

CHINA FIRE & SECURITY GROUP, INC.  
Form 10-Q  
May 15, 2008

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

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FORM 10-Q

(Mark one)

- ☒ Quarterly Report Under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Quarterly Period Ended March 31, 2008

or

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

Commission File Number 000-50491

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

Florida  
(State or other jurisdiction  
of incorporation or organization)

65-1193022  
(I.R.S. Employer  
Identification No.)

**B-2508 TYG Center, C2**  
**Dongsanhuanbeilu,**  
**Chaoyang District, Beijing 100027,**  
**People's Republic of China**  
(Address of principal executive offices)

100027  
(Zip Code)

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

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Check whether the issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

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

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Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☒

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

As of May 13, 2008, the Registrant had 27,556,893 shares of common stock outstanding.

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China Fire & Security Group, Inc.

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## PART I - FINANCIAL INFORMATION

## Item 1. Financial Statements.

## CHINA FIRE &amp; SECURITY GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS  
AS OF MARCH 31, 2008 AND DECEMBER 31, 2007

	March 31, 2008 (Unaudited)	December 31, 2007
<b><u>ASSETS</u></b>		
<b>CURRENT ASSETS:</b>		
Cash	\$ 15,111,922	\$ 17,110,449
Restricted cash	4,345,297	3,829,927
Accounts receivable, net of allowance for doubtful accounts of \$2,586,606 and \$2,483,359 as of March 31, 2008 and December 31, 2007, respectively	16,262,560	16,525,161
Notes receivable	3,867,484	3,315,811
Other receivables	1,218,120	748,195
Inventories	4,291,730	4,048,283
Costs and estimated earnings in excess of billings	20,417,138	13,068,036
Employee advances	526,791	1,307,433
Employee advances - officers and directors	14,654	18,682
Prepayments and deferred expenses	2,805,928	2,218,391
Total current assets	68,861,624	62,190,368
 PLANT AND EQUIPMENT, net	 6,803,292	 6,568,250
<b>OTHER ASSETS:</b>		
Accounts receivable - retentions	602,281	193,029
Deferred expenses - non current	32,492	21,234
Advances on building and equipment purchases	297,552	366,317
Investment in joint ventures	1,162,793	1,156,294
Intangible assets, net of accumulated amortization	1,156,237	1,150,935
Total other assets	3,251,355	2,887,809
 Total assets	 \$ 78,916,271	 \$ 71,646,427
<b><u>LIABILITIES AND SHAREHOLDERS' EQUITY</u></b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 6,169,266	\$ 6,327,182
Customer deposits	6,946,981	4,757,179
Billings in excess of costs and estimated earnings	1,555,297	4,882,217
Other payables	552,448	168,868
Accrued liabilities	5,539,274	4,214,530
Taxes payable	1,114,762	1,088,335
Total current liabilities	21,878,028	21,438,311

## COMMITMENTS AND CONTINGENCIES

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## SHAREHOLDERS' EQUITY:

Common stock, \$0.001 par value, 65,000,000 shares authorized,  
27,556,893 shares issued and outstanding as of March 31, 2008 and

December 31, 2007, respectively	27,556	27,556
Additional paid-in-capital	19,339,718	19,317,287
Statutory reserves	5,067,061	5,067,061
Retained earnings	26,968,875	22,228,095
Accumulated other comprehensive income	5,635,033	3,568,117
Total shareholders' equity	57,038,243	50,208,116

Total liabilities and shareholders' equity	\$	78,916,271	\$	71,646,427
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The accompanying notes are an integral part of this statement.

## CHINA FIRE &amp; SECURITY GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME AND OTHER COMPREHENSIVE INCOME  
FOR THE THREE MONTHS ENDED MARCH 31, 2008 AND 2007  
(UNAUDITED)

	2008	2007
<b>REVENUES</b>		
System contracting projects	\$ 11,329,380	\$ 7,276,508
Products	2,881,171	2,101,754
Maintenance services	486,075	121,198
Total revenues	14,696,626	9,499,460
<b>COST OF REVENUES</b>		
System contracting projects	5,570,210	3,644,668
Products	841,882	828,702
Maintenance services	240,139	10,185
Total cost of revenues	6,652,231	4,483,555
<b>GROSS PROFIT</b>	<b>8,044,395</b>	<b>5,015,905</b>
<b>OPERATING EXPENSE</b>		
Selling and marketing	1,162,062	551,410
General and administrative	1,798,710	1,011,044
Depreciation and amortization	167,262	126,483
Research and development	266,649	50,295
Total operating expense	3,394,683	1,739,232
<b>INCOME FROM OPERATIONS</b>	<b>4,649,712</b>	<b>3,276,673</b>
<b>OTHER INCOME (EXPENSE)</b>		
Other income, net	96,299	-
Interest income, net	28,360	19,280
Investment Income	15,051	-
Change in fair value of derivative instruments	-	834,163
Total other income	139,710	853,443
<b>INCOME BEFORE PROVISION FOR INCOME TAXES</b>	<b>4,789,422</b>	<b>4,130,116</b>
<b>PROVISION FOR INCOME TAXES</b>	<b>48,642</b>	<b>-</b>
<b>NET INCOME</b>	<b>4,740,780</b>	<b>4,130,116</b>
<b>OTHER COMPREHENSIVE INCOME:</b>		
Foreign currency translation adjustment	2,066,916	295,559
<b>COMPREHENSIVE INCOME</b>	<b>\$ 6,807,696</b>	<b>\$ 4,425,675</b>
<b>BASIC EARNINGS PER SHARE</b>		
Weighted average number of shares	27,556,893	26,461,678

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Earnings per share	\$	0.17	\$	0.16
DILUTED EARNINGS PER SHARE				
Weighted average number of shares		28,153,181		27,001,528
Earnings per share	\$	0.17	\$	0.15

The accompanying notes are an integral part of this statement.

## CHINA FIRE &amp; SECURITY GROUP, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

	Common Shares	Stock Par value	Additional paid-in-capital	Retained Earnings Statutory reserves	Unrestricted	Accumulated other comprehensive income	Totals
BALANCE, December 31, 2006	26,461,678	\$ 26,462	\$ 13,393,171	\$ 4,030,627	\$ 6,462,893	\$ 1,065,522	\$ 24,978,675
Net income					4,130,116		4,130,116
Options issued to employees			65,000				65,000
Foreign currency translation adjustment						295,559	295,559
BALANCE, March 31, 2007 (Unaudited)	26,461,678	\$ 26,462	\$ 13,458,171	\$ 4,030,627	\$ 10,593,009	\$ 1,361,081	\$ 29,469,350
Net income					12,671,520		12,671,520
Warrants reclassified from liabilities			1,475,020				1,475,020
Issuance of common stock	984,680	983	4,164,214				4,165,197
Warrants exercised	110,535	111	(111)				-
Warrants issued for services			94,274				94,274
Options issued to employees			125,719				125,719
Adjustment to registered capital				(605,000)	605,000		-
Adjustment to statutory reserves				1,641,434	(1,641,434)		-
Foreign currency translation adjustment						2,207,036	2,207,036
BALANCE, December 31, 2007	27,556,893	\$ 27,556	\$ 19,317,287	\$ 5,067,061	\$ 22,228,095	\$ 3,568,117	\$ 50,208,116
Net income					4,740,780		4,740,780
Options issued to employees			22,431				22,431



Foreign currency translation adjustment	2,066,916	2,066,916
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BALANCE, March 31, 2008 (Unaudited)	27,556,893	\$ 27,556	\$ 19,339,718	\$ 5,067,061	\$ 26,968,875	\$ 5,635,033	\$ 57,038,243
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The accompanying notes are an integral part of this statement.

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## CHINA FIRE &amp; SECURITY GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE THREE MONTHS ENDED MARCH 31, 2008 AND 2007  
(UNAUDITED)

	2008	2007
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 4,740,780	\$ 4,130,116
Adjustments to reconcile net income to cash used in operating activities:		
Depreciation	169,388	123,134
Amortization of land use rights	3,629	3,349
Amortization of technology rights	15,219	-
Provision for doubtful accounts	428,347	119,382
Gain on disposal of equipment	(31,252)	-
Compensation expense for options issued to employees	22,431	65,000
Change in fair value of derivative instruments	-	(834,163)
Change in operating assets and liabilities:		
Accounts receivable	536,779	(1,397,038)
Notes receivable	(405,036)	(71,343)
Other receivables	(429,507)	(543,711)
Inventories	(73,543)	681,373
Costs and estimated earnings in excess of billings	(6,661,383)	(732,119)
Employee advances	817,282	(332,749)
Employee advances from officers and directors	4,703	-
Prepayments and deferred expenses	(494,952)	(467,161)
Accounts payable	(412,039)	(1,020,929)
Accounts payable - related party	-	(322,781)
Customer deposits	1,949,752	2,442,783
Billings in excess of costs and estimated earnings	(3,455,001)	(2,063,070)
Other payables	368,569	227,663
Other payables - related party	-	(50,321)
Accrued liabilities	1,125,132	227,401
Taxes payable	(18,422)	(465,384)
Net cash used in operating activities	(1,799,124)	(280,568)
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchase of building and equipment	(57,661)	(226,350)
Proceeds from sale of equipment	38,968	-
Net cash used in investing activities	(18,693)	(226,350)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Change in restricted cash	(348,582)	902,781
Net cash (used in) provided by financing activities	(348,582)	902,781
<b>EFFECTS OF EXCHANGE RATE CHANGE IN CASH</b>	<b>167,872</b>	<b>99,403</b>
<b>(DECREASE) INCREASE IN CASH</b>	<b>(1,998,527)</b>	<b>495,266</b>
CASH, beginning of period	17,110,449	9,426,091

CASH, end of period	\$	15,111,922	\$	9,921,357
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The accompanying notes are an integral part of this statement.

