Sureland Industrial became a minority shareholder, with 16.7% ownership in Tianxiao Equipment. The investment is recorded under the cost accounting method. Sureland Industrial is continuing to purchase fire safety and protection products through Tiaoxiao Equipment, which does not require the classification of the deconsolidation of Tianxiao Equipment as a discontinued operation in accordance with FASB Accounting Standards Codification (“ASC”) 205-20-55.

### Formation of Shenyang Hongshida Electronics Co., Ltd (“Shenyang Hongshida”)

Shenyang Hongshida was incorporated in Shenyang, Liaoning Province, China with registered capital of \$1,465,000 (RMB10,000,000). Pursuant to Shenyang Hongshida’s by-laws dated on June 1, 2009, the registered capital is required to be injected over the subsequent two years. Shenyang Hongshida is 80% owned by Beijing Hua An with 20% noncontrolling interest owned by an unrelated party. Shenyang Hongshida engages in the production and sales of fire equipment, electronic products, instrumentation, computer parts and provides technical advisory services. Shenyang Hongshida will focus on the low- to middle-end segment of the fire products market. The company received capital contributions of \$295,200 (RMB 2,000,000) in June 2010 of those, \$58,920 (RMB 400,000) was received from the non-controlling interest investor. As of June 30, 2010, the registered capital received was \$736,500 (RMB 5,000,000) and the Company is in pre-operating stage.

### Note 2 - Summary of significant accounting policies

#### The reporting entity

The consolidated financial statements of China Fire & Security Group Inc. and Subsidiaries reflect the activities of the parent and the following subsidiaries:

Subsidiaries	Incorporated in	Ownership Percentage
China Fire Protection Group Inc. (“CFPG”)	British Virgin Islands	100%
Zeetech System Private Limited (“Zeetech”)	India	100%
Sureland Industrial Fire Safety Limited (“Sureland Industrial”)	People’s Republic of China	100%
Sureland Industrial Fire Equipment Co. Ltd. (“Sureland Equipment”)	People’s Republic of China	100%
Beijing Hua An Times Fire Safety Technology Co., Ltd. (“Beijing Hua An”)	People’s Republic of China	100%
Beijing Shian Kexin Technology Co., Ltd	People’s Republic of China	100%
Shenyang Hongshida Electronics Co., Ltd	People’s Republic of China	80%



CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2010  
(Unaudited)

Basis of presentation

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. All material intercompany transactions and balances have been eliminated in consolidation.

However, these consolidated financial statements are not indicative of a full year of operations. The information included in this Quarterly Report on Form 10-Q should be read in conjunction with the audited consolidated financial statements and footnotes for the year ended December 31, 2009 included in the Company's Annual Report on Form 10-K.

Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles of the United States of America requires management to make estimates and assumptions that affect the amounts reported in the combined financial statements and accompanying notes. Management believes that the estimates utilized in preparing its financial statements are reasonable and prudent. Actual results could differ from these estimates.

Certain of the Company's accounting policies require higher degrees of judgment than others in their application. These include the recognition of revenue and earnings from system contracting projects under the percentage-of-completion method, determining the fair value of stock based compensation and the allowance of doubtful accounts and warranty expenses. Management evaluates all of its estimates and judgments on an on-going basis.

Revenue recognition

Revenue is recognized when it is probable that the economic benefits will flow to the Company as follows:

CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2010  
(Unaudited)

1. Revenue from system contracting projects are recognized using the percentage-of-completion method of accounting and, therefore, take into account the costs, estimated earnings and revenue to date on contracts not yet completed. Revenue recognized is that percentage of the total contract price that cost expended to date bears to anticipated final total cost, based on current estimates of costs to complete. Contract costs include all direct material and labor costs and those indirect costs related to contract performance, such as indirect labor, supplies, tools, repairs, and depreciation costs. Selling, general, and administrative costs are charged to expense as incurred. At the time a loss on a contract becomes known, the entire amount of the estimated ultimate loss is recognized in the consolidated financial statements. Claims for additional contract costs are recognized upon a signed change order from the customer.
2. Revenue from product sales is recognized when the goods are delivered and title has passed. Product sales revenue is presented net of a value-added tax ("VAT"). All of the Company's products that are sold in the People's Republic of China ("PRC") are subject to a Chinese value-added tax at a rate of 17% of the gross sales price. This VAT may be offset by VAT paid by the Company on raw materials and other materials included in the cost of producing the finished product.
3. Revenue from the rendering of Maintenance Services is recognized over the service period on a straight-line basis.

In accordance with ASC 605-15, "Revenue Recognition when Right of Return Exists," revenue is recorded net of an estimate of markdowns, price concessions and warranty costs. Such reserve is based on management's evaluation of historical experience, current industry trends and estimated costs.

