

SENSOR SYSTEM SOLUTIONS INC  
Form 10KSB  
May 19, 2006

---

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

---

**FORM 10-KSB**

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

For the fiscal year ended - **December 31, 2005**

**OR**

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

For the transition period from

Commission file number **0-024828**

**SENSOR SYSTEM SOLUTIONS, INC.**  
(Name of Small Business Issuer in Its Charter)

**NEVADA**  
(State or Other jurisdiction of Incorporation or Organization)

**98-0204898**  
(I.R.S. Employer Identification No.)

**45 Parker Avenue, Suite A**  
**Irvine, California 92618**  
(Address of Principal Executive Offices, including zip code.)

**(949) 855-6688**  
(Issuer's Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Act:

<b>Title of each class</b>	<b>Name of each exchange on which registered</b>
<b>None</b>	<b>None</b>

Securities registered pursuant to Section 12(g) of the Act:

<b>Title of each class</b>	<b>Common Stock</b>
----------------------------	---------------------

Check whether the issuer is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. **o**

Check whether the issuer (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  No

---

---

---

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act. o

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by referenced in Part III of this Form 10-KSB or any amendment to this Form 10-KSB x

State issuer's revenues for its most fiscal year **December 31, 2005: \$1,324,872.**

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was sold, or the average bid and asked price of such common equity. **As of May 1, 2006, the value was \$6.1 million.**

State the number of shares outstanding of each of the issuer's classes of common equity, as of **May 1, 2006: 76,586,112**

2

---

**PART I**

- ITEM 1. DESCRIPTION OF BUSINESS.
- ITEM 2. DESCRIPTION OF PROPERTY.
- ITEM 3. LEGAL PROCEEDINGS.
- ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

**PART II**

- ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDERS MATTERS AND SMALL BUSINESS ISSUER PURCHASES OF EQUITY SECURITIES.
- ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OR FINANCIAL PLAN OF OPERATION.
- ITEM 7. FINANCIAL STATEMENTS.
- ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.
- ITEM 8A. CONTROLS AND PROCEDURES.
- ITEM 8B. OTHER INFORMATION.

**PART III**

- ITEM 9. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS; COMPLIANCE WITH SECTION 16(a) OF THE EXCHANGE ACT.
- ITEM 10. EXECUTIVE COMPENSATION.
- ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.
- ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.
- ITEM 13. EXHIBITS.
- ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.

SIGNATURES



## PART I

### ITEM 1. DESCRIPTION OF BUSINESS

Sensor System Solutions, Inc. (the "Company" or "3S") was incorporated in Nevada in April 1982 under the name The Enchanted Village, Inc. As the result of the March 13, 2004 acquisition of Advanced Custom Sensors, Inc., a California corporation ("ACSI"), the Company is now in the business of design and manufacturing sensors and signal conditioning modules.

#### *Acquisition of Advanced Custom Sensors*

Pursuant to an Agreement and Plan of Merger (the "Merger Agreement") dated as of March 13, 2004, by and among the Company, Spectre Merger Sub, Inc., a California corporation and wholly owned subsidiary of the Company ("Merger Sub"), Ian S. Grant ("Shareholder") and ACSI, on May 24, 2004 (the "Closing Date"), Merger Sub merged with and into Advanced Custom Sensors, Inc. ("ACSI") (the "Merger"). As a result of the Merger, ACSI became a subsidiary of the Company. As consideration for the Merger, the Company issued 2,584,906 shares of common stock and warrants to purchase up to 47,802,373 shares of common stock to the shareholders of ACSI. The terms of the Merger were determined through arms-length negotiations between the management of the Company and management of ACSI. We changed our company name to Sensor System Solutions, Inc. in December 2004 to better represent our new focus. As such, the following results of operations are those of ACSI.

Until we acquired ACSI, we had only nominal assets and liabilities and limited business operations. Although ACSI became our wholly-owned subsidiary following the acquisition, because the acquisition resulted in a change of control, the acquisition was recorded as a "reverse merger" whereby ACSI is considered to be the accounting acquirer. Also, as a result of the acquisition, we have had a change of our financial position and our business. 3S is now a holding company and after the Spin-Off, defined below, will have no significant operations or assets other than our interest in Advanced Custom Sensors, Inc. Since the acquisition of ACSI, the Company has been engaged in the development, manufacturing, marketing and distribution of high quality sensors and transducers at an economical price by employing innovative designs and creative manufacturing methods.

