PACIFICNET INC
Form 10-K/A
November 14, 2007

U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K/A
(Amendment No. 1)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM _________ TO __________

COMMISSION FILE NUMBER: 000-24985
PACIFICNET INC.
(Exact name of registrant in its charter)

DELAWARE	**91-2118007**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
23/F, TOWER A, TIMECOURT, NO.6 SHUGUANG XILI, CHAOYANG DISTRICT, BEIJING, CHINA 100028	N/A
(Address of principal executive offices)	(Zip Code)

Registrant's Telephone Number: 0086-10-59225000

601 New Bright Building, 11 Sheung Yuet Road, Kowloon Bay, Kowloon, Hong Kong.
(Former Name and Address)

Securities Registered under Section 12(b) of the Exchange Act: NONE

Securities Registered under Section 12(g) of the Exchange Act: Common Stock, par value $0.0001

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act YES o NO x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act YES o NO x

Indicate by check mark whether the registrant (1) 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 x NO o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K contained herein, and will not be contained, to the best of the registrant's knowledge in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark if the registrant is a large accelerated filer, an accelerated filer or a non- accelerated filer.

Large Accelerated Filer o   Accelerated Filer o   Non- Accelerated Filer x

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

The aggregate market value of the common stock held by non-affiliates of the registrant as of March 31, 2007 was approximately $44,400,866 based upon the closing sale price of $5.34 per share as reported by The NASDAQ Global Market on such date. There were 11,733,929 shares of the Company's common stock outstanding on March 31, 2007.

DOCUMENTS INCORPORATED BY REFERENCE - NONE

Explanatory Note:

This Annual Report on Form 10K/A ("Form 10K/A") is being filed as Amendment No. 1 to our Annual Report on Form 10K for the year ended December 31, 2006, which was originally filed with the Securities and Exchange Commission (the "SEC") on May 11, 2007. We are amending and restating the following items in this amendment:

(i) Part II. ITEM 7. Management discussion and analysis of financial condition and result of operations
(ii) Part II. Item 8. Financial Statements and supplementary data
(iii) Part III. Item 10. Directors, Executive Officers, Promoters and Control Persons: Compliance with Section 16(a) of the Exchange Act to update director information for our newly elected director who will be signing the Annual Report on Form 10-K/A
(iv) Part III. Item 14. Principal Accountant Fees and Services, to reflect the fees of our new auditor in connection with the re-statement of the fiscal year ended December 31, 2006.
(v) Part IV. Item 15. Exhibits and Financial Statements

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This annual report contains forward-looking statements within the meaning of the federal securities laws. These include statements about our expectations, beliefs, intentions or strategies for the future, which we indicate by words or phrases such as "anticipate," "expect," "intend," "plan," "will," "we believe," "the Company believes," "management believes" and similar language. The forward-looking statements are based on our current expectations and are subject to certain risks, uncertainties and assumptions, including those set forth in the discussion under "Description of Business," including the "Risk Factors" described in that section, and "Management's Discussion and Analysis or Plan of Operation." Our actual results may differ materially from results anticipated in these forward-looking statements. We base our forward-looking statements on information currently available to us, and we assume no obligation to update them.

PART II

ITEM 7. MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESTATEMENT

On March 19, 2007 the Company's predecessor auditor, Clancy and Co. P.L.L.C., withdrew its opinion on our previously filed financial statements for the years ended December 31, 2005 and 2004 due to uncertainties around certain option grants during the said period. Despite independent investigation in this connection commissioned by our Audit Committee resulting in extra stock-based compensation charges of approximately $0.3 million, $1.2 million and $0.1 million to each of the years ended December 31, 2005, 2004 and 2003, respectively, the predecessor auditor did not re-instate its opinion.

The Company engaged the incumbent auditors to conduct a re-audit of the financial statements for the years ended December 31, 2005 and 2004. Upon completion of the re-audit, the Company has restated the opening balances of the financial statements for the year ended December 31, 2006 as previously filed on May 11, 2007 with the ending balances of the audited financial statements for the years ended December 31, 2005 and 2004 as reported in the form 10-KSB/A that was filed with the SEC on October 25, 2007.

In the course of the financial statements restatement for the year ended December 31, 2006, management has decreased total non-current assets by $1 million worth of goodwill as a result of the re-audit restatement to the ending goodwill balances as at December 31, 2005. Further, management has also decreased total selling, general and administrative expenses by an aggregate of $5.3 million. Said decrease mainly comprises of extra goodwill impairment amounting to approximately $3.7 million and $2.6 million, respectively, already charged to the restated Selling, General and Administrative expenses for the years ended December 31, 2005 and 2004.

Further details of the effects of the restatement are found below in Note 18 - Restatement to the audited financial statements contained in this form 10K.

RESULTS OF OPERATIONS

REVENUES

Revenues for the year ended December 31, 2006 were $42,738,000, which represents a year-over-year increase of 147% as compared to $17,307,000 for the same periods of prior year.

The increase in revenues was mainly due to the growth in Products (Telecom & Gaming) and Other Business Groups, which posted a year-over-year increase of 712% and 325% respectively. In aggregate, the newly acquired subsidiaries during 2006 contributed to 18% of the total revenues. Revenues for the fourth quarter of the year were $9,573,000, an increase of 989% as compared to $4,812,000 for the fourth quarter of 2005; or a decrease of 11.2% as compared to $10,785,000 for the third quarter of the year. Segmented financial information of the four business operating groups is set out below followed by a brief discussion of each business group.

YEAR ENDED DECEMBER 31, 2006 COMPARED TO YEAR ENDED DECEMBER 31, 2005

For the year ended December 31, 2006 (in thousands of US Dollars, except percentages)	Group 1. Outsourcing Services ($) Restated	Group 2. Telecom Value-Added Services ($) Restated	Group 3. Products (Telecom & Gaming) ($) Restated	Group 4. Other Business ($) Restated	Total ($) Restated
Revenues	14,146	1,555	23,385	3,652	42,738
(% of Total Revenues)	33%	4%	55%	8%	100%
Earnings / (Loss) from Operations	677	(44)	(1,054)	(5,889)	(6,310)

For the year ended December 31, 2005 (in thousands of US Dollars, except percentages)	Group 1. Outsourcing Services ($) Restated	Group 2. Telecom Value-Added Services ($) Restated	Group 3. Products (Telecom & Gaming) ($) Restated	Group 4. Other Business ($) Restated	Total ($) Restated
Revenues	13,568		2,880	859	17,307
(% of Total Revenues)	78%		17%	5%	100%
Earnings / (Loss) from Operations	686		(106)	(6,188)	(5,608)

(1) OUTSOURCING SERVICES

Revenues for the year ended December 31, 2006 were $14,146,000, a year-over-year decrease of 4% as compared to $13,568,000 for the year ended December 31, 2005. Outsourcing services revenues made up 33% of the Company's total revenues for the FY 2006 which was primarily due to 13% growth in the call center related revenues as compared to the same period in 2005. Revenues from outsourcing services for the fourth quarter of the year were $3,833,000, an increase of 5% as compared to $3,645,000 for the fourth quarter of 2005; or an increase of 3% as compared to $3,733,000 for the third quarter of 2006.

