

Acorn International, Inc.
Form 20-F/A
August 24, 2010
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 20-F

(Amendment No. 1)

(Mark One)

REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934
OR

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2009

OR

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

SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Date of event requiring this shell company report

For the transition period from to .

Commission file number: 001-33429

Acorn International, Inc.

(Exact name of Registrant as specified in its charter)

Not applicable

(Translation of Registrant's name into English)

Cayman Islands

(Jurisdiction of incorporation or organization)

18/F, 20th Building, 487 Tianlin Road, Shanghai 200233

(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act.

Title of each class	Name of each exchange on which registered
American Depositary Shares, each representing three ordinary shares, par value \$0.01 per share	New York Stock Exchange

Securities registered or to be registered pursuant to Section 12(g) of the Act.

None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.

None

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report: 88,856,915

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

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If this report is an annual or transaction report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes No

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, or a non-accelerated filer.

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

US GAAP International Financial Reporting Standards as issued by the Other

International Accounting Standards Board

If Other has been checked in response to the previous question indicate by check mark which financial statement item the registrant has elected to follow. Item 17 Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

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Explanatory Note:

We are filing this Amendment No. 1 (the "Amendment No. 1") to our Annual Report on Form 20-F for the fiscal year ended December 31, 2009 (the "Original Form 20-F"), as filed with the Securities and Exchange Commission (the "Commission") on May 6, 2010 in order correct an inadvertent error in the Principal Executive Officer and Principal Financial Officer certifications originally filed as Exhibits 12.1 and 12.2 with the Original Form 20-F. This Amendment No. 1 includes the Item 15T and financial statements disclosure; however, the revisions to the Principal Executive Officer and Principal Financial Officer certifications has no effect on and has not resulted in any changes to the Company's audited financial statements or the Notes to the Financial Statements thereto for the year ended December 31, 2009 or the Item 15T disclosure as previously reported in the Original Form 20-F.

Except for the new certifications filed herewith, no other changes have been made to the Item 15T disclosure or the Company's audited financial statements as included in the Original Form 20-F. The other information in the Original Form 20-F continues to speak as of the date of the Original Form 20-F, and we have not updated the disclosures contained therein to reflect any events which occurred at a date subsequent to the filing of the Original Form 20-F. Accordingly, this Amendment No. 1 should be read in conjunction with our filings with the Commission that are subsequent to the filing of the Original Form 20-F.

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PART II

ITEM 15T. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures.

We evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of December 31, 2009. Based on that evaluation, our principal executive officer and our principal financial officer concluded that our disclosure controls and procedures were effective and designed to ensure that the information required to be disclosed by us in reports filed under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the SEC's rules, regulations and forms and to ensure that information required to be disclosed by us in the reports we file or submit is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Management's Report on Internal Control over Financial Reporting.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act for our company. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements in accordance with generally accepted accounting principles and includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of a company's assets, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of consolidated financial statements in accordance with generally accepted accounting principles, and that a company's receipts and expenditures are being made only in accordance with authorizations of a company's management and directors and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of a company's assets that could have a material effect on the consolidated financial statements. Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation, our management concluded that our internal control over financial reporting was effective as of December 31, 2009.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

This annual report does not include an attestation report of the company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the company's registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the company to provide only management's report in this annual report.

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ITEM 19. EXHIBITS

EXHIBITS INDEX

Exhibit Number	Description
1.1*	Amended and Restated Memorandum and Articles of Association of Acorn International, Inc.
2.1*	Specimen American Depositary Receipt
2.2*	Specimen Certificate for Ordinary Shares
2.3**	Form of Deposit Agreement among Acorn International, Inc., Citibank, N.A., and holders and beneficial owners of American Depositary Shares issued thereunder
4.1*	2006 Equity Incentive Plan
4.2*	Forms of option grant agreements and form of SARs Award Agreement
4.3*	Form of Indemnification Agreement with the directors of Acorn International, Inc.
4.4*	Form of Employment Agreement of Acorn International, Inc. and Employment Agreement of James Yujun Hu
4.5*	Investors Rights Agreement among Acorn International, Inc., SB Asia Investment Fund II L.P., and the several ordinary shareholders therein as of March 31, 2006
4.6*	Asset Purchase Agreement between Acorn Information Technology (Shanghai) Co., Ltd. and Tianjin BABAKA Technology Development Co., Ltd. dated June 1, 2005
4.7*	Equity Transfer Agreement between Shanghai Acorn HJX Digital Technology Co., Ltd. and Acorn Information Technology (Shanghai) Co., Ltd. dated June 30, 2005
4.8*	Equity Transfer Agreement between Shanghai Acorn HJX Digital Technology Co., Ltd. and Acorn International Electronic Technology (Shanghai) Co., Ltd. dated June 30, 2005
4.9*	Patent Application Right Transfer Agreement between Acorn Information Technology (Shanghai) Co., Ltd. and Tianjin BABAKA Technology Development Co., Ltd. dated August 1, 2005
4.10*	Joint Venture Contract between Acorn Information Technology (Shanghai) Co., Ltd. and Shanghai Yimeng Digital Technology Co., Ltd. dated December 9, 2005
4.11*	2005 Service Fee Pricing Agreement under the Exclusive Technical Service Agreement between Acorn Information Technology (Shanghai) Co., Ltd. and Shanghai Acorn Network Technology Development Co., Ltd. dated December 31, 2005
4.12*	2005 Service Fee Pricing Agreement under the Exclusive Technical Service Agreement between Acorn Information Technology (Shanghai) Co., Ltd. and Beijing Acorn Trade Co., Ltd. dated December 31, 2005

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Exhibit Number	Description
4.13*	2005 Service Fee Pricing Agreement under the Exclusive Technical Service Agreement between Acorn Information Technology (Shanghai) Co., Ltd. and Shanghai Acorn Advertising Broadcasting Co., Ltd. dated December 31, 2005
4.14*	Joint Venture Contract between China DRTV, Inc. and Shanghai Jia Guan Hang Automobile Maintenance Products Co., Ltd. dated February 28, 2006
4.15*	Loan Agreement by and among Acorn Information Technology (Shanghai) Co., Ltd., Don Dongjie Yang and David Chenghong He dated March 20, 2006
4.16*	Form of Operation and Management by and among Acorn Information Technology (Shanghai) Co., Ltd., Shanghai Acorn Advertising Broadcasting Co. Ltd./Beijing Acorn Trade Co., Ltd./Shanghai Acorn Network Development Technology Co., Ltd., Don Dongjie Yang and David Chenghong He
4.17*	Form of Equity Pledge Agreement among Acorn Information Technology (Shanghai) Co., Ltd., Don Dongjie Yang and David Chenghong He
4.18*	Form of Exclusive Technical Service Agreement between Shanghai Acorn Advertising Broadcasting Co., Ltd./Beijing Acorn Trade Co., Ltd./Shanghai Acorn Network Development Technology Co., Ltd. and Acorn Information Technology (Shanghai) Co., Ltd.
4.19*	Form of Exclusive Purchase Agreement among Acorn Information Technology (Shanghai) Co., Ltd., Don Dongjie Yang, David Chenghong He and Shanghai Acorn Advertising Broadcasting Co., Ltd./ Beijing Acorn Trade Co., Ltd./Shanghai Acorn Network Development Technology Co., Ltd.
4.20*	Form of Power of Attorney issued by Don Dongjie Yang and David Chenghong He in favor of designees of Acorn Information Technology (Shanghai) Co., Ltd.
4.21*	Agreement among Don Dongjie Yang, David Chenghong He, Acorn Information Technology (Shanghai) Co., Ltd. and Acorn International Electronic Technology (Shanghai) Co., Ltd. dated March 20, 2006
4.22*	Agreement among Don Dongjie Yang, David Chenghong He, Acorn Information Technology (Shanghai) Co., Ltd. and Shanghai HJX Digital Technology Co., Ltd. dated March 20, 2006
4.23*	Agreement between China Express Mail Service Corporation and Shanghai Acorn Network Technology Development Co., Ltd. dated March 24, 2006
4.24*	Joint Venture Contract between China DRTV, Inc. and Zhuhai Sunrana Cosmetics Products Co., Ltd. dated May 10, 2006
4.25*	Voting Agreement among James Yujun Hu, The 2004 Trust for Robert W. Roche s Descendants and Acorn Composite Corporation dated July 6, 2006
4.26*	Voting Agreement between SB Asia Investment Fund II L.P. and James Yujun Hu dated March 30, 2007
4.27*	Strategic Cooperation Agreement dated January 24, 2007 between Unicom Huasheng Telecommunication Technology Co., Ltd. and Shanghai Acorn Advertising Broadcasting Co., Ltd. and the Supplementary Agreement dated March 12, 2007
4.28*	Subscription Agreement dated April 17, 2007 by and among Acorn International, Inc., Alibaba.com Corporation, Merrill Lynch, Pierce, Fenner & Smith Incorporated and Deutsche Bank Securities Inc.
8.1***	List of subsidiaries
11.1*	Code of Business Conduct and Ethics of Acorn International, Inc.
12.1	CEO Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

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Exhibit Number	Description
12.2	CFO Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
13.1	CEO Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
13.2	CFO Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
23.1***	Consent of Commerce & Finance
23.2	Consent of Deloitte Touche Tohmatsu CPA Ltd.

* Previously filed as an exhibit to the Registration Statement on F-1 registration (File No. 333-141860), as amended, initially filed with the Securities and Exchange Commission on April 3, 2007.

** Incorporated by reference to the Registration Statement on Form F-6 (File No. 333-142177), which was filed with the Securities and Exchange Commission with respect to American depositary shares representing ordinary shares on April 17, 2007.

*** Previously filed as an exhibit to the annual report on Form 20-F for the fiscal year ended December 31, 2009, filed with the Securities and Exchange Commission on May 6, 2010.

Confidential treatment has been requested with respect to certain portions of this exhibit. A complete copy of the agreement, including the redacted portions, has been filed separately with the Commission.

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SIGNATURE

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

ACORN INTERNATIONAL, INC.

Name: /s/ DAVID CHENGHONG HE
Title: David Chenghong He
Chief Financial Officer

Date: August 24, 2010

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ACORN INTERNATIONAL, INC.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

TO THE BOARD OF DIRECTORS AND SHAREHOLDERS OF

ACORN INTERNATIONAL, INC.

We have audited the accompanying consolidated balance sheets of Acorn International, Inc. and its subsidiaries and variable interest entities (collectively, the Group) as of December 31, 2008 and 2009, and the related consolidated statements of operations, changes in equity and comprehensive income (loss) and cash flows for each of the three years in the period ended December 31, 2009 and related financial statement schedule. These financial statements and related financial statement schedule are the responsibility of the Group s management. Our responsibility is to express an opinion on these financial statements and related financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Group is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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, such consolidated financial statements present fairly, in all material respects, the financial position of Acorn International, Inc. and its subsidiaries and variable interest entities as of December 31, 2008 and 2009 and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2009 in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects, the information set forth therein.

As discussed in Note 2 to the consolidated financial statements, on January 1, 2009, the Group adopted FASB Accounting Standards Codification 810-10-65, Consolidation Overall Transition and Open Effective Date Information (previously Statement of Financial Accounting Standards No. 160, Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51).

/s/ Deloitte Touche Tohmatsu CPA Ltd.

Shanghai, China

May 6, 2010

Table of Contents**ACORN INTERNATIONAL, INC.****CONSOLIDATED BALANCE SHEETS****(In US dollars, except share data)**

	December 31,	
	2008	2009
	(As adjusted)	
Assets		
Current assets:		
Cash and cash equivalents	\$ 147,648,774	\$ 142,952,944
Restricted cash	1,425,102	2,394,213
Short-term investments	19,745,444	18,572,790
Accounts receivable, net of allowance for doubtful accounts of \$3,524,673 and \$1,597,556 as of December 31, 2008 and 2009, respectively	27,708,460	17,030,857
Notes receivable	150,607	2,242,641
Inventory	29,521,680	26,180,629
Prepaid advertising expenses	16,756,954	9,968,493
Other prepaid expenses and current assets, net of allowance for doubtful accounts of \$1,109,547 and \$11,643 as of December 31, 2008 and 2009, respectively	13,362,528	7,794,537
Deferred tax assets, net	3,355,151	2,320,535
Total current assets	259,674,700	229,457,639
Prepaid land use right		7,349,957
Property and equipment, net	15,641,434	14,818,404
Acquired intangible assets, net	21,313,949	3,181,596
Long-term investments	5,275,000	8,020,069
Investments in affiliates	1,159,134	8,881,830
Other long-term assets	1,121,100	1,673,755
Total assets	\$ 304,185,317	\$ 273,383,250
Liabilities and equity		
Current liabilities:		
Accounts payable	\$ 20,734,493	\$ 15,528,580
Accrued expenses and other current liabilities	19,652,820	14,838,142
Notes payable	3,657,859	3,253,005
Income taxes payable	3,327,869	3,422,261
Dividend payable		29,322,782
Deferred revenue	12,797,716	
Total current liabilities	60,170,757	66,364,770
Deferred tax liability	3,581,569	889,625
Business combination liability	11,107,375	1,103,015
Total liabilities	74,859,701	68,357,410
Commitments and contingencies (Note 22)		
Equity:		
Acorn International, Inc. shareholders' equity:		
Ordinary shares (\$0.01 par value; 100,000,000 shares authorized, 93,543,506 and 93,544,748 shares issued and 88,209,368 and 88,856,915 shares outstanding as of December 31, 2008 and 2009,	935,435	935,447

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respectively)		
Additional paid-in capital	205,651,072	178,176,225
Retained earnings	9,737,468	18,573,296
Accumulated other comprehensive income	15,113,507	17,562,561
Treasury stock, at cost (5,334,138 and 4,687,833 shares as of December 31, 2008 and 2009, respectively)	(15,676,206)	(11,612,546)
Total Acorn International, Inc. shareholders' equity	215,761,276	203,634,983
Noncontrolling interests	13,564,340	1,390,857
Total equity	229,325,616	205,025,840
Total liabilities and equity	\$ 304,185,317	\$ 273,383,250

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

Table of Contents**ACORN INTERNATIONAL, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS****(In US dollars, except share data)**

	For the years ended December 31,		
	2007 (As adjusted)	2008 (As adjusted)	2009
Revenues:			
Direct sales, net	\$ 181,319,805	\$ 166,947,475	\$ 160,357,948
Distribution sales, net	66,717,204	67,189,946	127,227,672
Total revenues, net	248,037,009	234,137,421	287,585,620
Cost of revenues:			
Direct sales	85,982,152	83,300,736	67,530,966
Distribution sales	37,366,039	37,326,214	83,096,932
Total cost of revenues	123,348,191	120,626,950	150,627,898
Gross profit	124,688,818	113,510,471	136,957,722
Operating (expenses) income			
Advertising expenses	(74,965,646)	(73,381,193)	(61,048,515)
Other selling and marketing expenses	(29,250,583)	(38,317,161)	(42,955,923)
General and administrative expenses	(26,100,091)	(27,746,833)	(31,195,949)
Impairment of goodwill and intangible assets		(8,667,961)	(15,247,873)
Other operating income, net	3,144,324	5,039,075	6,004,481
Total operating (expenses) income	(127,171,996)	(143,074,073)	(144,443,779)
Loss from operations	(2,483,178)	(29,563,602)	(7,486,057)
Other income (expenses)	13,710,909	(667,297)	1,651,386
Income (loss) before income taxes and discontinued operations	11,227,731	(30,230,899)	(5,834,671)
Income tax (expenses) benefits:			
Current	(1,453,133)	(127,933)	(1,280,089)
Deferred	1,466,082	122,965	3,819,354
Total income tax (expenses) benefits	12,949	(4,968)	2,539,265
Income (loss) from continuing operations	11,240,680	(30,235,867)	(3,295,406)
Discontinued operations (Note 4):			
Income from discontinued operations	13,156,605	9,036,863	841,559
Gain on disposition of discontinued operations			16,366,355
Income tax (expenses) benefits	1,317,054	(763,234)	(1,845,225)
Total income from discontinued operations	14,473,659	8,273,629	15,362,689