#### *Spin-Off of Spectre Holdings*

On December 15, 2004, in consideration for making and guaranteeing certain representations, warranties and obligation in connection with the Agreement and Plan of Merger dated March 13, 2004 by and between the Company and ACSI, the Company transferred 20,878,081 shares of common stock (the "Shares"), which were all of the issued and outstanding shares of Spectre Holdings, Inc., our then wholly-owned subsidiary, to Ian Grant. As a result of the distribution of the Shares, the Company no longer owns any stock of Spectre Holdings, Inc.

#### *Advanced Custom Sensors*

ACSI was founded by an engineering management team with over 50 years of Micro-electro-mechanical-systems or "MEMS" transducer experience. Its objective is to provide high quality sensors and transducers at an economical price by employing innovative designs and creative manufacturing methods. Through ACSI, 3S offers a variety of digital pressure gauges, pressure transducers, pressure sensors, force beams, load cells, intelligent sensor interface electronics, intelligent embedded control systems, and wireless communication network interfaces. 3S produces or supplies a family of nearly 30 distinctive products. 3S is a supplier of thin-film and micro-machined force and pressure sensors to the medical, chemical, oil, and gas industries. 3S believes that its technology will enable it to become a global supplier of advanced MEMS/Microelectronic products in myriad developing markets. 3S' strategic plan is to focus on developing custom MEMS pressure sensor devices and forming strategic partnerships where its strategic partners dominate the sales channels in industries accepting MEMS sensor applications.



### *Universal Sensors, Inc.*

In April 2005, 3S, China Automotive Systems, Inc. (CAAS) and Shanghai Hongxi Investment Inc. (HX) formed Universal Sensors, Inc. (USI), a joint venture in the People's Republic of China to develop, produce and market sensor and related electronic products, targeting the Chinese automotive sensor market. 3S is transitioning to move its production line in Taiwan to this joint venture. The ownership percentages of USI are 30%, 60% and 10% to 3S, CAAS and HX, respectively. CAAS and HX will contribute cash, land and building by the end of 2006. 3S has contributed technology. Since there was no cash contributed by 3S and the technology it contributed was not recorded on its books, no investment in USI was recorded. USI is in a start-up mode and had not begun operations as of December 31, 2005. It is currently beginning its sales and marketing operations.

### *Strategic Plan*

We plan to grow our business in four areas.

- **Increase the revenue of our existing sensor component business.** Once finalized, the majority of our sensor component manufacturing will be moved to our joint venture in China to help reduce the cost of our products. We will invest to increase our production capacity and will qualify offshore suppliers to meet the increasing demands. Substantial efforts will be invested in sales and marketing in order to expand our customer base and to secure additional OEM projects.
- **Develop sensor solution business.** By leveraging the advances in technology and the large industry-wide investments in wireless and telecommunication in the last decade, we can now offer total sensor solutions at a very affordable price. These sensor solutions are modules containing sensing elements, signal conditioning circuitry, software for calibration and interface, and capability of wireless communication and/or networking. They will provide information continuously to decision makers in all phases of business operation.
- **Penetrate the automotive sensor market in China and India.** By leveraging the marketing channel of USI, our joint venture partner, and X-Lab Global, a leading technology advisory and strategic consulting firm, we will have access to the automotive market in China and India immediately. We plan to use the next two years to build up our production capacity, product offerings and technical team there. We expect to import automotive sensors produced by our joint venture to North America and Europe around 2008.
- **Strategic acquisition:** Being a public company gives us a supplemental tool to grow our business through acquisition in addition to internal growth. We will actively seek equity or debt funding to enable us to bring in the necessary resources to execute this plan.

### *Industry Overview*

Micro-Electro-Mechanical Systems, or MEMS, is the integration of mechanical elements, sensors, actuators and electronics on a common silicon substrate through the utilization of microfabrication technology. MEMS is an enabling technology, allowing the development of smart products by augmenting the computational ability of microelectronics with the perception and control capabilities of microsensors and microactuators. MEMS is also an extremely diverse and fertile technology, both with regard to applications and the methodology of how electronic devices are designed and manufactured.

