ALTERNET SYSTEMS INC
Form 10QSB
August 14, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-QSB

(Mark One)

[x] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED **JUNE 30, 2006**

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM ___________ TO __________

COMMISSION FILE NUMBER: **000-31909**

ALTERNET SYSTEMS, INC.

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

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

#610 815 West Hastings Street
Vancouver, British Columbia
V6C 1B4
(604) 608-2540
(Registrant s telephone number)

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

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

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

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [x] No [ ]

As of June 30, 2006, the Registrant had 41,499,428 shares of common stock issued and outstanding.

Transitional Small Business Disclosure Format (check one) Yes [ ] No [x]

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

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ALTERNET SYSTEMS INC.

(A Development Stage Company)

INTERIM CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2006

(Unaudited)

ALTERNET SYSTEMS INC.
(A Development Stage Company)
CONSOLIDATED BALANCE SHEETS

	June 30, 2006 (Unaudited)	December 31, 2005
ASSETS		
Current Assets		
Cash	$ 26,996	$ 5
Prepaid expenses	-	3,981
Total Current Assets	26,996	3,986
PROPERTY AND EQUIPMENT - net of depreciation of $10,681 and $8,862	10,779	12,598
TOTAL ASSETS	**$ 37,775**	**$ 16,584**
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities	$ 160,092	$ 177,163
Deferred license revenue	-	2,140
Due to related parties (Note 3)	3,838	5,299
TOTAL LIABILITIES	163,930	184,602
CONTINGENCIES (Notes 1 and 4)		
STOCKHOLDERS' DEFICIT		
Capital Stock (Note 2)		
Common stock, $0.00001 par value, 100,000,000 shares authorized 41,499,428 (2005 29,947,428) issued and outstanding	416	301
Additional paid-in capital	3,640,370	3,014,635
Private placement subscriptions	61,369	161,808
Obligation to issue shares	26,000	26,000
Accumulated other comprehensive income	5,515	2,139
Deficit accumulated during the development stage	(3,859,825)	(3,372,901)
TOTAL STOCKHOLDERS' DEFICIT	(126,155)	(168,018)
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	**$ 37,775**	**$ 16,584**

See accompanying notes to the consolidated financial statements.

ALTERNET SYSTEMS INC.
(A Development Stage Company)
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three months ended June 30, 2006	Three months ended June 30, 2005	Six months ended June 30, 2006	Six months ended June 31, 2005	Results of Operations from October 13, 2000(inception) to June 30, 2006
REVENUE					
License fees and hardware sales	$ -	$ 3,796	$ 3,604	$ 7,707	$ 225,973
COST OF SALES					
Purchases	-	-	-	-	16,393
Royalties	-	1,340	-	2,697	29,233
Installation costs and other	-	-	-	-	58,127
	-	1,340	-	2,697	103,753
GROSS PROFIT	-	2,456	3,604	5,010	122,220
OPERATING EXPENSES					
Advertising and promotion	-	-	-	-	110,753
Bad debt	-	-	-	-	15,344
Commissions	-	-	-	-	13,439
Depreciation and amortization	910	956	1,819	1912	42,040
License fees	-	-	-	-	696,000
Management and consulting	108,812	236,172	247,132	242,586	1,450,809
Marketing	107,434	(3,444)	153,298	2,648	1,176,516
Office and general	18,194	1,626	25,893	7,061	224,204
Professional fees	11,077	18,019	29,602	43,012	267,736
Rent	8,853	8,049	17,565	16,136	130,993
Telephone and utilities	1,628	2,034	3,487	3,296	37,512
Training and documentation	-	-	-	-	153,154
Travel	11,627	1,912	11,732	2,383	62,097
	268,535	265,324	490,528	319,034	4,380,597
LOSS FROM OPERATIONS	(268,535)	(262,868)	(486,924)	(314,024)	(4,258,377)

Gain on Settlement of Debt	-	-	-	-	398,552
NET LOSS	**$** (268,535)	$ (262,868)	$ (486,924)	**$** (314,024)	$ (3,859,825)
BASIC AND DILUTED NET LOSS PER SHARE	**$** (0.01)	$ (0.01)	$ (0.01)	**$** (0.02)	
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING BASIC AND DILUTED	38,316,901	26,928,549	35,880,312	26,390,036	

See accompanying notes to the consolidated financial statements.

