CHINA FIRE & SECURITY GROUP, INC.
Form 10-Q
May 16, 2011

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

FORM 10-Q

(Mark one)

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

For the Quarterly Period Ended March 31, 2010

or

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

Commission File Number 000-50491

China Fire & Security Group, Inc.
(Name of small business issuer in its charter)

Florida (State or other jurisdiction of incorporation or organization)	65-1193022 (I.R.S. Employer Identification No.)
B-2508 TYG Center, C2 Dongsanhuanbeilu, Chaoyang District, Beijing 100027, People's Republic of China (Address of principal executive offices)	100027 (Zip Code)

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

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

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

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

Large accelerated filer [ ] Accelerated filer [x]

Non-accelerated filer [ ]

(Do not check if smaller reporting company) Smaller reporting company [ ]

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

As of May 10, 2011, the Registrant had 27,855,934 shares of common stock outstanding.

China Fire & Security Group, Inc.

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Item 1. Financial Statements

CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
AS OF MARCH 31, 2011 AND DECEMBER 31, 2010

	March 31, 2011 (Unaudited)	December 31, 2010
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$23,863,331	$28,151,689
Restricted cash	2,759,050	1,935,979
Notes receivable	15,789,722	14,428,802
Accounts receivable, net of allowance for doubtful accounts of $8,637,861 and $8,153,727 as of March 31, 2011 and December 31, 2010, respectively	42,279,662	41,895,129
Receivables from and prepayments to related parties	2,737,957	2,448,066
Other receivables	919,013	792,386
Refundable bidding and system contracting project deposits	1,651,406	1,667,437
Inventories	8,347,077	6,713,448
Costs and estimated earnings in excess of billings	47,560,291	40,660,013
Employee advances	1,705,365	1,114,080
Prepayments and deferred expenses	7,416,480	10,281,292
Total current assets	155,029,354	150,088,321
PLANT AND EQUIPMENT, net	9,600,012	9,641,119
OTHER ASSETS:		
Restricted cash - non current	9,603,141	7,533,407
Accounts receivable - retentions	3,156,624	2,790,492
Investment in joint ventures	499,440	496,834
Intangible assets, net	969,842	985,643
Total other assets	14,229,047	11,806,376
Total assets	$178,858,413	$171,535,816
LIABILITIES AND EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$8,121,496	$7,666,967
Customer deposits	3,886,756	3,023,329
Billings in excess of costs and estimated earnings	2,317,412	2,872,706
Other payables	1,305,024	838,413
Accrued liabilities	20,123,301	19,737,906
Taxes payable	10,278,325	9,416,829
Total current liabilities	46,032,314	43,556,150
COMMITMENTS AND CONTINGENCIES		

EQUITY:		
Common stock, $0.001 par value, 65,000,000 shares authorized,		
27,855,934 and 27,855,934 shares issued and outstanding as of		
March 31, 2011 and December 31, 2010, respectively	27,855	27,855
Additional paid-in-capital	25,806,817	24,771,143
Subscriptions receivable	(27,570)	(27,570)
Statutory reserves	7,147,795	7,147,795
Retained earnings	87,828,374	84,703,984
Accumulated other comprehensive income	12,020,909	11,349,619
Total shareholders' equity	132,804,180	127,972,826
Noncontrolling interest	21,919	6,840
Total equity	132,826,099	127,979,666
Total liabilities and equity	$178,858,413	$171,535,816

The accompany notes are integral part of these consolidated financial statements.

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CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME AND OTHER COMPREHENSIVE INCOME
FOR THE THREE MONTHS ENDED MARCH 31, 2011 AND 2010
(Unaudited)

	Three Months Ended March 31, 2011	2010
REVENUES		
System contracting projects	$ 14,619,364	$ 15,521,748
Products	5,189,266	4,530,599
Maintenance services	1,187,246	891,379
Total revenues	20,995,876	20,943,726
COST OF REVENUES		
System contracting projects	7,029,218	7,311,285
Products	2,808,481	1,454,067
Maintenance services	859,523	546,218
Total cost of revenues	10,697,222	9,311,570
GROSS PROFIT	10,298,654	11,632,156
OPERATING EXPENSES		
Selling and marketing	2,356,402	1,996,198
General and administrative	3,308,393	2,940,077
Depreciation and amortization	246,822	200,106
Research and development	517,582	396,896
Total operating expenses	6,429,199	5,533,277
INCOME FROM OPERATIONS	3,869,455	6,098,879
OTHER INCOME (EXPENSES)		
Other income, net	104,652	35,263
Interest income, net	108,102	83,800
Total other income, net	212,754	119,063
INCOME BEFORE PROVISION FOR INCOME TAXES AND NONCONTROLING INTEREST	4,082,209	6,217,942
PROVISION FOR INCOME TAXES	973,225	1,002,874
NET INCOME BEFORE NONCONTROLLING INTEREST	3,108,984	5,215,068
Less: Net loss attributable to noncontrolling interest	(15,406)	(32,157)
NET INCOME ATTRIBUTABLE TO CONTROLLING INTEREST	3,124,390	5,247,225
OTHER COMPREHENSIVE INCOME		
Foreign currency translation adjustment	671,290	(20,473)

Comprehensive (income) loss attributable to noncontrolling interest	105	(11)
COMPREHENSIVE INCOME	$ 3,795,785	$ 5,226,741
BASIC EARNINGS PER SHARE		
Weighted average number of shares	27,855,934	27,595,541
Earnings per share	$ 0.11	$ 0.19
DILUTED EARNINGS PER SHARE		
Weighted average number of shares	29,197,961	28,397,085
Earnings per share	$ 0.11	$ 0.18

The accompany notes are integral part of these consolidated financial statements.

CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	China Fire & Security Group, Inc. Shareholders' Equity								
	Common Stock				Retained Earnings				
	Shares	Par value	Additional paid-in-capital	Subscriptions receivable	Statutory reserves	Unrestricted	Accumulated other comprehensive income	Noncontrolling interest	To
BALANCE, December 31, 2009	27,595,541	$27,595	$20,601,138	$-	$7,147,795	$69,266,049	$7,324,237	$32,742	$104,3
Net income (loss)						5,247,225		(32,157)	5,215
Options issued to employees			245,047						245,0
Stock based compensation for services			790,626						790,6
Foreign currency translation adjustment							(20,473)	(11)	(20,4
BALANCE, March 31, 2010, (Unaudited)	27,595,541	27,595	21,636,811	-	7,147,795	74,513,274	7,303,764	574	110,6
Capital received from non-controlling interest								58,440	58,44
Options exercised	10,393	10	27,560	(27,570)					-
Restricted shares issued	250,000	250	(250)						-
Net income (loss)						10,190,710		(53,171)	10,13
Options issued to employees			735,148						735,1
Stock based compensation for services			2,371,874						2,371

Foreign currency translation adjustment							4,045,855	997	4,046
BALANCE, December 31, 2010	27,855,934	27,855	24,771,143	(27,570)	7,147,795	84,703,984	11,349,619	6,840	127,9
Capital received from non-controlling interest								30,380	30,38
Net income (loss)						3,124,390		(15,406)	3,108
Options issued to employees			245,049						245,0
Stock based compensation for services			790,625						790,6
Foreign currency translation adjustment							671,290	105	671,3
BALANCE, March 31, 2011, (Unaudited)	27,855,934	$27,855	$25,806,817	$(27,570)	$7,147,795	$87,828,374	$12,020,909	$21,919	$132,8

The accompany notes are integral part of these consolidated financial statements.

