

# **CHINA EDUCATION RESOURCES INC.**



**Management's Discussion and Analysis  
For the year ended December 31, 2010**

**FORM 51-102F1**

**December 31, 2010**

This Management Discussion and Analysis (“MD&A”) reviews the activities of China Education Resources Inc., its Chinese operating subsidiaries, Today’s Teachers Technology & Culture Ltd. (“TTTC”), CEN Smart (“CEN”) and Zhong Yu Cheng Yuan Curriculum Development Center Ltd. (previously known as Yu Cheng Yuan Consulting and Service Ltd.) (“ZYCY”) effective from July 1, 2009 (and/or collectively “CER” or the “Company”) and compares the financial results for the year ended December 31, 2010 with the same period of 2009. The MD&A should be read in conjunction with the audited consolidated financial statements and accompanying notes for the year ended December 31, 2010, copy of which is filed on the SEDAR website.

The Company prepares its consolidated financial statements in accordance with Canadian generally accepted accounting principles, and these statements are filed with the relevant regulatory authorities in Canada. All dollar amounts presented are expressed in United States dollars unless otherwise noted.

## **FORWARD LOOKING INFORMATION**

Except for statements of historical fact, the discussion and analysis of financial performance and position including, without limitation, statements regarding projections, future plans, and objectives of CER are forward-looking statements that are subject to various risks and uncertainties. Forward-looking statements are based on management experience, historical results, current expectations and analyses, trends, government policies, and current business and economic conditions, including CER’s analysis of its product and distribution system and its expectations regarding the effects of anticipated product and distribution changes and the potential benefits of such efforts and activities on CER’s results of operations in future periods. There can be no assurance that such statements will prove to be accurate; actual results and future events could differ materially from those anticipated in such statements.

## **DESCRIPTION AND OVERVIEW OF BUSINESS**

The Company is a corporation organized under the predecessor to the *Business Corporations Act* of British Columbia. CER is public company traded on the TSX Venture Exchange with the trading symbol “CHN” and OTCQX with the trading symbol “CHNUF”. The Company, through its subsidiaries in China, is a leading provider of kindergarten to grade 12 (“K-12”) education resources and services through its national internet portal, China Education Resources and Services Platform (“CERSP”), [www.cersp.com](http://www.cersp.com), to China’s kindergarten to grade 12 education market.

The Company has worked in all areas of education resources development, marketing and sales. Working with the Curriculum Development Center (“CDC”) of China’s Ministry of Education (“MOE”), CER has developed a unique national education portal ([www.CERSP.com](http://www.CERSP.com)) to help the Central Government implement policy reform. This reform effort is designed to bring China’s education system into the twenty first century by changing teaching methods from rote memory learning to a more individualized and creative approach. Teachers completed the CERSP.com training program will receive a national level certificate from CDC which is nationally recognized. In collaboration with China’s various education authorities and experts, the CERSP portal is designed to support all stakeholders and participants in the K-12 education domain; teachers, students, administrators, subject matter experts, and parents.

In late 2008, the Company launched its comprehensive Education Services Portal (“ESP”). ESP is a natural extension of CERSP, and helps to organize the wealth of teaching, learning, and administrative resources available through CERSP at the individual school level.

CERSP is the equivalent of a mega-portal. It is designed to be accessible by everyone associated with K-12 education across China and is loaded with robust features and resources that enable the development, delivery, and support of resources and activities related to the national K-12 education reform initiative. CERSP is a primary venue for teacher training in schools, districts, cities, and provinces. It is also the aggregator for subject matter experts in all K-12 subject areas and a place where they can gather virtually to improve upon the work they have done in response to national mandates.

ESP, on the other hand, is a commercial service for the K-12 education marketplace that extends the reach and relevance of the CERSP portal at the school and individual level. Its primary function is to support the administrative, teaching, learning, testing, and assessment needs of an individual school, and it does so in a way that is standardized, allowing for combined results to the district, city, province, or national level. CERSP can be regarded as a large "back-end" resource that greatly enriches each instance of ESP. ESP can be considered as a way to monetize the momentum of CERSP by creating a direct, revenue producing relationship with every school, administrator, teacher, parent and student that subscribes.

Currently, our ESP provides the following services:

(a) School Platform

The school platform provides a link between a school with its teachers, students and parents. Through the platform, the school can send messages to the teachers, students and parents. The teachers can upload homework and tests to the platform and the students can go to the platform to complete and submit their homework and write the tests. The school can automatically collect the markings received by each student. Each teacher and student has his own account number registered with the platform. Currently, approximately 1,500 schools have applied to join the platform. We have already opened accounts for approximately 500 schools with around 500,000 students and teachers.

(b) Online tutoring program

Online tutoring program is a platform developed for a teacher to provide online tutoring services through the internet to his students. Currently, we are the only company providing such comprehensive education resources, services and technology in China. Right now we have around 2,000 online tutoring courses provided from 5,000 teachers. Students have to prepay for the services to TTTC and TTTC pays the net amount to the teachers after deducting our share of revenue.

(c) CD products

CD products are packages with CDs containing tutorial materials that are sold at retail stores. We sell them at a discount price to the wholesalers. The CDs only contain some tutorial materials and if a student has further interest, he/she can go to our website for further pay services and attend our online tutoring. There are many competitors in this area. However, we have the advantage of linking our CD products to other services provided by our ESP.

Currently, the Company's revenues are derived from our interests in TTTC which develops and maintains the CERSP and ESP. Our cash flow and financial condition is dependent on TTTC.

The Company, through TTTC, acquired a 60% interest in Zhong Yu Cheng Yuan Curriculum Development Center Ltd. (previously known as Yu Cheng Yuan Consulting and Service Ltd.) ("ZYCY"), a distributor of education products in China for RMB6,000,000 (\$878,460) payable in 2,860,000 shares of common stock of the Company at a deemed value of CND0.35 (\$0.30) per share. One-third of the purchase consideration has been paid up front with the balance paid on the first and second anniversary of the closing date, contingent upon YCY generating an annual net profit of RMB2,000,000 (\$292,820). No additional shares were released in the year ended December 31, 2010. On top of increasing its book selling business, the Company can also strengthen its sales and distribution of its national CERSP and ESP web portal services in China through the sales team of ZYCY.