During 2006, the outsourcing contract center in Hong Kong was close to full utilization. Pricing was highly competitive but demand for outbound calling lists, in-sourcing operators and sub-contract call center facilities management, for American Express and MetLife, remained strong. New contracts won during the year included customer service operation management training for NanJing Airlines, web-based quality management services and supplier quality management services for McDonalds Corporation, and CRM consulting and call center training services for China Telecom's Xinjiang Branch and China Unicom's Shanghai Branch. Under the project service agreement, the Company will enhance the CRM service level and telemarketing management capability of China Unicom's customer service center called the "10010 Information Hotline."

(2) TELECOM VALUE-ADDED SERVICES (VAS)

Revenues for the year ended December 31, 2006 were $1,555,000 as compared to $0 for the year ended December 31, 2005 as a result of reclassifications induced by Note 16. Our acquisitions in 2006 contributed to the increase in revenues and made the company a major mobile internet contents provider in China. Revenues from VAS for the fourth quarter of the year were $1,448,000, a sequential increase of 4,520% from $40,000 for the third quarter of 2006. VAS revenues made up 13.9% of the Company's total revenues for the fourth quarter of the year.

(3) PRODUCTS (TELECOM & GAMING)

Revenues for the year ended December 31, 2006 were $23,385,000, a significant year-over-year increase of 712% from $2,880,000 for the year ended December 31, 2005. Revenues from the products group for the fourth quarter of the year were $5,124,000, an increase of 735.9% as compared to $613,000 for the fourth quarter of 2005; or a decrease of 20% as compared to $6,411,000 for the third quarter of 2006. The Product revenues made up 55% of the Company's total revenues for the FY 2006.

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During the year, substantially all of the products group revenue derived from the Company's mobile phone distribution business in Greater China. The Company owned one of the largest on-line mobile phone distribution portal in China and was one of the top five largest mobile phone wholesalers in Hong Kong. New agreements had been entered into with Motorola to become its designated channel partner and after-sale service provider for Motorola mobile products and accessories in China. Economies of scale continued to drive year-over-year revenue increase of the products group.

Also included in the products group was the Company's high potential gaming technology business. In spite of rather insignificant revenue contribution in 2006, the acquisition of Able Entertainment in Macau, along with its exceptionally talented R&D team in Zhuhai, by PacificNet Games Limited (PacGames) during the year had given the Company major first movers advantage into the fast growing Asian gaming technology provider market. With PacGames' world class multi-player electronic table game machines customized to the taste of Asian gaming customers, the Company has managed to build up excellent relationships with leading casino operators in Macau and the rest of Asia in no time.

(4) OTHER BUSINESS

Revenues for other business for the year ended December 31, 2006 was $3,652,000, an increase of 325% as compared to $859,000 for the year ended December 31, 2005. Incremental revenues were largely derived from new air conditioning installation contracts won by the Company's subcontracting business in Hong Kong.

COST OF REVENUES AND GROSS MARGIN

Cost of revenues for the year ended December 31, 2006 was $36,217,000, which represents a year-over-year increase of 174% as compared to $13,221,000 for the year ended December 31, 2005.

The increase in the cost of revenues was directly associated with the corresponding increase in revenues. Cost of revenues, as a percentage of revenues, was 85% for the year ended December 31, 2006 as compared with 76% for the year ended December 31, 2005. The improvement in cost of revenues was attributable to the Company's constant pursuit of higher margin businesses. The cost of revenues in services and product sales for the year ended December 31, 2006 increased by 34% and 66% respectively as compared to 79% and 21% for the same periods of prior year.

Gross profit for the year ended December 31, 2006 was $6,521,000, which represents a year-over-year increase of 60% as compared to $4,086,000 for the same periods of prior year, resulting from our newly acquired subsidiaries in 2006 and call centre business. Gross profit for the fourth quarter of the year was $1,899,000, a year-over-year increase of 10% from $1,724,000 for the same period in 2005; or a sequential increase of 72% for the third quarter of 2006. Gross margin was 15% for the year ended December 31, 2006, compared to 24% for the year ended December 31, 2005.

Going forward, decline of gross margin is expected to continue as a result of the new strategic initiative of moving away from the highly competitive legacy telecom business into the new niche gaming technology business. Assistance will be sought from financial advisors and bankers to help dispose of the legacy businesses units, including but not limited to disposition, spin-offs, mergers and sale back to founders.

(1) OUTSOURCING SERVICES

In 2006, year-over-year cost of revenues for outsourcing services increased by 5% to $10,908,000 (2005: $10,366,000). Gross profit was 1% lower at $3,238,000 (2005: $3,202,000). Gross margin for outsourcing services was 23% for the year ended December 31, 2006, as compared to 24% for the year ended December 31, 2005. Gross profit for outsourcing services accounted for 50% of the total gross profit for the year ended December 31, 2006, as compared to 79% for the same period in 2005. Gross profit of $950,000 for the fourth quarter represented a year-over-year reduction of 11% to the same period in 2005; but a sequential increase of 30% as compared to $732,000 for the third quarter of 2006 due to the increasing demand for outsourcing contact center services, especially from the industries of telecom, banking, market research and fast-moving consumer goods, among others. Year-over-year gross profit erosion was primarily due to a combination of aggressive pricing and higher cost of labor in the highly competitive Hong Kong market. Extra call center space and depreciation of newly acquired fixed assets for operations purposes also contributed to a higher cost of revenues. Gross margin for this segment mainly depends on the facilities management services.

(2) TELECOM VALUE-ADDED SERVICES (VAS)

Cost of revenues and gross profit for VAS were $1,138,000 and $416,000 for the year ended December 31, 2006 respectively, as compared to $0and $0 for the year ended December 31. For the fourth quarter of 2006, VAS gross profit was $118,000 as compared to $0 for the same period in 2005; or a sequential increase of 372% as compared to $87,000 for the third quarter of 2006. The increase in year-over-year gross profit is due to a major VAS acquisition in 2006.

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(3) PRODUCTS (TELECOM & GAMING)

Increase of 755% in year-over-year cost of revenues for products (telecom & gaming) to $22,002,000 (2005: $2,572,000) was commensurate with its 61% year-over-year revenue growth. Gross profit was 349% higher at $1,384,000 (2005: $307,000) in absolute terms. Gross margin of mobile phone distribution business in China and Hong Kong largely remained steady on a year-over-year basis. Gross profit for products (telecom & gaming) accounted 21% and 8% of the total gross profit both for the year ended December 31, 2006 and 2005 respectively. Gross profit of $583,000 for the fourth quarter represented a year-over-year increase of 122% as compared to the same period in 2005; or a sequential increase of 163% as compared to $222,000 for the third quarter of 2006

Slight year-over-year gross margin improvement from 24% (2005) to 15% (2006) can be attributed to the newly acquired gaming technology business. Gross margin contribution of the gaming technology provider business was not apparent in 2006 due to its startup nature and had relative insignificant revenue throughout the year.

(4) OTHER BUSINESS

A year-over-year increase of 666% in cost of revenues to $2,169,000 for the year ended December 31, 2006 (2005: $283,000) for Other Business is largely driven by subcontracting revenue growth. 95% of cost of revenues in 2006 was attributable to the new installation contracts won by the Company, gross margins of which remained almost steady at 24% from year to year.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, General and Administrative expenses ("SG&A") totaled $11,126,000 for the year ended December 31, 2006, which represents a year-over-year increase of 104% as compared to $5,447,000 for the year ended December 31, 2005. The increase in selling, general and administrative expenses reflected the expansion of our operations of which expenses were incurred by our newly acquired subsidiaries and the expansion of the call centre business. In addition to making several key acquisitions in 2006, we laid the foundation for a strong future, by hiring additional personnel in key areas to support our accounting and back-office functions, as well as implemented the systems to allow the Company to better measure the performance of each of its units.