Microelectronic integrated circuits ("IC's") can be thought of as the "brains" of systems and MEMS augments this decision-making capability with "eyes" and "arms" to allow microsystems to sense and control the environment. In its most basic form, the sensors gather information from the environment through measuring mechanical, thermal, biological, chemical, optical and magnetic phenomena; the electronics process the information derived from the sensors and through some decision making capability direct the actuators to respond by moving, positioning, regulating, pumping and filtering, thereby controlling the environment for some desired outcome or purpose. Since MEMS devices are manufactured using batch fabrication techniques, similar to ICs, unprecedented levels of functionality, reliability and sophistication can be placed on a small silicon chip at a relatively low cost.

### ***Market Size and Viability***

The total MEMS market size was about \$5.1 billion worldwide and is expected to grow to \$9.7 billion by 2010, according to a recent market study report. MEMS pressure sensors has the largest market share of the MEMS market. The applications of MEMS pressure sensors can be separated into five categories: Automotive, Process Control, Medical, Consumer Appliances and Aerospace. Currently, the market in Consumer Electronics is enjoying the fastest growth. Due to its versatility, MEMS is taking the lead in the various fast-growing electronic applications in addition to its excellent performance and price ratio.

### ***Products***

The Company's future technology strategy is to develop and/or acquire core intellectual property that will place it in a leadership position to manufacture and market MEMS sensors. 3S has been granted three patents by the United States Patent and Trademark Office, including the most recent in February 2006 for its Sensor Signal Conditioner for temperature compensation, linearization and amplification of a transducer output signal. 3S has also filed one provisional patent for a backflow testing device. In addition, the Company has developed many proprietary techniques/processes. These serve as the foundation to further develop our MEMS business.

3S produces or supplies a family of nearly thirty (30) distinctive products. These products employ or utilize the latest state-of-the-art technologies. The products are primarily electro-mechanical sensing devices and are identified under the following categories: Pressure Transducers, Pressure Transmitters, Pressure Switches, Force Sensors, Load Cells, Strain Gages and MEMS Sensors. We are expanding our product offering to include intelligent embedded systems that combine the attributes of both intelligent sensor and host systems

3S uses sputtered thin film, bonded foil, semi-conductor gages and piezoresistive strain gage technologies primarily in the design, development and manufacture of its general sensor products, although other technology options are also available. All of 3S' products employ proven technologies with little or no risk involved with their manufacture. What sets 3S' products apart from our competitors is our ability to optimize the performance of our products by efficient application of our diverse technologies into unique design concepts and by utilizing sophisticated materials in construction and packaging techniques.

### ***Customers***

We supply our sensors mainly to the medical and automation industries. In general customers are divided into three groups: original equipment manufacturers ("OEM's"), end users and catalogs. OEM's accounted for 56% of our revenue in 2005 with end users and catalogs splitting the rest.

We have established a wide presence in the catalog business with our 1200 Series of digital pressure gauges starting in 2004. We are currently signed up with six catalog houses, including the largest instrumentation catalog house in N. America in 2005. This additional account will allow us to increase our revenue.



### ***Sales and Marketing***

We use independent sales representatives with industry expertise to promote our product since sensors are quite complicated devices. We have a network of nine sales representatives to cover North America and two international representatives. In addition to our sales rep network, we also have a network of distributors to handle products that do not require much technical support. Both networks are managed by our VP of Marketing and Sales.

We are seeking new distribution channels for our sensor modules and we are working to leverage existing market intelligence. We hired a VP of Marketing and Sales in January 2006 to assist us in exploring the market for our sensor modules.

We plan to increase our market presence in China through our joint venture - Universal Sensors, Inc. (USI). USI has a 7-person sales team to promote not only its own automotive sensors but also 3S' products in China.

### ***Research and Development***

We hired two key engineers in October of 2004. Together, they have sixty years of combined experience in designing creative sensor modules. To date, two series of sensor modules have been designed, models have been constructed and beta-site tested. We began production in the first quarter of 2006. One additional product that we filed a provisional patent for will be ready for production in the third quarter of 2006. The unit price of these modules will be at least ten times higher than our current sensor component's sale price. We expect an increase in our sales from these two product lines.