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

	Six months ended June 30, 2006	Six months ended June 30, 2005	October 13, 2000 (inception) to June 30, 2006
OPERATING ACTIVITIES			
Net loss	$ (486,924)	$ (314,024)	$ (3,859,825)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation	1,819	1,912	42,040
Gain on disposal of assets	-	-	(215)
Gain on settlement of debt	-	-	(398,552)
Issuance of shares for services rendered	89,100	244,000	1,162,389
Obligation to issue shares for services rendered	-	(11,150)	492,320
Changes in operating assets and liabilities:			
Prepaid expenses	3,981	(802)	-
Deferred license revenue	(2,140)	(4,282)	-
Accounts payable and accrued liabilities	(3,071)	23,139	706,412
Net cash used in operating activities	(397,235)	(61,207)	(1,855,431)
INVESTING ACTIVITIES			
Acquisition of fixed assets	-	-	(22,605)
Cash acquired on reverse acquisition of SchoolWeb	-	-	74
Net cash used in investing activities	-	-	(22,531)
FINANCING ACTIVITIES			
Advances (to) from related parties	(1,461)	(12,866)	-
Net proceeds on sale of common stock and subscriptions	422,311	74,945	1,899,440
Net cash provided by financing activities	420,850	62,079	1,899,440
EFFECT OF EXCHANGE RATE CHANGES ON CASH	3,376	(929)	5,515
NET INCREASE (DECREASE) IN CASH DURING THE PERIOD	26,991	(57)	26,993
CASH, BEGINNING OF PERIOD	5	30	3
CASH, END OF PERIOD	$ 26,996	$ (27)	$ 26,996

SUPPLEMENTAL CASH FLOW INFORMATION AND NON-CASH TRANSACTIONS:

During the six months ended June 30, 2006, the Company issued 990,000 common shares for services valued at $89,100 and 80,000 common shares for settlement of debt valued at $14,000.

SUPPLEMENTARY DISCLOSURE:

Interest paid	$ -	$ -	$ -
Income taxes paid	$ -	$ -	$ -

See accompanying notes to the consolidated financial statements.

ALTERNET SYSTEMS INC.
(A Development Stage Company)
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2006

(Unaudited)

NOTE 1 NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Alternet Systems Inc. (Alternet or the Company) designs, markets and sells proprietary software and hardware systems known as SchoolWeb and CommunityWeb . The Company s products provide high speed Internet access to schools and rural communities, in North America and internationally.

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

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-QSB of Regulation S-B. They may not include all information and footnotes required by generally accepted accounting principles for complete financial statements. However, except as disclosed herein, there has been no material changes in the information disclosed in the notes to the financial statements for the year ended December 31, 2005 included in the Company s Annual Report on Form 10-KSB filed with the Securities and Exchange Commission. The interim unaudited financial statements should be read in conjunction with those financial statements included in the Form 10-KSB. In the opinion of Management, all adjustments considered necessary for a fair presentation, consisting solely of normal recurring adjustments, have been made. Operating results for the six months ended June 30, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006.

The consolidated financial statements have been prepared on the basis of a going concern, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. At June 30, 2006 the Company had a working capital deficiency of $136,935 (2005 - $560,879). The Company has incurred losses since inception and further losses are anticipated in the development of its products raising substantial doubt as to the Company s ability to continue as a going concern. The Company s continued operations are dependent on the successful implementation of its business plan, its ability to obtain additional financing as needed, continued support from creditors, settling its outstanding debts and ultimately attaining profitable operations. It is management's intention to continue to pursue market acceptance for its proprietary software and hardware systems technology, to settle its outstanding debts and to identify funding sources until such time that there is sufficient operating cash flow to fund operating requirements. Funding for continuing operations will be pursued on a private placement basis with qualified investors in applicable US states and Canada.

NOTE 2 CAPITAL STOCK

Through June 30, 2006, the Company had not granted any stock options although shareholders approved a stock option plan (the "Option Plan") for 3,000,000 incentive stock options at its annual meeting of shareholders held on May 31, 2004. Options under the Option Plan, when granted, can be for a term of up to five (5) years at an exercise price to be determined by the Directors.