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Net income (loss)	25,714,339	(21,962,238)	12,067,283
Net income attributable to noncontrolling interests	(7,062,433)	(3,629,131)	(184,019)
Net income (loss) attributable to Acorn International, Inc.	18,651,906	(25,591,369)	11,883,264
Deemed dividend on Series A convertible redeemable preferred shares	(53,800)		
Net income (loss) attributable to holders of ordinary shares	\$ 18,598,106	\$ (25,591,369)	\$ 11,883,264
Income (loss) per ordinary share:			
Continuing operations	\$ 0.11	\$ (0.34)	\$ (0.04)
Discontinued operations	0.09	0.05	0.17
Basic	\$ 0.20	\$ (0.29)	\$ 0.13
Continuing operations	\$ 0.10	\$ (0.34)	\$ (0.04)
Discontinued operations	0.09	0.05	0.17
Diluted	\$ 0.19	\$ (0.29)	\$ 0.13
Weighted average number of shares used in calculating income (loss) per ordinary share:			
Basic	77,738,701	86,856,467	88,174,675
Diluted	84,472,947	86,856,467	88,174,675

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Table of Contents**ACORN INTERNATIONAL, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS (Continued)****(In US dollars, except share data)**

	For the years ended December 31,		
	2007 (As adjusted)	2008 (As adjusted)	2009
Net income (loss) attributable to Acorn International, Inc.:			
Income (loss) from continuing operations, net of tax	\$ 11,270,342	\$ (29,810,919)	\$ (2,999,844)
Income from discontinued operations, net of tax	7,381,564	4,219,550	14,883,108
	\$ 18,651,906	\$ (25,591,369)	\$ 11,883,264
Includes share-based compensation related to:			
Other selling and marketing expenses	\$ 423,490	\$ 292,135	\$ 94,453
General and administrative expenses	6,095,588	2,997,097	1,751,432
	\$ 6,519,078	\$ 3,289,232	\$ 1,845,885

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

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ACORN INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY AND COMPREHENSIVE INCOME (LOSS)

(In US dollars, except share data)

	Ordinary shares		Additional paid-in capital	Acorn International, Inc. shareholders' equity			Treasury stock, at cost		Total	Noncontrolling interests	Total equity	Comprehensive income (loss)
	Shares	Amount		Subscription receivable	Retained earnings	Accumulated other comprehensive income	Shares	Amount				
Balance at January 1, 2007	48,979,394	\$ 489,794	\$ 35,902,165	\$ (9,289,478)	\$ 21,084,593	\$ 3,029,752		\$	\$ 51,216,826	\$ 1,437,796	\$ 52,654,622	
Issuance of ordinary shares in public offering	23,565,000	235,650	112,994,175						113,229,825		113,229,825	
Cost of initial offering			(4,344,262)						(4,344,262)		(4,344,262)	
Conversion of A-1 convertible preferred shares into ordinary shares	17,709,815	177,098	31,872,401						32,049,499		32,049,499	
Issuance of A-1 convertible preferred shares into ordinary shares	2,882,155	28,822	18,836,902						18,865,724		18,865,724	
Repurchase of stock and stock option	119,076	1,190	121,152						122,342		122,342	
Repurchase of ordinary shares based on asset							(2,049,000)	(6,833,124)	(6,833,124)		(6,833,124)	
Share-based compensation			6,519,078						6,519,078		6,519,078	
Share repurchase					18,651,906				18,651,906	7,062,433	25,714,339	\$ 25,714,339
Change in noncontrolling interests upon acquisition of a subsidiary										430,000	430,000	
Dividend on A-1 convertible preferred shares					(53,800)				(53,800)		(53,800)	

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zed losses														
le-for-sale es														
n currency ion ments														
e at ber 31, s adjusted)	93,255,440	\$ 932,554	\$ 201,901,611	\$	\$ 39,682,699	\$ 7,690,985	(2,049,000)	\$ (6,833,124)	\$ 243,374,725	\$ 9,241,277	\$ 252,616,002	\$ 30,68		

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Table of Contents**ACORN INTERNATIONAL, INC.****CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY AND COMPREHENSIVE INCOME (LOSS) (Continued)**

(In US dollars, except share data)

	Ordinary shares		Acorn International, Inc. shareholders' equity				Treasury stock, at cost		Total	Noncontrolling interests	Total equity	Comprehensive income (loss)
	Shares	Amount	Additional paid-in capital	Subscription receivable	Retained earnings	Accumulated other comprehensive income	Shares	Amount				
Noncontrolling interests upon formation of a subsidiary										758,720	758,720	
Noncontrolling interests derecognized upon consolidation of Shanghai Jimeng										(13,139,887)	(13,139,887)	
Unrealized losses on available-for-sale securities						2,312,564			2,312,564	19,965	2,332,529	2,332,529
Foreign currency translation adjustments						136,490			136,490	3,700	140,190	140,190
Balance at December 31, 2009	93,544,748	\$ 935,447	\$ 178,176,225	\$	\$ 18,573,296	\$ 17,562,561	(4,687,833)	\$ (11,612,546)	\$ 203,634,983	\$ 1,390,857	\$ 205,025,840	\$ 14,540,000

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

Table of Contents**ACORN INTERNATIONAL, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In US dollars, except share data)

	For the years ended December 31,		
	2007 (As adjusted)	2008 (As adjusted)	2009
Operating activities:			
Net income (loss)	\$ 25,714,339	\$ (21,962,238)	\$ 12,067,283
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Gain on disposition of discontinued operations, net of taxes			(14,386,301)
Goodwill and intangible assets impairment losses		8,667,961	15,247,873
Share-based compensation	6,519,078	3,289,232	1,845,885
Equity in loss of affiliates		40,939	416,337
Loss on change in fair value of derivative assets		3,275,000	1,306,256
Allowance for doubtful receivables	1,517,638	2,607,753	(3,024,575)
Depreciation and amortization	1,928,016	2,355,726	5,561,533
Loss on disposal of equipment	60,137	20,510	64,463
Deferred income tax benefits	(2,783,136)	(380,698)	(4,625,879)
Realized gain from sales of trading securities	(9,255,911)	(2,177,486)	(1,275,164)
Unrealized (gain) loss on trading securities	(1,449,241)	1,554,429	(302,484)
Accrued interests on available-for-sale securities	(225,556)	190,001	(735,455)
Changes in operating assets and liabilities:			
Purchase of trading securities	(44,565,920)	(11,554,176)	(45,906,632)
Proceeds from sales of trading securities	41,757,384	20,648,615	36,112,589
Accounts receivable	(12,432,611)	5,887,247	11,785,575
Notes receivable	(1,348,977)	1,544,011	(2,092,034)
Inventory	(8,568,071)	(5,754,799)	3,118,315
Prepaid advertising expenses	2,232,734	6,481,182	6,449,501
Other prepaid expenses and current assets	1,693,590	(4,507,136)	18,469,172
Purchase of prepaid land use right			(7,489,280)
Accounts payable	4,488,152	4,775,729	(6,178,250)
Accrued expenses and other current liabilities	5,054,694	3,687,492	(3,442,827)
Notes payable	997,180	2,660,679	(404,854)
Income taxes payable	(20,684)	63,631	(806,305)
Deferred revenue	9,159,076	(554,655)	6,029,869
Net cash provided by operating activities	\$ 20,471,911	\$ 20,858,949	\$ 27,804,611
Investing activities:			
Purchase of available-for-sale securities	(20,000,000)		(1,355,325)
Redemption of available-for-sale securities by the issuer			10,000,000
Purchase of property and equipment	(9,248,137)	(2,902,844)	(3,079,508)
Proceeds from disposal of equipment	124,008	56,299	24,773
Purchase of acquired intangible assets	(208,129)	(623,716)	(514,814)
Purchase of other long-term assets		(175,072)	(891,379)
Acquisition of Yiyang Yukang, net of cash acquired		(6,971,274)	
Disposal of Shanghai Yimeng, net of cash disposed			(23,571,819)
Investments in affiliates		(1,200,073)	(3,939,801)
Increase in restricted cash	(224,430)	(750,842)	(969,111)

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Net cash used in investing activities	\$ (29,556,688)	\$ (12,567,522)	\$ (24,296,984)
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Table of Contents**ACORN INTERNATIONAL, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)**

(In US dollars, except share data)

	For the years ended December 31,		
	2007 (As adjusted)	2008 (As adjusted)	2009
Financing activities:			
Capital contribution from noncontrolling interests	430,000		758,720
Proceeds from initial public offering (net of issuance cost of \$4,344,262)	108,885,563		
Collection of subscription receivable	9,289,478		
Proceeds from exercise of stock options	122,342	463,110	2,062
Repurchase of ordinary shares	(6,833,124)	(16,378,724)	(2,288,136)
Yiyang Yukang first earn-out payment			(6,700,000)
Net cash provided by (used in) financing activities	\$ 111,894,259	\$ (15,915,614)	\$ (8,227,354)
Effect of exchange rate changes	\$ 5,189,272	\$ 6,529,802	\$ 23,897
Net increase (decrease) in cash and cash equivalents	\$ 107,998,754	\$ (1,094,385)	\$ (4,695,830)
Cash and cash equivalents at the beginning of the year	40,744,405	148,743,159	147,648,774
Cash and cash equivalents at the end of the year	\$ 148,743,159	\$ 147,648,774	\$ 142,952,944
Supplemental disclosure of cash flow information:			
Income taxes paid	\$ 1,658,178	\$ 1,879,118	\$ 2,567,446
Interest paid	\$ 320	\$	\$
Acquisition of Yiyang Yukang:			
Cash consideration		\$ 6,700,000	\$ 6,700,000
Fair value of ordinary shares issued		3,181,780	3,304,360
Direct expenses related to the acquisition		657,757	
Business combination liability		11,107,375	(10,004,360)
Assets acquired (including intangible asset of \$17,632,341)		\$ 21,646,912	\$
Purchase consideration settled in cash		\$ (7,357,757)	\$ (6,700,000)
Add: cash and cash equivalents acquired		386,483	
Cash outflow on the acquisition		\$ (6,971,274)	\$ (6,700,000)
Disposition of Shanghai Yimeng:			
Total cash received			\$ 10,477,081
Less: cash and cash equivalents disposed			(34,048,900)
Cash outflow on the disposition			\$ (23,571,819)

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

Table of Contents**ACORN INTERNATIONAL, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009****(In US dollars, except share data, unless otherwise stated)****1. Organization and principal activities**

Acorn International, Inc. (Acorn International) was incorporated in Cayman Islands on December 20, 2005. China DRTV, Inc. (China DRTV) was incorporated in the British Virgin Islands (BVI) on March 4, 2004.

Acorn International and its subsidiaries and variable interest entities (VIEs) (collectively, the Group) is an integrated multi-platform marketing company in China which develops, promotes and sells consumer products and services. The Group's two primary sales platforms are vertically integrated direct sales and a nationwide distribution network. Direct sales platforms include TV direct sales, third-party bank channel sales, catalogs sales, internet sales and direct sales through print media and radio. Direct sales are not only combined with the nationwide distribution network to market and sell the Group's products and services to consumers, but also used to promote and sell third-party branded products and services to consumers pursuant to joint sales arrangements and marketing services arrangements.

As of December 31, 2009, the subsidiaries and VIEs of Acorn International were as follows:

Name of subsidiaries and variable interest entities	Percentage of ownership	Date of incorporation	Place of incorporation
China DRTV, Inc. (China DRTV)	100%	March 4, 2004	BVI
Smooth Profit Limited (Smooth Profit)	100%	September 18, 2007	BVI
MK AND T Communications Limited (MK AND T)	100%	October 27, 1998	Hong Kong
Emony Investments Limited (Emony)	100%	October 26, 2007	Hong Kong
Bright Rainbow Investments Limited (Bright Rainbow)	100%	October 29, 2007	Hong Kong
Acorn Hong Kong Holdings Limited (Acorn Hong Kong)	51%	September 10, 2009	Hong Kong
U King Communication Equipment (Hong Kong) Limited (U King Hong Kong)	100%	November 30, 2009	Hong Kong
Shanghai Acorn Advertising Broadcasting Co., Ltd. (Shanghai Advertising)	100%	August 19, 2004	PRC
Shanghai HJX Digital Technology Co., Ltd. (Shanghai HJX)	100%	August 23, 2004	PRC
Acorn International Electronic Technology (Shanghai) Co., Ltd. (Acorn Electronic)	100%	August 23, 2004	PRC
Shanghai An-Nai-Chi Automobile Maintenance Products Co., Ltd. (Shanghai An-Nai-Chi)	51%	August 23, 2004	PRC
Acorn Information Technology (Shanghai) Co., Ltd. (Acorn Information)	100%	August 27, 2004	PRC
Beijing Acorn Youngleda Oxygen Generating Co., Ltd. (Beijing Youngleda)	100%	October 20, 2004	PRC
Yiyang Yukang Communication Equipment Co., Ltd. (Yiyang Yukang)	100%	November 29, 2005	PRC
Zhuhai Sunrana Bio-tech Co., Ltd. (Zhuhai Sunrana)	51%	June 16, 2006	PRC
Shanghai Acorn Enterprise Management Consulting Co., Ltd. (Acorn Consulting)	100%	September 26, 2006	PRC
Zhuhai Acorn Electronic Technology Co., Ltd. (Zhuhai Acorn)	100%	November 8, 2006	PRC
Beijing HJZX Software Technology Development Co., Ltd. (Beijing HJZX)	100%	January 22, 2007	PRC
Zhongshan Meijin Digital Technology Co., Ltd. (Zhongshan Meijin)	75%	February 13, 2007	PRC
Acorn Trade (Shanghai) Co., Ltd. (Acorn Trade)	100%	December 14, 2007	PRC
Shanghai Acorn HJX Software Technology Development Co., Ltd. (HJX Software)	100%	May 12, 2009	PRC
Beijing Acorn Trade Co., Ltd. (Beijing Acorn)	100%	March 19, 1998	PRC
Shanghai Acorn Network Technology Development Co., Ltd. (Shanghai Network)	100%	November 2, 2004	PRC

Table of Contents**ACORN INTERNATIONAL, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009****(In US dollars, except share data, unless otherwise stated)****1. Organization and principal activities (Continued)**

People's Republic of China (PRC) laws and regulations restrict foreign ownership entities engaged in direct sales in China. To comply with PRC laws and regulations, Acorn International conducts its direct sales through two VIEs (Beijing Acorn and Shanghai Network) which hold direct sales licenses. The two VIEs are owned 100% by two PRC nationals: Yang Dongjie (or Don Dongjie Yang), Acorn International's president, and He Chenghong (or David Chenghong He), Acorn International's executive officer. Acorn International has entered into various agreements with the two VIEs, including the use of trademarks of Acorn International and exclusive service agreement, entitling Acorn International to receive service fees based on the services provided. In addition, Acorn International has been assigned all voting rights by the owners of the two VIEs through an agreement valid indefinitely, which cannot be amended or terminated except by written consent of all parties. Finally, Acorn International has the option to acquire all the equity interests of the two VIEs once the PRC laws permit.

Through the above arrangements, Acorn International holds all the variable interests of the two VIEs through which it absorbs the majority of the economic risks and rewards of the VIEs and has been determined to be most closely associated with the two VIEs. Therefore, Acorn International is the primary beneficiary of the two VIEs. Accordingly, the financial statements of Beijing Acorn and Shanghai Network have been consolidated with Acorn International as its subsidiaries since they were established.