### ***Our Goals***

Our goal is to become the market leader in innovative sensor system solutions, and a supplier with a competitive pricing and performance mix. To accomplish this objective, the Company plans to integrate proprietary techniques and processes developed by 3S that serve as the foundation to develop the Company's MEMS business. These MEMS core competences include MEMS front-end wafer design and processing, volume assembly and testing, application-specific environmental protection and cost modeling. Combined with 3S's expansion plans to increase marketing and sales efforts, these technologies present the Company with opportunities to further grow the business in international markets such as China. 3S formed a joint venture in China with China Automotive Systems, Inc. (CAAS) in April of 2005 to address its production requirements. 3S also has MEMS wafer fabrication partners in China and Taiwan, allowing the Company to maintain sensor wafer supplies as well as to continue MEMS device research.

3S intends to upgrade from the sensor component business to the system solution business. We will focus on providing complete data management solutions that can accommodate the needs of a wide range of industries and businesses. These solutions include a comprehensive set of products and services that establish the infrastructure necessary for manufacturing process partners to proactively participate in sustaining and optimizing the operation.

The Company is striving to be an important provider of sensor solutions with built-in network connectivity to supply critical data continuously for enterprises to monitor and control:

- Machine conditions
- Manufacturing processes
- Business transactions

The Company plans to develop and integrate various core intellectual properties in the areas of MEMS sensors, intelligent sensor interface electronics, intelligent embedded control systems and meters, wireless communication network interfaces, data appliances and mobile devices that facilitate machine-to-business data sharing, software & hardware to support web-based device diagnostics and data collection/data distribution, and web-based data management.

The Company believes that MEMS is an enabling technology allowing the development of smart products by augmenting the computational ability of microelectronics with the sensing and control capabilities of microsensors and microactuators.

The Company's strategy includes the hiring of world-class engineering and sales and marketing teams coupled with robust off-shore joint ventures such as the one with CAAS. Management expects that the Company's joint venture with CAAS will enable the transformation of 3S into a global supplier of advanced MEMS/Microelectronic products in the automotive market.

Implementation of our goals depends to a large extent on our ability to raise funds in the form of debt or equity or a combination thereof. The Company is actively seeking funding to expand its design, development and marketing.

### ***Strategy***

The keys to success for 3S are as follows:

- Penetrate automotive and appliance markets thru the Joint Venture with CAAS in China;
- Leverage the cost performance of above alliance to penetrate industrial and medical markets in North America and Europe;
- Complete development of sensor-based systems to increase revenues;
- Merger and acquisition.

### ***Competition***

Our products and services are affected by varying degrees of competition. We compete with other companies in most markets we serve, many of which have far greater sales volumes and financial resources. The principal competitive factors in the commercial markets in which we participate are product performance, service and price. Part of product performance requires expenditures in research and development that lead to product improvement. The market for many of our products may be affected by rapid and significant technological changes and new product introduction. Our principal competitors include Honeywell, GE and MSI in the sensor component segment, and Delphi, Bosch and Denso in the automotive sensor segment. There is no major competitor in the Sensor System Solutions Market at the current time.

### ***Employees and employment agreements***

The Company currently employs 17 persons: There are no employment agreements with any of the employees.

**ITEM 2. DESCRIPTION OF PROPERTY.**

Our headquarters is located at 45 Parker Avenue, Suite A, Irvine, California 92618. The facilities include 25,000 square feet of office, production and warehouse, which we lease from the Irvine Company under a five year lease. Annual rental payments for this lease are listed in the MD&A section.

We believe that these facilities have the capacity to meet our manufacturing and assembly needs for the foreseeable future, in combination with the production by our joint venture, USI.

**ITEM 3. LEGAL PROCEEDINGS.**

We are not a party to any pending litigation and none is contemplated or threatened.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.**

There were no matters submitted to the stockholders in the fourth quarter of 2005.

**PART II****ITEM 5. MARKET FOR COMMON EQUITY, RELATED STOCKHOLDERS MATTERS AND SMALL BUSINESS ISSUERS PURCHASES OF EQUITY SECURITIES.**

The Company's shares are quoted on the Over-The-Counter Bulletin Board. Our symbol is "SSYO". The table shows the high and low bid price of our stock for 2004 and 2005. These prices represent prices between dealers; they do not include retail markup, markdown or commission. These are bid prices only and do not represent actual transactions and are adjusted for dividends and splits.