Due to the size of the Company, the provision of education internal portal services and distribution of educational textbooks and materials were considered in one segment based on the organizational structure, strategies, decision making and the availability of financial information.

## OVERALL PERFORMANCE

### Comparative Figures

Certain comparative figures have been reclassified to conform to the presentation of the current year. These reclassifications do not have any impact on results of operations for the period.

### Selected Annual Information

	2010	2009	2008
Total revenue	\$ 5,436,165	\$ 2,790,137	\$ 476,691
Net loss	(615,832)	(2,080,670)	(3,534,628)
Net loss per share	(0.01)	(0.05)	(0.08)
Total assets	7,109,590.00	4,891,929.00	5,980,981.00
Long-term liabilities	32,650	-	-
Cash dividends	-	-	-

The Company's revenue increased significantly in 2010 as compared with 2009 upon the acquisition of the 60% interest in ZYCY in July 2009. Net loss was also decreased materially as revenue increased but expenses were controlled in a reasonable level for 2010.

### Results of Operations

#### *For the three months ended December 31, 2010:*

For the three months ended December 31, 2010, the Company reported aggregate sales of \$726,576 (2009: \$702,541). There was a slightly increase in sales for the current quarter as compared to the sales of the same quarter of previous year. Sales revenue of \$571,176 (2009: \$319,406) was attributable to revenue derived from teacher training service through the internet portal and \$155,400 (2009: \$383,135) was from the Company's traditional business, book selling, with related cost of sales of \$209,883 (2009: \$190,958).

The Company recognized a net loss for the three months ended December 31, 2010 of \$266,231 as compared to \$1,147,679 for the comparable 2009 period. The net loss per share was \$0.01 for the three months ended December 31, 2010 as compared to a net loss per share of \$0.03 for comparable period ended December 31, 2009 which is primarily attributed by the decrease of amortization and directors' fees.

The following is a discussion of certain expense categories:

#### *General and administrative expenses*

For the three months ended December 31, 2010, general and administrative expenses were \$426,296 compared to \$447,518 recorded in 2009. The decrease in expenses was a result of the fluctuation of the foreign exchange difference over the period.

Included as part of the general and administrative expenses:

Management and director fees decreased to \$nil for the three months ended December 31, 2010 from \$49,593 for the comparable 2009 period as no directors' fees are proposed for the quarter.

Other expenses decreased to \$nil for the three months ended December 31, 2010 from \$52,627 for the comparable 2009 period is a result of no impairment of goodwill recognized for the quarter.

The Company recorded a foreign exchange loss of \$133 for the current quarter as compared to \$912 for the same quarter of 2009. It reflected the fluctuation of the foreign currency exchange over the period.

#### *Amortization*

The amortization decreased to \$22,286 for the three months ended December 31, 2010 as compared to \$276,210 in the same period of 2009 as the website development cost was fully amortized by the end of January 2010.

#### *Selling expenses*

The selling expenses of \$402,799 for the three months ended December 31, 2010 decreased as compared to \$490,582 in the same period of 2009.

#### *Stock based compensation*

During the three months ended December 31, 2010, the Company recorded a non-cash stock based compensation expense of \$82,661 (2009: \$8,988) for options granted during the period.

#### ***For the year ended December 31, 2010:***

For the year ended December 31, 2010, the Company reported aggregate sales of \$5,436,165 (2009: \$2,790,137). There was a significant increase in sales for the current year as compared to the sales of the previous year. Sales revenue of \$1,751,214 (2009: \$474,830) was attributable to revenue derived from teacher training service through the internet portal and \$3,684,951 (2009: \$2,315,307) was from the Company's traditional business, book selling, with related cost of sales of \$1,819,302 (2009: \$1,141,382).

The Company incurred a net loss for the year ended December 31, 2010 of \$615,832 as compared to a net loss of \$2,080,670 for the year ended December 31, 2009. The net loss per share was \$0.01 for the year ended December 31, 2010 as compared to a net loss per share of \$0.05 for the year ended December 31, 2009. The decrease in net loss for the current period was a result of the increase of sales, however expenses were only increased in an reasonable manner except for the non-cash stock based compensation expenses of \$623,449 as there were stock options newly granted and some of the previously granted stock options were modified by extending the expiry date.

The following is a discussion of certain expense categories:

#### *General and administrative expenses*

For the year ended December 31, 2010, general and administrative expenses were \$1,419,914 compared to \$1,276,370 recorded in 2009. The increase in expenses was a result of the consolidation of the operating expenses of ZYCY for the full year in 2010 and only six months in 2009.

*Amortization*

The amortization decreased to \$237,165 for the year ended December 31, 2010 as compared to \$1,169,631 in fiscal 2009 as the website development cost was fully amortized by the end of January 2010.

*Selling expenses*

The selling expenses of \$1,862,438 for the year ended December 31, 2010 increased as compared to \$718,511 in fiscal 2009, being in line with the increase of revenue.

*Stock based compensation*

During the year ended December 31, 2010, the Company recorded a non-cash stock based compensation expense of \$623,449 (2009: \$19,846) for options newly granted during the year, as well as the extension of the expiry date of the stock options previously granted.

**SUMMARY OF QUARTERLY AND ANNUAL RESULTS**

All amounts are expressed in United States dollars. In addition, all amounts are in thousands except for per share amounts.