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CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2008

(Unaudited)

**Note 1 – Background**

**China Fire & Security Group Inc.** (the “Company”), is a Florida corporation. The Company, through its subsidiaries, is engaged in the design, development, manufacturing and sales of fire protection products and services for industrial customers in China.

On September 1, 2006, the Company signed a Securities Exchange Agreement (the “Agreement”) with China Fire Protection Group, Inc. (“CFPG”). Based on the agreement, each CFPG Shareholder agreed to sell, assign, transfer and deliver to Unipro all of the CFPG’s ordinary shares of capital stock, par value US \$0.01 each (the “CFPG Shares”), in exchange for the issuance by Unipro to each such CFPG Shareholder a pro rata share of 701,538.46 Unipro shares of Series A Convertible Preferred Stock, no par value (“Unipro Preferred”). Each CFPG Shareholder’s pro rata share of the Unipro Preferred was determined by multiplying 701,538.46 Unipro Preferred by a fraction, the numerator equaled the total number of CFPG Shares owned by the CFPG Shareholder at the Closing and the denominator was the total number of CFPG Shares issued and outstanding at the closing. The transaction was completed on October 27, 2006. Prior to closing, CFPG had outstanding options to purchase CFPG shares. The options were converted into 750,000 options to purchase Unipro Common Stock, \$0.001 par value (“Common Stock”) on the same terms and conditions as the outstanding options. Fractional shares of Unipro Preferred were issued as necessary.

For accounting purpose this transaction was treated as a recapitalization of CFPG where CFPG is considered the accounting acquirer. As a result of the reverse acquisition and recapitalization under common control, CFPG’s financial statements are presented as the continuing accounting entity. Thus, the historical financial statements of CFPG were recapitalized with the historical equity shares of the Company.

**China Fire Protection Group, Inc. (“CFPG”)** was incorporated in the British Virgin Islands as a limited liability company on June 2, 2006. On June 19, 2006, CFPG entered a sales and purchase agreement with the existing five shareholders (“Original Shareholders”) of Sureland Industrial Fire Safety Limited (“Sureland Industrial”) who agreed to transfer their 100% ownership in Sureland Industrial to the CFPG. The total purchase consideration was \$10,087,527 which was determined based upon the net asset value of Sureland Industrial as of December 31, 2005. On July 18, 2006, this transfer was approved by the Beijing Bureau of Commerce, and the registration was completed with the Beijing State Administration for Industry and Commerce of the People’s Republic of China, (“PRC”). As a result of this transfer, CFPG became the 100% shareholder of Sureland Industrial. On October 30, 2006, CFPG transferred 25% ownership in Sureland Industrial to Sureland Industrial Fire Equipment Co., Ltd. The \$10,087,527 payment was made in December 2006.

During June and July 2006, CFPG issued 33,500 shares of common stock to the Original Shareholders in consideration of a promissory note receivable totaling \$10,752,500 and the total number of shares outstanding in the Company is 33,500. As a result of this transaction, the Original Shareholders exercised control over the Company.

CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2008

(Unaudited)

The purchase of Sureland Industrial and the issuance of CFPG's common stock has been accounted for as a reverse acquisition and recapitalization under common control. The assets and liabilities transferred have been accounted for at historical cost. The consolidated financial statements have been presented as if the acquisition of the subsidiary occurred at the beginning of 2006.

**Sureland Industrial Fire Safety Limited ("Sureland Industrial")** was established as a Sino-foreign equity joint venture in Beijing, PRC on February 22, 1995. Sureland Industrial and its subsidiaries in China principally engage in the design, development, manufacturing and sale of fire protection products and services for industrial customers in China.

On June 12, 2006, the Beijing Administration for Industry and Commerce approved the conversion of Sureland Industrial into a limited liability company with registered capital at RMB 50,000,000. On May 17, 2007, the Beijing Shunyi District Business Administration approved the Company to increase registered capital to RMB 100,000,000. The Company obtained a new business license on July 2, 2007 which was issued by the Beijing Administration for Industry and Commerce.

**Beijing Hua An Times Fire Safety Technology Co., Ltd. ("Beijing Hua An")** is a subsidiary of Sureland Industrial established in the PRC as a limited liability company on September 22, 2005 upon its establishment, 80% and 20% of its registered capital was contributed, in cash, by Sureland Industrial and Sureland Creation, respectively. On October 8, 2006, Sureland Industrial and Sureland Creation agreed to transfer the 20% ownership in Beijing Hua An from Sureland Creation to Sureland Industrial, and Sureland Industrial became 100% shareholder of Beijing Hua An.

**Sureland Industrial Fire Equipment Co., Ltd. ("Sureland Equipment")** was established as a Sino-foreign equity joint venture in Beijing, the People's Republic of China (the PRC) on April 12, 2006 with a registered capital \$660,000. Upon its establishment, 75% and 25% of its registered capital was contributed, in cash, by Sureland Industrial and Vyle Investment Inc., respectively. On June 22, 2006, CFPG signed a sales and purchase agreement with the existing two shareholders, Sureland Industrial and Vyle Investment Inc., to become 100% shareholder of Sureland Equipment. The purchase price was based on the registered capital of Sureland Equipment. On August 4, 2006, this transaction was approved by the Beijing Bureau of Commerce, and the registration with the Beijing State Administration for Industry and Commerce of the People's Republic of China, ("PRC") was completed on August 15, 2006.

**Tianjin Tianxiao Fire Safety Equipment Co., Ltd. ("Tianxiao Equipment")** was established as a limited liability company in Tianjin, PRC on April 11, 2007 with a registered capital RMB 10,000,000. 100% of its registered capital was contributed, in cash, by Sureland Industrial. Tianxiao Equipment principally engages in the manufacturing and sale of fire protection products and services for industrial customers in China.

CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2008

(Unaudited)

**Note 2 – Summary of significant accounting policies**

The reporting entity

The consolidated financial statements of China Fire & Security Group Inc. and subsidiaries reflect its wholly-owned subsidiaries CFPG, Sureland Industrial, Beijing Hua An, Sureland Equipment, and Tianxiao Equipment.

Basis of presentation

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

Management has included all normal recurring adjustments considered necessary to give a fair presentation of operating results for the periods presented. Interim results are not necessarily indicative of results for a full year. The information included in this Form 10-Q should be read in conjunction with information included in the 2007 annual report filed on Form 10-KSB.

Use of estimates

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

Certain of the Company's accounting policies require higher degrees of judgment than others in their application. These include the recognition of revenue and earnings from system contracting projects under the percentage of completion method and the allowance of doubtful accounts. Management evaluates all of its estimates and judgments on an on-going basis.

CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2008

(Unaudited)

Revenue recognition

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

1. Revenue from system contracting projects are recognized using the percentage-of-completion method of accounting and, therefore, take into account the costs, estimated earnings and revenue to date on contracts not yet completed. Revenue recognized is that percentage of the total contract price that cost expended to date bears to anticipated final total cost, based on current estimates of costs to complete. Contract costs include all direct material and labor costs and those indirect costs related to contract performance, such as indirect labor, supplies, tools, repairs, and depreciation costs. Selling, general, and administrative costs are charged to expense as incurred. At the time a loss on a contract becomes known, the entire amount of the estimated ultimate loss is recognized in the consolidated financial statements. Claims for additional contract costs are recognized upon a signed change order from the customer or in accordance with paragraphs 62 and 65 of the AICPA'S Statement of Position ("SOP") 81-1, "Accounting for Performance of Construction - Type and Certain Production - Type Contracts" ("SOP 81-1").
2. Revenue from product sales is recognized when the goods are delivered and title has passed. Product sales revenue is presented net of a value-added tax (VAT). All of the Company's products that are sold in the PRC are subject to a Chinese value-added tax at a rate of 17% of the gross sales price. This VAT may be offset by VAT paid by the Company on raw materials and other materials included in the cost of producing their finished product.
3. Revenue from the rendering of Maintenance Services is recognized over the service period on a straight line basis.

In accordance with SFAS 48, "Revenue Recognition when Right of Return Exists," revenue is recorded net of an estimate of markdowns, price concessions and warranty costs. Such reserve is based on management's evaluation of historical experience, current industry trends and estimated costs.