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CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED MARCH 31, 2011 AND 2010
(Unaudited)

	Three Months Ended March 31, 2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income attributable to controlling interest	$ 3,124,390	$ 5,247,225
Net loss attributable to noncontrolling interest	(15,406)	(32,157)
Consolidated net income	3,108,984	5,215,068
Adjustments to reconcile net income to cash		
used in operating activities:		
Depreciation	244,350	196,621
Amortization	18,953	18,822
Provision for doubtful accounts	626,386	620,724
Recovery of doubtful allowance	(186,698)	-
Option issued to employees	245,049	245,047
Stock based compensation for services	790,625	790,626
Provision for estimated warranty claims	32,879	-
Change in operating assets and liabilities		
Notes receivable	(1,280,616)	(1,334,580)
Accounts receivable	(976,031)	(2,006,671)
Receivable from and prepayments to related parties	(277,850)	(1,207,294)
Other receivables	(113,819)	(274,691)
Refundable bidding and system contracting project deposits	16,031	235,653
Inventories	(1,593,586)	(216,429)
Costs and estimated earnings in excess of billings	(6,663,375)	(7,148,973)
Employee advances	(583,490)	(455,684)
Prepayments and deferred expenses	2,908,642	(233,886)
Accounts payable	433,798	(442,237)
Customer deposits	845,046	95,042
Billings in excess of costs and estimated earnings	(568,574)	(181,946)
Other payables	460,891	154,995
Accrued liabilities	249,194	(969,344)
Taxes payable	809,872	(249,870)
Net cash used in operating activities	(1,453,339)	(7,149,007)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of plant and equipment	(152,719)	(340,642)
Payments for long term investments	-	(4,648)
Net cash used in investing activities	(152,719)	(345,290)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Change in restricted cash	(2,836,376)	(2,321,317)
Capital contributed by noncontrolling interest shareholder	30,380	-
Net cash used in financing activities	(2,805,996)	(2,321,317)
EFFECT OF EXCHANGE RATE CHANGES ON CASH	123,696	(23,908)

DECREASE IN CASH	(4,288,358)	(9,839,522)
CASH and CASH EQUIVALENTS, beginning of periods	28,151,689	34,976,880
CASH and CASH EQUIVALENTS, end of periods	$ 23,863,331	$ 25,137,358
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Income taxes paid	$ 839,411	$ 1,125,930
Interest paid	$ -	$ -

The accompany notes are integral part of these consolidated financial statements.

CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2011
(Unaudited)

Note 1 - Background

Principal activities and reorganization

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

Recent developments

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

Sureland India was incorporated in New Delhi, India with registered capital of $51,398 (INR2,500,000). Sureland India engages in project design, consulting and construction services for the fire protection industry in India. In January 2010, Sureland India received approval from the Indian government to accept foreign investment of 5% equity from the Company’s wholly-owned subsidiary China Fire Protection Group, Inc. ("CFPG"). CFPG completed the payment of $2,710 (INR125,000) in January 2010. After the transaction, the Company became a minority interest holder of Sureland India and the investment was recorded under the cost accounting method. The Company made advance payments to Sureland India of $ 243,639 and $450,169 as of March 31, 2011 and December 31, 2010, respectively, for future services.

Acquisition of 99% ownership interest and 1% controlling interest in Zeetech System Private Ltd. (“Zeetech”)

Zeetech was incorporated in New Delhi, India with registered capital of $2,215 (INR101,000). On February 4, 2010, CFPG signed an agreement to acquire 99% ownership and 1% controlling interest in Zeetech from the existing shareholders for $2,215 (INR101,000), approximately equal to the fair value of the net assets as of January 12, 2010. Zeetech is 100% controlled by CFPG with 99% direct holding and 1% through nominee holding where the nominee agrees to hold the shares on behalf of CFPG. Zeetech does not currently have any operations.

Restructuring of Sureland Industrial

During the first quarter of 2010, CFPG entered into an agreement with Zeetech, our 100% controlled subsidiary, to transfer CFPG's entire interest (75%) in Sureland Industrial to Zeetech. On March 12, 2010, the restructuring transaction was approved by the Chinese Ministry of Commerce. During the fourth quarter of 2010, CFPG entered into an agreement with Zeetech, pursuant to which Zeetech's entire interest (75%) in Sureland Industrial Fire Safety Limited ("Sureland Industrial") shall revert back to CFPG. On December 9, 2010, the reverse transaction was approved by the Chinese Ministry of Commence. Subsequent to the transaction, CFSG still holds 100% of the interests in Sureland Industrial through its subsidiaries.

Formation of Shenyang Hongshida Electronics Co., Ltd ("Shenyang Hongshida")

Shenyang Hongshida was incorporated in Shenyang, Liaoning Province, China with registered capital of $1,525,000 (RMB10,000,000). Pursuant to Shengyang Hongshida's by-laws dated June 1, 2009, the registered capital is required to be injected over the subsequent two years. Shenyang Hongshida is 80% owned by our wholly-owned subsidiary, Beijing Hua An, with a 20% noncontrolling interest owned by an unrelated party. Shenyang Hongshida, which is in the pre-operating stage, will engage in the production and sale of fire equipment, electronic products, instrumentation, and computer parts and provision of technical advisory services. Shenyang Hongshida will focus on the low- to middle-end segment of the fire products market. As of March 31, 2011, $915,000 (RMB 6,000,000) of the registered capital of Shenyang Hongshida has been received, including $152,500 (RMB 1,000,000) in February 2011, of which $30,500 (RMB 200,000) was received from the non-controlling interest investor.

Receipt of "Going Private" Proposal

On March 7, 2011, the Special Committee of its Board of Directors (the "Special Committee") has received a non-binding letter from a leading global private equity firm (the "PE"), pursuant to which the PE proposes to acquire all of the outstanding shares of common stock of China Fire in cash at a price which represents a premium over the current stock price (the "Proposal"). According to the Proposal, the PE is willing to structure the proposed acquisition to allow the existing members of the Company's management to exchange all or part of their equity interests in the Company into equity securities in the post-acquisition company. The Proposal is subject to certain conditions, including, among other things, successful completion of due diligence to the satisfaction of the PE.

The Special Committee was formed to consider certain potential transactions involving the Company (including the Proposal). The Board cautions the Company's shareholders and others considering trading in its securities that no decision has been made by the Special Committee with respect to the Company's response to the Proposal. There can be no assurance that any definitive offer will be made, that any agreement will be executed or that this or any other transaction will be approved or consummated.