	<b>For the Quarters Ended</b>			
	12/31/2010	9/30/2010	6/30/2010	3/31/2010
	(\$'000)	(\$'000)	(\$'000)	(\$'000)
Revenue	726.6	2,112.6	894.2	1,702.8
Income (Loss) before non-controlling interest	(461.1)	328.9	(354.4)	(74.4)
Net income (loss) for the period	(266.2)	332.8	(368.4)	(314.0)
Net income (loss) per share	(0.0056)	0.0070	(0.0078)	(0.0068)
Total assets	7,109.6	7,894.3	7,056.3	6,525.9
Total liabilities including non-controlling interest	7,005.6	7,548.1	7,037.4	6,166.2

	<b>For the Quarters Ended</b>			
	12/31/2009	9/30/2009	6/30/2009	3/31/2009
	(\$'000)	(\$'000)	(\$'000)	(\$'000)
Revenue	703	2,022.8	53.3	11.5
Income (Loss) before non-controlling interest	(1,325)	429.2	(323.2)	(647.7)
Net income (loss) for the period	(1,148)	38.0	(323.2)	(647.8)
Net income (loss) per share	(0.0253)	0.0009	(0.0075)	(0.0151)
Total assets	4,987.4	6,779.9	4,652.4	5,292.2
Total liabilities including non-controlling interest	5,579.3	6,565.1	4,385.3	4,796.0

The Company generated net income in Q3 of 2010 with significant increase in revenue. The net loss in Q1 and Q2 of 2010 decreased significantly as revenue went up in the captioned quarters with the operating expenses controlled in a reasonable pace except for non-cash stock based compensation expenses as there were stock options newly granted and the extension of the expiry date of some of the previously granted stock options in the current quarter.

The increase in net loss for Q4 of 2009 was mainly due to the consolidation of the operating expenses of ZYCY and the provision made on the goodwill impairment of \$650,000 during the quarter.

The increase in revenue in Q3 of 2009 was due to expansion in the operations in China after the acquisition of ZYCY.

## **FINANCIAL POSITION, LIQUIDITY AND CAPITAL RESOURCES**

Working capital improved by \$1,075,220 to a negative working capital of \$2,173,168 from a negative working capital of \$3,248,388 at the beginning of the year, primarily as a result of the proceeds from private placement of \$745,617 completed on February 3, 2010 and the increase in sale of book selling and teacher training for the current period.

On October 15, 2009, the Company issued 2,860,000 shares for completion of the acquisition of ZYCY. One-third of the shares were released to the other party according to the agreement and the balance of the shares of common stock are held in escrow and half of them will be released on the first and second anniversary of the closing date, respectively, contingent upon ZYCY generating an annual net profit of RMB2,000,000 (\$292,820).

Cash provided by operating activities was \$1,994,437 for the year ended December 31, 2010, compared to \$717,277 used for operating activities for 2009. This significant change was primarily due to the decrease of net loss from \$2,080,670 in 2009 to \$615,832 in 2010. Included in the net loss for fiscal 2010, \$623,449 (2009 - \$19,846) was the non-cash stock-based compensation.

Cash used in investing activities was \$59,294 for the year ended December 31, 2010, compared to cash provided by investing activities in the amount of \$38,232 for 2009. The cash outflows for investing activities in fiscal 2010 were primarily related to the purchase of new servers for the teacher training. The cash inflows for investing activities in fiscal 2010 were primarily related to cash transferred in from acquisition of ZYCY.

Cash used in financing activities was \$1,096,013 for the year ended December 31, 2010 (compared to \$Nil for 2009), due to the advance to related parties of \$1,841,630, offset by the net proceeds of \$745,617 from private placement of 1,500,000 common shares at CAD\$0.53 (\$0.50) per share.

### **Equipment and website development costs**

At December 31, 2010, the Company's net equipment and website development costs were \$225,592 as compared to \$411,335 as at December 31, 2009. This decrease was the amortization and depreciation of \$237,165 for the current period. Website development costs were fully amortized by the end of January 2010.

### **Liabilities**

The Company's total liabilities were \$6,503,513 as at December 31, 2010, which is comparable with \$5,143,581 at December 31, 2009.

### **Shareholders' Equity**

There was a shareholders' equity of \$103,981 at December 31, 2010 as compared to a negative \$591,950 at December 31, 2009, which included the net loss of \$615,832 for the year ended December 31, 2010.

### **Outstanding share data**

The Company's common shares outstanding as at May 2, 2011 were 47,364,983.

At May 2, 2011, the Company has outstanding stock options of 3,574,000. Details are as follows:

\$	0.45	100,000	October 5, 2013
	0.60	50,000	February 3, 2011
	0.60	300,000	August 20, 2012
	0.60	650,000	February 21, 2013
	0.60	400,000	July 28, 2013
	0.60	100,000	October 5, 2013
	0.60	200,000	February 3, 2015
	0.70	100,000	October 26, 2012
	1.00	450,000	July 28, 2013
	1.00	300,000	February 3, 2015
	1.05	924,000	February 3, 2015
		3,574,000	

At May 2, 2011, there was no outstanding stock purchase warrants.

### **Dividend**

The payment of dividends to shareholders will depend on a number of factors such as earnings, CER's financial requirements and other factors that the Board of Directors considers relevant in the circumstances. The Company currently does not have intention to pay dividends on the common shares. The Board of Directors will review this policy, from time to time, as circumstances change. To date, CER has not declared or paid any dividends on any of its shares.

### **OFF-BALANCE SHEET ARRANGEMENTS**

The Company does not have any off-balance sheet arrangements.

### **TRANSACTIONS WITH RELATED PARTIES**

All related party transactions were recorded at the exchange amounts as agreed upon by the related parties.

	<b>December 31, 2010</b>	<b>December 31, 2009</b>
Amount due from Beijing Anli Information and Consulting Company ("Anli"), net of bad debt provision of \$94,960 [i]	\$ 48,434	\$ 80,778
Amount due from a shareholder of the subsidiary company [ii]	1,731,911	14,647
	\$ 1,780,345	\$ 95,425

[i] Anli and its major shareholder are shareholders of the Company. In 2003, the Company advanced funds of RMB 1,200,000 (\$175,896) to Anli. A loan agreement was signed on October 28, 2003 for a one-year term, non-interest bearing. The loan was extended to October 31, 2008. At December 31, 2009, the loan was not yet been repaid and collateralized by the shares of the Company owned by Anli. The Company made a bad debt provision of RMB648,500 (\$95,057) in total based on the

market value of the shares of the Company that held by the Company as the guarantee at December 31, 2008. No additional provision was recorded as of December 31, 2009.

ii) It represents an advance to a shareholder of ZYCY as non-secured and non-interest bearing short-term loan. Subsequently, \$910,320 was received.