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

Shipping and handling

Costs related to shipping and handlings are included in cost of revenue. The Company accounts for shipping and handling fees and costs in accordance with Emerging Issues Task Force ("EITF") Issue No. 00-10 "Accounting for Shipping and Handling Fees and Costs."





CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2008

(Unaudited)

Foreign currency translation

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

Translation adjustments amounted to \$5,635,033 and \$3,568,117 as of March 31, 2008 and December 31, 2007, respectively. Asset and liability accounts at March 31, 2008 were translated at 7.00 RMB to \$1.00 USD as compared to 7.29 RMB at December 31, 2007. Equity accounts were stated at their historical rate. The average translation rates applied to income statements accounts for the three months ended March 31, 2008 and 2007 were 7.15 RMB and 7.75 RMB, respectively. Cash flows are also translated at average translation rates for the period, therefore, amounts reported on the statement of cash flows will not necessarily agree with changes in the corresponding balances on the balance sheet.

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

Plant and equipment

Plant and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets with 5% residual value. Depreciation expense amount to \$169,388 and \$123,134 for the three months ended March 31, 2008 and 2007, respectively.

Estimated useful lives of the assets are as follows:

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

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

## CHINA FIRE &amp; SECURITY GROUP, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2008

(Unaudited)

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

Long-term assets of the Company are reviewed periodically or more often if circumstances dictate, to determine whether their carrying value has become impaired. The Company considers assets to be impaired if the carrying value exceeds the future projected cash flows from related operations. The Company evaluates the periods of depreciation and amortization to determine whether subsequent events and circumstances warrant revised estimates of useful lives. As of March 31, 2008, the Company expects these assets to be fully recoverable.

Plant and equipment consist of the following:

	March 31, 2008	December 31, 2007
Buildings and improvements	\$ 5,288,468	\$ 5,077,373
Transportation equipment	2,062,667	1,985,701
Machinery	1,005,444	970,500
Office equipment	1,087,138	1,047,350
Furniture	37,468	35,972
Total	9,481,185	9,116,896
Less accumulated depreciation	2,677,893	2,548,646
Total	\$ 6,803,292	\$ 6,568,250

Concentration of risk

Cash includes cash on hand and demand deposits in accounts maintained with state owned banks within the People's Republic of China and Hong Kong. Total cash (including restricted cash balances) in these banks at March 31, 2008 and December 31, 2007, amounted to \$19,444,952 and \$20,940,016, respectively of which no deposits are covered by insurance. The Company has not experienced any losses in such accounts and believes it is not exposed to any risks on its cash in bank accounts.

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

## CHINA FIRE &amp; SECURITY GROUP, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2008

(Unaudited)

The Company has one major customer who represents approximately 15% of the Company's sales for the three months ended March 31, 2008. Accounts receivable from this customer was \$0 as of March 31, 2008. The Company had one major customer who represents approximately 26% of the Company's sales for the three months ended March 31, 2007. Account receivable from this customer was \$0 as of March 31, 2007.

Cash and cash equivalents

The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents. Cash equivalents are carried at cost, which approximates at its market value.

Restricted cash

Restricted cash represents cash required to be deposited in a separate bank account subject to withdrawal restrictions by its system contracting projects and product sales customers to guarantee its contracts will be performed. The deposit cannot be drawn or transferred by the Company until the restriction period has expired. The amounts are \$4,345,297 and \$3,829,927 as of March 31, 2008 and December 31, 2007, respectively.

	March 31, 2008	December 31, 2007
Restricted Cash		
Products sales	\$ 298,695	\$ 102,355
System contracting projects	4,046,602	3,727,572
Total Restricted Cash	\$ 4,345,297	\$ 3,829,927

Inventories

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

	March 31, 2008	December 31, 2007
Raw materials	\$ 499,609	\$ 310,255
Finished goods	2,388,458	2,617,638
Work in progress	1,403,663	1,120,390
Total	\$ 4,291,730	\$ 4,048,283

Raw materials consist primarily of materials used in production. Finished goods consist primarily of equipment used in product sales and system contracting projects. The costs of finished goods include direct costs of raw materials as well as direct labor used in production. Indirect production costs such as utilities and indirect labor related to production such as assembling, shipping and handling costs are also included in the cost of inventory. The Company reviews its inventories periodically to determine if any reserves are necessary for potential obsolescence. As of March 31, 2008 and December 31, 2007 the Company determined no reserves are necessary.

## CHINA FIRE &amp; SECURITY GROUP, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2008

(Unaudited)

Accounts receivable

Accounts receivable represents amounts due from customers for products sales, maintenance services and system contracting projects. Overdue balances are reviewed regularly by senior management. Reserves are recorded when collection of amounts due are in doubt.

Accounts receivable consists of the following:

	March 31, 2008	December 31, 2007
Accounts receivable:		
System contracting projects	\$ 9,320,610	\$ 10,296,762
Maintenance services	2,245,677	670,357
Products sales	7,885,160	8,234,430
Total accounts receivable	19,451,447	19,201,549
Allowance for bad debts	(2,586,606)	(2,483,359)
Accounts receivable, net	16,864,841	16,718,190
Accounts receivable - non-current retentions	(602,281)	(193,029)
Accounts receivable - current	\$ 16,262,560	\$ 16,525,161

Costs and estimated earnings in excess of billings

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

	March 31, 2008	December 31, 2007
Contract costs incurred plus recognized profits less recognized losses to date	\$ 67,543,054	\$ 50,877,880
Less progress billings	47,125,916	37,809,844
Costs and estimated earnings in excess of billings	\$ 20,417,138	\$ 13,068,036

## CHINA FIRE &amp; SECURITY GROUP, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2008

(Unaudited)

Billings in excess of costs and estimated earnings

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

	March 31, 2008	December 31, 2007
Progress billings	\$ 7,886,705	\$ 15,713,786
Contracts costs incurred plus recognized profits estimated less recognized losses	6,331,408	10,831,569
Billings in excess of costs and estimated earnings	\$ 1,555,297	\$ 4,882,217

At March 31, 2008 and December 31, 2007, retentions held by customers of system contracting projects included in the Company’s accounts receivable as following:

	March 31, 2008	December 31, 2007
Retentions		
Current	\$ 2,347,466	\$ 2,829,250
Non-current	602,281	193,029
Total retentions	\$ 2,949,747	\$ 3,022,279

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

Research and development

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

Warranties

Generally, the Company’s products are not covered by specific warranty terms. However, it is the Company’s policy to replace parts if they become defective within one year after deployment at no additional charge. Historically, failure of product parts due to materials or workmanship is rare. Therefore, at March 31, 2008 and December 31, 2007, the Company made no provision for warranty claims for our products. Management continuously evaluates the potential warranty obligation. Management will record the expenses related to the warranty obligation when the estimated amount become material at the time revenue is recorded.

CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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Fair value of financial instruments

On January 1, 2008, the Company adopted SFAS No. 157. SFAS No. 157, Fair Value Measurements, defines fair value, establishes a three-level valuation hierarchy for disclosures of fair value measurement and enhances disclosures requirements for fair value measures. The carrying amounts reported in the balance sheets for current assets and current liabilities qualify as financial instruments and are a reasonable estimate of fair value because of the short period of time between the origination of such instruments and their expected realization and their current market rate of interest. The three levels are defined as follow:

- Level 1 inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the assets or liability, either directly or indirectly, for substantially the full term of the financial instruments.
- Level 3 inputs to the valuation methodology are unobservable and significant to the fair value.

The Company invested \$162,793 to Hubei Shou An Changjiang Fire Protection Co., Ltd for 19% ownership and invested \$1,000,000 to King Galaxy Investments Limited for 5% ownership. Total investment as of March 31, 2008 amounted to \$1,162,793. Since there is no quoted or observable market price for the fair value of similar long term in joint venture, the Company then used the level 3 inputs for its valuation methodology. The determination of the fair value was based on the cost of the capital contribution to the joint ventures.

The Company did not identify any other assets and liabilities that are required to be presented on the balance sheet at fair value in accordance with SFAS No. 157.

Intangible assets

Land use rights - All land in the People's Republic of China is owned by the government. However, the government grants the user "land use rights". The Company acquired land use rights in 2001 for \$635,757. The land use rights expire in 2051. The costs of these rights are being amortized over fifty years using the straight-line method. As of March 31, 2008 and December 31, 2007, accumulated amortization amounted to \$141,301 and \$137,672, respectively. Amortization expense amounted to \$3,629 and \$3,349 for the three months ended March 31, 2008 and 2007, respectively.

Technology rights - In May 2007, the Company acquired two technology rights to manufacture fire protection products for \$608,745. The costs of these rights are being amortized over ten years using the straight-line method. As of March 31, 2008, accumulated amortization amounted to \$55,802. Amortization expense amounted to \$15,219 for the three months ended March 31, 2008

CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES

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(Unaudited)

Intangible assets of the Company are reviewed annually to determine whether their carrying value has become impaired. The Company considers assets to be impaired if the carrying value exceeds the future projected cash flows from related operations. The Company also evaluates the periods of amortization to determine whether subsequent events and circumstances warrant revised estimates of useful lives. As of March 31, 2008, the Company expects these assets to be fully recoverable.