The following balance sheet amounts of the Group's two VIEs were included in the Group's consolidated balance sheets as of December 31, 2008 and 2009:

	December 31,	
	2008	2009
Total assets	\$ 27,867,651	\$ 34,171,811
Total liabilities	\$ 31,172,867	\$ 29,284,198

In June 2009, the Group sold 33% equity interests in Shanghai Yimeng Software Technology Co., Ltd. (Shanghai Yimeng), previously a subsidiary engaged in development and marketing of CPS stock tracking software. Upon completion of the disposal, the Group owned 18% of equity interests in Shanghai Yimeng and ceased to consolidate Shanghai Yimeng as a subsidiary (refer to Note 4 for details of the discontinuance of the stock tracking software business).

2. Summary of principal accounting policies**(a) Basis of presentation**

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

(b) Basis of consolidation

The consolidated financial statements include the financial statements of the Group, its majority-owned subsidiaries and VIEs. All intercompany transactions and balances are eliminated upon consolidation.

(c) Use of estimates

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The preparation of financial statements in conformity with US GAAP requires the Group to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets

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ACORN INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009

(In US dollars, except share data, unless otherwise stated)

2. Summary of principal accounting policies (Continued)

(c) Use of estimates (Continued)

and liabilities at the date of the financial statements, as well as the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Significant accounting estimates reflected in the Group's financial statements include allowance for doubtful accounts, inventory valuation, assumptions related to the valuation of available-for-sale debt securities and embedded derivative, useful lives and impairment of long-lived assets and goodwill, assumptions used in purchase price allocation, assumptions related to the valuation of share-based compensation and related forfeiture rates, assumptions used in determining the fair value of retained noncontrolling investment upon deconsolidation of a former subsidiary, and valuation allowance on deferred tax assets and provision for uncertain tax positions.

(d) Fair value of financial instruments

On January 1, 2008, the Group adopted the provisions of Accounting Standards Codification (ASC) 820-10, Fair Value Measurements and Disclosures Overall (previously Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements), for financial assets and financial liabilities. As permitted by an amendment to ASC 820-10 that the Financial Accounting Standards Board (FASB) issued in February 2008 (previously FASB Staff Position No. FAS 157-2, Effective Date of FASB Statement No. 157), the Group elected to defer the adoption of ASC 820-10 for the Group's nonfinancial assets and nonfinancial liabilities until January 1, 2009, except those that are recognized or disclosed at fair value in the consolidated financial statements on a recurring basis. The guidance defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (also referred to as an exit price) and expands disclosure requirements about assets and liabilities measured at fair value. The guidance establishes a hierarchy for inputs used in measuring fair value that gives the highest priority to observable inputs and the lowest priority to unobservable inputs as follows:

Level 1 Observable unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2 Observable inputs other than quoted prices in active markets for identical assets or liabilities, for which all significant inputs are observable, either directly or indirectly.

Level 3 Unobservable inputs to the valuation methodology that are significant to the measurement of fair value of assets or liabilities.

When available, the Group measures the fair value of financial instruments based on quoted market prices in active markets, valuation techniques that use observable market-based inputs or unobservable inputs that are corroborated by market data. The Group uses valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. Assets and liabilities measured at fair value are classified in the categories of Level 1, Level 2, and Level 3 based on the lowest level input that is significant to the fair value measurement in its entirety. Pricing information the Group obtains from third parties is internally validated for reasonableness prior to use in the consolidated financial statements. When observable market prices are not readily available, the Group generally estimates the fair value using valuation techniques that rely on alternate market data or inputs that are generally less readily observable from objective sources and are estimated based on pertinent information available at the time of the applicable reporting periods. In certain cases, fair values are not subject to precise quantification or verification and may fluctuate as economic and market factors vary and the Group's evaluation of those factors changes. Although the Group uses its best judgment in estimating the fair value of these financial instruments, there are inherent limitations in any

estimation technique. In these cases, a

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ACORN INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009

(In US dollars, except share data, unless otherwise stated)

2. Summary of principal accounting policies (Continued)

(d) Fair value of financial instruments (Continued)

minor change in an assumption could result in a significant change in its estimate of fair value, thereby increasing or decreasing the amounts of the Group's consolidated assets, liabilities, equity and net income or loss.

The Group's financial instruments consist of cash and cash equivalents, restricted cash, short-term investments, accounts receivable, notes receivable, long-term investments, accounts payable and notes payable. For cash and cash equivalents, restricted cash, accounts receivable, notes receivable, accounts payable and notes payable, the carrying amounts of these financial instruments as of December 31, 2008 and 2009 were considered representative of their fair values due to their short terms to maturity.

(e) Cash and cash equivalents

Cash and cash equivalents consist of cash on hand and highly liquid investments which are unrestricted as to withdrawal or use, and which have original maturities of three months or less when purchased.

(f) Restricted cash

Under the notes payable and third-party bank channel sales arrangements with the banks, the Group is required to maintain certain cash balances in the banks based on the amounts of notes payable granted or certain fixed amounts. These balances related to the notes payable and third-party bank channel sales arrangements were reflected as restricted cash in the balance sheet and amounted to \$1,278,788 and \$2,394,213 as of December 31, 2008 and 2009, respectively.

The restricted cash also included \$146,314 and nil as of December 31, 2008 and 2009, respectively, which represented the cash frozen by the court in regard to a pending lawsuit.

(g) Short-term and long-term investments

The Group's short-term investments consist of trading securities and available-for-sale securities.

The Group's long-term investments consist of available-for-sale securities and an embedded derivative instrument.

Securities that the Group buys and holds principally for the purpose of selling them in the near term are classified as trading securities. Trading securities are recorded at fair value, with unrealized gains and losses recognized in the consolidated statements of operations.

Securities that the Group has the positive intention and ability to hold to maturity are classified as held-to-maturity securities and reported at amortized cost.

Securities not classified as either trading securities or held-to-maturity securities are classified as available-for-sale securities and reported at fair value, with unrealized gains and losses recorded as a component of accumulated other comprehensive income or loss in equity. Realized gains or losses are recognized in the consolidated statements of operations during the period in which the gains or losses are realized. If the Group

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ACORN INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009

(In US dollars, except share data, unless otherwise stated)

2. Summary of principal accounting policies (Continued)

(g) Short-term and long-term investments (Continued)

determines that a decline in the fair value of the individual available-for-sale security is other-than-temporary, the cost basis of the security is written down to the fair value as a new cost basis and the amount of the write-down is accounted for as a realized loss. The new cost basis will not be changed for subsequent recoveries in fair value. The Group reviews several factors to determine whether a loss is other-than-temporary. These factors include, but are not limited to, the: (1) nature of the investment; (2) cause and duration of the impairment; (3) extent to which fair value is less than cost; (4) financial conditions and near term prospects of the issuers; and (5) the Group's ability to hold the security for a period of time sufficient to allow for any anticipated recovery of its amortized cost or fair value.

On April 1, 2009, the Group adopted an amendment to ASC 320-10, Investments in Debt and Equity Securities Overall (previously FASB Staff Position FAS 115-2 and 124-2), regarding the other-than-temporary impairment model for debt securities. The amended guidance requires an entity to recognize other-than-temporary impairment in earnings if an investor has the intent to sell the debt security or if it is more-likely-than-not that the investor will be required to sell the debt security before recovery of its amortized cost basis. Additionally, an entity must evaluate expected cash flows to be received and determine if credit-related losses on debt securities exist, which are considered to be other-than-temporary impairment recognized in earnings (refer to Note 5 for the impact of the adoption of ASC 320-10 on the Group's consolidated financial statements).

Available-for-sale securities not expected to be realized in cash or sold in the next normal operating cycle of the business are classified as long-term investments.

(h) Derivative instruments

The Group holds investment in securities that meet the definition of a derivative instrument, including investment in share options of a Japanese public company. In addition, one of the Group's long-term investments contains an embedded derivative instrument that is linked to an equity index and an interest rate index. The embedded derivative is bifurcated from the host contract for separate accounting.

Derivative instruments are recognized as assets or liabilities and measured at fair value initially and at the end of each reporting period. Changes in fair value of the derivatives are recorded in the consolidated statements of operations. The Group's derivative instruments do not qualify for hedge accounting.

The balances of the share options of the Japanese public company are presented in other long-term assets in the consolidated balance sheets. The balances of the embedded derivative and the host security are combined in one line and presented in long-term investments in the consolidated balance sheets.

(i) Inventory

The cost of inventory comprises all costs of purchase, costs of conversion, and other costs incurred to bring inventory to its present location and condition. The cost of inventory is calculated using the weighted-average method.

Inventory is stated at the lower of cost or market value. Adjustments are recorded to write down the cost of obsolete and excess inventory to the estimated market value based on historical and forecast demand.

(j) Prepaid land use right

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In January 2009, the Group obtained a 50-year land use right of a piece of land in Qingpu district of Shanghai for an aggregate cash consideration of \$7,489,280. The land use right is valued at cost less accumulated amortization. Amortization is computed using the straight-line method over its useful lives of 50 years.

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Table of Contents**ACORN INTERNATIONAL, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009****(In US dollars, except share data, unless otherwise stated)****2. Summary of principal accounting policies (Continued)*****(k) Property and equipment, net***

Property and equipment are carried at cost less accumulated depreciation and amortization. Depreciation and amortization is calculated on a straight-line method over the following estimated useful lives:

	Estimated useful lives
Buildings	20 years
Leasehold improvements	Lesser of the term of the lease or the estimated useful lives of the assets
Machinery	10 years
Computers and office equipment	3-5 years
Vehicles	5 years

(l) Acquired intangible assets, net

Acquired intangible assets, which consist primarily of distribution networks, trademarks, securities investment advisory service license, patents and assembled and trained workforce, are valued at cost less accumulated amortization. Amortization is computed using the straight-line method over their expected useful lives of 3 to 15 years.

(m) Impairment of long-lived assets

The Group evaluates its long-lived assets and finite-lived intangibles for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. When these events occur, the Group measures impairment by comparing the carrying amount of the assets to the future undiscounted cash flows expected to result from the use of the assets and their eventual disposition. If the sum of the future undiscounted cash flow is less than the carrying amount of the assets, the Group would recognize an impairment loss equal to the excess of the carrying amount over the fair value of the assets.

(n) Investment in affiliates

The affiliated companies in which the Group has non-significant influence are accounted for using cost method of accounting. Dividends received that are distributed from the net accumulated earnings of the investee are recognized in the Group's consolidated statements of operations. Dividends received in excess of earnings are recorded as reductions of cost of the investment. A series of operating losses of the investee or other factors may indicate that a decrease in value of the investment has occurred which is other-than-temporary and should accordingly be recognized.

The affiliated companies in which the Group has significant influence are accounted for using equity method of accounting. The share of earnings or losses of the investee are recognized in the Group's consolidated statements of operations and adjusts the carrying amount of the investment. Dividends received reduce the carrying amount of the investment. A series of operating losses of the investee or other factors may

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indicate that a decrease in value of the investment has occurred which is other-than-temporary and should accordingly be recognized even though the decrease in value is in excess of what would otherwise be recognized by application of the equity method of accounting.

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Table of Contents**ACORN INTERNATIONAL, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009****(In US dollars, except share data, unless otherwise stated)****2. Summary of principal accounting policies (Continued)****(o) Goodwill**

The Group performs a two-step goodwill impairment test on an annual basis. The first step compares the fair value of each reporting unit to its carrying amount, including goodwill. If the fair value of each reporting unit exceeds its carrying amount, goodwill is not considered to be impaired and the second step will not be required. If the carrying amount of a reporting unit exceeds its fair value, the second step compares the implied fair value of goodwill to the carrying value of a reporting unit's goodwill. The fair value of each reporting unit is estimated using the expected present value of future cash flows. The implied fair value of goodwill is determined in a manner similar to accounting for a business combination with the allocation of the assessed fair value determined in the first step to the assets and liabilities of the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to the assets and liabilities is the implied fair value of goodwill. This allocation process is only performed for purposes of evaluating goodwill impairment and does not result in an entry to adjust the value of any assets or liabilities. An impairment loss is recognized for any excess in the carrying value of goodwill over the implied fair value of goodwill. Goodwill is reviewed at least annually for impairment, or earlier if there is an indication of impairment.

In 2007, the Group performed an annual goodwill impairment test on April 30. In 2008, the Group changed the annual goodwill impairment testing day to October 1, so in 2008 the Group performed the goodwill impairment test on both April 30 and October 1. This change is considered preferable because it allows the Group to use more current financial information and matches the Group's business plan timing. This change in the method of applying accounting principle does not delay, accelerate or avoid an impairment charge or affect the Group's financial statements.

In 2008, the Group determined that an indication of potential goodwill impairment existed due to the sustained decrease in the Group's market capitalization below book value along with the consideration of certain 2009 budgeting activities that indicated lower operating results than previously forecasted. After the goodwill impairment test, the Group recognized \$7,571,865 goodwill impairment loss in 2008.

The carrying amount of goodwill allocated by segment for the years ended December 31, 2008 and 2009 were as follows:

	Direct sales	Distribution sales	Total
Balance at January 1, 2008	\$ 1,481,777	\$ 6,090,088	\$ 7,571,865
Impairment loss recognized during the year	(1,481,777)	(6,090,088)	(7,571,865)
Balance at December 31, 2008	\$	\$	\$
Impairment loss recognized during the year			
Balance at December 31, 2009	\$	\$	\$

The changes in the gross amount and accumulated impairment losses of goodwill for the year ended December 31, 2008 were as follows:

Gross amount	Accumulated impairment loss	Net amount
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Balance at January 1, 2008	\$7,571,865	\$	\$ 7,571,865
Impairment loss recognized		(7,571,865)	(7,571,865)
Balance at December 31, 2008	\$ 7,571,865	\$ (7,571,865)	\$

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ACORN INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009

(In US dollars, except share data, unless otherwise stated)

2. Summary of principal accounting policies (Continued)

(p) Revenue recognition

Direct sales, net

The Group's direct sales net revenues primarily represent product sales through the Group's TV direct sales and other direct sales platforms, such as third-party bank channel sales, outbound calls, catalogue sales, internet sales, and direct sales through print media and radio. Revenues from sales of products are recognized once the products are delivered to and accepted by the customers.

Under marketing services arrangements, the Group provides a TV direct sales marketing plan, the related TV advertising time and call center support to third parties for a fixed fee. Marketing services revenues are recognized ratably over the contractual period of the arrangements. The related costs, including TV advertising expenses, are classified as cost of direct sales net revenues.

Under joint sales arrangements, the Group generates direct sales net revenues from the sales of products and also receives payments from the joint sales partners based on sales of the featured products through the joint sales partners' own distribution channels. These payments are classified as a reduction to cost of direct sales net revenues via a reduction in the purchase price of the products purchased by the Group from the joint sales partners.

The Group conducted promotional activities of direct sales primarily through the use of cash coupon discounts and the membership-based loyalty program which includes membership points. All such costs are netted against revenues at the time the revenue is recorded. The Group uses historical trend experience to accrue for cash coupon discounts and membership points.

The Group relies on China Express Mail Service Corporation (EMS) and local delivery companies to provide the Group data as to their successful deliveries for the Group's direct sales products. EMS and local delivery companies regularly report product delivery information. Direct sales net revenues for 2007, 2008 and 2009 reflected actual delivery information received from EMS and local delivery companies to ensure the Group did not recognize revenues on unsuccessful deliveries. For unsuccessful deliveries, EMS and local delivery companies are required to return the undelivered products to the Group. It generally takes two to three weeks for EMS to return the undelivered products to the Group whereas it generally takes seven days for local delivery companies to do so.