During the year ended December 31, 2010, the Company incurred \$64,173 (2009: \$62,087) accounting fees for accounting services provided by a company controlled by an officer of the Company. Included in accounts payable was an amount of \$33,624 (2009: \$10,269) due to the Company controlled by an officer as at December 31, 2010.

The Company rents office space from a company controlled by a director of the Company. The Company paid rent of \$20,972 (2009: \$18,911) for the year ended December 31, 2010.

The Company paid/accrued wages of \$177,097 (2009: \$162,449) to a director of the Company for the year ended December 31, 2010.

Included in accounts payable, \$221,890 (2009: \$165,109) was payable to four directors of the Company relating to the salary payable, director fee payable and travel expenses reimbursement at December 31, 2010.

Included in Due to related parties, \$1,731,911 (2009: \$nil) was receivable from a company controlled by the minority shareholders of ZYCY as non-secured and non-interest bearing short-term loan at December 31, 2010. Subsequently, \$910,320 was received.

Included in other payable, \$nil (2009: \$276,406) was payable to a company controlled by the minority shareholders of ZYCY for the normal operations of the Company at December 31, 2010.

## **BOARD AND MANAGEMENT CHANGES**

The Company does not have any changes on the board and management.

## **RISK AND UNCERTAINTY FACTORS**

### **History of losses and anticipate that we may continue for the foreseeable future**

The Company has incurred a net loss of \$615,832 (2009: \$2,080,670) for the year ended December 31, 2010 and has incurred a cumulative loss of \$31,985,600 since inception. The Company's future business plan includes the further development and operation of CER's education service portal and sino-foreign co-operation to develop English as a second language training program in China and Chinese Mandarin training program in U.S. The Company's ability to continue as a going concern is depending upon achieving acceptance by the users and profitable level of operations of the education service portal and on the ability to obtain necessary financing to fund our operations. The outcome of these matters cannot be predicted at this time.

### **Seasonality**

Historically in its traditional distribution business, the operations of the business are highly seasonal. The Company is attempting to lessen the seasonality of the business by expanding its business into other related areas in the education sector through its internet education service portals.

### **Reliance on Government Relationships**

The Company is relying upon continued good working relationships and acceptance from both the national and regional governments it works with. Additionally, continued collaboration with the CDC is important to the Company being able to sell and deliver the teacher training programs. If the CERSP portal was no longer acceptable or it failed to meet acceptable government standards for the K-12 sector, it would seriously impact the continued successful deployment of the CERSP portal and education service portal.

### **Tax and Legal Systems in China**

The Company, through its subsidiaries, conducts a significant amount of its business in China. China currently has a number of laws related to various taxes imposed by both federal and regional governmental authorities. Applicable taxes include value added tax, corporate income tax (profits tax), and payroll (social) taxes, together with others. Laws related to these taxes have not been in force for a significant period, in contrast to more developed market economies; therefore, implementing regulations are often unclear or nonexistent. Often, differing opinions regarding legal interpretation exist both among and within government ministries and organizations; thus, creating uncertainties and areas of conflict. Tax declarations, together with other legal compliance areas (as examples, customs and currency control matters) are subject to review and investigation by a number of authorities, which are enabled by law to impose extremely severe fines, penalties and interest charges. These facts create tax risks in China substantially more significant than typically found in countries with more developed tax systems.

Management believes that the Company is in substantial compliance with the tax laws affecting its operations; however, the risk remains that the relevant authorities could take different positions with regard to interpretive issues and the effect could be significant. The fact that a year has been reviewed does not close that year, or any tax declaration applicable to that year, from further review.

### **Competition**

Foreign direct investment in China has increased rapidly and the investment environment has further improved to encourage foreign and local investors to invest in fields, such as education, high-tech, modern agriculture and infrastructure construction. A number of large companies are involved in the publishing and distribution of educational products in the mainstream areas of math, science and language arts. There is no guarantee that other competitors will not become involved in business similar to that of the Company.

### **Management**

The Company currently has a small executive management group, which is sufficient for its present stage of development. Although the Company's development to date has largely depended and in the future will continue to depend upon the efforts of certain current executive management, the loss of a member of this group could have a material adverse effect on the Company.

### **Funds Remittance**

Provided that conversion of Renminbi into foreign exchange and the remittance of foreign exchange are duly arranged in accordance with the relevant laws and regulations on foreign exchange, a Foreign Investment Enterprise ("FIE") is able to remit dividends and other payments from China.

According to the 1999 Circular on Relevant Questions Concerning the Remittance of Profits, Dividends and Bonuses out of China Through Designated Foreign Exchange Banks, effective from October 1, 1999, an FIE is permitted to remit profits, dividends and bonuses out of China in proportion to the amount of registered capital that has been paid up, notwithstanding that its registered capital has not been paid up pursuant to its constitutional documents.

## **Financial Instruments**

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Company's financial instruments consist of cash and cash equivalents, accounts receivable, other receivables, due from related parties, long term other receivable, and accounts payable and accrued liabilities.

The Company's financial instruments are exposed to the risks described below:

### **(a) Credit risk**

Credit risk is the risk of an unexpected loss if a party to a financial instrument fails to meet its contractual obligations. The Company's credit risk is primarily attributable to cash and cash equivalents and accounts receivables. The Company has no significant concentration of credit risk arising from operations. Other receivables mainly consist of an advance to a third party for project development which accounts for 59% of the other receivable as of December 31, 2010, as well as goods and services tax due from the Federal Government of Canada, interest receivable and amounts advanced to employees and others. Management assesses the credit risk concentration with respect to accounts receivable and other receivables annually and adjusts them accordingly.