Income taxes

The Company adopted Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" (SFAS 109). SFAS 109 requires the recognition of deferred income tax liabilities and assets for the expected future tax consequences of temporary differences between income tax basis and financial reporting basis of assets and liabilities. Provision for income taxes consist of taxes currently due plus deferred taxes. There are no deferred tax amounts at March 31, 2008 and December 31, 2007.

The Company adopted FASB Interpretation 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"), as of January 1, 2007. A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosures, and transition. The adoption had no affect on the Company's financial statements.

The Company's operations are subject to income and transaction taxes in the United States and in the PRC jurisdictions. Significant estimates and judgments are required in determining the Company's worldwide provision for income taxes. Some of these estimates are based on interpretations of existing tax laws or regulations. The ultimate amount of tax liability may be uncertain as a result.

The Company does not anticipate any events which could cause change to these uncertainties.

The Company is subject to taxation in the U.S. and in the PRC jurisdictions. There are no ongoing examinations by taxing authorities at this time. The years 2005 to 2008 remain subject to examination by the United States tax authorities. The year 2008 remain subject to examination by the PRC tax authorities.

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

CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES

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

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

Beginning January 1, 2008, the new Enterprise Income Tax ("EIT") law will replace the existing laws for Domestic Enterprises ("DES") and Foreign Invested Enterprises ("FIEs").

Value Added Tax

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

VAT on sales and VAT on purchases amounted to \$964,361 and \$742,064 for the three months ended March 31, 2008, and \$1,246,335 and \$959,663 for the three months ended March 31, 2007 respectively. Sales and purchases are recorded net of VAT collected and paid as the Company acts as an agent for the government. VAT taxes are not impacted by the income tax holiday.

Stock based compensation

The Company adopted Statement of Financial Accounting Standards No. 123R "Accounting for Stock-Based Compensation" ("SFAS 123R") at the beginning of 2006, which defines a fair-value-based method of accounting for stock based employee compensation and transactions in which an entity issues its equity instruments to acquire goods and services from non-employees. Stock compensation for stock granted to non-employees has been determined in accordance with SFAS 123R and the Emerging Issues Task Force consensus Issue No. 96-18, "Accounting for Equity Instruments that are issued to Other than Employees for Acquiring, or in Conjunction with Selling Goods or Services" ("EITF 96-18"), as the fair value of the consideration received or the fair value of equity instruments issued, whichever is more reliably measured.



CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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Recently issued accounting pronouncements

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities—including an amendment of FASB Statement No. 115 (“FAS 159”). FAS 159 permits companies to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The objective of FAS 159 is to provide opportunities to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply hedge accounting provisions. FAS 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 is effective as of the beginning of an entity’s first fiscal year that begins after November 15, 2007. The Company adopted SFAS No. 159 on January 1, 2008. The Company chose not to elect the option to measure the fair value of eligible financial assets and liabilities.

In June 2007, the FASB issued FASB Staff Position No. EITF 07-3, “Accounting for Nonrefundable Advance Payments for Goods or Services Received for use in Future Research and Development Activities” (“FSP EITF 07-3”), which addresses whether nonrefundable advance payments for goods or services that used or rendered for research and development activities should be expensed when the advance payment is made or when the research and development activity has been performed. FSP EITF 07-3 will be effective for an entity’s financial statements issued for fiscal years beginning after than December 15, 2007. The adoption of FSP EITF 07-3 did not impact our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, “Noncontrolling Interests in Consolidated Financial Statements - an amendment of Accounting Research Bulletin No. 51” (“SFAS 160”), which establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent’s ownership interest and the valuation of retained non-controlling equity investments when a subsidiary is deconsolidated. The Statement also establishes reporting requirements that provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the non-controlling owners. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The Company has not determined the effect that the application of SFAS 160 will have on its consolidated financial statements.

## CHINA FIRE &amp; SECURITY GROUP, INC. AND SUBSIDIARIES

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In December 2007, Statement of Financial Accounting Standards No. 141(R), *Business Combinations*, was issued. SFAS No. 141R replaces SFAS No. 141, *Business Combinations*. SFAS 141R retains the fundamental requirements in SFAS 141 that the acquisition method of accounting (which SFAS 141 called the *purchase method*) be used for all business combinations and for an acquirer to be identified for each business combination. SFAS 141R requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date, with limited exceptions. This replaces SFAS 141's cost-allocation process, which required the cost of an acquisition to be allocated to the individual assets acquired and liabilities assumed based on their estimated fair values. SFAS 141R also requires the acquirer in a business combination achieved in stages (sometimes referred to as a step acquisition) to recognize the identifiable assets and liabilities, as well as the noncontrolling interest in the acquiree, at the full amounts of their fair values (or other amounts determined in accordance with SFAS 141R). SFAS 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. An entity may not apply it before that date. The Company is currently evaluating the impact that adopting SFAS No. 141R will have on its financial statements.

Reclassifications

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

**Note 3 – Earnings per share**

The Company reports earnings per share in accordance with the provisions of SFAS No. 128, "Earnings per Share." SFAS No. 128 requires presentation of basic and diluted earnings per share in conjunction with the disclosure of the methodology used in computing such earnings per share. Basic earnings per share is computed by dividing income available to common stockholders by the weighted average common shares outstanding during the period. Diluted earnings per share takes into account the potential dilution that could occur if securities or other contracts to issue common stock were exercised and converted into common stock.

The following is a reconciliation of the basic and diluted earnings per share computation for the three months ended March 31, 2008 and 2007:

	2008	2007
Net income for earnings per share	\$ 4,740,780	\$ 4,130,116
Weighted average shares used in basic computation	27,556,893	26,461,678
Diluted effect of stock options and warrants	596,288	539,850
Weighted average shares used in diluted computation	28,153,181	27,001,528
Earnings per share:		
Basic	\$ 0.17	\$ 0.16
Diluted	\$ 0.17	\$ 0.15



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At March 31, 2008, all outstanding stock options and warrants were included in the calculation of diluted earnings per share.

**Note 4 - Supplemental disclosure of cash flow information**

For the three months ended March 31, 2008 and 2007, supplemental cash flow information is as follows:

	2008	2007
Interest paid	\$ -	\$ -
Income tax paid	\$ 5,510	\$ 47,978

**Note 5 – Notes receivable**

Notes receivable represents trade accounts receivable due from various customers where the customers' bank has guaranteed the payment of the receivable. This amount is non-interest bearing and is normally paid within three to six months. The Company has the ability to submit their request for payment to the customer's bank earlier than the scheduled payment date. However, the Company will incur an interest charge and a processing fee when they submit the payment request early. The Company's notes receivable totaled \$3,867,484 and \$3,315,811 as of March 31, 2008 and December 31, 2007, respectively.

**Note 6 – Prepayments and deferred expenses**

Prepayments and deferred expenses are monies deposited with or advanced to subcontractors to perform services on System Contracting Projects. Some subcontractors require a certain amount of money to be deposited as a guarantee payment in order for them start performing the services. Prepayments and deferred expenses also include monies deposited or advanced to vendors on future inventory purchases to ensure timely delivery. The total outstanding amount was \$2,805,928 and \$2,218,391 as of March 31, 2008 and December 31, 2007, respectively.

**Note 7 – Investment in joint ventures**

During the second quarter of 2007, the Company invested \$162,793 for a 19% interest in Hubei Shou An Changjiang Fire Protection Co., Ltd., located in China Hubei, PRC. Investment is recorded under cost method.

During the third quarter of 2007, the Company invested \$1,000,000 for a 5% interest in King Galaxy Investments Limited. King Galaxy through its wholly owned subsidiary, China Alliance Security Holdings Company Limited owns 100% of Wan Sent (China) Technology Co., Ltd. ("Wan Sent"), an emerging Chinese fire emergency remote-monitoring system provider based in Beijing, PRC. The investment has been recorded under the cost accounting method.

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The Company has not consolidated the financial statements of these two joint ventures into its financial statements as the Company does not have the ability to exercise significant influence over the joint venture companies.

**Note 8 – Customer deposits**

Customer deposits represent amounts advanced by customers on products orders, maintenance services deposits and system contracting projects deposits. The product or service normally is shipped or performed within six months after receipt of the advance payment and the related sale is recognized in accordance with the Company's revenue recognition policy. As of March 31, 2008 and December 31, 2007, customer deposits amounted to \$6,946,981 and \$4,757,179, respectively.

**Note 9 – Accrued liabilities**

Accrued liabilities represent subcontractors' expenses incurred as of balance sheet date for system contracting projects. As of March 31, 2008 and December 31, 2007, accrued liabilities amounted to \$5,539,274 and \$4,214,530, respectively.