Distribution sales, net

The Group's distribution sales net revenues represent product sales to the distributors comprising the Group's nationwide distribution networks. The distributor agreements do not provide discounts, chargeback, price protection or stock rotation rights. However, there were certain distributor agreements that provided performance-based cash rebates which were netted against revenues at the time the revenue was recorded. Accordingly, the Group records the revenues when products are delivered to and accepted by the distributors as there are no future remaining obligations.

Software revenue recognition

The Group generated revenues from annual subscription fees from subscribers for the Group's stock tracking software which includes access to the Group's initial software CD containing data analysis tools and services. Upon receipt of the upfront cash payments from the subscriber, the Group provides an access code to

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ACORN INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009

(In US dollars, except share data, unless otherwise stated)

2. Summary of principal accounting policies (Continued)

(p) Revenue recognition (Continued)

the subscriber and activates the subscriber's account when the subscriber first logs on. This commences the one-year subscription period and the full payment is deferred and recognized ratably over the one-year subscription period. After the initial subscription period, the subscribers can register for an additional one year renewal. The pricing of the initial subscription fee and renewal fee is same regardless of whether it is sold by the Group directly or through the Group's distribution network. Because the data services are essential to the functionality of the software analysis tools, the Group recognizes revenue ratably over the one-year subscription period. In June 2009, the Group discontinued its stock tracking software business and included a gain from disposition and its results prior to the disposition in income from discontinued operations in the consolidated statements of operations (refer to Note 4 for details of the discontinuance of the stock tracking software business).

The Group estimates the amount of sales returns and cost of product warranty replacements based on the products' historical trend of sales returns and current economic trends including market acceptance of new and existing products. In 2007, 2008 and 2009, the sales returns and warranty replacements were insignificant.

The Group presented revenues net of sales taxes incurred. The sales taxes amounted to \$825,022, \$209,469 and \$195,923 for the years ended December 31, 2007, 2008 and 2009, respectively. Before subtracting sales taxes, gross direct sales were \$182,138,800, \$167,156,706 and \$160,553,758 and gross distribution sales were \$66,723,231, \$67,190,184 and \$127,227,785 for the years ended December 31, 2007, 2008 and 2009, respectively.

(q) Advertising expenses

The Group records cash advances to the advertising companies as prepaid advertising expenses in the consolidated balance sheets. The Group then expenses the prepaid advertising expenses as the advertisement is shown.

(r) Shipping and handling costs

The Group records costs incurred for shipping and handling as part of other selling and marketing expenses in the consolidated statements of operations. Shipping and handling costs were \$7,216,096, \$9,992,238 and \$12,431,793 for the years ended December 31, 2007, 2008 and 2009, respectively.

(s) Operating leases

Leases where substantially all the rewards and risks of ownership of assets remain with the leasing company are accounted for as operating leases. Payments made under operating leases are charged to the consolidated statements of operations on a straight-line basis over the lease periods.

(t) Government subsidies

The Group receives unrestricted government subsidies from local governmental agencies for certain taxes paid by the Group which include value-added, business and income taxes. The Group records unrestricted government subsidies as other operating income in the consolidated statements of operations.

The government subsidies in 2007, 2008 and 2009 were \$1,789,900, \$3,669,893 and \$5,094,301, respectively.

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ACORN INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009

(In US dollars, except share data, unless otherwise stated)

2. Summary of principal accounting policies (Continued)

(u) Income taxes

Current income taxes are provided for in accordance with the relevant statutory tax laws and regulations.

Deferred income taxes are recognized for temporary differences between the tax basis of assets and liabilities and their reported amounts in the financial statements. Net operating losses are carried forward and credited by applying enacted statutory tax rates applicable to future years. Deferred tax assets are reduced by a valuation allowance when, in the opinion of the Group, it is more-likely-than-not that some portion or all of the deferred tax assets will not be realized. The components of the deferred tax assets and liabilities are individually classified as current and non-current based on the characteristics of the underlying assets and liabilities, or the expected timing of their use when they do not relate to a specific asset or liability.

The Group recognizes the impact of an uncertain income tax position at the largest amount that is more-likely-than-not to be sustained upon audit by the relevant tax authority. The Group classifies interests and penalties related to income tax matters in income tax expense.

(v) Foreign currency translation

The functional currency and reporting currency of Acorn International, China DRTV, Smooth Profit, MK AND T, Emoney, Bright Rainbow, Acorn Hong Kong and U King Hong Kong are the United States dollar (US dollar). Monetary assets and liabilities denominated in currencies other than the US dollar are translated into the US dollar at the rates of exchange ruling at the balance sheet date. Transactions in currencies other than the US dollar during the year are converted into US dollar at the applicable rates of exchange prevailing on the first day of the month in which the transactions occurred. Transaction gains and losses are recognized in the consolidated statements of operations.

The financial records of the Group's PRC subsidiaries and VIEs are denominated in its local currency, the Renminbi (RMB), which is the functional currency. Assets and liabilities are translated at the exchange rates at the balance sheet date. Equity accounts are translated at historical exchange rates. Revenues, expenses, gains and losses are translated using the average rate for the period. Translation adjustments are reported as cumulative translation adjustments and are shown as a separated component of accumulated other comprehensive income in the consolidated statements of changes in equity and comprehensive income (loss).

The aggregated gains through foreign currency transactions in 2007 and 2008 were \$486,471, \$542,423 and losses through foreign currency transactions in 2009 were \$1,925.

The RMB is not a freely convertible currency. The PRC State Administration for Foreign Exchange, under the authority of the People's Bank of China, controls the conversion of RMB into foreign currencies. The value of the RMB is subject to changes in central government policies and to international economic and political developments affecting supply and demand in China's foreign exchange trading system market. The Group's aggregate amount of cash and cash equivalents and restricted cash denominated in RMB amounted to RMB589,841,731 and RMB605,716,689 as of December 31, 2008 and 2009, respectively.

(w) Comprehensive income (loss)

Comprehensive income (loss) includes all changes in equity except those resulting from investments by owners and distributions to owners and is comprised of net income (loss), unrealized gains and losses on available-for-sale securities and foreign currency translation adjustments. Comprehensive income (loss) is reported in the consolidated statements of changes in equity and comprehensive income (loss).

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ACORN INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009

(In US dollars, except share data, unless otherwise stated)

2. Summary of principal accounting policies (Continued)

(x) Concentration of credit risk

Financial instruments that potentially expose the Group to concentration of credit risk consist primarily of cash and cash equivalents, restricted cash, available-for-sale securities, derivative instruments, accounts receivable and notes receivable. All of the Group's cash and cash equivalents and restricted cash are held with financial institutions that the Group believes to be high credit quality. The Group's available-for-sale securities and derivative instruments are issued by financial institutions and a Japanese public company listed on the JASDAQ with high credit ratings. The Group conducts credit evaluations of customers and generally does not require collateral or other security from its customers. The Group establishes an allowance for doubtful accounts primarily based on the age of the receivables and factors surrounding the credit risk of specific customers.

The Group mainly engaged EMS to deliver products to customers and to collect cash from the customers for direct sales gross revenues through direct sales platforms. As of December 31, 2008 and 2009, accounts receivables from EMS were \$9,010,888 and \$2,173,542, respectively. These amounts represented 32.52% and 12.76% of the total accounts receivables as of December 31, 2008 and 2009, respectively.

(y) Share-based compensation

Share-based compensation cost is measured at grant date, based on the fair value of the award, and recognized in expense over the requisite service period. The Group has made an estimate of expected forfeitures and is recognizing compensation costs only for those equity awards to vest.

(z) Income (loss) per share

The Group has determined that its Series A convertible redeemable preferred shares and Series A-1 convertible redeemable preferred shares are participating securities as the preferred shares participate in undistributed earnings on the same basis as the ordinary shares. Accordingly, the Group has used the two-class method of computing income per share under which income per share is computed for ordinary and preferred shares according to participation rights in undistributed earnings. Under this method, net income applicable to holders of ordinary shares is allocated on a pro rata basis to the ordinary and preferred shares to the extent that each class may share in income for the period had been distributed. Diluted income per share is computed using the more dilutive of (a) the two-class method or (b) the if-converted method. For the period from January 1, 2007 to the Group's initial public offering (IPO) on May 3, 2007, the application of the two-class method was more dilutive than the if-converted method. The preferred shares have been converted into ordinary shares upon the completion of the IPO, the two-class method of computing income per share ceased to apply on the conversion date.

Table of Contents**ACORN INTERNATIONAL, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009****(In US dollars, except share data, unless otherwise stated)****2. Summary of principal accounting policies (Continued)****(z) Income (loss) per share (Continued)**

The computation of basic and diluted income (loss) per ordinary share from continuing operations and discontinued operations for the years ended December 31, 2007, 2008 and 2009 was as follows:

	For the years ended December 31,		
	2007	2008	2009
Numerator:			
Net income (loss) attributable to Acorn International, Inc. from continuing operations	\$ 11,270,342	\$ (29,810,919)	\$ (2,999,844)
Deemed dividend on Series A convertible redeemable preferred shares	(48,729)		
Income allocated to Series A and Series A-1 convertible redeemable preferred shares for participating rights to dividends	(2,492,040)		
Income (loss) attributable to holders of ordinary shares from continuing operations basic and diluted	\$ 8,729,573	\$ (29,810,919)	\$ (2,999,844)
Net income attributable to Acorn International, Inc. from discontinued operations	\$ 7,381,564	\$ 4,219,550	\$ 14,883,108
Deemed dividend on Series A convertible redeemable preferred shares	(5,071)		
Income allocated to Series A and Series A-1 convertible redeemable preferred shares for participating rights to dividends	(260,079)		
Income attributable to holders of ordinary shares from discontinued operations basic and diluted	\$ 7,116,414	\$ 4,219,550	\$ 14,883,108
Denominator:			
Weighted average ordinary shares outstanding basic	77,738,701	86,856,467	88,174,675
Stock options and stock appreciation rights	6,734,246		
Weighted average ordinary shares outstanding diluted	84,472,947	86,856,467	88,174,675
Income (loss) per ordinary share:			
continuing operations	\$ 0.11	\$ (0.34)	\$ (0.04)
discontinued operations	0.09	0.05	0.17
Basic	\$ 0.20	\$ (0.29)	\$ 0.13
continuing operations	\$ 0.10	\$ (0.34)	\$ (0.04)
discontinued operations	0.09	0.05	0.17
Diluted	\$ 0.19	\$ (0.29)	\$ 0.13

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The Group had 1,824,646, 16,020,975 and 15,709,569 weighted average stock options and stock appreciation rights (SAR) outstanding in 2007, 2008 and 2009, respectively, which could have potentially diluted income per share in the future, but were excluded in the computation of diluted income (loss) per share in those periods, as their exercise prices were above the average market share prices in 2007, and the Group had net loss attributable to holders of ordinary shares from continuing operations in 2008 and 2009.

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ACORN INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009

(In US dollars, except share data, unless otherwise stated)

2. Summary of principal accounting policies (Continued)

(aa) Noncontrolling interest

On January 1, 2009, the Group adopted ASC 810-10-65, Consolidations Overall Transition and Open Effective Date Information (previously SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51). A noncontrolling interest in a subsidiary or VIE of the Group represents the portion of the equity (net assets) in the subsidiary or VIE not directly or indirectly attributable to the Group. This pronouncement requires noncontrolling interests to be presented as a separate component of equity in the consolidated balance sheet and modifies the presentation by requiring earnings and other comprehensive income to be attributed to controlling and noncontrolling interests. The presentation regarding noncontrolling interests was retrospectively applied for all the periods presented.

As a result of the adoption of this accounting standard, the Group retrospectively (1) reclassified \$9,241,277 and \$13,564,340 of minority interests to noncontrolling interests, a component of equity as of December 31, 2007 and 2008, respectively, and (2) presented \$7,062,433 and \$3,629,131 of minority interests, previously deducted from net income (loss) for the years ended December 31, 2007 and 2008, respectively, as an adjustment to net income (loss) to arrive at net income (loss) attributable to Acorn International, Inc. in the consolidated statements of operations.

For the year ended December 31, 2009, the Group derecognized \$13.1 million noncontrolling interests in Shanghai Yimeng in its consolidated statement of changes in equity and comprehensive income (loss). Prior to the deconsolidation of Shanghai Yimeng in June 2009, Shanghai Yimeng declared cash dividends of \$30.0 million pro rata to its existing shareholders, of which the noncontrolling interest holders were entitled to receive \$14.7 million. The cash dividends were recorded to reduce the balance of noncontrolling interests when the dividends were declared. The negative carrying amount of the noncontrolling interests in Shanghai Yimeng of \$1.6 million was derecognized upon deconsolidation.

(bb) Recently issued accounting pronouncements

In June 2009, the FASB issued amendments to ASC 860-10, Transfers and Servicing Overall (previously SFAS No. 166, Accounting for Transfers of Financial Assets). The amendments limit the circumstances in which a financial asset, or a portion of a financial asset, should be derecognized when the transferor has not transferred the entire original financial asset to an entity that is not consolidated with the transferor in the financial statements being presented, and/or when the transferor has continuing involvement with the transferred financial asset. The new guidance in ASC 860-10 is effective for financial asset transfers occurring after the beginning of an entity's first fiscal year that begins after November 15, 2009, or January 1, 2010 for companies reporting earnings on a calendar-year basis. The adoption of this new guidance is not expected to have a material impact on the Group's financial position, results of operations or cash flows.

In June 2009, the FASB issued amendments to ASC 810-10, Consolidation Overall (previously SFAS 167, Amendments to FASB Interpretation No. 46(R)). This accounting standard eliminates exceptions of the previously issued pronouncement to consolidating qualifying special purpose entities, contains new criteria for determining the primary beneficiary, and increases the frequency of required reassessments to determine whether a company is the primary beneficiary of a variable interest entity. This accounting standard also contains a new requirement that any term, transaction, or arrangement that does not have a substantive effect on an entity's status as a variable interest entity, a company's power over a variable interest entity, or a company's obligation to absorb losses or its right to receive benefits of an entity must be disregarded in applying the provisions of the previously issued pronouncement. This accounting standard will be effective for the Group's

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ACORN INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009

(In US dollars, except share data, unless otherwise stated)

2. Summary of principal accounting policies (Continued)

(bb) Recently issued accounting pronouncements (Continued)

fiscal year beginning January 1, 2010. The adoption of this new guidance is not expected to have a material impact on the Group's financial position, results of operations or cash flows.

In August 2009, the FASB issued Accounting Standards Update (ASU) 2009-05, Fair Value Measurements and Disclosures (Topic 820) Measuring Liabilities at Fair Value. ASU 2009-05 amends ASC 820-10, Fair Value Measurements and Disclosures Overall, for the fair value measurement of liabilities. It provides clarification that in circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure the fair value using (1) a valuation technique that uses the quoted price of the identical liability when traded as an asset or quoted prices for similar liabilities or similar liabilities when traded as assets or (2) another valuation technique that is consistent with the principles of Topic 820. It also clarifies that when estimating the fair value of a liability, a reporting entity is not required to include a separate input or adjustment to other inputs relating to the existence of a restriction that prevents the transfer of the liability and that both a quoted price in an active market for the identical liability at measurement date and that the quoted price for the identical liability when traded as an asset in an active market when no adjustments to the quoted price of the asset are required are Level 1 fair value measurements. The provisions of ASU 2009-05 are effective for the first reporting period (including interim periods) beginning after January 1, 2010. Early application is permitted. The adoption of this new guidance is not expected to have a material impact on the Group's financial position, results of operations or cash flows.