During the six months ended June 30, 2006, the Company filed an application under the registration exemptions available in Regulation D or Regulation S, to commence sales of up to 12,000,000 shares of its common stock at a price of $0.05 per share of common stock. On February 20, 2006, the Company completed a private placement of 5,765,000 common shares at a price of $0.05 per share for total proceeds of $288,250 under this exemption of which $161,808 was received during 2005. On June 1, 2006, the Company completed another private placement of 4,690,000 common shares at a price of $0.05 per share for total proceeds of $234,500 under this exemption.

During the six months ended June 30, 2006, the Company issued 990,000 common shares for services valued at $89,100 and 80,000 for settlement of debt valued at $14,000.

ALTERNET SYSTEMS INC.
(A Development Stage Company)
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2006

(Unaudited)

NOTE 2 CAPITAL STOCK (continued)

The Company has received $61,369 in respect of a private placement of common stock at a price of $0.05 per share. These shares were not issued as at June 30, 2006 and this amount is reported as private placement subscriptions within stockholders deficit.

Effective March 1, 2003, the Company adopted a Retainer Stock Plan for Employees, Directors and Consultants (the 2003 Plan) for the purpose of providing the Company with the means to compensate employees, directors and consultants for their efforts in furthering the future success of the Company. The 2003 Plan allows for direct awards of common stock as a reward or incentive to employees or as consideration to directors or consultants for their services. A total of 5,000,000 common shares may be awarded under this plan. The 2003 Plan will terminate February 29, 2008. The Company filed a Registration Statement on Form S-8 to cover the 2003 Plan. To date, 4,876,000 common shares valued at $1,066,160 relating to services provided in 2003, 2004 and 2005 have been awarded leaving a balance of 124,000 shares which maybe awarded under this plan.

Effective January 21, 2005 the Company adopted a Retainer Stock Plan for Employees, Directors and Consultants (the 2005 Plan) for the purpose of providing the Company with the means to compensate employees, directors and consultants for their efforts in furthering the future success of the Company. The 2005 Plan allows for direct awards of common stock as a reward or incentive to employees or as consideration to directors or consultants for their services. A total of 5,000,000 common shares may be awarded under this plan. The 2005 Plan will terminate January 21, 2010. The Company filed a Registration Statement on Form S-8 to cover the 2005 Plan. To date, 4,550,000 common shares valued at $562,550 relating to services provided for the period ended June 30, 2006 have been awarded leaving a balance of 450,000 shares which maybe awarded under this plan.

Effective April 22, 2006 the Company adopted a Retainer Stock Plan for Employees, Directors and Consultants (the 2006 Plan) for the purpose of providing the Company with the means to compensate employees, directors and consultants for their efforts in furthering the future success of the Company. The 2006 Plan allows for direct awards of common stock as a reward or incentive to employees or as consideration to directors or consultants for their services. A total of 6,000,000 common shares may be awarded under this plan. The 2006Plan will terminate April 23, 2011. The Company filed a Registration Statement on Form S-8 to cover the 2006 Plan. To date, no shares have been issued under this plan.

There were no warrants outstanding at December 31, 2005 or June 30, 2006.

NOTE 3 RELATED PARTY TRANSACTIONS

At June 30, 2006, a total of $3,839 (December 2005 - $5,299) was owed to directors. Amounts due to related parties are non-interest bearing and have no specific terms of repayment.

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

	Six months ended June 30, 2006	2005

Management and consulting	$	71,104	$	-
Marketing		37,470		13,647
	$	108,574	$	13,647

NOTE 4 LAWSUIT

On March 14, 2005, Native Investment and Trade Association (plaintiff) filed a Writ of Summons and Statement of Claim requesting an order that the Company pay the plaintiff $53,500 and for specific performance of the obligation to transfer 100,000 free trading common shares to the plaintiff. The Company has disputed any liability and the likelihood of any further losses resulting from the above lawsuit is not determinable at this time.

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

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

The statements contained herein, other than historical information, are or may be forward-looking statements, and may involve factors, risks and uncertainties that may cause the Company s actual results to differ materially from such statements. These factors, risks and uncertainties, include the relatively short operating history of the Company; market acceptance and availability of products and services; the impact of competitive products, services and pricing; possible delays in the shipment or development of new products; and the availability of sufficient financial resources to enable the Company to expand or even continue its operations.