**Note 10 – Income taxes**

Prior to January 1, 2008, under the Income Tax Laws of PRC, the Company's subsidiaries are generally subject to an income tax at an effective rate of 33% on income reported in the statutory financial statements after appropriate tax adjustments, unless the enterprise is located in a specially designated region where it allows enterprises a three-year income tax exemption and a 50% income tax reduction for the following three years or the enterprise is a manufacturing related joint venture with a foreign enterprise or a wholly owned subsidiary of a foreign enterprise, where it allows enterprises a two-year income tax exemption and a 50% income tax reduction for the following three years.

Under the Income Tax Laws of Beijing State Administration Taxation of PRC, any enterprise with manufacturing operations in the City of Beijing who is a wholly owned subsidiary of a foreign enterprise is subject to income tax rate of 24%.

On July 19, 2006, Sureland Industrial became a wholly owned subsidiary of the Company, a foreign enterprise, and will start enjoying the exemption from January 1, 2007 to December 31, 2008, and is entitled to a 50% reduction of the special income tax rate of 24%, which is a rate of 12% from January 2009 to December 31, 2011.

On August 4, 2006, Sureland Equipment became a wholly owned subsidiary of the Company, a foreign enterprise, and was granted income tax exemption from April 2006 to December 31, 2007, and is entitled to a 50% reduction of the special income tax rate of 24%, which is a rate of 12% from January 2008 to December 31, 2010.

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Beijing Hua An were established and registered in the New Technology Enterprise Development Zone, Beijing, PRC and are subject to the rate of 15% and have been certified by the relevant PRC authorities high technology enterprises. However pursuant to approval documents issued by the relevant tax bureau, Beijing Hua An obtained additional tax benefits. Beijing Hua An is exempt from income taxes from January 2006 to December 31, 2008 and is entitled to a 50% reduction of the special income tax rate of 15% which is a rate of 7.5% from January 2009 to December 31, 2011.

Tianxiao Equipment has no income tax exemption and therefore it has an income tax rate of 33% from its establishment.

Beginning from January 1, 2008, the new Enterprise Income Tax ("EIT") law will replace the existing income tax laws for Domestic Enterprises ("DES") and Foreign Invested Enterprises ("FIEs").

The key changes are:

- a. The new standard EIT rate of 25% will replace the 33% rate currently applicable to both DES and FIEs, except for High Tech companies who pays a reduced rate of 15%;
- b. Companies established before March 16, 2007 will continue to enjoy tax holiday treatment approved by local government for a grace period of the next 5 years or until the tax holiday term is completed, whichever is sooner.

Beginning from January 1, 2008, Sureland Industrial will continue to enjoy the exemption from income tax till December 31, 2008 and be entitled to a 50% reduction of the income tax rate of 25% which is a rate of 12.5% from January 2009 to December 31, 2011. Beginning January 1, 2012, Sureland Industrial will be entitled to an income tax rate of 25%.

Beginning from January 1, 2008, Sureland Equipment will continue to enjoy a 50% reduction of the income tax rate of 25%, which is a rate of 12.5%, till December 31, 2010. Beginning January 1, 2011, Sureland Equipment will be entitled to an income tax rate of 25%.

Beginning from January 1, 2008, Tianxiao Equipment will be entitled to an income tax rate of 25%.

Beginning from January 1, 2008, Beijing Hua An will continue to enjoy the exemption from income tax till December 31, 2008 and be entitled to a reduced income tax rate of 10%, 11%, 12% for 2009, 2010 and 2011 respectively. Beginning January 1, 2012, Beijing Hua An will be entitled to an income tax rate of 25%.

The provision for income taxes for the three months ended March 31, 2008 and 2007 amounted to \$48,642 and \$0, respectively.

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

	2008	2007
U.S. Statutory rates	34.0%	34.0%
Foreign income not recognized in USA	(34.0)	(34.0)
China income taxes	25.0	33.0
China income tax exemption	(24.0)	(33.0)
Total provision for income taxes	1.0%	-%

The estimated tax savings for the three months ended March 31, 2008 and 2007 amounted to \$1,241,570 and \$1,185,465, respectively. The net effect on basic earnings per share if the income tax had been applied would decrease basic earnings per share for the three months ended March 31, 2008 and 2007 by \$0.05 and \$0.04, respectively.

China Fire & Security Group, Inc. was incorporated in the United States and has incurred net operating losses of \$0 for income tax purposes for the three months ended March 31, 2008. The net operating loss carry forwards for United States income taxes amounted to \$1,004,414 which may be available to reduce future years' taxable income. These carry forwards will expire, if not utilized, beginning in 2025 and continue through 2027. Management believes that the realization of the benefits from these losses appears uncertain due to the Company's limited operating history and continuing losses for United States income tax purposes. Accordingly, the Company has provided a 100% valuation allowance on the deferred tax asset benefit to reduce the asset to zero. The accumulated valuation allowance as of March 31, 2008 amounted to \$341,501. Management will review this valuation allowance periodically and make adjustments as warranted.

Taxes payable

Taxes payable as of March 31, 2008 and December 31, 2007 consisted of the following:

	March 31, 2008	December 31, 2007
VAT taxes (credit) payable	\$ (102,008)	\$ 71,367
Income taxes payable	49,696	5,915
Sales taxes	1,167,378	979,999
Other taxes (credit) payable	(304)	31,054
Total	\$ 1,114,762	\$ 1,088,335

**Note 11 – Retirement plan**

The Company and its subsidiaries are required to participate in a central pension scheme operated by the local municipal government. The Company is required to contribute 20% of its payroll costs to the central pension scheme in 2008 and 2007. The contributions are charged to the income statement of the Company as they become payable in accordance with the rules of the scheme. The aggregate contributions of the Company to retirement benefit schemes amounted to \$50,780 and \$36,996 for the three months ended March 31, 2008 and 2007, respectively.





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**Note 12 – Statutory reserves**

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

Surplus reserve fund

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

The transfer to this reserve must be made before distribution of any dividend to shareholders. For the three months ended March 31, 2008 and 2007, the Company transferred \$1,641,434 and \$0, respectively. The surplus reserve fund is non-distributable other than during liquidation and can be used to fund previous years' losses, if any, and may be utilized for business expansion or converted into share capital by issuing new shares to existing shareholders in proportion to their shareholding or by increasing the par value of the shares currently held by them, provided that the remaining reserve balance after such issue is not less than 25% of the registered capital.

On May 17, 2007, the Beijing Shunyi District Business Administration approved the Company to increase registered capital from RMB 50,000,000 to RMB 100,000,000. \$605,000 or RMB 5,000,000 was approved by the Beijing Shunyi District Business Administration to be transferred out from this surplus reserve fund as an increase of registered capital.

Enterprise fund

The enterprise fund may be used to acquire plant and equipment or to increase the working capital to expend on production and operation of the business. No minimum contribution is required and the Company did not make any contribution to this fund for the three months ended March 31, 2008 and 2007.

**Note 13 – Shareholders' equity**

On October 27, 2006, pursuant to a Securities Purchase Agreement dated October 27, 2006 ("SPA"), the Company issued 1,538,600 units of common stock at \$3.25 per share, Series A warrants expiring on October 27, 2011 to acquire 307,723 shares at \$3.58 per share and Series B warrants expiring on October 27, 2011 to acquire 307,723 shares at \$4.88 per share. The Company also issued 115,395 warrants at exercise price of \$3.25 per share, expiring on October 27, 2011.

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On December 5, 2006, under the SPA, the Company issued 923,078 units of common stock at \$3.25 per share, Series A warrants expiring on December 5, 2011 to acquire 184,617 shares at \$3.58 per share and Series B warrants expiring on December 5, 2011 to acquire 184,617 shares at \$4.88 per share. The Company also issued 69,231 warrants at exercise price of \$3.25 per share, expiring December 5, 2011.

On January 30, 2008, the Company's 2008 Omnibus Long-term Incentive Plan was adopted and approved by shareholders. Pursuant to the 2008 Omnibus Long-term Incentive Plan, the Company reserved 2,000,000 shares of our common stock for issuance.

On March 12, 2008, the Company's Board of Directors authorized the repurchase of up to \$10 million of the Company's outstanding common stock.

Warrants

In order for the warrants to be accounted for as equity, the warrants must comply with FAS 133 and EITF 00-19. Under the original terms, the Series A and Series B warrant agreements, the warrant holders under certain circumstances, at their option, could elect to receive an amount in cash equal to the fair value of the warrant calculated in accordance with the Black-Scholes formula. Thus, the warrant holders had rights to a cash payment that are not available to other common stockholders, which failed the test in paragraph 27 of EITF 00-19. The failure of this test therefore resulted in classification of the warrants as derivative instrument liabilities, rather than as equity instruments. The Company allocated the proceeds received between the common stock and warrants based upon the fair values on the dates the proceeds were received. The value of the warrants was determined using the Cox-Ross-Rubinstein binomial model using the following assumptions: volatility 75%; risk free interest rate 4.64%; dividend yield of 0% and expected term of 5 years. Net proceeds were allocated as the follows:

Warrants	\$ 1,110,236
Common stock	6,030,602
Total Net Proceeds	\$ 7,140,838

Subsequent to the initial recording, the change in the fair value of the warrants, determined under the Cox-Ross-Rubinstein binomial model, at each reporting date was recorded as a gain or loss on derivative instruments.