In October 2009, the FASB issued ASU 2009-13, Revenue Recognition (Topic 605) Multiple-Deliverable Revenue Arrangements (previously EITF 08-1, Revenue Arrangements with Multiple Deliverables). This ASU addresses the accounting for multiple-deliverable arrangements to enable vendors to account for products or services (deliverables) separately rather than as a combined unit. Specifically, this guidance amends the criteria for separating consideration in multiple-deliverable arrangements. This guidance establishes a selling price hierarchy for determining the selling price of a deliverable, which is based on: (a) vendor-specific objective evidence; (b) third-party evidence; or (c) estimates. This guidance also eliminates the residual method of allocation and requires that arrangement consideration be allocated at the inception of the arrangement to all deliverables using the relative selling price method. In addition, this guidance significantly expands required disclosures related to a vendor's multiple-deliverable revenue arrangements. This accounting standard will be effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. The Group is currently evaluating the impact of adoption on its consolidated financial statements.

In January 2010, the FASB issued ASU 2010-06, Fair Value Measurements and Disclosures (Topic 820) Improving Disclosures about Fair Value Measurements. ASU 2010-06 amends ASC 820 (formerly SFAS 157) to add new requirements for disclosures about (1) the different classes of assets and liabilities measured at fair value, (2) the valuation techniques and inputs used, (3) the activity in Level 3 fair value measurements, and (4) the transfers between Levels 1, 2, and 3. The guidance in ASU 2010-06 is effective for the first reporting period beginning after December 15, 2009, except for the requirement to provide the Level 3 activity of purchases, sales, issuances, and settlements on a gross basis, which will be effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. In the period of initial adoption, entities will not be required to provide the amended disclosures for any previous periods presented for comparative purposes. However, those disclosures are required for periods ending after initial adoption. Early adoption is permitted. The Group is currently evaluating the impact of adoption on its consolidated financial statements.

Table of Contents**ACORN INTERNATIONAL, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009****(In US dollars, except share data, unless otherwise stated)****3. Acquisition**

On December 24, 2008, the Group completed its acquisition of 100% equity interests of Yiyang Yukang, a cell phone producer and distributor in the PRC, pursuant to the terms of the definitive agreement entered into on December 18, 2008. Under the agreement, the Group acquired Yiyang Yukang for an initial purchase price of \$6,700,000 in cash and 2,564,103 of its ordinary shares at a fair value of \$3,181,780 in aggregate, based on average market price of the Group's ordinary shares for a reasonable period before and after the date of the agreement. The Group shall additionally pay up to three earn-out payments equivalent to the maximum amount of \$37.1 million in a combination of cash and ordinary shares, contingent on Yiyang Yukang meeting certain earnings targets in 2008 to 2010. The ordinary shares repurchased through the Group's share repurchase program were used for the acquisition. The Group's total expenses related to the acquisition were \$657,757. A business combination liability resulted from the acquisition and amounted to \$11,107,375 as of December 31, 2008.

In 2009, Yiyang Yukang met the first earn-out payment earnings target for the year 2008 and the first quarter of 2009. The Group paid out \$6,700,000 in cash and 2,564,103 of its ordinary shares at a fair value of \$3,304,360 in aggregate, based on average market price of the Group's ordinary shares for a reasonable period before and after the date of the agreement. In addition, Yiyang Yukang did not meet the second earn-out payment earnings target for the year 2009 and the Group did not need to pay the second earn-out payment. The maximum amount of the third earn-out payment is \$14.7 million, contingent on Yiyang Yukang meeting earnings target for the year 2010. The business combination liability after the first earn-out payment amounted to \$1,103,015 as of December 31, 2009.

The Group believes that the acquisition will provide it a strong pipeline of mid-to-high end, differentiated and branded cell phone products as well as strengthening its distribution capability in the PRC.

The following table represented the purchase price payments as of December 31, 2009:

Initial cash consideration	\$ 6,700,000
Cash consideration as a result of first contingent consideration resolved	6,700,000
Fair value of initial ordinary shares issued	3,181,780
Fair value of ordinary shares issued as a result of first contingent consideration resolved	3,304,360
Direct expenses related to the acquisition	657,757
Business combination liability	1,103,015
Total	\$ 21,646,912

The assets acquired and liabilities assumed in the acquisition were as follows:

		Amortization Period
Tangible assets	\$ 22,298,973	
Liabilities incurred	(14,702,833)	
Intangible asset - distribution network	17,632,341	8 years
Deferred tax liability on intangible asset amortization	(3,581,569)	8 years

Total	\$ 21,646,912
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Table of Contents**ACORN INTERNATIONAL, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009****(In US dollars, except share data, unless otherwise stated)****3. Acquisition (Continued)**

The transaction was accounted using the purchase method of accounting, and accordingly, the acquired assets were recorded at their estimated fair values on the acquisition date. When the contingency is resolved and the third earn-out payment becomes issuable, the excess of the fair value of the third earn-out payment over the business combination liability will be recorded to goodwill as additional purchase price. If the business combination liability exceeds the fair value of the third earn-out payment, the excess will be allocated as a pro rata reduction to the amounts assigned to certain acquired assets.

The valuation of the distribution network was based on the excess earnings method, a method within the income approach whereby the value of an intangible asset was captured by discounting to present value the earnings generated by the asset that remains after a deduction for a return on other contributory assets. These assets normally include working capital, fixed assets and other intangible assets. After a fair return on tangible and other intangible assets is subtracted, the remaining excess cash flow (or net cash flow) is attributed to the intangible asset being valued. The excess-earnings approach explicitly recognizes that the current value of an investment is premised upon the expected receipt of future economic benefits. In the valuation of an intangible asset, an indication of value is developed by discounting excess cash flows attributed to the asset to present value at a rate that reflects the current return requirements of the market.

4. Disposal of stock tracking software business

In June 2009, in order to focus on the Group's core competency and enhance operating efficiency, the Group sold 33% of its equity interests in Shanghai Yimeng, a company engaged in development and marketing CPS stock tracking software. Shanghai Yimeng was established in December 2005 with 51% of its equity interests held by the Group and 49% by Shanghai Yimeng Digital Technology Co., Ltd., a third party. The Group sold the 33% equity interests to a shareholder of Shanghai Yimeng Digital Technology Co., Ltd. for a total cash consideration of \$10.5 million. The gain on deconsolidation of \$16.4 million was calculated as the difference between: a) the aggregate of (1) the cash consideration received of \$10.5 million, (2) the fair value of the retained 18% equity interests of \$4.2 million, (3) the 49% noncontrolling interests with a negative carrying amount of \$1.6 million, and b) Shanghai Yimeng's net assets with a negative carrying amount of \$3.3 million. The resulting gain on disposition of \$16.4 million was included in income from discontinued operations for the year ended December 31, 2009. The income tax expenses on the gain of disposition was \$2.0 million. There were no remaining assets or liabilities associated with discontinued operations in the consolidated balance sheet as of December 31, 2009.

Accordingly, the discontinued operations were retrospectively reflected for all the years presented in the consolidated statements of operations. The following shows summarized operating results reported as discontinued operations for the years ended December 31, 2007, 2008 and 2009:

	For the years ended December 31,		
	2007	2008	2009
Net revenues	\$ 14,260,446	\$ 16,530,024	\$ 7,447,940
Income from discontinued operations before income taxes	\$ 13,156,605	\$ 9,036,863	\$ 17,207,914
Income tax (expenses) benefits	1,317,054	(763,234)	(1,845,225)
Income from discontinued operations	\$ 14,473,659	\$ 8,273,629	\$ 15,362,689

Table of Contents**ACORN INTERNATIONAL, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009****(In US dollars, except share data, unless otherwise stated)****5. Short-term and long-term investments***Trading securities*

The Group's trading securities were marketable equity shares. The cost and fair value of the trading securities as of December 31, 2008 and 2009 were as follows:

	December 31,			
	2008		2009	
	Cost	Fair value	Cost	Fair value
Trading securities	\$ 9,104,901	\$ 10,088,054	\$ 17,254,651	\$ 18,572,790

Investment gain (loss) of trading securities for the years ended December 31, 2007, 2008 and 2009 consisted of the following and was included in the other income (expenses) in the consolidated statements of operations:

	For the years ended December 31,		
	2007	2008	2009
Realized gain from sales of trading securities	\$ 7,817,094	\$ 426,004	\$ 1,210,816
Unrealized holding gain (loss)	111,612	(155,445)	333,137
Total investment gain	\$ 7,928,706	\$ 270,559	\$ 1,543,953

Available-for-sale securities

The Group's available-for-sale securities represent investments in 950,000 shares of the ordinary shares of a Japanese company listed on JASDAQ securities exchange, which was acquired in November 2009 (refer to Note 6 for the terms of the investment in equity shares of the Japanese company), and two index-linked notes (Note A and Note B), each with a principal of USD10,000,000.

In June 2007, the Group purchased Note A from a bank. Note A has a contractual variable interest rate ranging from 0%-8% (increased to 9% and 10% in years 6-10 and 11-15, respectively), computed based on the number of days in which the 6-month USD-LIBOR rate is within a stated range. Interests are paid at fixed intervals on a quarterly basis. Interests received on Note A for the years ended December 31, 2007, 2008 and 2009 were \$435,556, \$800,000 and \$164,445, respectively, which was included in the other income in the consolidated statements of operations. The issuer has an option to call the note before or at maturity for an amount equal to principal plus any unpaid interests. Note A matures on June 14, 2022. On March 14, 2009, Note A was called by the issuer for an amount equal to principal plus all unpaid interests. The Group received the total redemption value on March 16, 2009 with no realized gain or loss recognized in 2009.

In August 2007, the Group purchased Note B from a bank. Note B has a contractual variable interest rate ranging from 0%-12%, computed based on the number of days in which both the Nikkei 225 index and the 3-month USD-LIBOR-BBA are above or within the stated ranges, respectively. Interests are paid at fixed intervals on a quarterly basis. Interests received on Note B for the years ended December 31, 2007, 2008 and 2009 were \$490,000, \$31,740 and nil, respectively, which was included in the other income in the consolidated statements of operations. The issuer has an option to call the note before or at maturity for an amount equal to principal plus any unpaid interests. Note B matures on

August 3, 2019.

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Table of Contents**ACORN INTERNATIONAL, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009****(In US dollars, except share data, unless otherwise stated)****5. Short-term and long-term investments (Continued)***Available-for-sale securities (Continued)*

Note B contains an embedded derivative instrument that is linked to an equity index and an interest rate index. The embedded derivative is bifurcated from the debt host for separate accounting and is measured at fair value initially and at the end of each reporting period (refer to Note 6). The debt host is accounted for as an available-for-sale security. The initial fair values of the embedded derivative and the debt host were \$5,287,940 and \$4,712,060, respectively.

Upon adoption of ASC 320-10, Investments in Debt and Equity Securities Overall (previously FASB Staff Position FAS 115-2 and 124-2) effective on April 1, 2009, the Group determined that credit-related losses with respect to the Note B debt host were insignificant and did not recognize credit-related losses in earnings or make any adjustments to the cumulative net unrealized loss of \$80,058 included in accumulated other comprehensive income in the consolidated balance sheet.

The cost and fair value of the available-for-sale securities as of December 31, 2009 were as follows:

	Cost	Unrealized gain	Accrued interest	Estimated fair value
Note B debt host	\$ 4,712,060	\$ 463,620	\$ 771,010	\$ 5,946,690
Equity shares of the Japanese company	1,355,325	40,744		1,396,069
	\$ 6,067,385	\$ 504,364	\$ 771,010	\$ 7,342,759

The cost and fair value of the available-for-sale securities as of December 31, 2008 were as follows:

	Cost	Unrealized loss	Accrued interest	Estimated fair value
Note A	\$ 10,000,000	\$ (378,165)	\$ 35,555	\$ 9,657,390
Note B debt host	4,712,060	(1,450,000)		3,262,060
	\$ 14,712,060	\$ (1,828,165)	\$ 35,555	\$ 12,919,450

The short-term investments as of December 31, 2008 and 2009 were as follows:

	December 31,	
	2008	2009
Trading securities	\$ 10,088,054	\$ 18,572,790
Note A	9,657,390	

\$ 19,745,444 \$ 18,572,790

The long-term investments as of December 31, 2008 and 2009 were as follows:

	December 31,	
	2008	2009
Note B debt host	\$ 3,262,060	\$ 5,946,690
Note B embedded derivative	2,012,940	677,310
Equity shares of the Japanese company		1,396,069
	\$ 5,275,000	\$ 8,020,069

In 2009, the Group re-evaluated its investment in Note B and bifurcated the embedded derivative contained in the debt host security. In 2007 and 2008 this adjustment is immaterial. The Group believes the current presentation and bifurcation of the embedded derivative more accurately reflects the hybrid instrument.

Table of Contents**ACORN INTERNATIONAL, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009****(In US dollars, except share data, unless otherwise stated)****6. Derivative instruments**

In September 2009, the Group and two third parties formed Acorn Hong Kong for the purpose of establishing business alliance relationship with and invest in a Japanese company listed on JASDAQ securities exchange. The Group and the other two parties each held 51.0%, 19.5% and 29.5% equity interests in Acorn Hong Kong, respectively. As the Group held controlling interests in Acorn Hong Kong, the Group consolidated Acorn Hong Kong since its inception. In November 2009, Acorn Hong Kong purchased 950,000 ordinary shares and 450 options each to subscribe for 1,000 ordinary shares of the Japanese company for cash consideration of \$1,541,142. Acorn Hong Kong held less than 20% of the equity interests of the Japanese company and does not have the ability to exercise significant influence in the operations of the Japanese company. The Group recorded the investment in 950,000 ordinary shares as an available-for-sale security (refer to Note 5). The 450 options are fully vested, non-forfeitable, and exercisable in three years. The Group recorded \$185,818 for the original estimated fair value of the share options in other long-term assets. The share options are considered a derivative instrument and are therefore marked to market at the end of each reporting period based on the market price of the underlying ordinary shares. The share options were valued at \$215,192 as of December 31, 2009. Accordingly, the Group recorded a gain of \$29,374 due to changes in the fair value of the derivative as an increase in other long-term assets and other income in 2009 (refer to Note 7 for disclosure of the method and assumptions used in determining the fair value of the share options).

The Group's investment in Note B contains an embedded derivative instrument that is linked to an equity index and an interest rate index. The embedded derivative has been bifurcated and accounted for at fair value with changes in the fair value recorded in the consolidated statements of operations. On the date when Note B was issued, the Group recorded \$5,287,940 initial estimated fair value of the embedded derivative in long-term investments on the consolidated balance sheet. The embedded derivative was valued at \$2,012,940 and \$677,310 as of December 31, 2008 and 2009. In 2008 and 2009, the Group recorded losses due to changes in the fair value of the embedded derivative of \$3,275,000 and \$1,335,630, respectively, which were included in the other expenses in the consolidated statements of operations (refer to Note 7 for disclosure of the method and assumptions used in determining the fair value of the embedded derivative).

7. Fair value measurement

The Group did not have any liabilities measured at fair value on a recurring or non-recurring basis for the years ended December 31, 2008 and 2009.

Assets measured at fair value on a recurring basis

As of December 31, 2009, the Group's assets measured at fair value on a recurring basis subsequent to initial recognition were as follows:

	Quoted prices in active markets for identical assets (Level 1)	Fair value measurements using		Total
		Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	
Trading securities	\$ 18,572,790	\$	\$	\$ 18,572,790
Note B			6,624,000	6,624,000
Equity shares of the Japanese company	1,396,069			1,396,069
Share options of the Japanese company		215,192		215,192

\$ 19,968,859	\$ 215,192	\$ 6,624,000	\$ 26,808,051
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Table of Contents**ACORN INTERNATIONAL, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009****(In US dollars, except share data, unless otherwise stated)****7. Fair value measurement (Continued)***Assets measured at fair value on a recurring basis (Continued)*

As of December 31, 2008, the Group's assets measured at fair value on a recurring basis subsequent to initial recognition were as follows:

	Quoted prices in active markets for identical assets (Level 1)	Fair value measurements using		Total
		Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	
Trading securities Note A and Note B	\$ 10,088,054	\$	\$ 14,932,390	\$ 10,088,054 14,932,390
	\$ 10,088,054	\$	\$ 14,932,390	\$ 25,020,444

Investments in trading securities consist of marketable equity shares measured using the closing stock prices from the exchange market as of the measurement date; as such, they are classified as Level 1 instruments.