#### Enterprise Wide Disclosure

Almost all of the Company's products (fire detecting products, fire alarm control device, and water mist/sprinkler systems) are sold via system contracting projects or as part of the integrated product sales. The composition of these three types of products varies significantly from project to project, both in quantity and in dollar amounts. Although the Company could provide a breakdown of sales contribution for the Company's own products for each project, it is almost impossible to provide revenues for each of the products when the revenue from each project is recognized based on a percentage of completion. More importantly, the revenues from the Company's own products do not accurately reflect the Company's overall financial performance. The Company is a system contracting projects provider rather than a product vendor that sells their own products directly or through channels. Therefore, it is not practical to separately disclose the revenues from external customers for each of the products.



CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2010  
(Unaudited)

The Company's chief operating decision-makers (i.e. chief executive officer and his direct reports) review financial information presented on a consolidated basis, accompanied by disaggregated information about revenues by business lines for purposes of allocating resources and evaluating financial performance. There are no segment managers who are held accountable for operations, operating results and plans for levels or components below the consolidated unit level. Based on qualitative and quantitative criteria established by ASC 280-10, "Disclosures about Segments of an Enterprise and Related Information", the Company considers itself to be operating within one reportable segment.

#### Shipping and handling

Costs related to shipping and handling are included in cost of revenue pursuant to ASC 605-45 "Accounting for Shipping and Handling Fees and Costs."

#### Foreign currency translation

The reporting currency of the Company is the US dollar. The Company uses their local currency, Renminbi (RMB) and Indian Rupee (INR), as their functional currency. Results of operations and cash flow are translated at average exchange rates during the period, and assets and liabilities are translated at the unified exchange rate as quoted by the People's Bank of China at the end of the period. Translation adjustments resulting from this process are included in accumulated other comprehensive income in the consolidated statements of changes in equity.

Asset and liability accounts at June 30, 2010 were translated at 6.79 RMB to \$1.00 and 46.47 INR to \$1.00 as compared to 6.82 RMB to \$1.00 and 46.75 INR to \$1.00 at December 31, 2009 respectively. Equity accounts were stated at their historical rate. The average translation rates of RMB applied to income statements accounts for the six months ended June 30, 2010 and 2009 were 6.82 RMB and 6.82 RMB, respectively. The average translation rates of INR applied to income statements accounts for the six months ended June 30, 2010 were 45.72 INR. Cash flows are also translated at average translation rates for the period, therefore, amounts reported on the statement of cash flows will not necessarily agree with changes in the corresponding balances on the balance sheets.

Transaction gains and losses that arise from exchange rate fluctuations on transactions denominated in a currency other than the functional currency are included in the results of operations as incurred. Historically, the Company has not entered any currency trading or hedging transactions, although there is no assurance that the Company will not enter into such transactions in the future.

#### Plant and equipment

Plant and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets with a 5% residual value. Depreciation expense amounted to \$193,222, and \$ 209,754 for the three months ended June 30, 2010 and 2009, respectively. Depreciation expense amounted to \$394,351 and \$410,521 for the six months ended June 30, 2010 and 2009, respectively.

CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2010  
(Unaudited)

Estimated useful lives of the assets are as follows:

	Useful Life
Buildings and improvements	40 years
Transportation equipment	5 years
Machinery	10 years
Office equipment	5 years
Furniture	5 years

Construction in progress represents the costs incurred in connection with the construction of buildings or additions to the Company's plant facilities. No depreciation is provided for construction in progress until such time as the assets are completed and placed into service. Interest incurred during construction is capitalized into construction in progress. All other interest is expensed as incurred.

The cost and related accumulated depreciation of assets sold or otherwise retired are eliminated from the accounts and any gain or loss is included in the consolidated statements of income. Maintenance, repairs and minor renewals are charged directly to expense as incurred. Major additions and betterments to buildings and equipment are capitalized.

Long-term assets of the Company are reviewed at least annually, more often if circumstances dictate, to determine whether their carrying value has become impaired. The Company considers assets to be impaired if the carrying value exceeds the future projected cash flows from related operations. The Company evaluates the periods of depreciation and amortization to determine whether subsequent events and circumstances warrant revised estimates of useful lives. As of June 30, 2010, the Company expects these assets to be fully recoverable.