Note 2 - Summary of significant accounting policies

The reporting entity

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

Subsidiaries	Incorporated in	Ownership Percentage
China Fire Protection Group Inc. ("CFPG")	British Virgin Islands	100 %
Zeetech System Private Limited ("Zeetech")	India	99 %(1)
Sureland Industrial Fire Safety Limited ("Sureland Industrial")	PRC	100 %
Sureland Industrial Fire Equipment Co. Ltd. ("Sureland Equipment")	PRC	100 %
Beijing Hua An Times Fire Safety Technology Co., Ltd. ("Beijing Hua An")	PRC	100 %
Beijing Shian Kexin Technology Co., Ltd	PRC	100 %
Shenyang Hongshida Electronics Co., Ltd	PRC	80 %

(1) CFPG has 1% controlling interest in Zeetech through nominee holding where the nominee agrees to hold the shares on behalf of CFPG

Basis of presentation

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

While management has included all normal recurring adjustments considered necessary to give a fair presentation of the operating results for the periods presented, interim results are not necessarily indicative of results for a full year. The information included in this Quarterly Report on Form 10-Q should be read in conjunction with the audited consolidated financial statements and footnotes for the year ended December 31, 2010 included in the Company's Annual Report on Form 10-K.

Use of estimates

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

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

Revenue recognition

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

1. Revenues from system contracting projects are recognized using the percentage-of-completion method of accounting, and therefore, take into account the costs, estimated earnings and revenue to date on contracts not yet completed. Revenue recognized is that percentage of the total contract price that costs expended to date bear to anticipated final total costs, based on current estimates of costs to complete. Contract costs include all direct material and labor costs and those indirect costs related to contract performance, such as indirect labor, supplies, tools, repairs, and depreciation costs. Adjustments to the original estimates of the total contract revenue, total contract costs, or the extent of progress toward completion are often required as work progresses. Such changes and refinements in estimation are reflected in reported results of operations as they occur; if material, the effects of changes in estimates are disclosed in the notes to the consolidated financial statements.

   The key assumptions used in the estimate of costs to complete relate to the unit material cost, the quantity of materials to be used, the installation cost and those indirect costs related to contract performance. The estimate of unit material cost is reviewed and updated on a quarterly basis, based on the updated information available in the supply markets. The estimate of material quantity to be used for completion and the installation cost is also reviewed and updated on a quarterly basis, based on the updated information on the progress of project execution. If the supply market conditions or the progress of project execution were different, it is likely that materially different amounts of contract costs would be used in the percentage of completion method of accounting. Thus the uncertainty associated with those estimates may impact our consolidated financial statements. Selling, general, and administrative costs are

charged to expense as incurred. At the time a loss on a contract becomes known, the entire amount of the estimated ultimate loss is recognized in the consolidated financial statements. Claims for additional contract costs are recognized upon a signed change order from the customer.

2. Revenue from product sales is recognized when the goods are delivered and title has passed. Product sales revenue is presented net of a value-added tax ("VAT"). All of the Company's products that are sold in the People's Republic of China ("PRC") are subject to a Chinese value-added tax at a rate of 17% of the gross sales price. This VAT may be offset by VAT paid by the Company on raw materials and other materials included in the cost of producing the finished product.

3. Revenue from the rendering of maintenance services is recognized over the service period on a straight-line basis.

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

Enterprise wide disclosure

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

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

Enterprise and Related Information," the Company considers itself to be operating within one reportable segment.

Shipping and handling

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

Foreign currency translation

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

Asset and liability accounts at March 31, 2011 were translated at 6.56 RMB to $1.00 and 45.25 INR to $1.00 as compared with 6.59 RMB to $1.00 and 45.45 INR to $1.00 at December 31, 2010, respectively. Equity accounts were stated at their historical rate. The average translation rates of RMB applied to income statement accounts for the three months ended March 31, 2011 and 2010 were 6.58 RMB, to $1.00 and 6.82 RMB to $1.00, respectively. The average translation rate of INR applied to income statement accounts for the three months ended March 31, 2011 and 2010 were 45.66 INR to $1.00 and 45.91 INR to $1.00, respectively. Cash flows are also translated at average translation rates for the period; therefore, amounts reported in the statement of cash flows will not necessarily agree with changes in the corresponding balances in the balance sheets.

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

Concentration of risk

Cash includes cash on hand and demand deposits in accounts maintained with state owned banks within the PRC, Hong Kong and India. The Company maintains balances at financial institutions which, from time to time, may exceed Hong Kong Deposit Protection Board insured limits for the banks located in Hong Kong. Balances at financial institutions or state owned banks within the PRC are not covered by insurance. The balances maintained in India are deposited in the branch of DBS Bank (Singapore) Limited, which are fully insured by the Government of Singapore as of March 31, 2011. As of March 31, 2011 and December 31, 2010, the Company had deposits (including restricted cash balances) totaling $36,069,397 and $37,596,887, respectively, that are not covered by insurance. The Company has not experienced any losses in such accounts and believes it is not exposed to any significant risks on its cash in bank accounts.

The Company's operations are mainly carried out in the PRC. The revenue recognized from operations in India is immaterial to the Company’s consolidated financial statements. Accordingly, the Company's business, financial condition and results of operations may be influenced primarily by the political, economic and legal environments in the PRC, and by the general state of the PRC's economy. The Company's operations in the PRC are subject to specific considerations and significant risks not typically associated with companies in North America and Western Europe. These include risks associated with, among others, the political, economic and legal environments and foreign currency exchange. The Company's results may be adversely affected by changes in governmental policies with respect to laws and regulations, anti-inflationary measures, currency conversion and remittances abroad, and rates and methods of taxation, among other things.

The Company has one major customer who represented approximately 45% of the Company’s revenues for the three months ended March 31, 2011. Accounts receivable from this customer were $2,364,545 as of March 31, 2011. The Company has one major customer who represented approximately 60% of the Company’s revenues for the three months ended March 31, 2010. Accounts receivable from this customer were $0 as of March 31, 2010.

For the three months ended March 31, 2011, one supplier accounted for approximately 16.3% of the Company’s purchases. This supplier represented 0.1% of the Company’s total accounts payable as of March 31, 2011. For the three months ended March 31, 2010, two suppliers accounted for approximately 65% of the Company’s purchases. These suppliers represented 3% of the Company’s total accounts payable as of March 31, 2010.

Cash and cash equivalents

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

Restricted cash

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

Restricted cash consists of the following:

	March 31, 2011 (Unaudited)	December 31, 2010
Restricted cash		
Product sales	$ 8,313,022	$ 4,803,276
System contracting projects	4,049,169	4,666,110
Total restricted cash	12,362,191	9,469,386
Restricted cash - non current	(9,603,141)	(7,533,407)
Restricted cash - current	$ 2,759,050	$ 1,935,979

Inventories

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

Inventories consist of the following:

	March 31, 2011 (Unaudited)	December 31, 2010
Raw materials	$ 373,094	$ 192,978
Finished goods	6,696,923	5,054,289
Work in progress	1,277,060	1,466,181
Total	$ 8,347,077	$ 6,713,448

Raw materials consist primarily of materials used in production. Finished goods consist primarily of equipment used in product sales and system contracting projects. The costs of finished goods include direct costs of raw materials as well as direct labor used in production. Indirect production costs such as utilities and indirect labor related to production such as assembling, shipping and handling costs are also included in the cost of inventory. The Company reviews its inventories periodically to determine if any reserves are necessary for potential obsolescence. As of March 31, 2011 and December 31, 2010, the Company determined no reserves were necessary.

Accounts receivable

Accounts receivable represents amounts due from customers for products sales, maintenance services and system contracting projects. Overdue balances are reviewed regularly by senior management.