100% of the Company's revenue for the year ended December 31, 2010 and 2009 were derived from customers located in China. Three (2009: Three) customers represent in excess of 10% of trade accounts receivable at December 31, 2010. Two (2009: Three) customers represent in excess of 10% of total revenue at December 31, 2010.

### **(b) Liquidity risk**

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. At December 31, 2010, the Company had a negative working capital of \$2,173,168 (2009: \$3,248,388). The Company is focused on generating sales revenue and is actively pursuing additional sources of financing to ensure that it can meet its ongoing operating requirements and planned capital expenditures.

### **(c) Market risk**

Market risk is the risk of loss that may arise from changes in market factors such as interest rates, foreign exchange rates and equity prices.

#### **(i) Interest rate risk**

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. From time to time, the Company is exposed to short term interest rates through the interest earned on cash and cash equivalents. The Company has no interest-bearing debt. The Company's current policy is to invest excess cash in short-term deposits with its banking institutions. The Company periodically monitors the investments it makes and is satisfied with the credit ratings of its banks.

#### **(ii) Foreign currency exchange rate risk**

Foreign currency exchange rate risk is the risk that the fair value of financial instruments or future cash flows will fluctuate as a result of changes in foreign exchange rates.

The majority of the Company's assets, liabilities, revenues and expenses are denominated in Chinese Renminbi ("RMB"), which was tied to the US dollar and is now tied to a basket of currencies of China's largest trading partners, is not a freely convertible currency. The appreciation of the RMB against the US dollar would result in an increase in the

assets, liabilities, revenues and expenses of the Company and a foreign currency gain included in comprehensive income. Conversely, the devaluation of the RMB against the US dollar would result in a decrease in the assets, liabilities, revenues and expenses of the Company and a foreign currency loss included in comprehensive income.

The Company's functional currency is the Canadian dollar and RMB, respectively, and major transactions are transacted in Canadian dollars and RMB. The Company maintains Chinese RMB bank accounts in China to support monthly forecasted cash outflows. Management believes the foreign exchange risk derived from currency conversions is minimal and therefore does not hedge its foreign exchange risk. At December 31, 2010, approximately \$1,015,650 (2009 – \$741,663) of cash was held in RMB.

Fluctuation in the value of Canadian dollar relative to US dollar has some impact on the Company's head office financial results. However, such exchange rate fluctuations have not materially affected the overall financial earnings and results on a consolidated basis.

(d) Sensitivity analysis

Based on management's knowledge and experience of the financial markets, the Company believes the following movements are "reasonably possible" over a year:

- (i) Cash and cash equivalents are subject to floating interest rates. Sensitivity to a plus or minus 1% change in rates would affect net loss by approximately \$10,100 (2009: \$1,100) for the year ended December 31, 2010.
- (ii) The Company is exposed to foreign currency risk on fluctuations of financial instruments related to cash and cash equivalents, accounts receivables, other receivables, due from a related party, long term other receivables and accounts payable and accrued liabilities that are denominated in Chinese RMB. Sensitivity to a plus or minus 5% change in the foreign exchange rates would affect net loss by approximately \$270,000 (2009: \$111,000) for the year ended December 31, 2010.

## **SIGNIFICANT ACCOUNTING POLICIES**

### **Use of Estimates and Measurement Uncertainty**

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions which affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses for the years reported. Actual results could differ from these estimates. The most significant estimates included in these consolidated financial statements are the amortization of website development cost, future income tax assets, accounts receivable provision and impairment assessments of website development cost and goodwill. Actual results could differ from the estimates used.

### **Stock-Based Compensation**

The Company accounts for all stock-based payments, including stock options granted, using the fair value based method. Under the fair value based method, stock-based compensation is measured at fair value of the instrument on the grant date and recognized over the vesting period as a charge to stock-based compensation with a corresponding increase in contributed surplus. Upon exercise of share purchase options, the consideration paid by the option holder, together with the amount previously recognized in contributed surplus, is recorded as an increase to share capital.

The Company uses the Black-Scholes option valuation model to calculate the fair value of share purchase options at the date of grant. Option pricing models require the input of highly subjective assumptions, including the expected price volatility. Changes in these assumptions can materially affect the fair value estimate.

### **Future Income Taxes**

The Company uses the asset and liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are determined based on “temporary differences” (differences between the accounting basis and the tax basis of the assets and liabilities), and are measured using the currently enacted, or substantively enacted, tax rates and laws expected to apply when these differences reverse. A valuation allowance is recorded against any future income tax asset if it is more likely than not that the asset will not be realized. Income tax expense or benefit is the sum of the Company’s provision for current income taxes and the difference between the opening and ending balances of the future income tax assets and liabilities.

### **Goodwill**

Goodwill is the residual amount that results when the purchase price of an acquired business exceeds the sum of the amounts allocated to the identifiable assets acquired, less liabilities assumed, based on their fair values. Goodwill is allocated as of the date of the business combination to the Company’s reporting units that are expected to benefit from the synergies of the business combination. When the net of the amounts assigned to identifiable net assets exceeds the cost of the purchase (“negative goodwill”), the excess is eliminated, to the extent possible, by a pro-rata allocation to certain non-current assets, with the balance presented as an extraordinary gain.

Goodwill is not amortized and is tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. Impairment is assessed through a comparison of the carrying amount of the reporting unit with its fair value. When the fair value of a reporting unit is less than its carrying amount, goodwill of the reporting unit is considered to be impaired, and the fair value of the reporting unit’s goodwill shall be compared with its carrying amount to measure the amount of the impairment loss. Any impairment of goodwill will be expensed in the period of impairment.

### **Revenue Recognition**

Sales from product sales are recognized when title and risk are transferred and payments are received or rights to receive consideration are obtained, evidence of an arrangement exists, and collection of consideration is reasonably assured. Revenues received in advance of these criteria are deferred until future periods.