Critical Accounting Policies

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

RESULTS OF OPERATIONS:

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

Software development of the Company s SchoolWeb product, including its innovative Internet content management system (CMS), has been completed. Although no new sales have occurred during this period, the Company has selected sales agents and is actively marketing the Company s software products internationally. In addition, two directors have been added to the Board, who have significant experience in sales and marketing of software and wireless broadband systems in North America and internationally.

Net Sales

For the six month period ending June 30, 2006 the Company sales of $3,604, which was a decrease from the corresponding period to June 30, 2005 which had sales of $7,707. Although no new sales were made this quarter, the Company is actively pursuing sales for CommunityWeb, SchoolWeb and HealthWeb systems in Europe, Latin America and Africa.

The decrease in sales is due to the fact that the Company had amortized the revenue from a previous sales contract and this contract has now expired. The Company has also undertaken a re-organization of its sales and marketing staff over the past year. The objective of the re-organization of the sales and marketing functions was to reduce overhead by utilizing independent sales agents to market SchoolWeb and CommunityWeb. Sales agents have been selected and have been actively pursuing sales for CommunityWeb, HealthWeb and SchoolWeb systems in Europe and Central America.

Net Loss

For the six month period ending June 30, 2006, the Company had a net loss of $486,924or $(0.01) per share, which was not changed when compared to the net loss for the corresponding period to June 30, 2005 was $314,024or $(0.01) per share. The increased loss for the period is due to the fact that the Company has increased its marketing efforts internationally and has incurred increased marketing expense.

Gross Profit

Gross Profit was $3,604 for the six month period ending June 30, 2006, compared to $5,010 for the six month period ended June 30, 2005. Gross profit decreased 72% compared to the prior period, due to the fact that the amortized revenue from a previous SchoolWeb contract ceased to be recognized, as the contract had expired prior to the beginning of the current quarter.

Selling, General and Administrative Expenses

For the six month period ended June 30, 2006 the Company incurred office and general expenses of $25,893; marketing expenses of $153,298; management and consulting fees of $247,132; and $29,602 in professional fees.

For the corresponding six month period to June 30, 2005, the Company had office and general expenses of $7,061 marketing expenses of $2,648, management and consulting fees of $242,586 and professional fees of $43,012.

Office and general expenses increased 366% during the six month period ending June 30 2006, compared to the corresponding six month period ending June 30, 2005. Marketing expense increased 5700% during the six month period ending June 30 2006, compared to the corresponding period to June 30, 2005. This is a result of increased activity in marketing the SchoolWeb, HealthWeb and CommunityWeb products internationally.

Management and consulting expense was largely unchanged for the period ending June 30, 2006, compared to the period ending June 30, 2005.

Accounts payable for the six month period ending June 30 2006 were $160,092 which was a 70% decrease when compared to accounts payable of $528,700 at June 30, 2005. This was due to the write-off of accounts payable due to settlement of the legal dispute between the Company and Advanced Interactive Inc., which was completed on November 1 2005.

Liquidity and Capital Resources

The Company had current assets and cash on hand of $26,996 as at June 30, 2006.

The Company had a net loss of $486,924 during the six month period ending June 30, 2006. The net loss was an increase of 35% when compared a loss of $314,024 in the corresponding period ending June 30, 2005. Approximately 18% of this loss was non-cash expense due to $89,100 in stock issued for services. Management of the Company has determined that the Company s ability to continue as a going concern is dependent on maintaining low expense levels and raising additional capital.

Management can give no assurance that any sales will occur in the future and if they do occur, may not be enough to cover the Company s operating expenses or any other costs. Should this be the case, we would be forced, unless sufficient working capital can be raised, to suspend operations and possibly liquidate the assets and wind up and dissolve the Company.

Recent Accounting Pronouncements

In February 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 155, Accounting for Certain Hybrid Financial Instruments-an amendment of FASB Statements No. 133 and 140 , to simplify and make more consistent the accounting for certain financial instruments. SFAS No. 155 amends SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities , to permit fair value remeasurement for any hybrid financial instrument with an embedded derivative that otherwise would require bifurcation, provided that the whole instrument is accounted for on a fair value basis. SFAS No. 155 amends SFAS No. 140, Accounting for the Impairment or Disposal of Long-Lived Assets , to allow a qualifying special-purpose entity to hold a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS No. 155 applies to all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006, with earlier application allowed. We do not expect the adoption of this statement will have a significant effect on our future reported financial position or results of operations.