On April 26, 2007, the Company amended its Series A Warrants and Series B Warrants issued to certain investors on October 27 and December 5, 2006 pursuant to the Securities Purchase Agreement in connection with a private placement (the "Amendment"). The Amendment eliminates the right of the warrant holders to be paid in cash in the event of a merger or other types of reorganization. The warrants no longer need to be accounted for as derivative instrument liabilities. The fair value of the warrants were transferred to equity on the signing date and no further accounting (i.e., no mark-to-market) is required going forward. As of December 31, 2006 the fair value of the derivative instrument totaled \$2,680,811. At April 26, 2007, the Company determined the fair value of the warrants was \$1,475,020 using the Cox-Ross-Rubinstein binomial model with the following assumptions: volatility 25%; risk free interest rate 4.59%; dividend yield of 0% and expected term of 4.5 years. A gain of \$1,205,791 was recognized in the accompanying income statement based on the decrease in fair value since prior period ended December 31, 2006. On April 26, 2007, the fair value of the warrants was transferred to additional paid-in capital.



## CHINA FIRE &amp; SECURITY GROUP, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2008

(Unaudited)

In 2007, a total of 492,340 Series A warrants exercised at \$3.58 and 492,340 Series B warrants exercised at \$4.88 for a total of 984,680 shares of common stock. The Company received a total of \$4,165,197 from various warrant holders.

In 2007, a total of 179,626 warrants were converted into 110,535 shares of common stock by the warrants holders using the cashless exercise options.

On February 1, 2007, CFPG issued 50,000 warrants to Hayden Communication, the Company's investor relations consultant, as part of its compensation. These warrants meet the conditions for equity classification pursuant to FAS 133 and EITF 00-19. Therefore, the warrants were classified as equity and accounted as compensation expenses. The warrants vest one year from the grant date. The Company used the Black Scholes model to value the options at the time they were issued, based on the exercise price of \$4.25 and expiration dates of the instruments and using a risk-free rate of 4.84% and the volatility at 50% that was estimated by analyzing the trading history of the Company's stock. At that market price, the 50,000 warrants had a fair value of approximately \$94,274. The service that the investor relation consultant provides started from the second quarter of 2007; the related compensation expense is recognized on a straight-line basis over the total service period and has been fully expensed in 2007.

The Company's warrant activity is as follows:

	Warrants Outstanding	Warrants Exercisable	Weighted Average Exercise Price	Average Remaining Contractual Life
Outstanding, December 31, 2006	1,169,306	1,169,306	\$ 4.23	4.58
Granted	50,000	50,000	\$ 4.25	3.58
Forfeited				
Exercised	(1,164,306)	(1,164,306)	\$ 4.23	
Outstanding, December 31, 2007	55,000	55,000	\$ 4.19	3.33
Granted				
Forfeited				
Exercised				
Outstanding, March 31, 2008	55,000	55,000	\$ 4.19	3.08

CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2008

(Unaudited)

**Note 14 – Options issued to employees**

On July 1, 2006, CFPG issued 750,000 options to the employees of Sureland Industrial. Fifty percent of the options vested immediately, with the balance vesting evenly each quarter over the following two years. The Company used the Cox-Ross-Rubinstein binomial model to value the options at the time they were issued, based on the stated exercise prices and expiration dates of the instruments and using a risk-free rate of 5.11%. Because the Company does not have a history of employee stock options, the estimated life is based on one half of the sum of the vesting period and the contractual life of the option. This is the same as assuming that the options are exercised at the mid-point between the vesting date and expiration date.

The Company's stock was not traded when the options were granted. Therefore, the Company had to estimate the market value of its shares. There was no significant change in the business between July and October 2006, therefore, the company used the fair value from the October 27 transaction of \$2.26 and took a discount of 30%, to estimate a market price of \$1.58. At that market price, the 750,000 employee options had a fair value of approximately \$834,000. Because 50% of the options vested immediately, the related compensation expense was recognized as the options vest, rather than on a straight-line basis over the total vesting period, as the amount recognized at any point in time must be at least equal to the portion vested. The expense recognized for the three months ended March 31, 2008 and 2007 amounted to \$14,000 and \$65,000, respectively.

On April 20, 2007, CFPG issued 9,500 options to the Company's four independent directors as part of their compensation. The options will vest immediately after one year from the issuance date. The fair value of these warrants was determined to be \$19,428 using the Black Sholes model with the following assumptions: volatility 45%; risk free interest rate 4.57%; dividend yield of 0% and expected term of 5 years. Options were vested immediately at exercise price of \$4.51 per share which was the close price of the Company's stock on April 19, 2007. Because the services that the independent directors are to provide started from the second quarter of 2007 and will last for one year, the related compensation expense is recognized on a straight-line basis over the total service period. The compensation expense for the three months ended March 31, 2008 was \$4,857.

On July 1, 2007, CFPG issued 20,000 options to Mr. Yuan, Xiaoyuan, who joined the Company as Chief Accounting Officer on the same day. The options will vest evenly each quarter over the following four years, starting from the third quarter of 2007. The Company used the Black Sholes model to value the options at the time they were issued, based on the exercise price of \$6.70, which was the close price of the Company's stock on June 30, 2007 and expiration dates of the instruments and using a risk-free rate of 4.84% and the volatility of 40% that was estimated by analyzing the trading history of the Company's stock. At that market price, the 20,000 employee options had a fair value of \$57,178. Because the options will vest each quarter over the following four years, the related compensation expense is recognized on a straight-line basis over the total vesting period. The expense recognized for the three months ended March 31, 2008 was \$3,574.

## CHINA FIRE &amp; SECURITY GROUP, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2008

(Unaudited)

The Company has stock options as follows:

	Options Outstanding	Weighted Average Exercise Price	Aggregate Intrinsic Value
Outstanding, December 31, 2006	750,000	\$ 1.25	2,782,500
Granted	29,500	\$ 5.99	
Forfeited			
Exercised			
Outstanding, December 31, 2007	779,500	\$ 1.43	8,925,615
Granted			
Forfeited			
Exercised			
Outstanding, March 31, 2008	779,500	\$ 1.43	4,365,845

Following is a summary of the status of options outstanding at March 31, 2008:

Outstanding Options			Exercisable Options		
Number of Options	Exercise Price	Average Remaining Contractual Life	Number of Options	Exercise Price	Average Remaining Contractual Life
750,000	1.25	3.25	656,250	1.25	3.25
9,500	4.51	4.08	9,500	4.51	4.08
20,000	6.70	4.25	3,750	6.70	4.25

**Note 15 -Restructuring of subsidiaries**

On April 2, 2007, the Company evaluated the operations of its subsidiary, Beijing Zhong Xiao Fire Safety Technology Co., Ltd. ("Beijing Zhong Xiao") and noted efficiencies could be obtained by consolidating the operations of Beijing Zhong Xiao into Sureland Equipment.

Beijing Zhong Xiao was a subsidiary of Sureland Industrial established in the PRC as a limited liability company on March 18, 2003. On April 3, 2007, Sureland Industrial signed an agreement to transfer 100% ownership in Beijing Zhong Xiao to Gong Gang Qiang, a Chinese individual, for consideration price equal to the net assets of Beijing Zhong Xiao as of March 31, 2007.

After the restructuring of Beijing Zhong Xiao, the Company still has a significant continuing involvement in the historical operations of the manufacturing of fire safety and protection products through Sureland Equipment, which results in the Company failing the test in paragraph 42 of FAS 144 "Accounting for the Impairment or Disposal of Long-Lived Assets". The failure of this test therefore does not require the classification of the disposal of Beijing Zhong Xiao as a discontinued operation.

## **Item 2. Management's Discussion and Analysis or Plan of Operation**

The following discussion and analysis provides information which the management of China Fire & Security Group, Inc., (the "Company" or "CFSG") believes to be relevant to an assessment and understanding of the Company's results of operations and financial condition. This discussion should be read together with the Company's financial statements and the notes to financial statements, which are included in this report.

### **Overview**

We are engaged in the design, development, manufacture and sale of fire protection products and services for large industrial consumers in China. We have developed a proprietary product line that addresses all aspects of industrial fire safety from fire detection to fire system control and extinguishing. The Company is the first in China to leverage high technology for fire protection and safety to clients such as iron and steel companies, power plants, petrochemical plants, as well as special purpose construction companies in China.

### **Reorganization**

We were organized as a Florida corporation on June 17, 2003.

On September 1, 2006, we entered into a share exchange agreement, pursuant to which we acquired all of the outstanding capital shares of Sureland Industrial Fire Equipment Co. Ltd (Sureland Equipment) in exchange for a controlling interest in our common shares. The transaction was completed on Oct 27, 2006.