Sales from distribution and consulting services are recognized when services are rendered and payments are received or rights to receive consideration are obtained and collection of consideration is reasonably assured. Revenues received in advance of these criteria are deferred until future periods. Sales from distribution and consulting services are not material.

Teacher training services provided through the internet portal are recognized when services are rendered and payments are received or rights to receive consideration are obtained and collection of consideration is reasonably assured.

Interest income is recognized when earned.

### **Change in Accounting Policies including Initial Adoption**

#### *Recent Accounting Pronouncements*

- (i) International Financial Reporting Standards (“IFRS”)

In February 2008, Canada's Accounting Standards Board ("AcSB") confirmed that GAAP, as used by publicly accountable enterprises, will be fully converged to International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB"). Publicly accountable enterprises must adopt IFRS for their interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011 and must be accompanied by IFRS comparative information for the 2010 financial year. IFRS uses a conceptual framework similar to GAAP, but there are significant differences on recognition, measurement and disclosures.

To transition to IFRS, the Company must apply IFRS 1 – First Time Adoption of IFRS ("IFRS 1") that sets out the rules for first time adoption. In general, IFRS 1 requires an entity to comply with each IFRS effective at the reporting date for the entity's first IFRS financial statements. This requires that an entity apply IFRS to its opening IFRS balance sheet as at January 1, 2010 (i.e. the balance sheet prepared at the beginning of the earliest comparative period presented in the entity's first IFRS financial statements). In the period leading up to the transition to IFRS, the AcSB has issued accounting standards that are converged with IFRS thus mitigating the impact of adopting IFRS at the mandatory transition date.

The adoption of IFRS will make it possible for the Company to re-assess the fair values of assets and liabilities on its balance sheet under IFRS 1, which could impact the balance sheet significantly. Within IFRS 1 there are exemptions, some of which are mandatory and some of which are elective. The exemptions provide relief for companies from certain requirements inspecified areas when the cost of complying with the requirements is likely to exceed the resulting benefit to users of financial statements. IFRS 1 generally requires retrospective application of IFRSs on first-time adoption, but prohibits such application in some areas, particularly when retrospective application would require judgments by management about past conditions after the outcome of a particular transaction is already known.

The Company has completed a detailed review of the impact of IFRS on the Company's consolidated financial statements. The Company has identified the following as key accounting policy differences. The Company has not yet quantified the impact of these differences on its consolidated financial statements:

**Plant and Equipment** – IFRS requires that the Company identify the different components of its fixed assets and record amortization based on the useful lives of each component. The Company has reviewed the amortization of its existing plant and equipment and does not expect any material differences between IFRS and the Company's current amortization policies.

**Business Combinations** – IFRS 1 provides an exemption that allows companies transitioning to IFRS not to restate business combinations entered into prior to the date of transition. The Company expects that it will use this exemption and accordingly will not be restating the accounting for any of its previous acquisitions.

**Impairment** - International Accounting Standard (IAS) 36, *Impairment of Assets*, uses a one step approach for both testing for and measurement of impairment, with asset carrying values compared directly with the higher of fair value less costs to sell and value in use (which uses discounted future cash flows). This may potentially result in more write-downs where carrying values of assets were previously supported under Canadian GAAP on an undiscounted cash flow basis, but could not be supported on a discounted cash flow basis. IFRS also has the requirement under IAS 36 to reverse any previous impairment losses where circumstances have changed such that the impairments have been reduced. Canadian GAAP prohibits reversal of impairment losses.

**Share-Based Payment Transactions** – IFRS 2 – Share-based Payment ("IFRS 2") The Company has identified differences relating to the measurement of share-based payments under IFRS 2 relating to the Company's stock compensation plans. The differences between Canadian GAAP and IFRS primarily relate to the attribution of fair value to each graded vesting period and the use of estimated forfeiture rates at the time of grant. The Company's election under IFRS 1 relating to share-based payments will restrict the adjustments relating to the measurement of such equity instruments to only those instruments granted after November 7, 2002 and which have not vested at the date of transition of January 1, 2011.

(ii) Business combinations

In January 2009, the CICA issued the new handbook Section 1582, “Business Combinations” effective for fiscal years beginning on or after January 1, 2011. Earlier adoption of Section 1582 is permitted. This pronouncement further aligns Canadian GAAP with US GAAP and IFRS and changes the accounting for business combinations in a number of areas. It establishes principles and requirements governing how an acquiring company recognizes and measures in its financial statements identifiable assets acquired, liabilities assumed, any non-controlling interest in the acquire, and goodwill acquired. The section also establishes disclosure requirements that will enable users of the acquiring company’s financial statements to evaluate the nature and financial effects of its business combinations. Although the Company is considering the impact of adopting this pronouncement on the consolidated financial statements, it will be limited to any future acquisitions beginning in 2011.

(iii) Consolidated financial statements and non-controlling interests

In January 2009, the CICA issued the new handbook Section 1601, “Consolidated Financial Statements”, and Section 1602, “Non-controlling Interests”, effective for fiscal years beginning on or after January 1, 2011. Earlier adoption of these recommendations is permitted. These pronouncements further align Canadian GAAP with US GAAP and IFRS. Sections 1601 and 1602 change the accounting and reporting for ownership interest in subsidiaries held by parties other than the parent. Non-controlling interests are to be presented in the consolidated statement of financial position within equity but separate from the parent’s equity. The amount of consolidated net income attributable to the parent and to the non-controlling interest is to be clearly identified and presented on the face of the consolidated statement of income. In addition, these pronouncements establish standards for a change in the parent’s ownership interest in a subsidiary and the valuation of retained non-controlling equity investments when a subsidiary is deconsolidated. They also establish reporting requirements for providing sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the non-controlling owners. The Company is currently considering the impact of adopting these pronouncements on its consolidated financial statements in 2010 in connection with the conversion to IFRS.

(iv) Multiple Deliverable Revenue Arrangements

CICA Emerging Issues Committee 175, “Multiple Deliverable Revenue Arrangements” was released and requires a vendor to allocate arrangement consideration at the inception of an arrangement to all deliverables using the relative selling price method. The new requirements are effective for fiscal years beginning on or after January 1, 2011 with early adoption permitted. The Company is currently evaluating the impact of the adoption of this standard.