We establish an allowance for doubtful accounts based on management's assessment of the collectability of our accounts receivable. A considerable amount of judgment is required in assessing the amount of the allowance. We consider the historical level of credit losses, apply percentages to aged receivable categories, make judgments about the creditworthiness of each customer based on ongoing credit evaluations, and monitor current economic trends that might impact the level of credit losses in the future. If the financial condition of the customers were to deteriorate, resulting in their inability to make payments, a larger allowance may be required.

Additional specific provision is made against accounts receivable to the extent that they are considered to be doubtful. Bad debts are written off against the allowance for doubtful accounts when identified. We do not accrue any interest on accounts receivable. Historically, losses from uncollectible accounts have not deviated from the general allowance estimated by management and no bad debts have been written off directly to the statements of operations. This general provisioning policy has not changed since establishment and management considers that the aforementioned general provisioning policy is adequate and does not expect to change this established policy in the near future. Any changes in the estimates of our general provision policy could have a material effect on our results of operations.

Accounts receivable consist of the following:

	March 31, 2011 (Unaudited)	December 31, 2010
Accounts receivable:		
System contracting projects	$ 31,125,980	$ 31,930,814
Maintenance services	4,247,522	3,817,251
Product sales	18,700,645	17,091,283
Total accounts receivable	54,074,147	52,839,348
Allowance for bad debts	(8,637,861)	(8,153,727)
Accounts receivable, net	45,436,286	44,685,621
Accounts receivable - non-current retentions	(3,156,624)	(2,790,492)
Accounts receivable - current	$ 42,279,662	$ 41,895,129

The activity in the allowance for doubtful accounts for trade accounts receivable for the three months ended March 31, 2011 and year ended December 31, 2010 is as follows:

	March 31, 2011 (Unaudited)	December 31, 2010
Beginning allowance for doubtful accounts	$ 8,153,727	$ 6,539,787
Additions charged to bad debt expense	626,386	1,894,361
Recovery of doubtful allowance	(186,698)	(540,913)
Foreign currency translation adjustment	44,446	260,492
Ending allowance for doubtful accounts	$ 8,637,861	$ 8,153,727

Retentions held by customers for system contracting projects included in the Company's accounts receivable are as follows:

	March 31, 2011 (Unaudited)	December 31, 2010
Retentions		
Current	$ 5,108,513	$ 6,130,574
Non-current	3,156,624	2,790,492
Total retentions	$ 8,265,137	$ 8,921,066

These balances represent portions of billings made by the Company but held for payment by the customer, pending satisfactory completion of the project. Retention payments are generally collected within one year of the completion of the project.

As of March 31, 2011, the Company believes that 9.1% of accounts receivable would be collected in more than one year, based on our historical collection pattern.

Costs and estimated earnings in excess of billings

The current asset "Costs and estimated earnings in excess of billings" on contracts, represents revenues recognized in excess of amounts billed.

Costs and estimated earnings in excess of billings consist of the following:

	March 31, 2011 (Unaudited)	December 31, 2010
Contract costs incurred plus recognized profits less recognized losses to date	$ 144,593,675	$ 130,434,619
Less: progress billings	(97,033,384)	(89,774,606)
Costs and estimated earnings in excess of billings	$ 47,560,291	$ 40,660,013

The Company believes that some portion of costs and estimated earnings in excess of billings would be collected in more than one year, based on our historical billing and collection pattern. Currently, we are actively evaluating all the possible estimation methods in order to best estimate the amount to be collected in more than one year.

Billings in excess of costs and estimated earnings

The current liability "Billings in excess of costs and estimated earnings" on contracts, represents billings in excess of revenues recognized.

Billings in excess of costs and estimated earnings consists of the following:

	March 31, 2011 (Unaudited)	December 31, 2010
Progress billings	$ 11,040,846	$ 16,126,195
Less: contract costs incurred plus recognized profits less recognized losses to date	(8,723,434)	(13,253,489)
Billings in excess of costs and estimated earnings	$ 2,317,412	$ 2,872,706

Plant and equipment

Plant and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets with a 5% residual value. Depreciation expense amounted to $244,350 and $196,621 for the three months ended March 31, 2011 and 2010, respectively.

Estimated useful lives of the assets are as follows:

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

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

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

Plant and equipment consists of the following:

	March 31, 2011 (Unaudited)	December 31, 2010
Buildings and improvements	$ 7,296,743	$ 7,258,465
Transportation equipment	4,074,948	3,963,302
Machinery	922,400	901,655
Office equipment	1,122,335	1,083,512
Furniture	126,697	126,032
Total depreciable assets	13,543,123	13,332,966
Less accumulated depreciation	(4,254,507)	(3,988,332)
Construction in progress	311,396	296,485
Plant and equipment, net	$ 9,600,012	$ 9,641,119

Intangible assets

Land use rights - All land in the PRC is owned by the government. However, the government grants the user “land use rights”. The Company acquired land use rights in 2001 and the land use rights expire in 2051. The costs of these rights are being amortized over fifty years using the straight-line method.

Technology rights - In May 2007, the Company acquired the rights to manufacture two fire protection products and the costs of these rights are being amortized over ten years using the straight-line method.

Intangible assets consist of the following:

	March 31, 2011 (Unaudited)	December 31, 2010
Land use rights	$ 770,789	$ 770,789
Technology rights	608,745	608,745
Accumulated amortization	(409,692)	(393,891)
Balance	$ 969,842	$ 985,643

Amortization expense amounted to $18,953 and $18,822 for the three months ended March 31, 2011 and 2010, respectively.

Impairment of long-lived assets

The Company assesses the impairment of long-lived assets, which include identifiable intangible assets, and property and equipment, at least annually or more often whenever events or changes in circumstances indicate that the carrying value of the long lived assets may not be recoverable. Changes in the underlying business could adversely affect the fair value and recoverability of these assets. Important factors which could require an impairment review include: (i) underperformance relative to expected historical or projected future operating results; (ii) changes in the manner of use of the assets or the strategy for our overall business; (iii) negative industry or economic trends; and (iv) our enterprise fair value relative to net book value.

Our impairment evaluation of identifiable intangible assets and property and equipment includes an analysis of estimated future undiscounted net cash flows expected to be generated by the assets over their remaining estimated useful lives. If the estimated future undiscounted net cash flows are insufficient to recover the carrying value of the assets over the remaining estimated useful lives, the

Company records an impairment loss in the amount by which the carrying value of the assets exceeds the fair value. The Company determines fair value based on either market quotes, if available, or discounted cash flows using a discount rate commensurate with the risk inherent in our current business model for the specific asset being valued. Major factors that influence our cash flow analysis are our estimates for future revenue and expenses associated with the use of the asset. Different estimates could have a significant impact on the results of our evaluation. If, as a result of our analysis, the Company determines that our amortizable intangible assets or other long-lived assets have been impaired, the Company will recognize an impairment loss in the period in which the impairment is determined. Any such impairment charge could be significant and could have a material negative effect on our results of operations. As of March 31, 2011, the Company expects these assets to be fully recoverable.

Backlog

System Contracting Projects

The following schedule shows a reconciliation of backlog representing the amount of revenue the company expects to realize from work to be performed on uncompleted contracts in progress at March 31, 2011, and from contractual agreements on which work has not yet begun.

