

# **CHINA EDUCATION RESOURCES INC.**



**Management's Discussion and Analysis  
For the three months ended March 31, 2010**

**FORM 51-102F1**

**May 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 three months ended March 31, 2010 with the same period of 2009. The MD&A should be read in conjunction with the unaudited consolidated financial statements and accompanying notes for the three months ended March 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. Revenue from on-line teacher training was a major source of income of the Company in year 2009.

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 will be 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). 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**

	2009	2008	2007
Total revenue	\$ 2,790,137	\$ 476,691	\$ 1,457,648
Net loss	(2,080,670)	(3,534,628)	(4,242,521)
Net loss per share	(0.04771)	(0.08260)	(0.11160)
Long-term liabilities	-	-	22,248
Cash dividends	-	-	-

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

Revenue decreased when comparing 2008 with 2007. This was due to the change of government policy with engagement of teacher training services being delegated from the central government level to the province, municipal and school levels. The Company has to contact different level of governments to re-establish the revenue from teacher training program. On top of that, there were also more competitors come into the teacher training market.

### **Results of Operations**

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

For the three months ended March 31, 2010, the Company reported aggregate sales of \$1,702,788 (2009: \$11,472). There was a significant increase in sales for the current quarter as compared to the sales of the same quarter of previous year. Sales revenue of \$283,319 (2009: \$3,990) was attributable to revenue derived from teacher training service through the internet portal and \$1,419,469 (2009: \$7,482) was from the Company’s traditional business, book selling, with related cost of sales of \$549,700 (2009: \$4,635).

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The Company recognized a net loss for the three months ended March 31, 2010 of \$314,019 as compared to a net loss of \$647,722 for the comparable 2009 period. The net loss per share was \$0.007 for the three months ended March 31, 2010 as compared to a net loss per share of \$0.015 for comparable period ended March 31, 2009. The decrease in net loss for the current quarter was a result of the increase of sales, however expenses were only increased in a reasonable manner except for the non-cash stock based compensation expenses of \$498,495 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 following is a discussion of certain expense categories:

*General and administrative expenses*

For the three months ended March 31, 2010, general and administrative expenses were \$324,487 compared to \$295,776 recorded in 2009. The increase in expenses was a result of the consolidation of the operating expenses of ZYCY starting from July 1, 2009.

Included as part of the general and administrative expenses:

Accounting and audit fees increased to \$41,790 for the three months ended March 31, 2010 from \$38,400 for the comparable 2009 period. The increase was mainly due to the consolidation of the operating expenses of ZYCY.

Travel expenses decreased to \$5,561 for the three months ended March 31, 2010 from \$9,589 for the comparable 2009 period.

The Company recorded a foreign exchange loss of \$2,072 for the current quarter as compared to a gain of \$1,319 for the same quarter of 2009.

*Amortization*

The amortization decreased to \$130,756 for the three months ended March 31, 2010 as compared to \$296,482 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 \$276,301 for the three months ended March 31, 2010 increased as compared to \$51,723 in the same period of 2009, which was in line with the increase in revenue.

*Stock based compensation*

During the three months ended March 31, 2010, the Company recorded a non-cash stock based compensation expense of \$498,495 (2009: \$11,039) for options granted during the period.

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**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>			
	3/31/2010 (\$'000)	12/31/2009 (\$'000)	9/30/2009 (\$'000)	6/30/2009 (\$'000)
Revenue	1,702.8	702.5	2,022.8	53.3
Income (Loss) before non-controlling interest	(74.4)	(1,325.4)	429.2	(323.2)
Net income (loss) for the period	(314.0)	(1,147.7)	38.0	(323.2)
Net income (loss) per share	(0.0068)	(0.0260)	0.0009	(0.0075)
Total assets	6,525.9	4,987.4	6,779.9	4,652.4
Total liabilities including non-controlling interest	6,166.2	5,579.3	6,565.1	4,385.3

	<b>For the Quarters Ended</b>			
	3/31/2009 (\$'000)	12/31/2008 (\$'000)	9/30/2008 (\$'000)	6/30/2008 (\$'000)
Revenue	11.5	27.5	148.8	187.8
Loss before non-controlling interest	(647.7)	(1,211.6)	(714.0)	(721.0)
Net loss for the period	(647.8)	(1,211.6)	(714.0)	(721.0)
Net loss per share	(0.0151)	(0.0282)	(0.0166)	(0.0168)
Total assets	5,292.2	5,981.0	7,084.4	7,974.2
Total liabilities including non-controlling interest	4,796.0	4,843.9	4,486.3	4,720.4

The net loss of Q1 of 2010 decreased significantly as revenue went up in the 1<sup>st</sup> quarter, however expenses were 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.