*IFRS Implementation Plan*

Effective January 1, 2011, the Company will apply Canadian GAAP for publicly accountable enterprises or International Financial Reporting Standards - International Accounting Standards Board (IFRS-IASB). In 2009, the Company prepared and started to implement an IFRS changeover plan designed to address and manage all aspects of the mandatory change in the financial reporting standards. A summary of the progress made by the Company and the expected financial reporting impact is outlined below. This represents our views based on all available information and decisions made at this time. As we finalize our changeover process, we will continue to provide updates on significant policy changes selected or required and the impact on the financial position and performance of the Company.

IFRS changeover requires the preparation of an opening statement of financial position at January 1, 2010. This will reflect retrospective application of IFRSs subject to certain items where prospective application is either required or permitted. We have identified certain accounting policies whereby IFRS will result in a significant change for the Company, whereas in other areas no policy change is expected. There are unavoidably some areas where the extent of the policy change has not yet been finalized pending completion of the related IASB project.

(i) IFRS 1 - First-time Adoption of IFRSs

In February 2008, Canada's Accounting Standards Board ("AcSB") confirmed that GAAP, as used by publicly accountable enterprises, will be fully converged to International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB"). Publicly accountable enterprises must adopt IFRS for their interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011 and must be accompanied by IFRS comparative information for the 2010 financial year. IFRS uses a conceptual framework similar to GAAP, but there are significant differences on recognition, measurement and disclosures.

To transition to IFRS, the Company must apply IFRS 1 – First Time Adoption of IFRS ("IFRS 1") that sets out the rules for first time adoption. In general, IFRS 1 requires an entity to comply with each IFRS effective at the reporting date for the entity's first IFRS financial statements. This requires that an entity apply IFRS to its opening IFRS balance sheet as at January 1, 2010 (i.e. the balance sheet prepared at the beginning of the earliest comparative period presented in the entity's first IFRS financial statements). In the period leading up to the transition to IFRS, the AcSB has issued accounting standards that are converged with IFRS thus mitigating the impact of adopting IFRS at the mandatory transition date.

The adoption of IFRS will make it possible for the Company to re-assess the fair values of assets and liabilities on its balance sheet under IFRS 1, which could impact the balance sheet significantly. Within IFRS 1 there are exemptions, some of which are mandatory and some of which are elective. The exemptions provide relief for companies from certain requirements inspecified areas when the cost of complying with the requirements is likely to exceed the resulting benefit to users of financial statements. IFRS 1 generally requires retrospective application of IFRSs on first-time adoption, but prohibits such application in some areas, particularly when retrospective application would require judgments by management about past conditions after the outcome of a particular transaction is already known.

The Company has completed a detailed review of the impact of IFRS on the Company's consolidated financial statements. The Company has identified the following as key accounting policy differences. The Company has not yet quantified the impact of these differences on its consolidated financial statements:

**Plant and Equipment** – IFRS requires that the Company identifies the different components of its fixed assets and records amortization based on the useful lives of each component. The Company has reviewed the amortization of its existing plant and equipment and does not expect any material differences between IFRS and the Company's current amortization policies.

**Business Combinations** – IFRS 1 provides an exemption that allows companies transitioning to IFRS not to restate business combinations entered into prior to the date of transition. The Company expects that it will use this exemption and accordingly will not be restating the accounting for any of its previous acquisitions.

**Impairment** - International Accounting Standard (IAS) 36, *Impairment of Assets*, uses a onestep approach for both testing for and measurement of impairment, with asset carrying values compared directly with the higher of fair value less costs to sell and value in use (which uses discounted future cash flows). This may potentially result in more write-downs where carrying values of assets were previously supported under Canadian GAAP on an undiscounted cash flow basis, but could not be supported on a discounted cash flow basis. IFRS also has the requirement under IAS 36 to reverse any previous impairment losses where circumstances have changed such that the impairments have been reduced. Canadian GAAP prohibits reversal of impairment losses.

**Share-Based Payment Transactions** – IFRS 2 – Share-based Payment ("IFRS 2") The Company has identified differences relating to the measurement of share-based payments under IFRS 2 relating to the Company's stock compensation plans. The differences between Canadian GAAP and IFRS primarily relate to the attribution of fair value to each graded vesting period and the use of estimated forfeiture rates at the time of grant. The Company's election under IFRS 1 relating to share-based payments will restrict the adjustments relating to the measurement of such equity instruments to only those instruments granted after November 7, 2002 and which have not vested at the date of transition of January 1, 2011.

(ii) Business Combinations

The Company will adopt IFRS 3 - Business Combinations (“IFRS 3”). This standard is substantially harmonized with the Canadian Institute of Chartered Accountants (CICA) Handbook Section 1582 – Business Combinations (Section 1582) which the Company has elected to adopt for business combinations initiated from January 1, 2010 onwards.

IFRS 3 will be applied prospectively in the opening IFRS statement of financial position and prior business combinations will not be restated due to the Company choosing to apply the IFRS 1 exemption for Business Combinations completed prior to January 1, 2010. As required by the prospective application requirements relating to IFRS 3, the Company will test its goodwill for impairment in accordance with IFRSs at the date of transition.

(iii) Property, Plant and Equipment (“PP&E”)

Under the requirements of IAS 16 - Property, Plant and Equipment (“IAS 16”), the Company will continue to account for all of its PP&E under the cost model. There will be some changes in the existing practices of the Company under IAS 16 which will also require information technology, process and controls changes.

IAS 16 requires that assets be depreciated at the significant parts level which will have an impact on two of the Company’s asset classes. Under IAS 16, the Company will be identifying and tracking parts of those assets which it considers to be significant based on an assessment of replacement activity, the relative cost of the part in relation to the asset and the consistent application of judgment. IAS 16 also requires annual reviews of estimates attached to PP&E. This will be formalized in the Company’s new accounting policy with the requisite processes being implemented to ensure compliance.