On the other hand, due to the reclassifying of certain former subsidiaries that the Company disposed of during 2006, extra provisions for doubtful accounts of approximately $6,173,000 was include in SG&A., which accounted for 55% of the total SG&A(Restated).

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES (in thousands, except percentages)	Total for the year ended December 31, 2006 ($) Restated	Total for the year ended December 31, 2005 ($) Restated	Percentage change (%) Restated
Remuneration and related expenses	3,083	1,664	85
Office (majority is rental and utilities)	1,047	758	38

Travel	291	225	29
Entertainment	151	78	94
Professional (legal and consultant)	446	327	36
Audit	174	138	26
Selling	243	147	65
BAD DEBTS	6,173	1,178	424
Other	(482)	931	(152)
Total	11,126	5,447	104

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(1) OUTSOURCING SERVICES

Selling, General and Administrative expenses for outsourcing services were $2,495,000 for the year ended December 31, 2006, an increase of 10% from $2,262,000 for the year ended December 31, 2005. Due to the increase in the demand for telemarketing and call center services, the Company purchased a call center facility in China, to support the rapidly growing business of the company. However, in order to meet clients' diversified needs, a wide array of supporting services are provided, including professional inbound services, outbound services, facilities management and insourcing services. The expansion of call centre services also leaded to the increase number of headcounts.

	Group 1. Outsourcing Services		
	Total for the year ended December 31, 2006	Total for the year ended December 31, 2005	Percentage change
(in thousands, except percentages)	($)	($)	(%)
	Restated	Restated	Restated
Remuneration and related expenses	1,207	785	54
Office (majority is rental and utilities)	535	566	(5)
Travel	33	56	(42)
Entertainment	39	38	4
Professional (legal and consultant)	62	47	33
Audit	21	18	15
Selling	33	5	512
BAD DEBTS	402	628	(36)
Other	163	118	38
Total	2495	2,262	10

(2) TELECOM VALUE-ADDED SERVICES (VAS)

Selling, General and Administrative expenses for VAS were $326,000 for the year ended December 31, 2006 as compared to $0 in 2005. The increase of SG&A expense resulted from acquisitions during the year.

	Group 2. Telecom Value-Added Services		
	Total for the year	Total for the year	Percentage change

(in thousands, except percentages)	ended December 31, 2006 ($) Restated	ended December 31, 2005 ($) Restated	(%) Restated
Remuneration and related expenses	189	-	n/a
Office (majority is rental and utilities)	64	-	n/a
Travel	36	-	n/a
Entertainment	20	-	n/a
Professional (legal and consultant)	0	-	n/a
Audit	0	-	n/a
Selling	5	-	n/a
BAD DEBTS	1	-	n/a
Other	11	-	n/a
Total	326	-	n/a

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(3) PRODUCTS (TELECOM & GAMING)

Selling, General and Administrative expenses for products (telecom & gaming) were $2,370,000 for the year ended December 31, 2006, a significant increase of 474% as compared to $413,000 for the year ended December 31, 2005. Increase is primarily due to new acquisitions during the year.

	Group 3. Products (Telecom & Gaming)		
	Total for the year ended December 31, 2006	Total for the year ended December 31, 2005	Percentage change
(in thousands, except percentages)	($)	($)	(%)
	Restated	Restated	Restated
Remuneration and related expenses	315	-	n/a
Office (majority is rental and utilities)	158	-	n/a
Travel	47	-	n/a
Entertainment	40	-	n/a
Professional (legal and consultant)	19	10	99
Audit	0	-	n/a
Selling	95	-	n/a
BAD DEBTS	1,627	377	332
Other	69	27	155
Total	2,370	413	473

(4) OTHER BUSINESS

Selling, General and Administrative expenses were $5,935,000 for the year ended December 31, 2006, an increase of 114% as compared to $2,772,000 in 2005. Year-over-year corporate level remuneration related expenses increased from approximately $246,000 to $535,000 as a result of strengthening of internal controls.

	Group 4. Other Business		
	Total for the year ended December 31, 2006	Total for the year ended December 31, 2005	Percentage change
	($)	($)	(%)

(in thousands, except percentages)			
	Restated	Restated	Restated
Remuneration and related expenses	1,372	879	56
Office (majority is rental and utilities)	290	193	51
Travel	175	169	4
Entertainment	51	40	28
Professional (legal and consultant)	365	271	35
Audit	153	120	27
Selling	110	142	(22)
BAD DEBTS	4,143	173	2,289
Other	(724)	787	(192)
Total	5935	2772	114

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DEPRECIATION AND AMORTIZATION EXPENSES

Depreciation and amortization expenses were $1,463,000 for the year ended December 31, 2006, representing a year-over-year increase of 430% as compared $276,000 for the same periods of prior year.

Depreciation	For the year ended December 31, 2006	For the year ended December 31, 2005	Percentage change
(in thousands of US Dollars, except percentages)	($) Restated	($) Restated	(%) Restated
Group 1. Outsourcing Services	67	16	319
Group 2. Telecom Value-Added Services	134	14	857
Group 3. Products (Telecom & Gaming)	38		
Group 4. Other Business	89		
Total	328	30	993

Amortization	For the year ended December 31, 2006	For the year ended December 31, 2005	Percentage change
(in thousands of US Dollars, except percentages)	($) Restated	($) Restated	(%) Restated
Group 1. Outsourcing Services		210	(100)
Group 2. Telecom Value-Added Services		36	(100)
Group 3. Products (Telecom & Gaming)	29		
Group 4. Other Business	1,106		
Total	1,135	246	361

OPERATING LOSS

Disposing or spin-off of the legacy telecom and VAS business units has been an integral part of the Company's efforts to become a leading Asian gaming technology provider. Management, thus, found making conservative provisions for certain long outstanding receivables with those legacy business units was necessary under the circumstances. As a result, an aggregate of $8 million of allowance for doubtful debts was charged at the year end, in which approximately $6 million was related to long outstanding trade receivables, $1 million related to mostly long outstanding other receivables extended to set up domestic enterprises in China, and the rest $1 million related to subsidiary loans for business development purposes.

Excluding all non-cash and nonrecurring items as set out below, non-GAAP net loss of $1,619,000, as compared to net income of $2,489,000 of the same period last year. Decrease is primarily due to adverse regulatory changes and highly competitive market environments as previously discussed.