<b>Quarter ended</b>	<b>High</b>	<b>Low</b>
<b>2004</b>		
March 31	\$3.15	\$0.45
June 30	\$2.40	\$1.20
September 30	\$2.40	\$1.20
December 31	\$2.75	\$0.51
<b>2005</b>		
March 31	\$2.40	\$1.05
June 30	\$2.10	\$0.25
September 30	\$1.25	\$0.30
December 31	\$0.51	\$0.18

***Stockholders***

At May 1, 2006, we had approximately 139 stockholders of record of our common stock. This number does not include shares held by brokerage clearing houses, depositories or otherwise in unregistered form.

***Dividends***

We have not declared any cash dividends, nor do we intend to do so. We are not subject to any legal restrictions respecting the payment of dividends, except that they may not be paid to render us insolvent.



**Securities Authorized for Issuance under Equity Compensation Plans**

The following table summarizes the securities authorized for issuance as of December 31, 2005 under our 2004 Stock Compensation Plan, the number of shares of our common stock issuable upon the exercise of outstanding options, the weighted average exercise price of such options and the number of additional shares of our common stock still authorized for issuance under such plan. The 2004 Stock Compensation Plan was replaced in March 2006. The existing options were canceled and new options on 3S shares were issued on a 10 for1 basis at the closing market price on March 3, 2006.

<b>Plan category</b>	<b>Number of securities to be issued upon exercise of outstanding options, warrants and rights</b>	<b>Weighted-average exercise price of outstanding options, warrants and rights</b>	<b>Number of securities remaining available or future issuance under equity compensation plans</b>
Equity compensation plans approved by security holders		—\$	—
Equity compensation plans not approved by security holders	76,000	.50	124,000
<b>Total</b>	<b>76,000</b>		<b>124,000</b>

**Recent Sales of Unregistered Securities**

None.

**ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION.**

The following is management's discussion and analysis of certain significant factors that have affected our financial position and operating results during the periods included in the accompanying consolidated financial statements, as well as information relating to the plans of our current management. This report includes forward-looking statements. Generally, the words "believes," "anticipates," "may," "will," "should," "expect," "intend," "estimate," "continue," and similar expressions or the negative thereof or comparable terminology are intended to identify forward-looking statements. Such statements are subject to certain risks and uncertainties, including the matters set forth in this report or other reports or documents we file with the Securities and Exchange Commission from time to time, which could cause actual results or outcomes to differ materially from those projected. Undue reliance should not be placed on these forward-looking statements that speak only as of the date hereof. We undertake no obligation to update these forward-looking statements.

The following discussion and analysis should be read in conjunction with and our consolidated financial statements and the related notes thereto and other financial information contained elsewhere in this Form 10-KSB.

**OVERVIEW**

On May 24, 2004, we acquired all of the issued and outstanding equity interests of Advanced Custom Sensors, Inc ("ACSI"). Until we acquired ACSI, we had only nominal assets and liabilities and limited business operations. Although ACSI became our wholly-owned subsidiary following the acquisition, because the acquisition resulted in a change of control, the acquisition was recorded as a "reverse merger" whereby ACSI is considered to be the accounting acquirer. We changed our company name to Sensor System Solutions, Inc. in December 2004 to better

represent our new focus. As such, the following results of operations are those of ACSI.

10

---

3S was founded by an engineering management team with over 50 years of Micro-electro-mechanical-systems or "MEMS" transducer experience. Its objective is to provide high quality sensors and transducers at an economical price by employing innovative designs and creative manufacturing methods. 3S offers a variety of digital pressure gauges, pressure transducers, pressure sensors, force beams, load cells, intelligent sensor interface electronics, intelligent embedded control systems, and wireless communication network interfaces.

3S commenced operations as a private company in September 1996. 3S is headquartered in Irvine, California where 3S occupies a 25,000 square foot facility fully equipped with fabrication capability.

3S has 17 employees in the United States, and utilizes a network of independent contractors and consultants throughout the United States and Asia. 3S produces or supplies a family of nearly 30 distinctive products. 3S formed a joint venture in China with China Automotive Systems, Inc. (NASDAQ: CAAS) in April 2005, targeting its automotive sensor market. 3S is transitioning to move its production line in Taiwan to this joint venture. 3S is a supplier of thin-film and micro-machined force and pressure sensors to the medical, chemical, oil and gas industries. 3S believes that its technology will enable it to become a global supplier of advanced MEMS/Microelectronic products in a myriad of developing markets. 3S's strategic plan is to focus on developing custom MEMS pressure sensor devices and forming strategic partnerships where its strategic partners dominate the sales channels in industries accepting MEMS sensor applications.