(iv) IAS 36 Impairment of Assets

The objective of this Standard is to prescribe the procedures that an entity applies to ensure that its assets are carried at no more than their recoverable amount.

The Company is currently assessing the impact of this standard on its reporting requirements.

(v) IFRS 2 Share Based Payments

This standard provides guidance for the recognition and measurement of share-based payments. Management must determine the fair value of a share-based payment at the grant date and the period over which this fair value should be recognized.

The Company is evaluating the impact of this standard.

(vi) IAS 37 Provisions, Contingent Liabilities and Contingent Assets

This requires that appropriate recognition criteria and measurement bases are applied to provisions, contingent liabilities and contingent assets and that sufficient information is disclosed in the notes to enable users to understand their nature, timing and amount.

The Company is currently assessing the impact of this standard on its reporting requirements.

(vii) IAS 12 Income Taxes

The objective of this standard is to prescribe the accounting treatment for income taxes. For the purposes of this standard, income taxes include all domestic and foreign taxes which are based on taxable profits. Income taxes also include taxes, such as withholding taxes, which are payable by a subsidiary, associate or joint venture on distributions to the reporting entity.

The Company is currently assessing the impact of this standard on its reporting requirements.

## **DISCLOSURE CONTROLS AND PROCEDURES**

The internal controls and procedures of the Company have problems similar to many small venture companies. The size and location of the company's offices makes the maintenance of desirable internal controls difficult. The Company regularly reviews its disclosure and procedures; however, it cannot provide an absolute level of assurance because of the inherent limitations in control systems to prevent or detect all misstatements due to error or fraud. Given the size of the Company and the number of staff, the Company does not have the resources to monitor and maintain in-depth and up-to-date understanding of all changes to financial and regulatory reporting.

Due to the limited number of staff, it is not possible to achieve segregation of duties, nor does the Company currently maintain written policies and procedures at its international offices. Similarly, the Company must engage accounting assistance with respect to complex, non-routine accounting issues, Canadian GAAP matters, tax compliance and reporting for its international operations. Notwithstanding these weaknesses, the Company's internal controls over financial reporting are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements and that information is timely and accurately disclosed consistent with Canadian securities laws and regulations. Although the identified weaknesses may be considered to increase the risk that a material misstatement in the Company's financial statements would not be prevented or detected, neither has resulted in a material misstatement in the financial statements. At the present time, the Company has no plans to increase the size of its staff, however, the CEO and the CFO oversee all material transactions and related accounting records and the audit committee of the Company reviews with management on a quarterly basis the financial statements of the Company. While management and the board of directors of the Company work to mitigate the risk of a material misstatement in the Company's financial reporting, the Company's control system, no matter how well designed or implemented, can only provide reasonable, but not absolute, assurance of detecting, preventing and deterring errors and fraud.

No material changes in the Company's internal control over financial reporting were identified by management during the most recent interim period.

## **OUTLOOK**

The Company's objective is to become one of the leading educational service providers in China. The Company has implemented a four step growth and revenue strategy which is now being commercialized in Gansu Province and is using the Gansu program as a model for expansion national wide.

The first step of the strategy involves working with various levels of government to deliver government-funded online teacher training programs. The Company developed 25 online teacher training courses for the continuous education of the teachers and the teachers can obtain government certificates upon successful completion any of these courses. In addition to the 25 teacher training courses, the Company recently developed another 56 new teacher training courses. The Company also obtained the rights to use 97 teacher training courses developed by others for provincial teacher training programs and has to pay a royalty to the course developers for the use of these courses. The Company also developed 80,000 K-12 online lesson plans and is continuing to develop new educational content and upgrade the technology and functions of its portal. More than 200,000 teachers were trained in the Company's teacher training programs. The Company is the only public company endorsed by China's Ministry of Education ("MOE") for the national level online teacher training programs. The Company has made agreements with fourteen provinces and Chongqing, to deliver province-wide teacher training.

The second step of the strategy involves integrating the Company's products and services into teachers' daily routine. This will allow teachers to interact and communicate with each other. These products include online teacher training, professional development and sharing of lesson plans. The CERSP portal has built up one of the largest and most popular K-12 teacher blog system in China with more than one million K-12 teachers registered. The CERSP portal has developed into a national brand and

has a reputation for offering leading edge in-class and online learning products and services. The first two steps are well underway in Gansu Province and have expanded into other provinces.

The third step is the promotion of our Education Services Platform (“ESP”) targeted primarily at teachers. Each school will pay a yearly subscription fee for this unique product. Liaoning Province has endorsed CERSP portal to provide the teacher training and services programs, which will be administered using CER’s School Platform. These programs are ongoing programs requiring teachers to achieve continuing training credits during their careers. Liaoning Province has 9,000 schools with 294,961 teachers instructing 4.5 million students. The Provincial Education Commission selected five cities, representing approximately 104,490 teachers and 1.6 million students, to initially start the program in March 2011. These five cities will each select 800 teachers, for a total 4,000 teachers, to participate in the initial program.

The program is a milestone achievement for our company. Liaoning Province offers an incredible opportunity for CER to participate in China’s education initiative. CER has built a powerful infrastructure to provide efficient and dynamic on-line training in support of the initiative.

The fourth step is the ESP that targets at the student area offering a number of products and services including our collection of online tutoring courses which is one of the largest in China, customized education resources, formative assessment tools and education games. Students and parents have to pay a subscription fee for this platform. A few provinces have confirmed strong interest in the program and requested CER to start the program in late 2011.

Our contacts with over 200 education authorities in various provinces in China further strengthen our confidence in the successful commercialization of our leading edge products and services. Our four-step growth plan has now been expanded to fourteen provinces throughout China. As our comprehensive training resource portal gains traction throughout the educational system, we anticipate achieving similar endorsements as we achieved in the Liaoning Province. With the successful 2010 result, we expect the sales will continue to grow significantly in 2011.