(in thousands of US Dollars)	Group 1. Outsourcing Services ($) Restated	Group 2. Telecom Value-Added Services ($) Restated	Group 3. Products (Telecom & Gaming) ($) Restated	Group 4. Other Business and Corporate ($) Restated	Total for the year ended December 31, 2006 ($) Restated	Total for the year ended December 31, 2005 ($) Restated
Operating profits before non-cash accounting provisions	1,079	(43)	573	(1,504)	105	1,788
Allowance for doubtful accounts (1)	(402)	(1)	(1,627)	(4,143)	(6,173)	(3,425)
Goodwill impairment (2)						(3,689)
Stock-based compensation expenses (3)				(242)	(242)	(282)
Operating profits	677	(44)	(1,054)	(5,889)	(6,310)	(5,608)

1. The Company's policy is to provide 50% and 100% provisions for trade and other receivables over 180 days and 360 days respectively under allowance for doubt accounts. As a result, over $1 million in provisions were made for the aging trade receivable in each of the Company's legacy mobile phone distribution business unit and subcontracting business unit in Hong Kong, and $0.5 million for the outstanding trade receivable of the Company's data center business unit. The Company also has a policy to review all other receivables on an individual basis in addition to the aforementioned provision by aging policy. As a result, approximately $2.3 million worth of provisions were provided for potential loss of long outstanding accounts arising either as a result of setting up domestic businesses under private name for operations on behalf of the Company's subsidiaries in China or specific accounts that are in dispute. Such accounts were considered doubtful should the Company dispose of those legacy business units in the near future as prescribed by its well-publicized business transformation strategy.

2. Stock-based compensation expenses of $242,473 are due to adoption of SFAS123R during the year.

INTEREST INCOME / (EXPENSES), NET

Interest income/(expense), net In thousands of US Dollars, except percentages	For the year ended December 31, 2006 ($) Restated	For the year ended December 31, 2005 ($) Restated	Percentage change (%) Restated
Interest income	162	223	(27)
Interest expense	(1,354)	(123)	507
Interest income/(expense), net	(1,192)	100	106

Interest income was $162,000 for the year ended December 31, 2006, a decrease of 27% as compared to $223,000for the year ended December 31, 2005, of which 86% ($139,000) was generated from lending and fixed-rate bank deposits. Interest expenses were $1,354,000 for the year ended December 31, 2006, an increase of 1001% as compared to $123,000 for the year ended December 31, 2005. Most of the interest expenses were attributed to bank loans and bank overdraft during the year.

Interest Income (in thousands, except percentages)	For the year ended December 31, 2006 ($) Restated	For the year ended December 31, 2005 ($) Restated	Percentage change (%) Restated
Group 1. Outsourcing Services		5	(100)
Group 2. Telecom Value-Added Services			
Group 3. Products (Telecom & Gaming)	140	152	(8)
Group 4. Other Business	22	66	(67)
Total	162	223	(27)

Interest Expense (in thousands, except percentages)	For the year ended December 31, 2006 ($) Restated	For the year ended December 31, 2005 ($) Restated	Percentage change (%) Restated
Group 1. Outsourcing Services	309	105	194
Group 2. Telecom Value-Added Services	1	(1)	(200)
Group 3. Products (Telecom & Gaming)	56	6	833
Group 4. Other Business	988	13	7,500
Total	1,354	123	1,001

SUNDRY INCOME/EXPENSE

Sundry income known as non-operating income is defined as the external income (miscellaneous income) that results from factors outside of our operating subsidiaries' control and such income does not related to each subsidiaries' core operating business. Income from the sale of various investments is one of the typical examples. (See Note 11 for details)

For the year ended December 31, 2005, the non-operating income or sundry income was $289,000 included in Statement of Operations was mainly derived from the investment income of $260,000, Leasehold income $6,000, Software service income $(11,000) and various others totaling $34,000.

For the year ended December 31, 2006, the non-operating income or sundry income was $105,000 mainly derived from leasehold income of $76,000 and various others totaling $29,000.

Sundry Income (Net) **(in thousands, except percentages)**	For the year ended December 31, 2006 ($) Restated	For the year ended December 31, 2005 ($) Restated	Percentage change (%) Restated
Group 1. Outsourcing Services		57	(100)
Group 2. Telecom Value-Added Services			
Group 3. Products (Telecom & Gaming)		20	(100)
Group 4. Other Business	105	212	(50)
Total	105	289	(64)

SHARE OF PROFIT OF ASSOCIATED COMPANIES

We recorded the total gain of $17,000 for the year ended 2006 with respect to $(295,000) for 20% ownership interest in Take1 Technology (Cheer Era Limited), acquired in April 2004, $(19,000) for MOABC, the new acquired subsidiary in October 2006, with 20% ownership interest, and $331,000 for PacGames, acquired 45% ownership interest in September 2006 (we now owned 51% interest of PacGames).

INCOME TAXES

The income taxes expenses for the Company's subsidiaries were $63,000 for the year ended December 31, 2006. The provision of income taxes depends on the tax rate and tax exemption. Pursuant to the PRC Income Tax Laws, the Company's subsidiaries and VIEs are generally subject to Enterprise Income Taxes ("EIT") at a statutory rate of 33%, which comprises 30% national income tax and 3% local income tax. Certain subsidiaries and VIEs are qualified for preferred high technology or software enterprise tax status, and they are subject to preferential tax rate of 15% under PRC Income Tax Rules. In addition, Guangzhou 3G-WOFE, as a new High Technology Foreign Investment Enterprises and under PRC Income Tax Laws, is entitled to a two-year tax exemption in 2005 and 2006.

Income Tax (in thousands, except percentages)	For the year ended December 31, 2006 ($)	For the year ended December 31, 2005 ($)	Percentage Change (%)
Group 1.Outsourcing Services		42	(100)
Group 2.Telecom Value-Added Services			
Group 3.Products (Telecom & Gaming)			
Group 4.Other Business	63	13	425
Total	63	55	15

MINORITY INTERESTS

Minority interests for the year ended December 31, 2006 was $153,000. Minority interests represented the interests of third parties in our subsidiaries' results.

NET LOSS

Net loss for the year ended December 31, 2006 was $12,805,000 as a result of a number of nonrecurring items. Segmented details are set out below:

Net Earnings (in thousands, except percentages)	Group 1. Outsourcing Services ($) Restated	Group 2. Telecom Value-Added Services ($) Restated	Group 3. Products (Telecom & Gaming) ($) Restated	Group 4. Other Business ($) Restated	Total for the year ended December 31, 2006 ($) Restated	Total for the year ended December 31, 2005 ($) Restated	Percentage Change (%) Restated
Operating profits	677	(44)	(1,054)	(5,889)	(6,310)	(5,608)	13
Interest income/(expenses), net	0	1	140	(1,333)	(1,192)	100	(1,292)
Loss in change in fair value of warrants	-	-	-	(214)	(214)	-	n/a
Maximum liquidated damage in connection with convertible debenture covenant breach	-	-	-	(3,817)	(3,817)	-	n/a
Sundry income	1	0	50	54	105	289	(64)
Earnings before Income Taxes, Minority Interest and Discontinued Operations	678	(43)	(864)	(11,199)	(11,428)	(5,219)	119

CONTRACTUAL OBLIGATIONS

CONTRACTUAL OBLIGATIONS

Cash resources required to satisfy short and long term contractual obligations as of December 31, 2006 are tabulated below:

Payments Due by Period

Contractual Obligations (in thousands)	Total	Less than 1 year	1-5 years	After 5 years
Line of credit	$ 855	$ 855	--	--
Bank Loans	$ 2,211	$ 576	$ 866	$ 769

Operating leases	$ 1,444	$ 680	$ 764	--
Capital leases	$ 244	$ 120	$ 124	--
Total cash contractual obligations	$ 4,754	$ 2,231	$ 1,754	$ 769

OFF-BALANCE SHEET ARRANGEMENTS

There were no off-balance sheet guarantees, interest rate swap transactions, foreign currency forward contracts or long term purchase commitments outstanding as of December 31, 2006. Further, the Company had not engaged in any non-exchange trading activities during 2006.