Backlog at December 31, 2010	$ 106,990,673
Less: Bids awarded and pending execution of contracts as of December 31, 2010	(32,450,706)
Contract revenue on uncompleted contracts at December 31, 2010	$ 74,539,967
Contract adjustments (change orders)	(564,890)
Contract revenue for new contracts for the three months ended March 31, 2011	13,922,209
Bids awarded and pending execution of contracts as of March 31, 2011	43,628,190
Less: Contract revenue earned for the three months ended March 31, 2011 excluded the effect of miscellaneous sales tax of $433,449	(15,052,813)
Effect of exchange rate changes	(83,586)
Backlog at March 31, 2011	$ 116,389,077

In addition, the Company entered into additional system contracting project contracts with revenues of $3,399,574 between April 1, 2011 and May 16, 2011.

Products

As of March 31, 2011, the backlog of unshipped and uninspected orders was $40,941,899. In addition, the Company entered into additional product sales contracts with revenues of $146,061 between April 1, 2011 and May 16, 2011.

Maintenance Service

As of March 31, 2011, the future revenue under existing service agreements amounted to $2,341,724.

Research and development

Research and development expenses include salaries, consultant fees, supplies and materials, as well as costs related to other overheads such as depreciation, facilities, utilities and other departmental expenses. The costs that the Company incurs with respect to internally developed technology and engineering services are included in research and development expenses as incurred as they do not directly relate to any particular licensee, license agreement or licenses fee.

Warranty

Generally, the Company's products are not covered by specific warranty terms. However, it is the Company's policy to replace parts if they become defective within one year after deployment at no additional charge to the customer. The Company maintains a provision for potential warranty costs on these products for one year. This provision represents management's assessment of the Company's history of warranty costs while incorporating estimates by the quality review staff of the potential product failure rates. The Company records a warranty obligation in selling expense at the time revenue is recognized. For the three months ended March 31, 2011 and 2010, the company accrued $32,879 and $0, respectively, warranty expense. As of March 31, 2011 and December 31, 2010, the Company recorded $429,471 and $383,744, respectively, as a provision for estimated warranty claims, which is included in the caption of accrued liabilities on the consolidated balance sheet.

Fair value of financial instruments

ASC 825-10-50, "Disclosures about Fair Value of Financial Instruments," defines financial instruments and requires fair value disclosures for those instruments. ASC 820-10, "Fair Value Measurements," defines fair value, establishes a three-level valuation hierarchy for disclosures of fair value measurement and enhances disclosure requirements for fair value measures. The three levels are defined as follow:

- Level 1 inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

- Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the assets or liability, either directly or indirectly, for substantially the full term of the financial instruments.

- Level 3 inputs to the valuation methodology are unobservable and significant to the fair value.

The carrying amounts reported in the balance sheets for receivables and payables qualify as financial instruments and are a reasonable estimate of fair value because of the short period of time between the origination of such instruments and their expected realization and their current market rate of interest.

Investments in joint ventures are also a financial instrument. The Company invested $173,850 (RMB 1,140,000) in Hubei Shou An Changjiang Fire Protection Co., Ltd for a 19% equity interest, invested $322,880 (RMB 2,117,246) in Tianxiao Fire Safety Equipment Co., Ltd. for 16.7% equity interest and $2,710 (INR 125,000) in Sureland India for a 5% equity interest. Total investments as of March 31, 2011 amounted to $499,440. There is no quoted or observable market price for the fair value of similar long term investments in joint ventures. The Company believes that the cost of the capital contributed to these joint ventures is a reasonable approximation of their fair values.

The Company did not identify any other assets and liabilities that are required to be presented on the balance sheet at fair value in accordance with ASC 820-10.

Income taxes

The Company reports income taxes pursuant to ASC 740, “Accounting for Income Taxes” and ASC 740-10, “Accounting for Uncertainty in Income Taxes” (formerly “FIN 48”). ASC 740 requires the recognition of deferred income tax liabilities and assets for the expected future tax consequences of temporary differences between the income tax basis and financial reporting basis of assets and liabilities. Provision for income taxes consists of taxes currently due plus deferred taxes. Deferred tax assets amounted to $99,350 and $85,678 as of March 31, 2011 and December 31, 2010, respectively, and are included in prepayment and deferred expenses in the accompanying consolidated balance sheets.

Under ASC 740-10, a tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely to be realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded. ASC 740-10 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosures, and transition. Penalties and interest incurred related to underpayment of income tax are classified as income tax expense in the year incurred. No significant penalties or interest relating to income taxes have been incurred during the three months ended March 31, 2011 and 2010.

The Company’s operations are subject to income and transaction taxes in the United States, the PRC and the India jurisdictions. Significant estimates and judgments are required in determining the Company’s worldwide provision for income taxes. Some of these estimates are based on interpretations of existing tax laws or regulations. The ultimate amount of tax liability may be uncertain as a result. The Company does not anticipate any events which could cause change to these uncertainties.

The charge for taxation is based on the results for the year as adjusted for items which are non-assessable or disallowed. It is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is accounted for using the balance sheet liability method in respect of temporary differences arising from differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax basis used in the computation of assessable tax profit.

In principle, deferred tax liabilities are recognized for all taxable temporary differences, and deferred tax assets are recognized to the extent that it is probable that taxable profit will be available against which deductible temporary differences can be utilized. Deferred tax is calculated using enacted tax rates that are expected to apply to the period when the asset is realized or the liability is settled. Deferred tax is charged or credited in the income statement, except when it is related to items credited or charged directly to equity, in which case the deferred tax is also dealt with in equity. Deferred tax assets and liabilities are offset when they relate to income taxes levied by the same taxation authority and the Company intends to settle its current tax assets and liabilities on a net basis.

Value Added Tax

Enterprises or individuals who sell products, engage in repair and maintenance or import and export goods in the PRC are subject to a value added tax in accordance with Chinese laws. The value added tax standard rate is 17% of the gross sales price. A credit is available whereby VAT paid on the purchases of semi-finished products or raw materials used in the contract and production of the Company's finished products can be used to offset the VAT due on sales of the finished product. All of our PRC subsidiaries' VAT is subject to a 17% rate.

VAT on sales and VAT on purchases amounted to $1,716,319 and $948,581 for the three months ended March 31, 2011 and $1,467,891 and $844,159 for the three months ended March 31, 2010, respectively. Sales and purchases are recorded net of VAT collected and paid as the Company acts as an agent for the government. VAT taxes are not impacted by the income tax holiday.

Stock-based compensation

The Company follows ASC 718, "Accounting for Stock-Based Compensation," which defines a fair-value-based method of accounting for stock-based employee compensation and transactions in which an entity issues its equity instruments to acquire goods and services from non-employees. Stock compensation granted to non-employees has been determined in accordance with ASC 718 and ASC 505-50, "Accounting for Equity Instruments that are issued to Other than Employees for Acquiring, or in Conjunction with Selling Goods or Services," as the fair value of the consideration received or the fair value of equity instruments issued, whichever is more reliably measured.