The equity shares of the Japanese company measured using the closing stock prices from the exchange market as of the measurement date; as such, they are classified as Level 1 instruments.

The fair value of the share options requires the observable inputs directly or indirectly obtained from active markets, including the Japanese company's stock price, volatility, interest rate, dividends, marketability and expected return requirements. The Group used the Black-Scholes-Merton option-pricing model to determine the fair value of the share options. As such, the derivative asset is classified as a Level 2 instrument.

Note A and Note B (including the embedded derivative) are index-linked notes measured using a discounted cash flow projection on principal and interest based on assumptions supported by, derived or implied from quoted market prices or rates, adjusted for the specific features of these instruments. They are classified as Level 3 instruments. Determining the appropriate fair value model and calculating the fair value of these instruments require the input of significant estimates and assumptions, some of which are unobservable. The significant estimates and assumptions include comparable bonds issued by the same issuer, risk-free interest rates, global banking industry bond yield curve, data on the indices, volatilities and dividend yield.

The fair value estimates presented above were based on pertinent information available to the Group as of December 31, 2008 and 2009. Although the Group is not aware of any factors that would significantly affect its fair value estimates, such amounts have not been comprehensively revalued for purposes of financial statements since December 31, 2008 and 2009, respectively, and current estimates of fair value may differ significantly from the amounts presented.

Table of Contents**ACORN INTERNATIONAL, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009****(In US dollars, except share data, unless otherwise stated)****7. Fair value measurement (Continued)***Assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3 inputs)*

A summary of changes in Level 3 instruments for the years ended December 31, 2008 and 2009 was as follows:

	For the years ended December 31,	
	2008	2009
Balance at beginning of the year	\$ 18,669,240	\$ 14,932,390
Redemption of Note A		(10,000,000)
Loss on change in fair value of embedded derivative	(3,275,000)	(1,335,630)
Unrealized gains (losses) included in accumulated other comprehensive income	(271,849)	2,291,785
Accrued interest	(190,001)	735,455
Balance at end of the year	\$ 14,932,390	\$ 6,624,000

Net unrealized gain (loss) included in net income (loss) related to assets and liabilities still held as of December 31, 2008 and 2009 consisted of loss on change in fair value of embedded derivative of \$3,275,000 and \$1,335,630 that were reported in other expenses in the consolidated statements of operations in 2008 and 2009, respectively.

Assets measured at fair value on a non-recurring basis

The following table presents the Group's assets measured at fair value on a non-recurring basis for the year ended December 31, 2009:

	Year ended December 31, 2009	Fair value measurements using			Total gains (losses)
		Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	
Acquired intangibles - distribution network	\$ 180,428	\$	\$	\$ 180,428	\$ (15,247,873)
Investment in an affiliate	4,196,707			4,196,707	4,794,083
					\$ (10,453,790)

In 2009, as a result of reduced expectations of future cash flows from certain identified intangible assets, the Group determined that the Yiyang Yukang distribution network with a carrying amount of \$15,428,301 was not recoverable and consequently recorded an impairment charge of \$15,247,873 for the year ended December 31, 2009. The Group applied the income approach multi-period excess earning method to estimate the fair value of the distribution network. Calculating the fair value of the distribution network requires the input of significant estimates and

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assumptions, some of which are unobservable. The significant estimates and assumptions include business assumptions, weighted average cost of capital, terminal growth rate, discount rate, return on contributory asset, attrition rate and tax amortization benefit.

Upon deconsolidation of Shanghai Yimeng in June 2009, the Group retained 18% equity interests in Shanghai Yimeng with a negative carrying amount of \$597,376 and accounted for the retained investment using the cost method of accounting. The 18% equity interests investment was recorded at the fair value of \$4,196,707 on the date the Group deconsolidated Shanghai Yimeng. The Group applied the income approach in measuring the equity value of Shanghai Yimeng using significant estimates and assumptions, some of which are unobservable. The significant estimates and assumptions include business assumptions, weighted average cost of capital and terminal growth rate.

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Table of Contents**ACORN INTERNATIONAL, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009****(In US dollars, except share data, unless otherwise stated)****8. Accounts receivable**

An analysis of allowance for doubtful accounts for the years ended December 31, 2007, 2008 and 2009 was as follows:

	2007	December 31, 2008	2009
Balance at beginning of the year	\$ 508,829	\$ 1,580,214	\$ 3,524,673
Charged to expenses	1,395,920	2,423,722	121,960
Charges taken against allowance	(324,535)	(479,263)	(2,049,077)
Balance at end of the year	\$ 1,580,214	\$ 3,524,673	\$ 1,597,556

9. Inventory

Inventory consisted of the following:

	December 31, 2008	2009
Raw materials and work in progress	\$ 14,236,630	\$ 11,131,629
Finished goods and merchandise goods	15,285,050	15,049,000
	\$ 29,521,680	\$ 26,180,629

10. Other prepaid expenses and current assets

Other prepaid expenses and current assets consisted of the following:

	December 31, 2008	2009
Advances to suppliers	\$ 2,036,232	\$ 2,712,740
Prepaid income tax	1,149,688	246,071
Other prepaid expenses	10,176,608	4,835,726
	\$ 13,362,528	\$ 7,794,537

The Group made allowance for doubtful accounts in the aggregate amount of \$446,253 and \$663,294 in 2007 and 2008, respectively. The Group reversed the allowance for doubtful accounts in the aggregate amount of \$1,097,904 in 2009.

Table of Contents**ACORN INTERNATIONAL, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009****(In US dollars, except share data, unless otherwise stated)****11. Property and equipment, net**

Property and equipment, net consisted of the following:

	December 31,	
	2008	2009
Buildings	\$ 10,378,406	\$ 10,399,957
Leasehold improvements	1,434,811	1,134,018
Machinery	199,621	370,010
Computers and office equipment	7,398,446	6,518,785
Vehicles	1,443,119	1,428,366
	\$ 20,854,403	\$ 19,851,136
Less: accumulated depreciation and amortization	(5,212,969)	(6,477,832)
	\$ 15,641,434	\$ 13,373,304
Construction in progress		1,445,100
	\$ 15,641,434	\$ 14,818,404

The construction in progress was a new factory building on the land in Qingpu district of Shanghai.

Depreciation and amortization expenses for property and equipment were \$1,249,659, \$1,326,081 and \$2,092,583 for the years ended December 31, 2007, 2008 and 2009, respectively.

12. Acquired intangible assets, net

Acquired intangible assets, net consisted of the following:

	December 31,	
	2008	2009
Distribution networks	\$ 19,962,190	\$ 4,714,317
Trademarks	2,447,064	2,962,303
Assembled and trained workforce	232,928	
Patents	311,210	178,232
Securities investment advisory service license	365,786	
	\$ 23,319,178	\$ 7,854,852
Less: accumulated amortization	(2,005,229)	(4,673,256)

\$ 21,313,949 \$ 3,181,596

In 2008, as a result of reduced expectations of future cash flows from certain identified intangible assets, the Group determined that the HJX distribution network was not recoverable and consequently recorded an intangible asset impairment charge of \$1,096,096 for the HJX distribution network.

In 2009, as a result of reduced expectations of future cash flows from certain identified intangible assets, the Group determined that the Yiyang Yukang distribution network was not recoverable and consequently recorded an intangible asset impairment charge of \$15,247,873 for the Yiyang Yukang distribution network (refer to Note 7 for fair value measurements relating to the impairment charge).

Table of Contents**ACORN INTERNATIONAL, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009****(In US dollars, except share data, unless otherwise stated)****12. Acquired intangible assets, net (Continued)**

The Group recorded amortization expenses of \$533,311, \$602,790 and \$2,992,679 for the years ended December 31, 2007, 2008 and 2009, respectively. The amortization expenses of the above intangible assets will be approximately \$475,764, \$462,262, \$358,131, \$344,941 and \$331,770 for the years 2010, 2011, 2012, 2013 and 2014, respectively.

13. Investments in affiliates*Investments accounted for under the equity method of accounting*

In July 2008, the Group invested 30% equity interests in Kela (Hong Kong) Jewelry Investment Limited (Kela) for cash of \$1,200,000. In October 2009, the Group increased its investment in Kela from 30% to 35%. As the Group has the ability to exercise significant influence over Kela, the Group accounts for this investment using the equity method of accounting. The Group's equity in losses of Kela in 2008 and 2009 were \$40,939 and \$12,351, respectively, and were recognized in other expenses in the consolidated statements of operations.

In June 2009, the Group invested 26% equity interests in KYOBI Cosmetics (Hong Kong) Co., Limited (KYOBI) for cash of RMB8 million USD equivalents. As the Group has the ability to exercise significant influence over KYOBI, the Group accounts for this investment using the equity method of accounting. The Group's equity in losses of KYOBI in 2009 was \$403,986 and was recognized in other expenses in the consolidated statements of operations.

Investment accounted for under the cost method of accounting

In June 2009, the Group sold 33% equity interests in Shanghai Yimeng, a company which previously was a 51% equity-owned consolidated subsidiary of the Group. After the sale, the Group retained 18% equity interests in Shanghai Yimeng and does not have the ability to exercise significant influence over Shanghai Yimeng's operational and financial policies and activities. The Group accounts for the retained 18% equity interests investment using the cost method of accounting. The retained 18% equity interests investment was recorded at the fair value of \$4.2 million on the date the Group deconsolidated Shanghai Yimeng (refer to Note 4 for details of deconsolidation of Shanghai Yimeng).

14. Accrued expenses and other current liabilities

Accrued expenses and other current liabilities consisted of the following:

	December 31,	
	2008	2009
Other taxes payable	\$ 4,086,616	\$ 2,906,553
Accrued employee payroll and welfare	3,522,526	2,897,918
Other payable	5,029,413	5,357,401
Accrued expenses	2,081,090	2,480,212
Advances from customers	4,933,175	1,196,058
	\$ 19,652,820	\$ 14,838,142

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Other taxes payable mainly consist of value-added tax payable and sales taxes payable. The Group's PRC subsidiaries are subject to value-added tax at a rate of 17% on product purchases and sales amount. Value-added tax payable on sales is computed net of value-added tax paid on purchases. The Group's PRC subsidiaries are also subject to business tax at a rate of 5% on sales related to service rendered.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009

(In US dollars, except share data, unless otherwise stated)

15. Dividend payable

On December 18, 2009, the board of directors of Acorn International approved and declared a one-time special cash dividend of \$0.33 per ordinary share on its outstanding shares to shareholders of record as of the close of trading on December 31, 2009 directly from the share premium account of Acorn International. The total dividend payable as of December 31, 2009 was \$29,322,782. The balance of additional paid-in capital was reduced for the full amount of this special dividend as of December 31, 2009.

16. Share-based compensation

In 2005, the Group adopted the 2005 Equity Incentive Plan and the 2005 Equity Incentive Plan B (collectively, the 2005 Option Plan) which allows the Group to offer a variety of incentive awards to employees, officers, directors or individual consultants or advisors who render services to the Group. In 2005, 9,415,366 ordinary shares were authorized under the 2005 Option Plan. In May 2006, the Group adopted the 2006 Equity Incentive Plan (the 2006 Option Plan) and authorized the issuance of 24,133,000 ordinary shares. Under the 2005 and 2006 Option Plans, the options and SARs are generally granted with an exercise price equal to the fair market value of the underlying shares, as determined by the Group's board of directors at the date of grant and expire after ten years and six years, respectively, with vesting occurring 25% upon grant and the remaining 75% vesting ratably over three years. Certain options and SARs granted vest immediately upon grant, and certain options and SARs granted vest upon the satisfaction of certain performance targets. The proceeds from the exercise of the SARs by the grantee will be equity settled by delivery of equivalent fair value of ordinary shares of the Group.

The Group recorded compensation expense of \$6,519,078, \$3,289,232 and \$1,845,885 for the years ended December 31, 2007, 2008 and 2009, respectively. In connection with the acquisition of Yiyang Yukang, the Group granted 900,000 performance-based options in 2009 under the 2006 Option Plan. These options will vest in three equal tranches of 300,000 options each upon Yiyang Yukang meeting certain earnings targets in 2008 to 2010. The Group excluded the last tranche of 300,000 options outstanding as of December 31, 2009 from compensation expense, as the Group does not expect that Yiyang Yukang 2010 earnings target will be met.

Prior to the Group's IPO in May 2007, the derived fair value of the ordinary shares underlying the options and SARs was determined based on a retrospective third-party valuation using generally accepted valuation methodologies, including a weighted average equity value derived by using a combination of the discounted cash flow method, a method within the income approach whereby the present value of future expected net cash flows is calculated using a discount rate and the guideline companies method, which incorporates certain assumptions including the market performance of comparable listed companies as well as the financial results and growth trends of the Group, to derive the total equity value of the Group. The valuation model allocated the equity value between the ordinary shares and the preferred shares and determined the fair value of ordinary shares based on the option-pricing method under the enterprise value allocation method. Under this method, the ordinary shares have value only if the funds available for distribution to shareholders exceed the value of the liquidation preference at the time of a liquidity event (for example, merger or sale). The ordinary shares are considered to be a call option with claim on the enterprise at an exercise price equal to the remaining value immediately after the preferred shares are liquidated. Subsequent to the Group's IPO in May 2007, the fair value of the underlying ordinary shares is based on quoted market prices.

Except for the options granted in 2009, the fair value of each option/SAR granted was estimated on the date of grant using the Black-Scholes-Merton option-pricing formula. The risk-free interest rate for periods within the contractual life of the option/SAR is based on the yield of Chinese International Bond. The expected life of options/SARs granted represents the period of time that the options/SARs are expected to be outstanding and is

Table of Contents**ACORN INTERNATIONAL, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009****(In US dollars, except share data, unless otherwise stated)****16. Share-based compensation (Continued)**

based on historical data related to option/SAR exercises and employee terminations. Expected volatilities are based on the average volatility of comparable companies with the time period commensurate with the expected time period.

	2007	
	SARs without performance condition	SARs with performance condition
Average risk-free interest rate	5.09%	5.03%
Average expected option/SAR life	3.58 years	3.58 years
Average expected volatility rate	36.00%	36.00%
Average dividend yield	0%	0%

The fair value of each option granted in 2009 was estimated on the date of grant using the binomial option-pricing formula. The risk-free interest rate for periods within the contractual life of the option is based on the yield of ten-year USD China Government BFV Curve with similar time maturity of the option valued as of grant date. The Group uses historical data to estimate option exercise and employee termination within the pricing formula. The contractual life of the option is ten years. Expected volatilities are based on the weighted average historical volatility of the Group and the comparable companies with the time period commensurate with the expected time period.