China Fire Protection Group, Inc. was organized on June 2, 2006 for the purpose of acquiring all of the capital shares of Sureland Industrial Fire Safety Limited (Sureland Industrial), a Chinese corporation, and, Sureland Equipment, a Chinese corporation, which collectively engage in the design, development, manufacturing and sale of fire protection products and services for large industrial consumers in China. As a result of the transactions described above, both Sureland Industrial and Sureland Equipment became wholly-owned subsidiaries of China Fire Protection Group, Inc., and China Fire Protection Group, Inc. is a wholly-owned subsidiary of Unipro Financial Services, Inc. (Unipro).

On February 9, 2007, Unipro changed its name to China Fire & Security Group, Inc. (CFSG) and started trading on OTC Bulletin Board under its new ticker symbol CFSG. On July 16, 2007, China Fire & Security Group, Inc. began trading on Nasdaq Capital Market and retained the ticker symbol CFSG.

CFSG owns, through its wholly owned subsidiary China Fire Protection Group, Inc., Sureland Industrial and Sureland Equipment (jointly "Sureland"). Sureland is engaged primarily in the design, development, manufacture and sale of a variety of fire safety products for the industrial fire safety market and of design and installation of industrial fire safety systems in which it uses its own fire safety products in China. To a minor extent, it provides maintenance services for customers of its industrial fire safety systems. Its business is primarily in China, but it has recently begun to manufacture products for the export market and it has begun to provide a fire safety system for a Chinese company operating abroad.

Sureland markets its industrial fire safety products and systems primarily to major companies in the iron and steel, power and petrochemical industries in China. It has also completed projects for highway and railway tunnels, wine distilleries, tobacco warehouses and a nuclear reactor. It is developing its business in the transportation, wine and tobacco, vessels, nuclear energy, and public space markets. Its products can be readily adapted for use on vessels and in exhibition halls and theatres. It plans to expand its marketing efforts to secure business in these industries.

Sureland has internal research and development facilities engaged primarily in furthering fire safety technologies. It believes that its technologies allow it to offer cost-effective and high-quality fire safety products and systems. It has developed products for industrial fire detecting and extinguishing. It believes that it is the only manufacturer in China which has successfully developed a comprehensive line of linear heat detectors.

By March 31, 2008, Sureland operates more than 30 sales and liaison offices in China.

Sureland has been ranked as the leading Chinese industrial fire safety company twice by the China Association for Fire Prevention based on six major factors including total revenue, growth rate, net profit, return on assets, investment in research and development and intellectual property. Its key products include linear heat detectors and water mist extinguishers, whose sales volumes are the largest in China. Its products have been used by its customers in more than 20 provinces throughout China.

### **Critical Accounting Policies and Estimates**

While our significant accounting policies are more fully described in Note 2 to our consolidated financial statements appearing at the end of this quarterly report, we believe that the following accounting policies are the most critical to aid you in fully understanding and evaluating our reported financial results.

#### **Revenue recognition**

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

1. Revenue from system contracting projects are recognized using the percentage-of-completion method of accounting and, therefore, take into account the costs, estimated earnings and revenue to date on contracts not yet completed. Revenue recognized is that percentage of the total contract price that cost expended to date bears to anticipated final total cost, based on current estimates of costs to complete. Contract costs include all direct material and labor costs and those indirect costs related to contract performance, such as indirect labor, supplies, tools, repairs, and depreciation costs. Selling, general, and administrative costs are charged to expense as incurred. At the time a loss on a contract becomes known, the entire amount of the estimated ultimate loss is recognized in the consolidated financial statements. Claims for additional contract costs are recognized upon a signed change order from the customer or in accordance with paragraphs 62 and 65 of AICPA Statement of Position 81-1, "Accounting for Performance of Construction - Type and Certain Production - Type Contracts" ("SOP 81-1")
2. Revenue from product sales is recognized when the goods are delivered and title has passed. Product sales revenue represents the invoiced value of goods, net of a value-added tax (VAT). All of the Company's products that are sold in the PRC are subject to a Chinese value-added tax at a rate of 17 percent of the gross sales price. This VAT may be offset by VAT paid by the Company on



raw materials and other materials included in the cost of producing their finished product.

3. Revenue from the rendering of Maintenance Services is recognized when such services are provided.

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4. Dividend income is recognized when the shareholders' right to receive payment has been established.
5. Provision is made for foreseeable losses as soon as they are anticipated by management.
6. Where contract costs incurred to date plus recognized profits less recognized losses exceed progress billings, the surplus is treated as an amount due from contract consumers. Where progress billings exceed contract costs incurred to date plus recognized profits less recognized losses, the surplus is treated as an amount due to contract customers.

#### Foreign currency translation

The reporting currency of the Company is the US dollar. The Company uses their local currency, Renminbi (RMB), as their functional currency. Results of operations and cash flow are translated at average exchange rates during the period, and assets and liabilities are translated at the unified exchange rate as quoted by the People's Bank of China at the end of the period. Translation adjustments resulting from this process are included in accumulated other comprehensive income in the statement of shareholders' equity. Transaction gains and losses that arise from exchange rate fluctuations on transactions denominated in a currency other than the functional currency are included in the results of operations as incurred. Historically, the Company has not entered any currency trading or hedging, although there is no assurance that the Company will not enter into such activities in the future.

#### Use of estimates

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

Certain of the Company's accounting policies require higher degrees of judgment than others in their application. These include the recognition of revenue and earnings from system contracting projects under the percentage of completion method and the allowance of doubtful accounts. Management evaluates all of its estimates and judgments on an on-going basis.

#### Inventories

Inventories are stated at the lower of cost or market, using the weighted average method. Inventories consist of raw materials, work in progress, finished goods and consumables. Raw materials consist primarily of materials used in production. Finished goods consist primarily of equipment used in project contracts. The cost of finished goods included direct costs of raw materials as well as direct labor used in production. Indirect production costs such as utilities and indirect labor related to production such as assembling, shipping and handling costs are also included in the cost of inventory. The Company reviews its inventory annually for possible obsolete goods or to determine if any reserves are necessary for potential obsolescence.

#### Accounts receivable

Accounts receivable represents the product sales, maintenance services and system contracting projects with its customers that were on credit. The credit term is generally for a period of three months for major customers. Each customer has a maximum credit limit. The Company seeks to maintain strict control over its outstanding receivables.

Overdue balances are reviewed regularly by senior management.

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**Results of Operations**

The following is a schedule showing results of our business.

**Three Months Financial Results**

*Comparison of the three months ended on March 31, 2008 and 2007:*

	<b>Three months ended March 31,</b>	
	<b>2008</b>	<b>2007</b>
Revenues	\$ 14,696,626	\$ 9,499,460
Cost of revenues	6,652,231	4,483,555
Gross profits	8,044,395	5,015,905
Operating expenses	3,394,683	1,739,232
Income from operations	4,649,712	3,276,673
Total other income(expense)	139,710	853,443
Change in fair value of derivative instruments	-	834,163
Income before income taxes and minority interest	4,789,422	4,130,116
Income taxes	48,642	-
Minority interest	-	-
Net profit (loss)	4,740,780	4,130,116
Foreign exchange adjustment	2,066,916	295,559
Comprehensive income	6,807,696	4,425,675
weighted average number of shares-basic	27,556,893	26,461,678
weighted average number of shares-diluted	28,153,181	27,001,528
earning per share-basic	0.17	0.16
earning per share-diluted	0.17	0.15

Total revenues were approximately \$14.7 million for the three months ended March 31, 2008 as compared to approximately \$9.5 million for the three months ended March 31, 2007, an increase of approximately \$5.2 million or 54.7 percent. This increase was primarily due to increases in our revenues from system contracting projects and maintenance service during the period. The Company performed 146 total solution, product sales and maintenance service contracts for the three months ended March 31, 2008 as compared to 96 contracts for the three months ended March 31, 2007.

The revenues from total solution contracts increased by 55.7 percent to \$11.3 million with 81 contracts performed for the three months ended March 31, 2008, compared to \$7.3 million with 63 contracts performed for the same period of last year; The revenues from product sales increased by 37.1 percent to \$2.9 million with 33 contracts performed for the three months ended March 31, 2008, compared to \$2.1 million with 26 contracts performed for the same period of last year. The revenues from maintenance service increased by 301.1 percent to \$0.5 million with 32 contracts performed for the three months ended March 31, 2008, compared to \$0.1 million with 7 contracts performed for the same period of last year. In particular, the three largest customers were Anshan Iron and Steel Group, Datang Tashan Power Plant and Wuhan Iron and Steel Group, which collectively contributed approximately \$4.9 million, representing 32.8 percent of our total revenues for this period.