#### ***PLAN OF OPERATION***

We plan to grow our business in four areas.

- **Increase the revenue of existing sensor component business.** The majority of our sensor component manufacturing is being moved to our joint venture in China to help reduce the cost of our products. In the meantime, we will strive to increase our production capacity and will qualify offshore suppliers to meet the increasing demands. Substantial efforts will be invested in sales and marketing in order to expand our customer base and to secure more OEM projects.
- **Develop sensor solution business.** With the rapid advance in technology and huge investment in wireless and telecommunication in the last decades, we can now offer total sensor solutions at a very affordable price. These sensor solutions are modules containing sensing elements, signal conditioning circuitry, software for calibration and interface, and capability of wireless and/or networking. These sensor solutions will provide information continuously to decision makers in all phases of business operation.
- **Penetrate automotive sensor market through China and India.** By leverage the marketing channel of our joint venture partner and X-Lab Global, we will have access to the automotive market in China and India immediately. We plan use the next two years to build up our production capacity, product offerings, and technical team there. We will import automotive sensors produced by our joint venture to North America and Europe around 2008.
- **Strategic acquisition:** Being a public company gives us a supplemental tool to grow our business through acquisition in addition to internal growth. We will actively seek equity or debt funding to bring in the necessary resources to execute this plan.

## ***RESULTS OF OPERATIONS***

***Years ended December 31, 2005 and 2004***

### **Revenues**

We generated revenues of \$1,324,872 for the year ended December 31, 2005, which was a \$663,532 or a 100.3% increase from \$661,340 for the year ended December 31, 2004. The increase is the result of the hiring of a full-time sales manager and his success in securing several OEM accounts.

### **Gross Profit**

Gross profit for the twelve months ended December 31, 2005, was \$446,656 or 33.7% of revenues, compared to \$81,550 or 12.3% of revenues for the year ended December 31, 2004. The \$365,106 increase in gross profit was a result of the decrease in cost of sales percentage, which in turn was the result of increased productivity and management's efforts to reduce operating expense, and production tooling improvement.

### **Total Operating expenses**

#### Operating expense

Operating expense increased to \$1,869,896 for the year ended December 31, 2005 compared to \$1,292,072 for the year ended December 31, 2004. The expense increased \$577,824, or 44.7%, from 2004, primarily as a result of an increase in payroll costs, professional fees, rent and interest expense.

#### Amortization of discount on notes payable

Amortization of discount on notes payable decreased to \$531,033 for the year ended December 31, 2005 compared to \$651,868 for the year ended December 31, 2004. The expense decreased \$120,835, or 18.5%, primarily due to the large amount of discount associated with the convertible loans from Sino-America and Tina Young in the prior year, partially offset by the Cornell Capital Partners, LP expense in 2005.

#### Non-cash compensation costs

On May 24, 2004, the Company issued 2,584,905 shares of its common stock and warrants (the Merger Warrants) to purchase up to 47,802,373 shares of its common stock, to the shareholders of ACSI in exchange for all the issued and outstanding shares of ACSI. On May 24, 2004, the OTCBB closing price for the Company's common stock was \$3.15 per share, resulting in a valuation of \$12,527,134 (the Merger Valuation) for the 3,976,868 shares of common stock outstanding immediately following the Merger. On December 4, 2004, the Company granted 7,500,000 shares of its common stock to five shareholders in Spectre, including two individuals who are also Directors of the Company, for providing services to the Company. 1,500,000 shares were treated as compensatory stock with a fair value \$1.20 per share, representing the most recent OTCBB closing price prior to that date, for a total of \$1,800,000 and was recognized as stock-based compensation expense in the accompanying financial statements. The remaining 6,000,000 shares were treated as a stock dividend. In 2005, 1,500,000 shares of common stock and warrants to purchase 86,866 shares of common stock were issued as compensation for borrowing arrangements. These had a market value of \$775,000.