	2009
Average risk-free interest rate	4.48%
Contractual life of the option	10 years
Average expected volatility rate	72.98%
Average dividend yield	0%

A summary of the options and SARs activities for the year ended December 31, 2009 and the information regarding the options and SARs outstanding as of December 31, 2009 were as follows:

	Number of options/ SARs	Weighted average exercise price	Weighted average remaining contract terms	Aggregate intrinsic value
Options/SARs outstanding at January 1, 2009	15,538,759	\$ 2.68		
Granted	900,000	\$ 2.00		
Forfeited	(311,736)	\$ 2.06		
Exercised	(1,242)	\$ 1.66		
Options/SARs outstanding at December 31, 2009	16,125,781	\$ 2.65	4.35 years	\$
Options/SARs vested or expected to vest at December 31, 2009	15,825,781	\$ 2.66	4.25 years	\$

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Options/SAR exercisable at December 31, 2009	15,758,250	\$	2.66	4.26 years	\$
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The weighted-average fair value of options and SARs granted in 2007, 2008 and 2009 was \$1.51, nil and \$1.05, respectively. The total fair value of options and SARs vested in 2007, 2008 and 2009 was \$5,852,492, \$5,134,790 and \$1,873,984, respectively. The aggregate intrinsic value of options and SARs exercised in 2007, 2008 and 2009 was \$643,532, \$186,881 and \$298, respectively.

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ACORN INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009

(In US dollars, except share data, unless otherwise stated)

16. Share-based compensation (Continued)

As of December 31, 2009, there was \$101,859 in total unrecognized compensation expense related to unvested share-based compensation arrangements granted under the 2005 and 2006 Option Plans, which is expected to be recognized over a weighted-average period of 0.25 years.

17. Taxation

Acorn International is incorporated in the Cayman Islands and is not subject to tax in this jurisdiction.

China DRTV and Smooth Profit are incorporated in the British Virgin Islands and are not subject to tax in this jurisdiction.

The Group's Hong Kong subsidiaries, MK AND T, Emoney, Bright Rainbow, Acorn Hong Kong and U King Hong Kong, are subject to Hong Kong statutory income tax on their Hong Kong sourced income.

In 2007, the Group's PRC subsidiaries are subject to Corporate Income Tax (CIT) on the taxable income in accordance with the Enterprise Income Tax Law and the Income Tax Law of the PRC concerning Foreign Investment Enterprise and Foreign Enterprises (collectively PRC Corporate Income Tax Laws), respectively.

On March 16, 2007, the PRC government promulgated Law of the People's Republic of China on Enterprise Income Tax (New EIT Law), which is effective from January 1, 2008. Under the New EIT Law, domestically-owned enterprises and foreign-invested enterprises are subject to a uniform tax rate of 25%. While the New EIT Law equalizes the tax rates for domestically-owned and foreign-invested companies, preferential tax treatment would continue to be given to companies in certain encouraged sectors and to enterprises classified as high and new technology companies, whether domestically-owned or foreign-invested enterprises. The New EIT Law also provides a five-year transition period starting from its effective date for those enterprises which were established before the promulgation date of the New EIT Tax Law and which were entitled to a preferential tax treatment such as a reduced tax rate or a tax holiday. The tax rate of such enterprises will transition to the uniform tax rate of 25% within a five-year transition period and the tax holiday, which has been enjoyed by such enterprises before the effective date of the New EIT Law, may continue to be enjoyed until the end of the holiday.

Shanghai Advertising registered in Pudong New District, Shanghai of the PRC, is subject to 15% CIT in 2007, 18% CIT in 2008 and 20% CIT in 2009 pursuant to the local tax preferential arrangement.

Shanghai HJX, Acorn Electronic, Shanghai An-Nai-Chi, Beijing Youngleda and Zhuhai Acorn registered in the Old Districts of the PRC, are subject to 27% CIT in 2007 as qualified foreign-invested manufacturing enterprises.

Acorn Information registered in Pudong New District, Shanghai of the PRC, are subject to 15% CIT in 2007 pursuant to the local tax preferential arrangement.

Zhuhai Sunrana registered in Zhuhai Specific Economic Zone of the PRC, is subjected to 15% CIT in 2007 pursuant to the local tax preferential arrangement. Starting from January 1, 2008, Zhuhai Sunrana is subject to the preferential five-year transition period tax rates under the New EIT Law and 2008 and 2009 applicable CIT rates are 18% and 20%, respectively.

Beijing HJZX, as a recognized high and new technology company and registered in Zhongguancun technology zone in Beijing of the PRC, is subject to 15% CIT in 2007.

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ACORN INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009

(In US dollars, except share data, unless otherwise stated)

17. Taxation (Continued)

The Group's remaining PRC subsidiaries are subject to the statutory rate of 33% in 2007 in accordance with the PRC Corporate Income Tax Laws, and 25% in 2008 and 2009 in accordance with the New EIT Law.

Shanghai HJX, Acorn Electronic, Shanghai An-Nai-Chi, Beijing Youngleda, Yiyang Yukang and Zhuhai Acorn, as foreign-invested manufacturing enterprises which are scheduled to operate for at least ten years, are entitled to a two-year exemption and three-year 50% reduction starting from the first profit making year after absorbing all prior years' tax losses, which can be carried forward for five years (the Tax Holiday). Under the New EIT Law, enterprises not generating profits before 2008 are required to commence the Tax Holiday beginning January 1, 2008.

Acorn Information, as a recognized software company, is eligible for the Tax Holiday from 2005.

Acorn Consulting, as a recognized new service company, is entitled to CIT exemption in 2007.

Beijing HJZX, as a recognized high and new technology company and registered in Zhongguancun technology zone in Beijing of the PRC, is entitled to CIT exemption in 2007.

Shanghai Network, as a recognized new trading company, is entitled to CIT exemption in 2007.

Tax that would otherwise have been payable without tax holidays amounted to \$22,185,570, \$908,069 and \$992,459 in 2007, 2008 and 2009, respectively (representing a (reduction) increase in basic income (loss) per ordinary share from continuing operations of \$(0.29), \$0.01 and \$0.01 and diluted income (loss) from continuing operations per ordinary share of \$(0.26), \$0.01 and \$0.01 in 2007, 2008 and 2009, respectively).

Under the New EIT Law and implementation regulations issued by the PRC State Council, income tax at the rate of 10% is applicable to interest and dividends payable to investors that are non-resident enterprises, which do not have an establishment or place of business in the PRC, or which have such establishment or place of business but the relevant income is not effectively connected with the establishment or place of business, to the extent such interest or dividends have their sources within the PRC. Undistributed earnings of the Group's PRC subsidiaries of \$105,084,071 as of December 31, 2009 are considered to be indefinitely reinvested and, accordingly, no provision for PRC dividend withholding tax has been provided thereon. Upon distribution of these earnings in the form of dividends or otherwise in the future, the Group would be subject to PRC withholding tax at 10% or a lower treaty rate.

Under applicable accounting principles, a deferred tax liability should be recorded for taxable temporary differences attributable to the excess of financial reporting basis over tax basis in a domestic subsidiary. However, recognition is not required in situations where the tax law provides a means by which the reported amount of that investment can be recovered tax-free and the enterprise expects that it will ultimately use that means. The Group has not recorded any such deferred tax liability attributable to the undistributed earnings of its financial interests in VIEs because these entities do not have any unremitted earnings to be distributed.

Effective on January 1, 2007, the Group adopted the provisions of ASC 740-10, Income Taxes - Overall (previously FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes - an Interpretation of SFAS No. 109). Based on its analysis under ASC 740-10, the Group made its assessment of the level of authority for each tax position (including the potential application of interests and penalties) based on the technical merits, and has measured the unrecognized benefits associated with the tax positions. As of

Table of Contents**ACORN INTERNATIONAL, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009****(In US dollars, except share data, unless otherwise stated)****17. Taxation (Continued)**

December 31, 2008 and 2009, the Group had unrecognized tax benefits of approximately \$3.1 million and \$3.1 million, respectively. The unrecognized tax benefits would impact the effective income tax if recognized. A reconciliation of the beginning and ending amount of unrecognized tax benefits for the years ended December 31, 2008 and 2009 was as follows:

	For the years ended December 31,		
	2007 (in million)	2008 (in million)	2009 (in million)
Unrecognized tax benefits at beginning of the year	\$	\$	\$ 3.1
Gross increases tax positions in prior years			
Gross decreases tax positions in prior years			
Gross increases tax positions in current year			
Settlements in current year			
Increases related to acquired business		3.1	
Lapsing of statutes of limitations			
Unrecognized tax benefits at end of the year	\$	\$ 3.1	\$ 3.1

As of December 31, 2008 and 2009, the amount of interests and penalties related to uncertain tax positions was immaterial. The Group does not anticipate any significant increases or decreases to its liabilities for unrecognized tax benefits within the next twelve months.

According to the PRC Tax Administration and Collection Law, the statute of limitations is three years if the underpayment of income taxes is due to computational errors made by the taxpayer. The statute of limitations will be extended to five years under special circumstances, which are not clearly defined, but an underpayment of income tax liability exceeding RMB100,000 (approximately \$15,000) is specifically listed as a special circumstance. In the case of a transfer pricing related adjustment, the statute of limitations is ten years. There is no statute of limitations in the case of tax evasion. The Group's PRC subsidiaries are therefore subject to examination by the PRC tax authorities from 2005 through 2009 on non-transfer pricing matters, and from 2000 through 2009 on transfer pricing matters.

Reconciliation between the effective income tax rate and the PRC statutory income tax rate was as follows:

	For the years ended December 31,		
	2007	2008	2009
PRC statutory tax rate	33%	25%	25%
Tax effect of advertising expenses that are not deductible in determining taxable profit	148%	(4)%	19%
Tax effect of other expenses that are not deductible in determining taxable profit	21%	(1)%	(22)%
Effect of differences between PRC statutory tax rate and foreign effective tax rates	10%	(15)%	(29)%
Effect of tax holidays granted to PRC subsidiaries	(212)%	4%	17%
Effect of deferred tax assets valuation allowance		(9)%	34%

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\$ (226,418) \$ 1,430,910

As of December 31, 2009, the Group had tax losses carrying forward of \$5,294,371. The tax losses will expire in 2010-2014 if they are not used.

The Group considers positive and negative evidence to determine whether some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible, the Group believes it is more-likely-than-not that the Group will realize the benefits of these deductible differences, net of the existing valuation allowances as of December 31, 2009. The amount of the deferred tax assets considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carry forward periods are reduced.

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Table of Contents**ACORN INTERNATIONAL, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009****(In US dollars, except share data, unless otherwise stated)****18. Other income (expenses)**

Other income (expenses) consisted of the following:

	For the years ended December 31,		
	2007	2008	2009
Investment gain (loss)	\$ 8,854,262	\$ (2,172,701)	\$ 402,142
Equity in loss in equity investment		(40,939)	(416,337)
Interest income	4,141,579	2,090,698	1,506,751
Interest expenses	(320)		
Others	715,388	(544,355)	158,830
	\$ 13,710,909	\$ (667,297)	\$ 1,651,386

19. Convertible redeemable preferred shares

In January 2005, the Group issued 17,709,815 Series A convertible redeemable preferred shares to SB Asia Investment Fund II L.P. (SAIF) for consideration of US\$1.98 per share for total proceeds of US\$32,479,902, net of issuance costs of \$2,520,098. In conjunction with the issuance of Series A preferred shares, the Group also issued a detachable warrant to SAIF for no additional consideration. As per the warrant agreement, SAIF could purchase an aggregate of 2,882,155 Series A-1 convertible redeemable preferred shares at a per share exercise price of US\$2.78. The warrant was exercised in full on December 28, 2005 for total proceeds of US\$8,000,000. The proceeds received in the Series A convertible redeemable preferred shares offerings were first allocated between the convertible instrument and the warrants on a residual fair value basis. The accretion to the redemption value was reflected as a reduction to net income to arrive at net income available to ordinary shareholders in the consolidated statements of operations and amounted to \$53,800, nil and nil for the years ended December 31, 2007, 2008 and 2009, respectively. The Group determined that there was no embedded beneficial conversion feature attributable to the Series A convertible redeemable preferred shares.

Upon the completion of the Group's IPO in May 2007, Series A convertible redeemable preferred shares and Series A-1 convertible redeemable preferred shares were converted into ordinary shares on a one-to-one basis.

20. Share repurchase program

In December 2007, the Group adopted a share repurchase program enabling it to repurchase up to an aggregate of \$30,000,000 of its ADSs, each representing its three ordinary shares. As of December 31, 2007, the Group had repurchased an aggregate of 683,000 ADSs, representing 2,049,000 ordinary shares, on the open market for total cash consideration of \$6,833,124. The share repurchase program continued until April 2008 and was extended by the board of directors in 2008 and run through May 31, 2009. As of December 31, 2008, the Group had repurchased an aggregate of 2,632,747 ADSs, representing 7,898,241 ordinary shares, on the open market for total cash consideration of \$23,211,848. As of December 31, 2009, the Group had repurchased an aggregate of 3,272,013 ADSs, representing 9,816,039 ordinary shares, on the open market for total cash consideration of \$25,499,984.

In December 2008, the Group issued 2,564,103 of its ordinary shares repurchased through the share repurchase program for the acquisition of Yiyang Yukang. The total repurchase costs of the shares issued in December 2008 for the acquisition of Yiyang Yukang is \$7,535,642. In June 2009, the Group issued 2,564,103 of its ordinary shares repurchased through the share repurchase program for the acquisition of Yiyang

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Yukang. The total repurchase costs of the shares issued in June 2009 for the acquisition of Yiyang Yukang is \$6,351,796.

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Table of Contents**ACORN INTERNATIONAL, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009****(In US dollars, except share data, unless otherwise stated)****21. Mainland China contribution plan and profit appropriation**

Employees of the Group in the PRC are entitled to retirement benefits calculated with reference to their salaries basis upon retirement and their length of service in accordance with a PRC government-managed retirement plan. The PRC government is directly responsible for the payments of the benefits to these retired employees. The Group is required to make contributions to the government-managed retirement plan based on certain percentages of the employees' monthly salaries. The amounts contributed by the Group were \$1,122,387, \$1,248,862 and \$1,237,011 for the years ended December 31, 2007, 2008 and 2009, respectively.

In addition, the Group is required by law to contribute medical, unemployment, housing and other statutory benefits based on certain percentages of the employees' monthly salaries. The PRC government is directly responsible for the payments of the benefits to these employees. The amounts contributed by the Group were \$1,076,278, \$1,224,088 and \$1,225,763 for the years ended December 31, 2007, 2008 and 2009, respectively.

In accordance with relevant PRC Company Law and regulations and the Group's Articles of Association, the Group's PRC subsidiaries were required to appropriate 10% of their respective profit after taxation reported in their statutory financial statements prepared under the PRC GAAP to the statutory surplus reserve. The Group has statutory reserve balance of \$6,146,485 and \$4,369,781 as of December 31, 2008 and 2009, respectively. The appropriation of statutory surplus reserve will cease upon the balance of the statutory surplus reserve reaching 50% of the companies' registered capital. The statutory surplus reserves may be used to make up losses or for conversion into the shareholders' equity.

22. Commitments and contingencies**(A) Leases commitments**

The Group leases certain office premises and buildings under non-cancelable leases. Rental expenses under operating leases for 2007, 2008 and 2009 were \$1,848,233, \$2,639,904 and \$3,260,183, respectively.

As of December 31, 2009, future minimum lease payments under non-cancelable operating leases agreements were as follows:

2010	\$ 1,969,552
2011	956,943
2012	359,370
2013	109,016
2014 and thereafter	51,323
	\$ 3,446,204

(B) Advertising commitments

As of December 31, 2009, the commitments for the advertising contracts signed by the Group were as follows:

2010

\$ 52,859,954

Of the total commitments, \$9,771,139 were prepaid as of December 31, 2009.

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ACORN INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009

(In US dollars, except share data, unless otherwise stated)

22. Commitments and contingencies (Continued)

(C) Legal matters

The Group is a party to legal matters and claims that are normal in the course of its operations. While the Group believes that the ultimate outcome of these matters will not have a material adverse effect on its financial position, results of operations and cash flows, the outcome of these matters is not determinable with certainty and negative outcomes may adversely affect the Group.