ASC 718 requires that all share-based compensation be recognized as an expense in the consolidated financial statements and that such cost be measured at the fair value of the award and requires compensation cost to reflect estimated forfeitures. The determination of the fair value of share-based compensation awards on the date of grant using an option-pricing model is affected by our stock price as well as assumptions regarding a number of complex and subjective variables, including our expected stock price volatility over the term of the awards, actual and projected share option exercise behaviors, risk-free interest rates and expected dividends. The volatility of the Company's common stock was estimated by management based on the historical volatility of our common stock, the risk free interest rate was based on Treasury Constant Maturity Rates published by the U.S. Federal Reserve for periods applicable to the expected life of the share option, the expected dividend yield was based on the Company's current and expected dividend policy, and the projected share option exercise behaviors is based on one-half of the sum of the vesting period and the contractual life of each share option. This is the same as assuming that the options are exercised at the mid-point between the vesting date and expiration date.

Recently issued accounting pronouncements

In January 2010, FASB issued ASU No. 2010-01- "Accounting for Distributions to Shareholders with Components of Stock and Cash." The amendments in this Update clarify that the stock portion of a distribution to shareholders that allows them to elect to receive cash or stock with a potential limitation on the total amount of cash that all shareholders can elect to receive in the aggregate is considered a share issuance that is reflected in EPS prospectively and is not a stock dividend for purposes of applying Topics 505 and 260 (Equity and Earnings Per Share). The amendments in this update are effective for interim and annual periods ending on or after December 15, 2009, and should be applied on a retrospective basis. Adoption of this ASU did not have material impact on the Company's consolidated financial statements.

In January 2010, FASB issued ASU No. 2010-02 – "Accounting and Reporting for Decreases in Ownership of a Subsidiary – a Scope Clarification." The amendments in this Update affect accounting and reporting by an entity that experiences a decrease in ownership in a subsidiary that is a business or nonprofit activity. The amendments also affect accounting and reporting by an entity that exchanges a group of assets that constitutes a business or nonprofit activity for an equity interest in another entity. The amendments in this update are effective beginning in the period that an entity adopts SFAS No. 160, "Non-controlling Interests in Consolidated Financial Statements – An Amendment of ARB No. 51." If an entity has previously adopted SFAS No. 160 as of the date the amendments in this update are included in the Accounting Standards Codification, the amendments in this update are effective beginning in the first interim or annual reporting period ending on or after December 15, 2009. The amendments in this update should be applied retrospectively to the first period that an entity adopted SFAS No. 160. Adoption of this ASU did not have material impact on the Company's consolidated financial statements.

In January 2010, FASB issued ASU No. 2010-06 – "Improving Disclosures about Fair Value Measurements." This update provides amendments to Subtopic 820-10 that requires new disclosure as follows: 1) Transfers in and out of Levels 1 and 2. A reporting entity should disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers. 2) Activity in Level 3 fair value measurements. In the reconciliation for fair value measurements using significant unobservable inputs (Level 3), a reporting entity should present separately information about purchases, sales, issuances, and settlements (that is, on a gross basis rather than as one net number). This update provides amendments to Subtopic 820-10 that clarifies existing disclosures as follows: 1) Level of disaggregation. A reporting entity should provide fair value measurement disclosures for each class of assets and liabilities. A class is often a subset of assets or liabilities within a line item in the statement of financial position. A reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities. 2) Disclosures about inputs and valuation techniques. A reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. Those disclosures are required for fair value measurements that fall in either Level 2 or Level 3. The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. These disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. Adoption of this ASU did not have material impact on the Company's consolidated financial statements.

In February 2010, the FASB issued Accounting Standards Update 2010-09, "Subsequent Events (Topic 855): Amendments to Certain Recognition and Disclosure Requirements," or ASU 2010-09. ASU 2010-09 primarily rescinds the requirement that, for listed companies, financial statements clearly disclose the date through which subsequent events have been evaluated. Subsequent events must still be evaluated through the date of financial statement issuance; however, the disclosure requirement has been removed to avoid conflicts with other SEC guidelines. ASU 2010-09 was effective immediately upon issuance and was adopted in February 2010.

In April 2010, the FASB issued Accounting Standards Update 2010-13, "Compensation—Stock Compensation (Topic 718): Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Currency of the Market in Which the Underlying Equity Security Trades," or ASU 2010-13. This Update provides amendments to Topic 718 to clarify that an employee share-based payment award with an exercise price denominated in currency of a market in which a substantial porting of the entity's equity securities trades should not be considered to contain a condition that is not a market, performance, or service condition. Therefore, an entity would not classify such an award as a liability if it otherwise qualifies as equity. The amendments in this Update are effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2010. Adoption of this ASU did not have material impact on the Company's consolidated financial statements.

In April 2010, the FASB issued Accounting Standard Update 2010-17, "Revenue Recognition—Milestone Method (Topic 605): Milestone Method of Revenue Recognition" or ASU 2010-17. This Update provides guidance on the recognition of revenue under the milestone method, which allows a vendor to adopt an accounting policy to recognize all of the arrangement consideration that is contingent on the achievement of a substantive milestone (milestone consideration) in the period the milestone is achieved. The pronouncement is effective on a prospective basis for milestones achieved in fiscal years and interim periods within those years, beginning on or after June 15, 2010. Adoption of this ASU did not have material impact on the Company's consolidated financial statements.

In July 2010, FASB issued Accounting Standard Update 2010-20, "Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses" or ASU 2010-20. This Update provides enhanced disclosures which are designed to assist financial statement users in assessing an entity's credit risk exposure and in evaluating the adequacy of an entity's allowance for credit losses. Public entities must apply the disclosure requirements applicable to period-end balances beginning with the first interim or annual reporting period ending on or after December 15, 2010. Adoption of this ASU did not have material impact on the Company's consolidated financial statements.

In September 2010, FASB issued Accounting Standard Update 2010-25, "Plan Accounting—Defined Contribution Pension Plans (Topic 962): Reporting Loans to Participants by Defined Contribution Pension Plans" or ASU 2010-25. The ASU clarifies how loans to participants should be classified and measured by defined contribution plans and how IFRS compare to these provisions. The amendments in this update are effective for fiscal years ending after December 15 2010. Adoption of this ASU did not have material impact on the Company's consolidated financial statements.

In December 2010, the FASB issued Accounting Standard Update 2010-28, Intangibles—Goodwill and Other (Topic 350): When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts. This ASU modified Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. For public entities, the amendments in the ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. Adoption of this ASU did not have material impact on the Company's consolidated financial statements.

In December 2010, the FASB issued Accounting Standard Update 2010-29, Business Combinations (Topic 805): Disclosure of Supplementary Pro Forma Information for Business Combinations. This ASU specifies that, if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. ASU 2010-29 is effective prospectively for business combinations where the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. Adoption of this ASU did not have material impact on the Company's consolidated financial statements.

Reclassifications

Certain prior period amounts have been reclassified to conform to the current period presentation. These reclassifications have no effect on net income or cash flows.

Note 3 - Earnings per share

The Company reports earnings per share in accordance with the provisions of ASC 260-10, "Earnings per Share." ASC260-10 requires presentation of basic and diluted earnings per share in conjunction with the disclosure of the methodology used in computing such earnings per share. Basic earnings per share are computed by dividing income available to common stockholders by the weighted average common shares outstanding during the period. Diluted earnings per share takes into account the potential dilution that could occur if securities or other contracts to issue common stock were exercised and converted into common stock.