LIQUIDITY AND CAPITAL RESOURCES

OVERVIEW

Net cash and cash equivalents at December 31, 2006 were approximately $1.9 million, a decrease of approximately $1.6 million compared to December 31, 2005. This change resulted from cash used in operations of $(8.6) million, cash used in investing activities of $(2.9) million and cash provided by financing activities of $9.9million.

Significant components of cash flows from operations are as follows:

(Amounts in millions of US Dollars)		
Net loss	$	(12.81)
Non-cash and/or nonrecurring items		13.93
Other changes in assets and liabilities		(9.70)
Net cash used in operations	$	(8.58)

Other significant sources (uses) of cash during 2006 were $7.5 million proceeds from issuance of convertible debenture, bank loan advances of $0.9 million, $2.6 million used in purchases of office properties in China and equipment, $0.7 million used in acquisition of and advancing loans to subsidiaries, and $0.3 million used in corporate development including debt repayments and purchases of treasury stock.

WORKING CAPITAL

The Company's working capital decreased by 96% to negative $335,000 at December 31, 2006, as compared to $9,198,000 at December 31, 2005. The decrease in working capital primarily resulted from $1,586,000 decrease in cash and cash equivalent, and the increase of $8,000,000 in convertible debentures.

ISSUANCE OF COMMON STOCK

During the year ended December 31, 2006, the Company had the following equity transactions (i) 394,000 shares as a result of exercise of stock options with cash consideration of $237,000; (ii) 618,112 shares for acquisition of subsidiaries valued at $4,346,000; and (iii) 275,000 shares returned by ChinaGoHi valued at $1,672,000, due to a termination agreement signed with ChinaGoHi in November 2006 (as filed in an 8K dated November 28, 2006); (iv) repurchase of 24,200 shares from Yueshen with a market value of $124,223.

FUTURE LIQUIDITY NEEDS

As of December 31, 2006, we had approximately $1,900,000 in cash. We regularly review our cash funding requirements and attempt to meet those requirements through a combination of cash on hand; cash provided by operations, available borrowings under bank lines of credit and possible future public or private equity offerings. We evaluate possible acquisitions of, or investments in, businesses that are complementary to ours, which transactions may require the use of cash. We believe that our cash, other liquid assets, operating cash flows, credit arrangements, access to equity capital markets, taken together, provide adequate resources to fund ongoing operating expenditures. In the event that they do not, we may require additional funds in the future to support our working capital requirements or for other purposes and may seek to raise such additional funds through the sale of public or private equity as well as from other sources.

On February 06, 2007, our subsidiary, PacificNet Games Limited (PacGames) entered into a definitive agreement for a $5 million financing in the form of secured convertible debt with Pope Asset Management, LLC (Pope), an institutional investor. Proceeds from the financing will be used to provide PacGames with additional working capital in expanding its gaming technology operations, funding for strategic acquisitions in China and funding for general corporate purposes.

The $5 million convertible debt issued by PacGames to Pope, matures on February 6, 2010, and may be converted into 26% to 32% ownership interest in PacGames based on reaching certain net income milestones during fiscal year 2007 The interest rate on the convertible debt will initially be set at 8%, and shall increase to 15% if the note is not converted prior to maturity.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The consolidated financial statements and the report and notes, are attached hereto following the signature page beginning on Page F-1.

INDEX TO FINANCIAL STATEMENTS

ITEM 9A. CONTROLS AND PROCEDURES

We maintain controls and procedures designed to ensure that information required to be disclosed in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission. Certain internal audit tests performed at the fiscal year-end of 2006 revealed that there were weaknesses inherent in the Company's internal control system. Among which it was noted that there were insufficient checks and balances in place for controlling the company's non-routine transactions, namely: accuracy and completeness of stock option expense calculation. Such weaknesses in our controls eventually led to prior period option expense restatements being charged to the Company's financial statements for the years ended December 31, 2003, 2004, and 2005 respectively. As a result, our chief executive officer and our former chief financial officer concluded that there was a material weakness in our disclosure controls and procedures.

As of the end of the period covered by this report, the company had taken various steps to maintain the accuracy of our financial disclosures, and improve company internal control. An internal control SOX implementation team led by senior managers had been set up to uncover potential significant deficiencies inherent in the internal control systems of the company, including but not limited to risk identification, control procedure setup, staff training, segregation of incompatible job duties, design of management reporting system, definition and delegation of signing authority, establishment of documentation system and implementation of a company-wide SOX compliant ERP system. Based on the current schedule, the Company is expected to be substantially SOX compliant by the end of FY2007.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

COMPLIANCE WITH SECTION 16(A) OF THE EXCHANGE ACT

Set forth below are the names of the directors, executive officers and significant employees of the Company as of October 24, 2007:

Name	Age	Title

Tony Tong	38	Chairman and Chief Executive Officer
Victor Tong	36	President, Secretary, and Director
Daniel Lui	43	Chief Financial Officer
ShaoJian (Sean) Wang	41	Director
Michael Ha	36	Independent Director (2) (3)
Jeremy Goodwin	33	Independent Director (1) (3)
Tao Jin	38	Independent Director (1) (2) (3)
Mike Fei	38	Company Secretary and General Counsel
Ho-Man Poon	34	Independent Director

(1) Member of Audit Committee
(2) Member of Nominating Committee
(3) Member of Compensation Committee

Our executive officers are appointed at the discretion of our board of directors with no fixed term. There are no family relationships between or among any of our executive officers or our directors other than the relationship between Mr. Tony Tong and Mr. Victor Tong.

The following is a brief description of each board of director, key positions and brief biography:

MR. TONY TONG, age 38, is the Chairman, CEO, Executive Director, and co-founder of PacificNet since 1999. From 1995 to 1997, Mr. Tong served as the Chief Information Officer of DDS Inc., a leading SAP-ERP consulting company in the USA, which was later acquired by CIBER, Inc. (NYSE: CBR). From 1993 to 1994, Mr. Tong worked for Information Advantage, Inc. (NASDAQ:IACO), a leading business intelligence, Data-Mining and CRM technology provider serving Fortune 500 clients. IACO consummated an IPO on NASDAQ in 1997 and was later acquired by Sterling Software and Computer Associates (NYSE:CA). From 1992 to 1993, Mr. Tong worked as a Business Process Re-engineering Consultant at Andersen Consulting (now Accenture, NYSE:ACN). From 1990 to 1991, Mr. Tong worked for ADC Telecommunications (NASDAQ:ADCT), a global supplier of telecom equipment. Mr. Tong"s R&D achievements include being the inventor and patent holder of US Patent Number 6,012,066 (granted by US Patent and Trademark Office) titled "Computerized Work Flow System, an Internet-based workflow management system for automated web creation and process management." Mr. Tong also serves on the board of advisors of Fortune Telecom (listed on Hong Kong Stock Exchange: 0110.HK), a leading distributor of mobile phones, PDAs, telecom services, and accessories in China and Hong Kong. Mr. Tong is a frequent speaker on technology investment in China, and was invited to present at the Fourth APEC International Finance & Technology Summit in 2001. Mr. Tong is the Vice Chairman (PRC) of Hong Kong Call Centre Association, a Fellow of Hong Kong Institute of Directors, a consultant on privatization and securitization for China's State-owned Assets Supervision and Administration Commission (SASAC), and a frequent speaker for LexisNexis, a licensed Continued Professional Development (CPD) trainer, on China investment. Mr. Tong graduated with Bachelor of Mechanical/Industrial Engineering Degree from the University of Minnesota and served on the Computer Engineering Department Advisory Board and was an Adjunct Professor at the University of Minnesota, USA. Tony Tong is the brother of Victor Tong.