Plant and equipment consists of the following:

	June 30, 2010 (Unaudited)	December 31, 2009
Buildings and improvements	\$ 6,443,427	\$ 6,439,015
Transportation equipment	3,237,971	3,307,236
Machinery	906,070	900,781
Office equipment	1,490,398	1,348,261
Furniture	141,410	165,736
Total depreciable assets	12,219,276	12,161,029
Less accumulated depreciation	(4,024,440)	(3,875,487)
Construction in progress	692,838	331,979
Plant and equipment, net	\$ 8,887,674	\$ 8,617,521

CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2010  
(Unaudited)

Concentration of risk

Cash includes cash on hand and demand deposits in accounts maintained with state owned banks within the People's Republic of China, Hong Kong and India. The Company maintains balances at financial institutions which, from time to time, may exceed Hong Kong Deposit Protection Board insured limits for the banks located in Hong Kong. Balances at financial institutions or state owned banks within the PRC are not covered by insurance. The balances maintained in India are deposited in the branch of DBS Bank (Singapore) Limited, which are fully insured by the Government of Singapore until December 31, 2010. As of June 30, 2010 and December 31, 2009, the Company had deposits (including restricted cash balances) totaling to \$35,494,245 and \$33,603,047, respectively, that are not covered by insurance. The Company has not experienced any losses in such accounts and believes it is not exposed to any risks on its cash in bank accounts.

The Company's operations are mainly carried out in the PRC while the revenue recognized from operations in India is immaterial to the Company's financial statement. Accordingly, the Company's business, financial condition and results of operations may be influenced by the political, economic and legal environments in the PRC, and by the general state of the PRC's economy. The Company's operations in the PRC are subject to specific considerations and significant risks not typically associated with companies in the North America and Western Europe. These include risks associated with, among others, the political, economic and legal environments and foreign currency exchange. The Company's results may be adversely affected 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.

The Company has one major customer who represented approximately 33% and 47% of the Company's sales for the three and six months ended June 30, 2010, respectively. Accounts receivable from this customer were \$2,263,058 as of June 30, 2010. The Company had one major customer who represented approximately 12% and 11% of the Company's sales for the three and six months ended June 30, 2009, respectively. Accounts receivable from this customer was \$0 as of June 30, 2009.

Cash and cash equivalents

The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents. Cash and cash equivalents also include unrestricted time deposits.

CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2010  
(Unaudited)

#### Restricted cash

Restricted cash represents cash required to be deposited in a separate bank account subject to withdrawal restrictions by its system contracting projects and product sales customers to guarantee its contracts will be performed. The deposit cannot be drawn or transferred by the Company until the restriction period has expired.

Restricted cash consists of the following:

	June 30, 2010 (Unaudited)	December 31, 2009
Restricted cash		
Products sales	\$ 3,747,840	\$ 3,728,599
System contracting projects	4,142,880	1,711,441
Total restricted cash	7,890,720	5,440,040
Restricted cash - non current	(3,566,050)	(3,602,906)
Restricted cash - current	\$ 4,324,670	\$ 1,837,134

#### Inventories

Inventories are stated at the lower of cost or market, using the weighted average method.

Inventories consist of the following as of:

	June 30, 2010 (unaudited)	December 31, 2009
Raw materials	\$ 194,493	\$ 144,829
Finished goods	4,354,614	4,574,075
Work in progress	979,759	641,616
Total	\$ 5,528,866	\$ 5,360,520

Raw materials consist primarily of materials used in production. Finished goods consist primarily of equipment used in product sales and system contracting projects. The costs of finished goods include direct costs of raw materials as well as direct labor used in production. Indirect production costs such as utilities and indirect labor related to production such as assembling, shipping and handling costs are also included in the cost of inventory. The Company reviews its inventories periodically to determine if any reserves are necessary for potential obsolescence. As of June 30, 2010 and December 31, 2009, the Company determined no reserves were necessary.

CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2010  
(Unaudited)

Accounts receivable

Accounts receivable represents amounts due from customers for products sales, maintenance services and system contracting projects. Overdue balances are reviewed regularly by senior management. Reserves are recorded when collection of amounts due are in doubt. Delinquent account balances are written-off after management has determined that collection is not probable; known bad debts are written off against allowance for doubtful accounts when identified.

Accounts receivable consist of the following:

	June 30, 2010 (Unaudited)	December 31, 2009
Accounts receivable:		
System contracting projects	\$ 24,175,892	\$ 23,814,248
Maintenance services	3,671,927	3,190,843
Products sales	16,718,315	13,988,263
Total accounts receivable	44,566,134	40,993,354
Allowance for bad debts	(7,274,109)	(6,539,787)
Accounts receivable, net	37,292,025	34,453,567
Accounts receivable - non-current retentions	(2,941,189)	(3,463,998)
Accounts receivable - current	\$ 34,350,836	\$ 30,989,569

The activity in the allowance for doubtful accounts for trade accounts receivable for the six months ended June 30, 2010 and for the year ended December 31, 2009 is as follows:

June 30, 2010 (Unaudited)	December 31, 2009
---------------------------------	----------------------