## **Net Loss**

Net loss decreased to (\$2,729,273) for the year ended December 31, 2005 compared to (\$3,662,390) for the year ended December 31, 2004. The loss decreased \$933,117, or 25.5%, from 2004, as a result of an increase of \$365,106 in gross profit, a decrease of \$1,145,835 in stock-based compensation expense and amortization of discount on notes payable offset by the \$577,824 in operating expenses.

## ***FINANCIAL CONDITION, LIQUIDITY, CAPITAL RESOURCES***

### **Going Concern**

In their report in connection with our 2005 financial statements, our auditors included an explanatory paragraph stating that, because we have incurred a net loss of \$2,729,273 and a negative cash flow from operations of \$928,809 for the year ended December 31, 2005, and had a working capital deficiency of \$2,004,770 and a stockholders' deficiency of \$1,695,890 at December 31, 2005 there is substantial doubt about our ability to continue as a going concern.

We have relied primarily on cash flow from operations, bank loans, and advances and investments from our shareholders for our capital requirements since inception. The company received \$800,000 from the issuance of a convertible debenture to Cornell Capital Partners, LP in December 2005 and \$200,000 in February 2006. This allowed the company to pay off some of the debt and continue its operations. Current cash on hand will allow the company to continue its operations for a short period of time; a combination of additional equity and debt offerings will be necessary to continue beyond the short term.

At December 31, 2005, cash was \$172,732 as compared to \$17,115 at December 31, 2004. The increase is due to the excess of net cash provided by financing activities over the net cash used in operations. We have a substantial working capital deficit. We require \$2,000,000 to continue operations for the next three years. We are in the process of raising capital in the form of equity and/or debt. However, there is no guarantee that we will raise sufficient funds to execute our business plan. To the extent we are unable to raise sufficient funds, our business plan will be required to be substantially modified, our operations curtailed or protection under bankruptcy/reorganization laws sought.

We are addressing our liquidity requirements by the following actions: Continue our programs for selling products and continue to seek investment capital through the public markets. However, there is no guarantee that these strategies will enable us to meet our obligations for the foreseeable future.

### **Commitments and Contingencies**

We have the following material contractual obligations and capital expenditure commitments:

The Company leases certain equipment under two capital leases with monthly payments of \$360 and \$701, respectively, including interest at 12.75% per annum.

Future minimum annual rental payments for capitalized leases are as follows:

<b>Years ending December 31,</b>	<b>Amount</b>
2006	\$ 12,732
2007	12,732
2008	12,732
2009	3,903
	42,099
Amount representing interest	(7,900)
Present value of minimum lease payments	34,199
Less: current portion	(8,877)
Non-current portion	\$ 25,322

The Company leases its office and facility through July 31, 2007 under a long-term operating lease agreement. Under terms of the lease, the Company pays the cost of repairs and maintenance. The office and warehouse facility was formally shared with TransOptix, but since the bankruptcy of TransOptix, the Company is liable for the entire lease obligation.

Future minimum lease commitments at December 31, 2005 are as follows:

<b>Years ending December 31,</b>	<b>Amount</b>
2006	\$ 250,900
2007	151,095
	\$ 401,995

Rent expense for the years ended December 31, 2005 and 2004 was \$185,924 and \$122,907 respectively.

### **Inflation and Changing Prices**

We do not foresee any adverse effects on our earnings as a result of inflation or changing prices.

### ***CRITICAL ACCOUNTING POLICIES***

#### **Revenue Recognition**

The Company recognizes revenue when risk of loss and title to the product is transferred to the customer, which occurs at shipment

#### **Stock - based compensation**

The Company has adopted the disclosure-only provisions of Statement of Financial Accounting Standards (SFAS) No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosures" as well as those outlined in SFAS No. 123, "Accounting for Stock-Based Compensation". As permitted by SFAS 148 and SFAS 123, the Company continues to apply the provisions of Accounting Principles Board Opinion (APB) No. 25, "Accounting for Stock issued to Employees" and related interpretations in accounting for the Company's stock option plan. Accordingly, compensation cost for stock options is measured as the excess, if any, of the estimated fair value of the Company's stock at the date of the grant, over the amount an employee must pay to acquire the stock. Stock based awards for non-employees are accounted for at fair value equal to the excess of the estimated fair value of the Company's stock over the option price using an estimated interest rate to calculate the fair value of the option. There were no stock based awards to non-employees in 2005 or 2004.