MR. VICTOR TONG, age 36, is the President, Secretary, and Director of PacificNet, and has served on our board as an Executive Director since 2002. Mr. Victor Tong gained his consulting, systems integration, and technical expertise through his experience at Andersen Consulting (now Accenture, NYSE:ACN), American Express Financial Advisors (IDS), 3M, and the Superconductivity Center at the University of Minnesota. In 1994, Victor co-founded Talent Information Management ("TIM"), a leading internet application development and consulting company in Minnesota. PacificNet.com was originally founded as an operating division of TIM. In 1997, Mr. Tong successfully sold GoWeb internet consulting division of TIM to Key Investment, a leading technology and media investment company owned by Vance Opperman, a billionaire in Minnesota who founded West Publishing. Mr. Tong became the President of KeyTech, a leading information technology consulting company based in Minnesota. In 1999, he was recognized in "City Business 40 Under 40" as one of the future business and community leaders in Minnesota. Mr. Tong won the Student Commencement Speaker Award and graduated with honors with a Bachelor of Science in Physics from the University of Minnesota. Mr. Tong was an adjunct professor at the College of Software of Beihang University, one of the top software colleges in China. Victor Tong is the brother of Tony Tong.

MR. DANIEL LUI, age 43, has served as Chief Financial Officer since March 1, 2007. Mr. Lui joined PacificNet with over 17 years of professional and commercial accounting experience, 7 years of which was in Mainland China. He carries the credentials of Chartered Accountant (Alberta, Canada) and CPA-inactive (Washington, USA). Mr. Lui was Vice President of Finance and Company Secretary of Fiberxon Inc., a leading communications subsystem maker, where he was in charge of Fiberxon's Finance, Company Secretarial, and Information Technology departments from 2002 to 2007. Prior to joining Fiberxon, Mr. Lui was Chief Financial Officer of China Motion NetCom Ltd., a wholly owned subsidiary of China Motion Telecom International Limited, a Hong Kong Exchange listed company, engaged in long distance call resale business from 2000 to 2001. Prior to that, Mr. Lui was Financial Advisory Services

Manager of PricewaterhouseCoopers and Auditor at KPMG. Mr. Lui received his Bachelors of Business Administration degree from the University of Hawaii at Manoa in 1987 and Masters of Business Administration from University of Alberta in Canada in 1994.

MR. SHAOJIAN (SEAN) WANG, age 41, has served on our board as a Director since 2002. From 2002 to May 2006, Mr. Wang also served as Chief Financial Officer of PacificNet. Mr. Wang is now President and Chief Operating Officer of Hurray! Holding Co., Ltd. (NASDAQ:HRAY), a NASDAQ-listed Chinese VAS company. Previously, Mr. Sean Wang was COO and acting Chief Financial Officer (CFO) at GoVideo and Opta Corporation, a public listed consumer Electronics Company in the US controlled by TCL, a leading consumer electronics maker in China. From 1987 to 2002, he served as a country manager at Ecolab, Inc. and as the managing director at Thian Bing Investments PTE, Ltd. From 1993 to 2002, Mr. Wang served as managing director of Thian Bing Investments PTE, Ltd. Where he managed the Singapore-based company's multi-million dollar investment operations and identified strategic and investment opportunities. Mr. Sean Wang attended Peking University and received a BS in Economics from Hamline University and an MBA from Carlson School of Management, University of Minnesota.

MR. MICHAEL CHUN HA, age 36, has served on our board as an Independent Director since December 24, 2003. Mr. Ha graduated from the Faculty of Law, University of Hong Kong in 1994 with a bachelor degree in law and was admitted as a solicitor of the High Court of the Hong Kong Special Administrative Region in 1997 and a solicitor of the Supreme Court of England and Wales in 1998. From 1995 to 2002, Mr. Ha worked as lawyer in a number of international and Hong Kong prestigious law firms, specializing in the areas of corporate finance, securities offerings, takeovers, cross-border mergers and acquisitions, venture capital, corporate restructuring, regulatory and compliance issues, project finance, and general commercial transactions and services in Hong Kong and the People's Republic of Hong Kong. In 2002, Mr. Ha commenced his own practice in the trade name of "Ha and Ho Solicitors" and the firm specializes in the areas of general commercial transactions, corporate finance and civil and criminal litigations. Mr. Ha is also the company secretary of, Shanxi Central Pharmaceutical International Company Limited, a Hong Kong main board listed company from year 2000 and a director of a private investment company, Metro Concord Investment Limited, from year 2002.

MR. JEREMY GOODWIN, age 33, has served on our board as an Independent Director since December 24, 2004. Jeremy Goodwin is founder of China Diligizer and Managing Partner of 3G Capital Partners. He began his career in 1995 at Mees Pierson Investment Finance S.A. in Geneva, Switzerland where he supported the fund's private placement/private equity finance team. Noteworthy transactions executed by the group included assistance on the placements of the $1.2 Billion Carlyle Partners II Limited Partnership. In 1997 he went to work for the then parent institution, ABN Amro, in Beijing, China. In 1999, Mr. Goodwin was employed with ING Barings in London as an International Associate. Mr. Goodwin received his BS from Cornell University in 1996 in conjunction with the Institute of Higher International Studies in Geneva, Switzerland. He later pursued his advanced degree with Princeton University with a concentration in Chinese affairs which he completed at the prestigious Nanjing Chinese Studies Center of the Johns Hopkins School of Advanced International Studies. Jeremy is fluent in written and spoken Mandarin Chinese, French and has working knowledge of Dutch.

MR. TAO JIN, age 38, has served on our board as an Independent Director since January 6, 2005. Mr. Jin is a resident partner at Jun He Law Offices (www.JunHe.com), a leading Chinese law firm specializing in commercial legal practice with over 160 lawyers and offices in Beijing, Shanghai, Shenzhen, Dalian, Haikou and New York. Founded in April 1989, Jun He was one of the first private law firms formed in China, and has been a pioneer in the re-established Chinese legal profession with a focus in representing foreign clients in business activities throughout China. Over the past few years, Jun He has been honored a number of times as one of the best law firms in China by the Ministry of Justice of China. With a team of more than 160 well-trained lawyers, Jun He is one of the largest and most established law firms in China. Prior to joining Jun He, Mr. Jin served as Vice President and Assistant General Counsel of J.P. Morgan Chase Bank, as the head legal counsel for capital markets transactions in Asia, and for JPMorgan's M&A transactions in China. Mr. Jin joined Jun He as a partner in 2005. From 1999 to 2002, Mr. Jin served as a Senior New York Qualified Lawyer for Sullivan & Cromwell, which represented China Unicom, PetroChina and China Telecom in their IPO's and dual listings in New York and Hong Kong. From 1996 to 1999, Mr. Jin served as Associate Lawyer for Cleary, Gottlieb Steen & Hamilton, which represented various Fortune 500 companies and investment banks in public and private securities offerings and M&A activities. Mr. Jin received his Juris Doctor in 1996 with high honors from Columbia University, and received B.S. in Psychology in 1990 from Beijing University.