In March 2009, the Group received a complaint from Advertising Broadcasting Center of Liaoning TV Station (Liaoning TV), which filed a suit against Shanghai Acorn Advertising Broadcasting Co., Ltd. (Shanghai Advertising), claiming that Shanghai Advertising breached its advertisement broadcasting contract with Liaoning TV by not fully performing its payment obligation under the contract and asserted damages of approximately RMB19.0 million (approximately \$2.8 million). Liaoning TV further applied for provisional seizure of Shanghai Advertising's bank account in the same amount of its claim. In June 2009, the people's court ruled in favor of Liaoning TV and awarded Liaoning TV an aggregate payment of RMB10.9 million (approximately \$1.6 million). In July 2009, the Group appealed to the people's court at higher level, which affirmed the judgment in September 2009. In November 2009, the Group paid Liaoning TV RMB10.9 million (approximately \$1.6 million), but the Group has applied for retrial of this case.

23. Segment and geographic information

The Group engages primarily in direct sales, including TV direct sales, third-party bank channel sales, catalogs sales, internet sales and direct sales through print media and radio, and distribution sales through its national distribution network in the PRC.

The Group's chief operating decision maker has been identified as the Chief Executive Officer (CEO), who reviews consolidated results when making decisions about allocating resources and assessing performance of the Group. The Group uses the management approach to determine operating segments. The management approach considers the internal organization and reporting used by the Group's chief operating decision makers for making decisions, allocating resources and assessing performance. Based on this assessment, the Group has determined that it has two operating and reporting segments, which are direct sales, net and distribution sales, net.

The Group's chief operating decision maker evaluates segment performance based on revenues, cost of revenues and gross profit. Accordingly, all expenses are considered corporate level activities and are not allocated to segments. Therefore, it is not practical to show profit or loss by reportable segments. Also, the Group's chief decision maker does not assign assets to these segments. Consequently, it is not practical to show assets by reportable segments.

Table of Contents**ACORN INTERNATIONAL, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009****(In US dollars, except share data, unless otherwise stated)****23. Segment and geographic information (Continued)**

The Group's revenues are all generated from external customers in the PRC. The revenues by each group of similar products and services are as follows:

Product	For the years ended December 31,		
	2007	2008	2009
Electronic learning device and dictionary	\$ 56,199,326	\$ 61,175,108	\$ 105,223,419
Beauty and health products	32,899,378	59,666,463	74,974,358
Cell phones	105,562,888	56,242,401	61,276,510
Consumer electronics	7,949,819	22,008,208	9,666,139
Collectible products	19,332,223	16,141,592	9,515,504
Subscription service revenues	2,586,550	1,160,290	223,207
Marketing service revenues	16,035,935	3,168,617	
Other products	8,295,912	14,784,211	26,902,406
Total gross revenues	\$ 248,862,031	\$ 234,346,890	\$ 287,781,543
Less: sales taxes	(825,022)	(209,469)	(195,923)
Total revenues, net	\$ 248,037,009	\$ 234,137,421	\$ 287,585,620

The gross profit by segments is as follows:

	For the years ended December 31,		
	2007	2008	2009
Direct sales	\$ 95,337,653	\$ 83,646,739	\$ 92,826,982
Distribution sales	29,351,165	29,863,732	44,130,740
Total	\$ 124,688,818	\$ 113,510,471	\$ 136,957,722

Geographic information

The Group operates in the PRC and all of the Group's long-lived assets are located in the PRC.

In 2007, 2008 and 2009, no customer accounted for 10% or more of the Group's net revenues.

24. Related party transactions**Transactions with employees**

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The Group's customers include distributors who are owned by certain employees of the Group. Details of the transactions for the years ended December 31, 2007, 2008 and 2009 were as follows:

	For the years ended December 31,		
	2007	2008	2009
Sales	\$ 18,947,783	\$ 11,523,922	\$ 16,202,838
Accounts receivable	802,859	730,897	1,011,897

These sales represented 7.6%, 4.9% and 5.6% of the total gross revenues in 2007, 2008 and 2009, respectively. The sales with the single entity owned by a family member of the Group's CEO were \$859,436, nil and nil for the years ended December 31, 2007, 2008 and 2009, respectively.

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ACORN INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE YEARS ENDED DECEMBER 31, 2007, 2008 AND 2009

(In US dollars, except share data, unless otherwise stated)

25. Restricted net assets

Relevant PRC laws and regulations permit payments of dividends by the Group's PRC subsidiaries only out of their retained earnings, if any, as determined in accordance with PRC accounting standards and regulations. As a result of these PRC laws and regulations, the Group's PRC subsidiaries are restricted in their abilities to transfer a portion of their net assets either in the form of dividends, loans or advances, which restricted portion amounted to \$35,432,956 as of December 31, 2009. This amount is made up of the registered equity of the Group's PRC subsidiaries and the statutory reserves disclosed in Note 21. In addition, as a result of the Group's restructuring effective January 1, 2005, retained earnings of \$20,336,734 related to the pre-restructuring companies was unavailable for distribution as a normal dividend to Acorn International in accordance with relevant PRC laws and regulations.

26. Subsequent events

In January 2010, the Group paid out the special dividend of \$29,322,782 to its shareholders.

In January 2010, Shanghai An-Nai-Chi, a previously consolidated subsidiary of the Group, received a cash injection of \$1.5 million from a third party. The Group's equity interests in Shanghai An-Nai-Chi therefore decreased from 51.00% to 33.15% so that the Group no longer had controlling interests in Shanghai An-Nai-Chi. Upon the completion of the capital injection, the Group ceased to consolidate Shanghai An-Nai-Chi and accounts for the retained investment using the equity method of accounting.

In February 2010, Emoney, a previously consolidated subsidiary of the Group, was deregistered and the Group ceased to consolidate Emoney upon the completion of this deregistration.

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Table of Contents**ADDITIONAL INFORMATION FINANCIAL STATEMENT SCHEDULE I****ACORN INTERNATIONAL, INC.**

These financial statements have been prepared in conformity with accounting principles generally accepted in the United States.

FINANCIAL INFORMATION OF PARENT COMPANY**BALANCE SHEETS**

(In US dollars, except share data)

	December 31,	
	2008	2009
Assets		
Current assets:		
Cash and cash equivalents	\$ 57,037,995	\$ 48,188,467
Short-term investments	9,657,390	
Other current assets	171,710	118,212
Amounts due from subsidiaries	8,918,791	9,963,344
Total current assets	75,785,886	58,270,023
Investments in subsidiaries	113,001,522	148,120,697
Amounts due from a subsidiary	1,200,000	
Long-term investments	5,275,000	6,624,000
Total assets	\$ 195,262,408	\$ 213,014,720
Liabilities and equity		
Current liabilities:		
Other current liabilities	\$ 880,470	\$ 1,436,293
Dividend payable		29,322,782
Total current liabilities	880,470	30,759,075
Equity:		
Ordinary shares (\$0.01 par value; 100,000,000 shares authorized, 93,543,506 and 93,544,748 shares issued and 88,209,368 and 88,856,915 shares outstanding as of December 31, 2008 and 2009, respectively)	935,435	935,447
Additional paid-in capital	203,113,548	175,638,701
Retained deficit	(9,104,346)	(268,518)
Accumulated other comprehensive income	15,113,507	17,562,561
Treasury stock, at cost (5,334,138 and 4,687,833 shares as of December 31, 2008 and 2009, respectively)	(15,676,206)	(11,612,546)
Total equity	194,381,938	182,255,645
Total liabilities and equity	\$ 195,262,408	\$ 213,014,720

Table of Contents**FINANCIAL INFORMATION OF PARENT COMPANY****STATEMENTS OF OPERATIONS****(In US dollars)**

	For the years ended December 31,		
	2007	2008	2009
Operating expenses:			
Other selling and marketing expenses	\$ 1,246,555	\$ 1,361,489	\$ 1,176,988
General and administrative expenses	7,084,014	5,005,417	3,647,183
Total operating expenses	8,330,569	6,366,906	4,824,171
Loss from operations	(8,330,569)	(6,366,906)	(4,824,171)
Equity in earnings (losses) of subsidiaries	22,122,152	(18,116,119)	17,051,897
Other income (expenses)	4,860,323	(1,108,344)	(344,462)
Income (loss) before income taxes	18,651,906	(25,591,369)	11,883,264
Income taxes			
Net income (loss) attributable to Acorn International, Inc.	18,651,906	(25,591,369)	11,883,264
Deemed dividend on Series A convertible redeemable preferred shares	(53,800)		
Net income (loss) attributable to holders ordinary shares	\$ 18,598,106	\$ (25,591,369)	\$ 11,883,264

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Table of Contents**FINANCIAL INFORMATION OF PARENT COMPANY****STATEMENTS OF CHANGES IN EQUITY AND COMPREHENSIVE INCOME (LOSS)**

(In US dollars, except share data)

	Ordinary shares		Additional Paid-in capital	Subscription receivable	Retained earnings (deficit)	Accumulated other comprehensive income	Treasury stock, at cost		Total equity	Comprehensive income (loss)
	Shares	Amount					Shares	Amount		
Balance at January 1, 2007	48,979,394	\$ 489,794	\$ 33,364,641	\$ (9,289,478)	\$ 2,242,779	\$ 3,029,752		\$	\$ 29,837,488	
Issuance of ordinary shares in initial public offering	23,565,000	235,650	112,994,175						113,229,825	
Cost of initial public offering			(4,344,262)						(4,344,262)	
Conversion of Series A convertible redeemable preferred shares to ordinary shares upon the completion of initial public offering	17,709,815	177,098	31,872,401						32,049,499	
Conversion of Series A-1 convertible redeemable preferred shares to ordinary shares upon the completion of initial public offering	2,882,155	28,822	18,836,902						18,865,724	
Collection of subscription receivable				9,289,478					9,289,478	
Exercise of stock options and stock appreciate rights	119,076	1,190	121,152						122,342	
Repurchase of ordinary shares							(2,049,000)	(6,833,124)	(6,833,124)	
Share-based compensation expenses			6,519,078						6,519,078	
Net income					18,651,906				18,651,906	\$ 18,651,906
Deemed dividend on Series A convertible redeemable preferred shares					(53,800)				(53,800)	
Unrealized losses on available-for-sales securities						(1,556,316)			(1,556,316)	(1,556,316)
Foreign currency translation adjustments						6,217,549			6,217,549	6,217,549

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Balance at December 31, 2007	93,255,440	\$ 932,554	\$ 199,364,087	\$	\$ 20,840,885	\$ 7,690,985	(2,049,000)	\$ (6,833,124)	\$ 221,995,387	\$ 23,313,139
Exercise of stock options	288,066	2,881	460,229						463,110	
Repurchase of ordinary shares							(5,849,241)	(16,378,724)	(16,378,724)	
Issuance of repurchased shares in connection with the acquisition of Yiyang Yukang					(4,353,862)	2,564,103	7,535,642		3,181,780	
Share-based compensation expenses			3,289,232						3,289,232	
Net loss					(25,591,369)				(25,591,369)	\$ (25,591,369)
Unrealized losses on available-for-sales securities						(271,849)			(271,849)	(271,849)
Foreign currency translation adjustments						7,694,371			7,694,371	7,694,371
Balance at December 31, 2008	93,543,506	\$ 935,435	\$ 203,113,548	\$	\$ (9,104,346)	\$ 15,113,507	(5,334,138)	\$ (15,676,206)	\$ 194,381,938	\$ (18,168,847)

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Table of Contents**FINANCIAL INFORMATION OF PARENT COMPANY****STATEMENTS OF CHANGES IN EQUITY AND COMPREHENSIVE INCOME (LOSS) (Continued)**

(In US dollars, except share data)

	Ordinary shares		Additional Paid-in capital	Subscription receivable	Retained earnings (deficit)	Accumulated other comprehensive income	Treasury stock, at cost		Total equity	Comprehensive income (loss)
	Shares	Amount					Shares	Amount		
Exercise of stock options	1,242	12	2,050						2,062	
Repurchase of ordinary shares							(1,917,798)	(2,288,136)	(2,288,136)	
Issuance of repurchased shares in connection with the acquisition of Yiyang Yukang					(3,047,436)		2,564,103	6,351,796	3,304,360	
Share-based compensation expenses			1,845,885						1,845,885	
Appropriate special dividend			(29,322,782)						(29,322,782)	
Net income					11,883,264				11,883,264	\$ 11,883,264
Unrealized losses on available-for-sales securities						2,312,564			2,312,564	2,312,564
Foreign currency translation adjustments						136,490			136,490	136,490
Balance at December 31, 2009	93,544,748	\$ 935,447	\$ 175,638,701	\$	\$ (268,518)	\$ 17,562,561	(4,687,833)	\$ (11,612,546)	\$ 182,255,645	\$ 14,332,318

Table of Contents**FINANCIAL INFORMATION OF PARENT COMPANY****STATEMENTS OF CASH FLOWS****(In US dollars)**

	For the years ended December 31,		
	2007	2008	2009
Operating activities:			
Net income (loss) attributable to holders of ordinary shares	\$ 18,598,106	\$ (25,591,369)	\$ 11,883,264
Deemed dividend on Series A convertible redeemable preferred shares	53,800		
Net income (loss) attributable to Acorn International, Inc.	18,651,906	(25,591,369)	11,883,264
Share-based compensation	6,519,078	3,289,232	1,845,885
Equity in (earnings) losses of subsidiaries	(22,122,152)	18,116,119	(17,051,897)
Loss on change in fair value of derivative asset		3,275,000	1,335,630
Accrued interests on available-for-sale securities	(225,556)	190,001	(735,455)
Changes in operating assets and liabilities:			
Other current assets	(823,821)	652,111	53,498
Amounts due from subsidiaries	199,761	(109,596)	(1,044,553)
Other current liabilities	505,637	(481,121)	555,823
Net cash provided by (used in) operating activities	\$ 2,704,853	\$ (659,623)	\$ (3,157,805)
Investing activities:			
Purchase of available-for-sale securities	(20,000,000)		
Redemption of available-for-sale securities by the issuer			10,000,000
Investments in subsidiaries	(10,290,000)	(20,357,757)	(7,905,649)
Amounts due from a subsidiary		(1,200,000)	1,200,000
Net cash used in investing activities	\$ (30,290,000)	\$ (21,557,757)	\$ 3,294,351
Financing activities:			
Proceeds from initial public offering (net of issuance cost of US\$4,344,262)	108,885,563		
Collection of subscription receivable	9,289,478		
Proceeds from exercise of stock options	122,342	463,110	2,062
Repurchase of ordinary shares	(6,833,124)	(16,378,724)	(2,288,136)
Yiyang Yukang first earn-out payment			(6,700,000)
Net cash provided by (used in) financing activities	\$ 111,464,259	\$ (15,915,614)	\$ (8,986,074)
Net increase (decrease) in cash and cash equivalents	\$ 83,879,112	\$ (38,132,994)	\$ (8,849,528)
Cash and cash equivalents at the beginning of the year	11,291,877	95,170,989	57,037,995
Cash and cash equivalents at the end of the year	\$ 95,170,989	\$ 57,037,995	\$ 48,188,467

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**FINANCIAL INFORMATION OF PARENT COMPANY
FOR THE YEARS ENDED DECEMBER 31, 2007, 2008, AND 2009**

Note to Schedule I

Schedule I has been provided pursuant to the requirements of Rule 12-04(a) and 5-04(c) of Regulation S-X, which require condensed financial information as to the financial position, changes in financial position and results of operations of a parent company as of the same dates and for the same periods for which audited consolidated financial statements have been presented when the restricted net assets of consolidated subsidiaries exceed 25 percent of consolidated net assets as of the end of the most recently completed fiscal year.

Certain balances in the prior year were reclassified to conform to current year presentation.

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