The following is a reconciliation of the basic and diluted earnings per share computation for the three months ended March 31:

	2011 (Unaudited)	2010 (Unaudited)
Net income for earnings per share	$ 3,124,390	$ 5,247,225
Weighted average shares used in basic computation	27,855,934	27,595,541
Dilutive effect of stock options and restricted stock	1,342,027	801,544
Weighted average shares used in diluted computation	29,197,961	28,397,085
Earnings per share:		
Basic	$ 0.11	$ 0.19
Diluted	$ 0.11	$ 0.18

As of March 31, 2011, 1,014,878 shares of options were excluded in the calculation of diluted earnings per share due to their anti-diluted effect. All other outstanding stock options and restricted stocks were included in the calculation of diluted earnings per share because of their dilutive nature. As of March 31, 2010, all outstanding stock options and restricted stocks were included in the calculation of diluted earnings per share.

Note 4 - Related party transactions

The Company has receivables from Hubei Shou An Changjiang Fire Protection Co., Ltd. ("Hubei Shou An"), in which the Company has a 19% ownership interest. The accounts receivable due from Hubei Shou An was $161,579 and $160,731 as of March 31, 2011 and December 31, 2010, respectively, which resulted from product sales of $57,016 and $41,045 for the years ended December 31, 2010 and 2009, respectively. This amount is expected to be repaid by December 31, 2011 in cash.

In addition, the Company has other receivables from Hubei Shou An in the amounts of $235,277 and $234,042 as of March 31, 2011 and December 31, 2010, respectively. This balance was for operating capital in Hubei Shou An and is expected to be repaid by December 31, 2011 in cash.

The Company has prepayments to Tianjin Tianxiao Fire Safety Equipment Co., Ltd., in which the Company has a 16.7% ownership interest. The prepayment to Tianjin Tianxiao Fire Safety Equipment Co., Ltd. was $2,097,462 and $1,603,123 as of March 31, 2011 and December 31, 2010. Total product purchases amounted to $325,970 and $1,407,126 for the three months ended March 31, 2011 and 2010, respectively.

Advance payments to Sureland India, in which the Company has a 5.0% ownership interest, were $243,639 and $450,170 as of March 31, 2011 and December 31, 2010, respectively. This balance was for the advance payment to Sureland India for the delivery of future services.

Note 5 - Notes receivable

Notes receivable represents trade accounts receivable due from various customers where the customers' bank or a customer with a AAA rating has guaranteed the payment of the receivable. These amount are non-interest bearing and are normally paid within three to six months. The Company has the ability to submit a request for payment to the customer's bank earlier than the scheduled payment date. However, the Company will incur an interest charge and a processing fee when they submit the payment request early. The Company's notes receivable totaled $15,789,722 and $14,428,802 as of March 31, 2011 and December 31, 2010, respectively, of which $7,853,750 and $6,826,500 as of March 31, 2011 and December 31, 2010, respectively, are corporate notes receivable that are guaranteed by a customer with a AAA rating.

Note 6 - Prepayments and deferred expenses

Prepayments and deferred expenses are monies deposited with or advanced to subcontractors to perform services on system contracting projects. Some subcontractors require a certain amount of money to be deposited as a guarantee payment in order for them to start performing the services. Prepayments and deferred expenses also include monies deposited or advanced to vendors on future inventory purchases to ensure timely delivery. The total outstanding amount was $7,416,480 and $10,281,292 as of March 31, 2011 and December 31, 2010, respectively.

Note 7 - Investment in joint ventures

During the second quarter of 2007, the Company invested $173,850 (RMB1,140,000) for a 19% interest in Hubei Shou An Changjiang Fire Protection Co., Ltd., located in China Hubei, PRC. The investment is recorded under the cost accounting method.

As of March 31, 2011, the Company held an investment of $322,880 (RMB2,117,246) for a 16.7% interest in Tianjin Tianxiao Fire Safety Equipment Co., Ltd. as a non-controlling interest holder. The investment is recorded under the cost accounting method at fair value at the deconsolidation date.

In January 2010, the company invested $2,710 (INR125,000) for a 5% interest in Sureland India as a non-controlling interest holder. The investment is recorded under the cost accounting method.

Note 8 - Customer deposits

Customer deposits represent amounts advanced by customers on product orders, maintenance services deposits and system contracting projects deposits. The product or service normally is shipped or performed within nine months after receipt of the advance payment and the related sale is recognized in accordance with the Company's revenue recognition policy. These advance payments are applied to the invoices when the Company bills the customer based on the progression of the projects. As of

March 31, 2011 and December 31, 2010, customer deposits amounted to $3,886,756 and $3,023,329, respectively.

Note 9 - Accrued liabilities

Accrued liabilities represent subcontractors' expenses incurred as of the balance sheet date for system contracting projects. Accrued liabilities also represent an accrued estimation of warranty expenses. As of March 31, 2011 and December 31, 2010, accrued liabilities amounted to $20,123,301 and $19,737,906, respectively.

Note 10 - Income taxes

Local PRC Income Tax

Starting from January 1, 2008, all of the Company's Chinese subsidiaries are subject to a 25% income tax rate according to the Income Tax Laws of the PRC. According to the PRC's central government policy, certain new technologies and/or high technology companies will enjoy a preferential tax rate of 15%, instead of 25%. Beijing Hua An qualifies for the preferential tax treatment in the year 2009 and 2010. Sureland Industrial receives a 50% income tax reduction for three years beginning in January 2009, Sureland Equipment receives a 50% income tax reduction for three years beginning in January 2008, and Beijing Hua An receives a 50% income tax reduction for the years of 2009 and 2010 due to the fact that they are located in a specially designated region.

India Project Office Income Tax

The Company's operation in India is managed on a project basis and projects are conducted under the name of CFPG or Sureland Industrial as a foreign enterprise. Under the India Income Tax Act, the Company's projects are generally subject to an income tax at an effective rate of 40% on income reported in the statutory financial statements after appropriate tax adjustments in accordance with Indian tax regulations.

The Company's subsidiaries are paying the following tax rate for the three months ended March 31, 2010:

Subsidiaries	Income tax exemption	Effective income tax rate
Sureland Industrial	12.5%	12.5%
Sureland Equipment	12.5%	12.5%
Beijing Hua An	17.5%	7.5%
Shian Kexin	-%	25.0%
Zeetech	-%	40.0%
India Project Office	-%	40.0%
Shanyang Hongshida	-%	25.0%

The Company's subsidiaries are paying the following tax rate for the three months ended March 31, 2011:

Subsidiaries	Income tax exemption	Effective income tax rate
Sureland Industrial	12.5%	12.5%
Sureland Equipment	-%	25.0%
Beijing Hua An	-%	25.0%
Shian Kexin	-%	25.0%
Zeetech	-%	40.0%
India Project Offices	-%	40.0%
Shanyang Hongshida	-%	25.0%

The provision for income taxes amounted to $973,225 and $1,002,874 for the three months ended March 31, 2011 and 2010, respectively.