MR. MIKE FEI, age 38, is the Company Secretary and General Counsel for PacificNet. Mr. Fei joined PacificNet in 2004 as in-house PRC Chief Legal Counsel for PacificNet's China Operations. Mr. Fei is a Member of the All-China Bar Association and holds a Master of Law degree from the University of New South Wales of Australia. Mr. Fei has 8 years of experience in the legal profession and dealt with more than 200 cases of litigation and arbitration which related to the issues of foreign investment, bankruptcy, merging, commercial contract and debt disputes.

MR. HO-MAN (MIKE) POON, is a nominee for independent director of PacificNet. Mr. Poon is a Chartered Financial Analyst (CFA). He is the first session graduate of the EMBA course of the Tsinghua University and holds a Bachelor degree from the University of Hong Kong. He has been registered as dealing director and investment advisor since 2002. He has over 11 years experience in the equity and capital markets of the Greater China Region, ranging from direct investment, fund management, securities brokerage and financial advisory. He is experienced in deal structuring, especially in relation to transactions of the listed companies in Hong Kong. Since 2002, he has served as the Chairman and the Chief Executive Officer of the Friedmann Pacific group of companies, which is a private financial groups covering investment, securities brokerage and financial services. He is a member of the Hong Kong Society of Financial Analyst and the member of the Hong Kong Institute of Directors.

CORPORATE GOVERNANCE

BOARD OF DIRECTORS

We have six members serving on our Board of Directors. Each board member is nominated for election at our annual meeting to serve until the next annual meeting of stockholders and until their successors are duly elected and qualified.

BOARD COMMITTEES

The Board of Directors has a Nominating Committee, Compensation Committee and an Audit Committee.

NOMINATING COMMITTEE

The purpose of the Nominating Committee is to assist the Board of Directors in identifying qualified individuals to become board members, in determining the composition of the Board of Directors and in monitoring the process to assess Board effectiveness. Michael Ha and Tao Jin are members of the Nominating Committee. There have been no changes to the procedures by which the stockholders of the Company may recommend nominees to the Board of Directors since the filing of the Company’s Definitive Proxy Statement on October 1, 2006, for its Annual Meeting of Stockholders, which was held on December 15, 2006. The Nominating Committee Charter is not available on the Company’s website. A copy of the Nominating Committee Charter was included in the proxy statement for the Annual Meeting held on December 30, 2005.

COMPENSATION COMMITTEE

Our Compensation Committee currently consists of Messrs. Jeremy Goodwin, Michael Chun Ha, Tao Jin, and Peter Wang, who are all independent directors. The Compensation Committee has a charter which states that it is the responsibility of the Compensation Committee to make recommendations to the Board of Directors with respect to all forms of compensation paid to our executive officers and to such other officers as directed by the Board and any other compensation matters as from time to time directed by the Board. The goal of the Compensation Committee's policies on executive compensation is to ensure that an appropriate relationship exists between executive compensation and the creation of stockholder value, while at the same time attracting, motivating and retaining executives.

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

Members of our Compensation Committee of the Board of Directors were Messrs. Goodwin, Ha, Tao and Wang. No member of our Compensation Committee was, or has been, an officer or employee of the Company or any of our subsidiaries. No member of the Compensation Committee has a relationship that would constitute an interlocking relationship with executive officers or directors of the Company or another entity.

AUDIT COMMITTEE OF THE BOARD OF DIRECTORS

The board of directors has established an audit committee in accordance with Section 3(a)(58)(A) of the Securities Exchange Act of 1934, as amended. The members of the Audit Committee are Messrs. Tao Jin (Chairman of Audit Committee), Jeremy Goodwin, and Peter Wang, each of whom are considered "independent" under the NASDAQ Stock Market listing standards currently in effect. The board of directors has determined that each of the members of the audit committee qualify as an "audit committee financial expert" under the Securities and Exchange Commission's definition.

The Audit Committee is responsible for nominating the Company's independent auditors and reviewing any matters that might impact the auditors' independence from the Company; reviewing plans for audits and related services; reviewing audit results and financial statements; reviewing with management the adequacy of the Company's system of internal accounting controls, including obtaining from independent auditors management letters or summaries on such internal accounting controls; determining the necessity and overseeing the effectiveness of the internal audit function; reviewing compliance with the U.S. Foreign Corrupt Practices Act and the Company's internal policy prohibiting insider trading in its Common Stock; reviewing compliance with the SEC requirements for financial reporting and disclosure of auditors' services and audit committee members and activities; reviewing related-party transactions for potential conflicts of interest; and reviewing with corporate management and internal and independent auditors the policies and procedures with respect to corporate officers' expense accounts and perquisites, including their use of corporate assets.

CODE OF ETHICS

On May 14, 2003, we adopted a code of ethics that applies to our Chief Executive Officer and Chief Financial Officer, and other persons who perform similar functions. A copy of our Code of Ethics was filed as an exhibit to our Annual Report on Form 10-KSB filed on April 2, 2004. Our Code of Ethics is intended to be a codification of the business and ethical principles which guide us, and to deter wrongdoing, to promote honest and ethical conduct, to avoid conflicts of interest, and to foster full, fair, accurate, timely and understandable disclosures, compliance with applicable governmental laws, rules and regulations, the prompt internal reporting of violations and accountability for adherence to this Code.

COMPLIANCE WITH SECTION 16(A) OF EXCHANGE ACT

Section 16(a) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), requires our executive officers, directors and persons who beneficially own more than 10% of a registered class of our equity securities to file with the Securities and Exchange Commission initial reports of ownership and reports of changes in ownership of our common stock and other equity securities. Such executive officers, directors, and greater than 10% beneficial owners are required by SEC regulation to furnish us with copies of all Section 16(a) forms filed by such reporting persons.

Based solely on our review of such forms furnished to us and written representations from certain reporting persons, we believe that the following executive officers and directors failed to timely file Form 4’s: Tony Tong failed to timely file Form 4’s, one Form 4 reporting the exercise of a stock option and three Form 4’s each reporting the grant of stock options; Victor Tong failed to timely file Form 4’s, one Form 4 reporting the exercise of a stock option and four Form 4’s each reporting the grant of stock options; Shaojian Wang failed to timely file Form 4’s, two Form 4’s each reporting the exercise of stock options and three Form 4’s each reporting the grant of stock options; Michael Chun Ha failed to timely file Form 4’s, one Form 4 reporting the exercise of an option and three Form 4’s each reporting the grant of stock options; Peter Wang failed to timely file three Form 4’s each reporting the grant of stock options; Jeremy Goodwin failed to timely file three Form 4’s each reporting the grant of stock options and Tao Jin failed to timely file three Form 4’s each reporting the grant of stock options.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

During fiscal years ended December 31, 2006 and 2005, our principal independent auditors were Kabani & Company, Inc. (“Kabani”), Clancy and Co., P.L.L.C. and its Hong Kong affiliate HLB Hodgson Impey Cheng (collectively, “Clancy”). Clancy resigned as our independent auditor on January 19, 2007. The following is a summary of the services provided and fees billed to us by Clancy during 2006 and 2005

AUDIT FEES

During 2006, the aggregate fees billed by Clancy for professional services rendered for the review of the financial statements included in the Company’s Registration Statement on Form S-1, including amendments thereto, the Company’s Quarterly Reports on Form 10-Q during the fiscal year ended December 31, 2006, and the Company’s Annual Report on Form 10-KSB for the fiscal year ended December 31, 2005, and amendments thereto, was $150,000.