Cost of revenues for the three months ended March 31, 2008 was approximately \$6.7 million or 45.3 percent of revenues, as compared to \$4.5 million or 47.2 percent of revenue for the three months ended March 31, 2007. Gross margin during this period was 54.7 percent, which is higher than the gross margin of 52.8 percent for the same period of 2007. The increase in the gross margin was mainly attributable to a higher percentage of revenue contribution from

the sales of the Company's proprietary products which enjoy higher margins.

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Operating expenses were approximately \$3.4 million for the three months ended March 31, 2008, as compared to approximately \$1.7 million for the three months ended March 31, 2007. This represents an increase of approximately \$1.7 million or 95.2 percent. Compared to the same period of last year, the Company increased the number of its employees, its expenditures in sales-related activities and raised the compensation for management to be in line with other US public companies. The increase in expenses is also attributable to the increased costs related to being listed as a public company in the United States.

Operating income was approximately \$4.6 million for the three months ended March 31, 2008 as compared to approximately \$3.3 million for the three months ended March 31, 2007, representing a 41.9 percent increase. The improvement in operating income was mainly attributable to the increased revenues and gross margin during the period.

Total other income was \$139,710 for the three months ended March 31, 2008, compared to \$853,443 for the three months ended March 31, 2007, which included a one-time non-cash gain of \$853,443 due to the change in fair value of derivative instruments.

Provision for income tax was \$48,642 for the three months ended March 31, 2008, compared to no provisions for income tax for the three months ended March 31, 2007. Starting in the year 2008, the Company's two subsidiaries, Sureland Equipment and Tianxiao Equipment, are subject to income tax charge rates of 12.5% and 25% respectively, resulting in income tax charges of \$32,889 and \$15,753 in this period.

The Company's net income was approximately \$4.7 million for the three months ended March 31, 2008 as compared to approximately \$4.1 million net income for the three months ended March 31, 2007, representing an increase of \$0.6 million or 14.8 percent.

Excluding a one-time non-cash gain of \$0.8 million for the change in fair value of derivative in the three months ended March 31, 2007, the non-GAAP net income for the three months ended March 31 of 2007 was \$3.3 million. On a non-GAAP basis, our net income for the three months ended March 31, 2008 increased 43.8 percent in comparison to the non-GAAP net income for the three months ended March 31, 2007. The reason for the increase in the net income was mainly due to the increase in the Company's revenues and improvement in gross margin.

Currency translation adjustments resulting from RMB appreciation process amounted to \$2,066,916 and \$295,559 for the three months ended March 31, 2008 and 2007, respectively.

The comprehensive income, which adds the currency adjustment to the net income, was approximately \$6.8 million for the three months ended March 31, 2008 as compared to approximately \$4.4 million comprehensive income for the three months ended March 31, 2007, representing an increase of \$2.4 million or 53.8 percent.

### **Liquidity and Capital Resources**

As of March 31, 2008, we had working capital of \$47.0 million including cash and cash equivalents of \$15.1 million. The following table sets forth a summary of our cash flows for the period indicated:

**Statement of Cash Flow**

	Three Months Ended March 31,	
	2008	2007
Net cash provided by (used in) operating activities	\$ (1,799,124)	\$ (280,568)
Net cash (used in) investing activities	(18,693)	(226,350)
Net cash provided by financing activities	(348,582)	902,781
Effect of foreign currency translation on cash and cash equivalents	167,872	99,403
Net cash flow	\$ (1,998,527)	\$ 495,266

***Operating Activities***

Net cash used by operating activities was approximately \$1.8 million for the three months ended March 31, 2008 as compared to approximately \$0.3 million net cash used by operating activities for the same period in 2007. Net cash used by operating activities in the three months ended March 31, 2008 was mainly due to the result of a \$6.7 million increase in costs and estimated earnings in excess of billings and a \$3.5 million decrease in billings in excess of costs and estimated earnings offset by the net income of \$4.7 million, a \$0.8 million decrease in employee advances, a \$2.0 million increase in customer deposits and a \$1.1 million increase in accrued liabilities.

The increase of \$6.7 million in costs and estimated earnings in excess of billings was mainly due to the increased number of projects where we have billed the customers more than we have recognized revenues for these projects, while the decrease of \$3.5 million in billings in excess of costs and estimated earnings was mainly due to the decreased number of projects where we have billed the customers less than we have recognized revenues for these projects. The Company's management intends to reinforce its efforts in the collection of account receivables in the following quarters of 2008.

***Investing Activities***

Net cash used in investing activities in the three months ended March 31, 2008 was \$18,693 as compared to net cash used in investing activities of \$226,350 in the same period of 2007 for the purchase of building and equipment.

***Financing Activities***

Net cash used by financing activities in the three months ended March 31, 2008 totaled \$348,582 as compared to \$902,781 provided in financing activities in the same period of 2007.

As a result of the total cash activities, net cash decreased \$2.0 million from December 31, 2007 to March 31, 2008. We believe that our currently available working capital of \$47.0 million including cash and cash equivalents of \$15.1 million should be adequate to sustain our operations at our current level.

**Off-Balance Sheet Arrangements**

We do not have any off-balance sheet financing arrangements.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

Not required.

**Item 4. Controls and Procedures**

As required by Rule 13a-15 under the Securities Exchange Act, our management has carried out an evaluation, with the participation of an external internal control consultant and under the supervision of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of March 31, 2008. Disclosure controls and procedures refer to controls and other procedures designed to ensure that information required to be disclosed in the reports we file or submit under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating and implementing possible controls and procedures.

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Management conducted its evaluation of disclosure controls and procedures under the supervision of our Chief Executive Officer and our Chief Financial Officer. Based on that evaluation, management concluded that as of March 31, 2008, and as of the date that the evaluation of the effectiveness of our disclosure controls and procedures was completed, our disclosure controls and procedures were ineffective subject to the following:

1 Inadequate US GAAP expertise - The current staff in the accounting department is relatively inexperienced, and needs substantial training so as to meet with the higher demands of being a U.S. public company. The accounting skills and understanding necessary to fulfill the requirements of US GAAP-based reporting, including the skills of subsidiary financial statements consolidation, are inadequate.

***Remediation Initiative***

We have recently expanded our internal accounting staff and intend to continue this effort in the future. In particular, we are seeking accountants experienced in several key areas of accounting, including persons with experience in Chinese and U.S. GAAP, U.S. GAAP consolidation requirements, and SEC financial reporting requirements. In addition, we plan to allocate additional resources to train our existing accounting staff.

The Management assessed the effectiveness of our internal control over financial reporting as of March 31, 2008. In making this assessment, management used the framework set forth in the report entitled Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission, or COSO. The COSO framework summarizes each of the components of a company's internal control system, including (i) the control environment, (ii) risk assessment, (iii) control activities, (iv) information and communication and (v) monitoring. Based on that evaluation, management concluded that as of March 31, 2008, and as of the date that the evaluation of the effectiveness of our disclosure controls and procedures was completed, our disclosure controls and procedures were satisfactory subject to the following:

1 Lack of internal audit function – the Company is lacking qualified resources to perform the internal audit functions properly.

***Remediation Initiative***

We have committed to set up the internal audit functions but due to limited qualified resources in the region, we were not able to hire sufficient internal audit resources before end of March 31, 2008. With an internal audit manager on board now, we will increase our efforts in hiring the qualified resources through the assistance from recruitment agents and referral from employees. We also plan to enhance the training of our internal audit team in order to increase the effectiveness of its internal audit function.

Despite the deficiencies reported above, the Company's management believes that the consolidated financial statements included in this report fairly present in all material respects the Company's financial condition, results of operations and cash flows for the periods presented and that this report does not contain any untrue statement of a material fact or omit a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report.

***Changes in Internal Controls over Financial Reporting***

Other than the remediation measures described above, during the period ended March 31, 2008, there was no change in our internal controls over financial reporting that has materially affected, or that is reasonably likely to materially affect our internal control over financial reporting.

**PART II - OTHER INFORMATION**

**Item 1. Legal Proceedings**

None

**Item 1A. Risk Factors**

Not required.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

On March 12, 2008, the Company announced the authorization of a stock repurchase program (the "repurchase program"). Under the repurchase program, the Company may repurchase up to 5 million shares of its outstanding common stock on the open market or in negotiated transactions. The Company did not make any repurchases under the repurchase program in the first quarter of 2008.

**Item 3. Defaults Upon Senior Securities**

None

**Item 4. Submission of Matters to a Vote of Security Holders**

None

**Item 5. Other Information**

None

**Item 6. Exhibits**

The following exhibits are hereby filed as part of this Quarterly Report on Form 10-Q.

Exhibit Number:	Description
31.1	Certification of Chief Executive Officer under Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Principal Accounting Officer under Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certifications Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350
33.2	Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350



## **SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant certifies that it has duly caused this Quarterly Report on Form 10-Q to be signed on its behalf by the undersigned, thereunto duly authorized, in Beijing, on May 15, 2008.

### **CHINA FIRE & SECURITY GROUP, INC.**

By:	/s/ Brian Lin
	Brian Lin
	Chief Executive Officer, Principal
	Accounting
	Officer

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