The increase in loss before non-controlling interest in Q4 of 2008 was due to the recording of bad debt provision of \$690,465.

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

### **Working capital**

Working capital improved by \$1,346,531 to a negative working capital of \$1,901,857 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 for the current quarter.

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).

On February 3, 2010, the Company completed a non-brokered private placement of C\$795,000 consisting of 1,500,000 common shares at C\$0.53 per share. The shares are subject to a four-month holding period expiring on June 3, 2010.

Incentive stock options were also granted on February 3, 2010. 300,000 share purchase options were granted to four directors of the Company exercisable at C\$1.00 per share. These options will be vested immediately and for a period of five years expiring February 3, 2015. 200,000 share purchase options were granted to an employee of the Company exercisable at C\$0.60 per share with 40,000 share purchase options vested immediately and the remaining balance over four years. 120,000 share purchase options were granted to two consultants at C\$0.60 per share with 30,000 share purchase option vested immediately and the balance in equal installments on April 3, 2010, June 3, 2010 and September 3, 2010 respectively.

The Company also extended the expiry date of 924,000 share purchase options granted in 2005 from February 3, 2010 to February 3, 2015. These options are exercisable at C\$1.05 per share.

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

At March 31, 2010, the Company's net equipment and website development costs were \$270,715 as compared to \$411,335 as at December 31, 2009. This decrease was the amortization and depreciation of \$130,756 for the current quarter. Website development costs were fully amortized by the end of January 2010.

### **Liabilities**

The Company's total liabilities were \$5,490,849 as at March 31, 2010, which is comparable with \$5,143,581 at December 31, 2009.

### **Shareholders' Equity**

There was a shareholders' equity of \$359,754 at March 31, 2010 as compared to a negative \$591,950 at December 31, 2009, which included the net loss of \$314,019 for the three months ended March 31, 2010.

### **Outstanding share data**

The Company's common shares outstanding as at May 31, 2010 were 47,364,983.

At May 31, 2010, the Company has outstanding stock options of 3,994,000. Details are as follows:

Exercise Prices (CND)	Number	Expiry Date
\$ 0.50	150,000	October 11, 2010
0.60	120,000	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	200,000	February 3, 2015
0.65	400,000	October 20, 2010
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
	<u>3,994,000</u>	

At May 31, 2010, 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.

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	<b>March 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]	\$ 80,800	\$ 80,778
Amount due from a shareholder of the subsidiary company [ii]	-	14,647
	<u>\$ 80,800</u>	<u>\$ 95,425</u>

[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. As the amount due from Anli has been long overdue, the anticipated time of collection is not certain, the Company has classified the amount as non-current item.

[ii] It represents an advance to a shareholder of ZYCY.

During the three months ended March 31, 2010, the Company incurred \$18,829 (2009: \$17,723) accounting fees for accounting services provided by a company controlled by an officer of the Company. Included in accounts payable, was an amount of \$19,853 due to the Company controlled by an officer as at March 31, 2010 (December 31, 2009: \$10,269).

The Company rents office space from a company controlled by a director of the Company. The Company paid rent of \$5,192 (2009: \$4,728) for the three months ended March 31, 2010.

The Company paid/accrued wages of \$43,843 (2009: \$42,676) to a director of the Company for the three months ended March 31, 2010.

The Company accrued director fees of \$nil (December 31, 2009: \$49,493) to four directors of the Company at March 31, 2010.

Included in accounts payable, \$74,833 (December 31, 2009: \$165,109) was payable to four directors of the Company relating to the salary payable, director fee payable and travel expenses reimbursement at March 31, 2010.

Included in other receivable, \$142,998 (December 31, 2009: \$276,406 payable) was receivable from a company controlled by the minority shareholders of ZYCY for the normal operations of the Company.

## **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 \$314,019 for the three months ended March 31, 2010 compared to a loss of \$647,722 for the same period of 2009. The Company has incurred a cumulative loss of \$31,683,787 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.

Subsequent to the year-end, the National People's Congress of China passed "The Law of the People's Republic of China on Enterprise Income Tax" (the "Enterprise Income Tax Law"). The Enterprise Income Tax Law became effective on January 1, 2008. This new law eliminated the existing preferential tax treatment that is available to the foreign invested enterprises ("FIEs") but provides grandfathering of the preferential tax treatment currently enjoyed by the FIEs. Under the new law, both domestic companies and FIEs are subject to a unified income tax rate of 25%.