The following table reconciles the U.S. statutory rate to the Company's effective tax rate for the three months ended March 31:

	2011	2010
U.S. Statutory rates	34.0%	34.0%
Foreign income not recognized in USA	(34.0)	(34.0)
China income taxes	25.0	25.0
China income tax exemption	(11.0)	(18.3)
Permanent Differences (China)(1)	2.4	1.4
Other item (2)	7.4	8.0
Effective income tax rates	23.8%	16.1%

(1) The 2.4% represents $529,402 of bad debt provisions and $150,286 of meals and entertainment expenses incurred by Sureland Industrial, Sureland Equipment, and Beijing Hua An that are not deductible in PRC for the three months ended March 31, 2011. These non-deductible expenses were offset by $258,791, which is a 50% additional deduction allowed in PRC for Research and Development expenses at Sureland Industrial. The 1.4% represents $620,724 of bad debt provisions and $148,350 of meals and entertainment expenses incurred by Sureland Industrial, Sureland Equipment, and Beijing Hua An that are not deductible in PRC for the three months ended March 31,

2010. These non-deductible expenses were offset by $198,448 which is a 50% additional deduction allowed by PRC for Research and Development expenses at Sureland Industrial.

(2) The 7.4% and 8.0% represents $1,520,803 and $1,387,159 in expenses incurred by CFSG and CFPG that are not deductible in PRC for the three months ended March 31, 2011 and 2010, respectively.

The estimated tax savings as a result of PRC income tax exemption for the three months ended March 31, 2011 and 2010 amounted to $620,161 and $1,139,778, respectively. The net effect on basic and diluted earnings per share if the income tax had been applied would decrease basic and diluted earnings per share for the three months ended March 31, 2011 and 2010 by $0.02 and $0.04, respectively.

China Fire & Security Group, Inc., the parent company, is incorporated in the United States and incurred net operating losses of $0 for income tax purposes for the three months ended March 31, 2011. The estimated net operating loss carry forwards at March 31, 2011 for United States income taxes amounted to $1,079,324 which may be available to reduce future years' taxable income. These carry forwards will expire, if not utilized, from 2024 through 2030. Management believes that the realization of the benefits from these losses appears uncertain due to the Company's limited operating history and continuing losses for United States income tax purposes. Accordingly, the Company has provided a 100% valuation allowance on the deferred tax asset benefit to reduce the asset to zero. The net change in the valuation allowance for the three months ended March 31, 2011 and 2010 was $0, respectively, and the accumulated valuation allowance as of March 31, 2011 amounted to $366,970. Management reviews this valuation allowance periodically and makes adjustments as warranted.

The Company has cumulative undistributed earnings of foreign subsidiaries of approximately $95.7 million as of March 31, 2011, which is included in the consolidated retained earnings and will continue to be indefinitely reinvested in international operations. Accordingly, no provision has been made for U.S. deferred taxes related to future repatriation of these earnings, nor is it practicable to estimate the amount of income taxes that would have to be provided if the Company concluded that such earnings will be remitted in the future.

Taxes payable

Taxes payable consisted of the following:

	March 31, 2011 (Unaudited)	December 31, 2010
VAT taxes payable	$ 7,387,464	$ 6,887,213
Income taxes payable	1,394,744	1,284,469
Sales taxes	1,369,103	1,120,446
Other taxes payable	127,014	124,701
Total	$ 10,278,325	$ 9,416,829

Note 11 - Retirement plan

The Company and its subsidiaries are required to participate in a central pension scheme operated by the local municipal government. The Company is required to contribute 20% of its payroll costs to the central pension scheme in 2011 and 2010. The contributions are charged to the consolidated income statement of the Company as they become payable in accordance with the rules of the scheme. The aggregate contributions of the Company to retirement benefit schemes amounted to $115,939 and $100,429 for the three months ended March 31, 2011 and 2010, respectively.

Note 12 - Statutory reserves

The laws and regulations of the PRC require that before an enterprise distributes profits to its partners, it must first satisfy all tax liabilities, provide for losses in previous years, and make allocations, in proportions determined at the discretion of the board of directors, after the statutory reserve. The statutory reserves include a surplus reserve fund and the enterprise fund. These statutory reserves represent restricted retained earnings.

Surplus reserve fund

The Company is required to transfer 10% of its net income, as determined in accordance with PRC accounting rules and regulations, to a statutory surplus reserve fund until such reserve balance reaches 50% of the Company's registered capital.

The transfer to this reserve must be made before distribution of any dividend to shareholders. The surplus reserve fund is non-distributable other than during liquidation and can be used to fund previous years' losses, if any, and may be utilized for business expansion or converted into share capital by issuing new shares to existing shareholders in proportion to their shareholding or by increasing the par value of the shares currently held by them, provided that the remaining reserve balance after such issue is not less than 25% of the registered capital.

Because the surplus reserve fund already totals 50% of Sureland Industrial, Sureland Equipment, and Beijing Hua An's registered capital, the Company did not reserve any surplus reserve fund at the end of

March 31, 2011 for these subsidiaries. As of March 31, 2011, the remaining reserve required for Shian Kexin and Shenyang Hongshida to fulfill the 50% registered capital requirement totaled $838,750.

Enterprise fund

The enterprise fund may be used to acquire plant and equipment or to increase the working capital to expend on production and operation of the business. No minimum contribution is required and the Company did not make any contribution to this fund for the three months ended March 31, 2011 and 2010.

Note 13 - Options issued to employees

On December 31, 2008, pursuant to the Company's 2008 Omnibus Long-term Incentive Plan, the Company's Board of Directors authorized the issuance of 1,000,000 share options for its employees, including 800,000 options issued to executive officers. The options vest evenly each quarter over the following four years, starting from the first quarter of 2009. The Company used the Black Scholes Model to value the options at the time they were issued, based on the exercise price of $6.81, which was the closing price of the Company’s stock on December 31, 2008 and using risk-free rates of 0.875%, 1.125%, 1.313% and 1.5% and volatility of 86% that was estimated by analyzing the trading history of the Company’s stock. Because the Company did not have historical exercise history, the Company used the simplified method to estimate the expected life of the options, which is equal to the midpoint between the vesting date and expiration date of the options. The 1,000,000 employee options had a grant date fair value of $3,863,606. The related compensation expense is recognized on a straight-line basis over the four year vesting period.

The total stock option compensation expense recognized for the three months ended March 31, 2011 and 2010 was $245,049 and $245,047, respectively. As of March 31, 2011, approximately $1.69 million of estimated expense related to un-vested stock-based awards has yet to be recognized and will be recognized over the employee’s remaining service period of approximately 1.73 years.

There were 1,765,607 options outstanding as of March 31, 2011.

The Company has stock options as follows:

	Options Outstanding	Weighted Average Exercise Price	Aggregate Intrinsic Value
Outstanding, December 31, 2009	1,776,000	$4.45	$16,120,860
Granted			
Forfeited			
Exercised			
Outstanding, March 31, 2010	1,776,000	$4.45	$15,126,300
Granted			
Forfeited			
Exercised	(10,393)	2.65	
Outstanding, December 31, 2010	1,765,607	$4.46	$3,719,188
Granted			
Forfeited			
Exercised			
Outstanding, March 31, 2011	1,765,607	$4.46	$3,012,917

Following is a summary of the status of options outstanding at March 31, 2011:

Outstanding Options			Exercisable Options		
Number of Options	Exercise Price	Average Remaining Contractual Life	Number of Options	Exercise Price	Average Remaining Contractual Life
742,229	$ 1.25	5.25	742,229	$ 1.25	5.25
6,000	$ 4.51	1.08	6,000		