In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets, an amendment of FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities". This statement requires all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable, and permits for subsequent measurement using either fair value measurement with changes in fair value reflected in earnings or the amortization and impairment requirements of Statement No. 140. The subsequent measurement of separately recognized servicing assets and servicing liabilities at fair value eliminates the necessity for entities that manage the risks inherent in servicing assets and servicing liabilities with derivatives to qualify for hedge accounting treatment and eliminates the characterization of declines in fair value as impairments or direct write-downs. SFAS No. 156 is effective for an entity's first fiscal year beginning after September 15, 2006. This adoption of this statement is not expected to have a significant effect on our future reported financial position or results of operations.

ITEM 3. CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the U.S. Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer (principal executive officer) and our VP Finance (principal financial officer) as appropriate, to allow timely decisions regarding required disclosure.

As of June 30, 2006, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer (principal executive officer) and our VP Finance (principal financial officer), of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-14. Based upon the foregoing, our Chief Executive (principal executive officer) and our VP Finance (principal financial officer) concluded that our disclosure controls and procedures are effective in the timely alerting of management to material information relating to us which is required to be included in our periodic SEC filings.

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in our reports filed under the Exchange Act is accumulated and communicated to management, including our Chief Executive Officer (principal executive officer) and our VP Finance (principal financial officer), to allow timely decisions regarding required disclosure. During our most recently completed fiscal quarter ended June 30, 2006, there were no changes in our internal control over financial reporting identified in connection with the evaluation referred to above that occurred during our last fiscal quarter which have materially affected, or are reasonably likely to affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

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

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

The Company had an agreement with Advanced Interactive Inc. (the License Agreement) under which it licensed certain of its software products from Advanced Interactive Inc. (AII) The Company has commenced legal proceedings against AII and its subsidiary by way of filing of a Writ of Summons and Statement of Claim in the Supreme Court of British Columbia, Canada, Vancouver Registry. The Writ states that the Defendants have breached the License Agreement and damages are being sought in the amount of Cdn $1,804,709.00.

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

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

On July 15, 2005, the Company and the Defendants signed a settlement agreement whereby the parties have agreed to settle all outstanding issues related to court proceedings brought by the Company against AII, The settlement agreement is subject to final closing documents being executed and the filing and receipt of British Columbia Court approval for the adjournment of all legal proceedings. The terms of settlement include the mutual full and final release of all outstanding debts, liabilities and obligations outstanding, a three year option by AII to the Company or its designees to acquire a total of 3,228,571 shares of the Company s stock held by AII for $10,000, and the retention by the Company of the software, code, trademarks and intellectual property relating to SchoolWeb and CommunityWeb.

On March 14 2005, Native Investment and Trade Association (NITA) filed a Writ of Summons and Statement of Claim requesting an order that the Company pay the plaintiff $53,500 and for specific performance of the obligation to transfer 100,000 free trading shares to the plaintiff. The fees and shares claimed are for trade shows attended by the Company and these amounts are being disputed by the Company.

The likelihood of any gain or loss resulting from the above lawsuit is not determinable at this time.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

During the six months ended June 30, 2006, the Company issued the following securities: January 11 2006, 990,000 common shares for services valued at $89,100; February 20 2006 completed a private placement of 5,765,000 shares at a price of $0.05 per share for total proceeds of $288,250 under registration exemptions available in Regulation D or Regulation S; May 15 2006 the company issued 80,000 shares in settlement of debt of $14,000; June 1 2006 the Company completed a private placement of 4,690,000 shares at a price of $0.05 for total proceeds of $234,500 under registration exemptions available in Regulations D or Regulation S.

There are no management contracts currently in force for the Company.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

Not Applicable

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

None.

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Reports on Form 8-K. The Registrant filed a report on Form 8K on June 19 2006, announcing the appointment of two new directors Paul Brandenburg and John Puentes

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

EXHIBIT INDEX

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

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SIGNATURE

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

ALTERNET SYSTEMS, INC.

Dated: August 11, 2006 By: /s/ Michael Dearden
Michael Dearden, President and Director