### **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 a related party, 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 consist of 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.

Four (December 31, 2009: Three) customer represent in excess of 10% of trade accounts receivable at March 31, 2010. Five (2009: Three) customers represent in excess of 10% of total revenue at March 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 March 31, 2010, the Company had a negative working capital of \$1,901,857 (December 31, 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. The Company is exposed to short term interest rates through the interest earned on cash and cash equivalents. The Company has significant cash balances and 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 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 March 31, 2010, approximately \$298,386 of the 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.

(iii) Price risk

The Company is exposed to risk of equity prices. Equity price risk is defined as the potential adverse impact on the Company's earnings due to movements in individual equity prices or general movements in the level of the stock market. The Company monitors the movements of the stock market to determine the appropriate course of action to be taken by the Company.

(d) Sensitivity analysis

The Company has designated its cash as held-for-trading, which is measured at fair value. Accounts receivable, other receivable, due from a related party and long term other receivable are classified as loans and receivables, which are measured at amortized cost. Accounts payable and accrued liabilities are classified as other financial liabilities, which are measured at amortized cost.

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 \$615 (2009: \$5,700) for the three months ended March 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 \$27,000 (2009: \$85,000) for the three months ended March 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, the Accounting Standards Board (AcSB) confirmed that the use of IFRS will be required in 2011 for publicly accountable enterprises in Canada. In April 2008, the AcSB issued an IFRS Omnibus Exposure Draft proposing the publicly accountable enterprises be required to apply IFRS, in full and without modification, on January 1, 2011. The adoption date of January 1, 2011 will require the restatement, for comparative purposes, of amounts reported by the Corporation for its year ended December 31, 2010, and of the opening balance sheet as of January 1, 2010. The AcSB proposed that CICA Handbook Section, Accounting Changes, paragraph 1506.30, which would require an entity to disclose information relating to a new primary source of GAAP that has been issued but is not yet effective and that the entity has not applied, not be applied with respect to the IFRS Omnibus Exposure Draft. The corporation is continuing to assess the financial reporting impacts of the adoption of IFRS and, at this time, the impact on future financial position and results of operations is not reasonably determinable or estimable. The Corporation does anticipate a significant increase in disclosure resulting from the adoption of IFRS and is continuing to assess the level of disclosure required, as well as system changes that may be necessary to gather and process the required information.

##### (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 2010.

(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

The initial adoption of IFRSs has required the Company to review each of its accounting policies and determine whether or not a change is required or permitted under IFRSs and whether any amended policy is required to be applied on a retrospective or prospective basis. As noted above, IFRS 1 generally requires retrospective application of the new policies but prospective application is required or permitted in some instances.

The below table is a high-level summary of the significant accounting policies of the Company and the impact of adopting the new standard under IFRS 1.

Accounting policy	Policy change expected on transition to IFRSs	Is there an IFRS1 exemption available ?	Will the IFRS1 exemption be applied ?
Revenue recognition	No	No	N/A
Consolidation	Not yet determined	Not yet determined	Not yet determined
Property, plant and equipment	Yes	Yes	Yes - to selected assets
Business combinations	Yes	Yes	Yes - to all prior business combinations
Income taxes	Yes	No	N/A

(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.

## **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 financing 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**

CER believes that while the commercialization of its business has been slow in terms of revenue generation, the business strategy is fundamentally sound. The Company has completed the development of certain ESP products which is an important step in the Company's commercialization strategy. The overall feedback to ESP has been positive.

CER has developed 25 teacher training courses, 30,000 lesson plans and course modules as well as more than 2,000 online tutoring courses with minimal capital expenditure. More than 200,000 teachers have already been trained in CER's teacher training programs. CER is also the only one public company endorsed by MOE for national level online teacher training programs. The CERSP portal has built up the largest K-12 teacher blog system in China with more than one million K-12 teacher registered and is the most popular education portal visited by teachers and education administrators. The ZYCY acquisition is an important step in CER's business plan which is to become a leading on-line provider of educational resources and services to China's 230 million K-12 students and 12 million teachers. After several years of development, our CERSP portal has developed into a national brand and has a reputation for offering best in-class learning products and services. ZYCY, already a profitable venture, will be able to extend its market reach by using the CERSP portal and sell our online products and services by ZYCY's sales team through its existing sales channel with 200 cities' contacts. All these factors are significant advantages for

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CER to promote its online and offline education services and will accelerate the generation of revenue commencing in 2010.