An aggregate of $160,000 has been accrued for professional services rendered by Kabani for the audit of the financial statements for the year ended December 31, 2006. Further, an aggregate of $500,000 has been accrued in 2007 for professional services rendered by Kabani & Company, Inc for the restatement of the Company's financial statements for the fiscal year ended December 31, 2006.

AUDIT RELATED FEES

NONE.

TAX FEES

NONE.

ALL OTHER FEES

NONE.

PRE-APPROVAL OF SERVICES

The Audit Committee pre-approves all services, including both audit and non-audit services, provided by our independent accountants. For audit services, each year the independent auditor provides the Audit Committee with an engagement letter outlining the scope of the audit services proposed to be performed during the year, which must be formally accepted by the audit commences. The independent auditor also submits an audit services fee proposal, which also must be approved by the audit commences.

SIGNATURES

In accordance with the requirements of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

	PACIFICNET INC.
Date: November 13 , 2007	BY: /S/ TONY TONG Tony Tong Chief Executive Officer (Principal Executive Officer)
Date: November 13, 2007	BY: /S/ DANIEL LUI Daniel Lui Chief Financial Officer (Principal Financial Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Name	Title	Date
/s/ TONY TONG Tony Tong	Director, Chairman and CEO	November 13, 2007
/s/ VICTOR TONG Victor Tong	Director, President and	November 13, 2007
/s/ DANIEL LUI Daniel Lui	Chief Financial Officer	November 13, 2007
/s/ SHAO JIAN WANG Shao Jian Wang	Director	November 13, 2007
/s/ MICHAEL CHUN HA Michael Chun Ha	Director	November 13, 2007
/s/ TAO JIN Tao Jin	Director	November 13, 2007
/s/ JEREMY GOODWIN Jeremy Goodwin	Director	November 13, 2007

/s/ HO-MAN POON	Director	November 13, 2007
Ho-Man Poon		

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Pacific Net Inc.

We have audited the accompanying consolidated balance sheets of PacificNet Inc. (a Delaware Corporation) and Subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of operations, changes in stockholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards established by the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of PacificNet Inc. and Subsidiaries as of December 31, 2006 and 2005, and the results of their consolidated operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. During the year ended December 31, 2006, the Company incurred net losses of $12,415,000. In addition, the Company had a negative cash flow in operating activities amounting to negative $8,190,000 in the year ended December 31, 2006, and the Company's accumulated deficit was $51,090,000 as of December 31, 2006. In addition, the Company is in default on its convertible debenture obligation. These factors, among others, as discussed in Note 1 to the consolidated financial statements, raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 1. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

As discussed in Note 18, the financial statements for the years ended December 31, 2006 and 2005 have been restated.

/s/ KABANI & COMPANY, INC.

LOS ANGELES, CA
March 30, 2007, except for notes 1, 2, 4, 6, 9, 10, 11, 12, 13, 14, 16, & 18 are as of November 5, 2007

PACIFICNET INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS–RESTATED
AS AT DECEMBER 31, 2006 AND 2005
(In thousands of United States dollars, except par values and share numbers)

	As at December 31, 2006 Restated	2005 Restated
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 1,900	$ 3,486
Restricted cash - pledged bank deposit	234	163
Accounts receivables, net of allowances for doubtful accounts	8,141	3,841
Inventories	201	203
Loan receivable from related parties	1,706	2,328
Loan receivable from third parties	128	1,062
Marketable equity securities - available for sale	558	539
Other current assets	4,173	1,375
Total Current Assets	17,041	12,997
Property and equipment, net	4,711	958
Intangible assets, net	323	0
Investments in affiliated companies and subsidiaries	115	1,161
Goodwill	5,601	3,964
Net assets held for disposition	8,664	8,854
Other assets	471	-
TOTAL ASSETS	**$ 36,926**	**$ 27,934**
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Bank line of Credit	$ 855	$ 1,059
Bank loans-current portion	576	188
Capital lease obligations - current portion	120	126
Accounts payable	1,266	628
Accrued expenses and other payables	1,828	704
Customer deposits	352	335
Convertible debenture	8,000	-
Warrant liability	904	-
Liquidated damages liability	2,837	-
Loan payable to related party	638	759
Total Current Liabilities	17,376	3,799
Bank loans - noncurrent portion	1,635	6
Capital lease obligations - noncurrent portion	124	78
Convertible debenture - non current portion	945	-
Total long-term liabilities	2,704	84
Total liabilities	**20,080**	**3,883**

Minority interest		2,869		846
Commitments and contingencies		-		-
Stockholders' Equity:				
Preferred stock, par value $0.0001, Authorized 5,000,000 shares				
Issued and outstanding - none		-		-
Common stock, par value $0.0001, Authorized 125,000,000 shares				
Issued and outstanding:				
December 31, 2006 - 14,155,597 issued; 11,538,664 outstanding; December 31, 2005: 12,000,687 issued, 10,809,562 outstanding		1		1
Treasury stock, at cost (2006: 2,616,933 Shares, 2005: 1,191,125 shares)		(272)		(134)
Additional paid-in capital		65,757		61,979
Cumulative other comprehensive income		(42)		(15)
Accumulated deficit		(51,090)		(38,627)
Less: stock subscription receivable		(377)		-
Total Stockholders' Equity		13,977		23,204
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	**$**	**36,926**	**$**	**27,934**

The accompanying notes form an integral part of these consolidated financial statements

F-3

PACIFICNET INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS - RESTATED
FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004
(In thousands of United States dollars, except loss per share and share amounts)

	For the Years Ended December 31,		
	2006 Restated	2005 Restated	2004 Restated
Net Revenues			
Services	$ 16,790	$ 14,091	$ 10,008
Product sales	25,948	3,216	849
Total net revenue	42,738	17,307	10,857
Cost of Revenues			
Services	(12,155)	(10,380)	(7,046)
Product sales	(24,062)	(2,841)	(841)
Total cost of revenue	(36,217)	(13,221)	(7,887)
Gross Profit	6,521	4,086	2,970
Operating expenses:			
Selling, General and Administrative expenses	(11,126)	(5,447)	(5,244)
Stock-based compensation expenses	(242)	(282)	(1,246)
Depreciation and amortization	(1,463)	(276)	(94)
Impairment of goodwill	-	(3,689)	(2,628)
Impairment of investment	(1,233)	-	-
Total Operating expenses	(14,064)	(9,694)	(9,212)
Loss from operations	(7,533)	(5,608)	(6,242)
Other income (expenses):			
Interest income/(expense), net	(1,192)	100	(57)
Gain/(loss) in change in fair value of derivatives	(214)	-	-
Liquidated damages expense	(3,817)	-	-
Sundry income, net	105	289	176
Total other income (expense)	(5,118)	389	119
Loss from operations before Income Taxes and Minority Interests	(12,661)	(5,219)	(6,123)
Provision for income taxes	(63)	(55)	(106)
Share of earnings from investment on equity method	17	855	87
Minority Interests	153	(1,461)	(296)
Loss from continued operations	(12,554)	(5,880)	(6,438)
Income/(loss) from discontinued operations:			
Gain on disposal	530	-	-
Loss on disposal	(504)	-	-
Income from discontinued operations	113	735	