## **Inventories**

Inventories are stated at the lower of cost (first-in, first-out method) or market.

### ***Recent Accounting Pronouncements***

In November 2004, the FASB issued Statement of Financial Accounting Standards No. 151, "Inventory Costs". This Statement amends the guidance in ARB No. 43 Chapter 4 Inventory Pricing, to require items such as idle facility costs, excessive spoilage, double freight and rehandling costs to be expensed in the current period, regardless if they are abnormal amounts or not. This Statement will become effective for us in the first quarter of 2006. The adoption of SFAS No. 151 is not expected to have a material impact on our financial condition, results of operations, or cash flows.

In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standard ("SFAS") No. 123 (R), "Share-Based Payment" ("SFAS 123(R)"). SFAS No. 123 (R) revises SFAS 123, "Accounting for Stock-Based Compensation" and supersedes Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees." SFAS 123 (R) focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. SFAS 123 (R) requires companies to recognize in the statement of operations the cost of employee services received in exchange for awards of equity instruments based on the grant-date fair value of those awards (with limited exceptions). SFAS 123 (R) is effective as of the first interim or annual reporting period of the first fiscal year that begins after June 15, 2005 for small business issuers. Accordingly, the Company will adopt SFAS 123 (R) in its quarter ending March 31, 2006.

As permitted by SFAS 123, the Company currently accounts for share-based payments to employees using APB 25's intrinsic value method. Accordingly, adoption of SFAS 123R's fair value method will have an effect on results of operations, although it will have no impact on overall financial position. The impact of adoption of SFAS 123R cannot be predicted at this time because it will depend on levels of share-based payments granted in the future. However, had SFAS 123R been adopted in prior periods, the effect would have approximated the SFAS 123 pro forma net loss and loss per share disclosures as shown above. SFAS 123R also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as currently required, thereby reducing net operating cash flows and increasing net financing cash flows in periods after adoption.

### ***RISKS RELATED TO OUR BUSINESS***

***We have had negative cash flows from operations. Our business operations may fail if our actual cash requirements exceed our estimates, and we are not able to obtain further financing.***

Our company has had negative cash flows from operations. To date, we have incurred significant expenses in product development and administration in order to ready our products for market. Our business plan calls for additional significant expenses necessary to bring our products to market. We believe we do not have sufficient funds to satisfy our short-term cash requirements. There is no assurance that actual cash requirements will not exceed our estimates, in which case we will require additional financing to bring our products into commercial operation, finance working capital and pay for operating expenses and capital requirements until we achieve a positive cash flow. Additionally, more capital may be required in the event that:

- we incur unexpected costs in completing the development of our technology or encounter any unexpected technical or other difficulties;
  - we incur delays and additional expenses as a result of technology failure;
  - we are unable to create a substantial market for our product and services; or
    - we incur any significant unanticipated expenses.

We may not be able to obtain additional equity or debt financing on acceptable terms if and when we need it. Even if financing is available it may not be available on terms that are favorable to us or in sufficient amounts to satisfy our requirements. If we require, but are unable to obtain, additional financing in the future, we may be unable to implement our business plan and our growth strategies, respond to changing business or economic conditions, withstand adverse operating results, and compete effectively. More importantly, if we are unable to raise further financing when required, our continued operations may have to be scaled down or even ceased and our ability to generate revenues would be negatively affected.

***A decline in the price of our common stock could affect our ability to raise further working capital and adversely impact our operations.***

A prolonged decline in the price of our common stock could result in a reduction in the liquidity of our common stock and a reduction in our ability to raise capital. Because our operations have been primarily financed through the issuance of convertible notes, a decline in the price of our common stock could be especially detrimental to our liquidity and our continued operations. Any reduction in our ability to raise equity capital in the future would force us to reallocate funds from other planned uses and would have a significant negative effect on our business plans and operations, including our ability to develop new products and continue our current operations. If the stock price declines, there can be no assurance that we can raise additional capital or generate funds from operations sufficient to meet our obligations.

***If we issue additional shares in the future this may result in dilution to our existing stockholders.***

Our Amended Certificate of Incorporation authorizes the issuance of 200,000,000 shares of common stock. Our board of directors has the authority to issue additional shares up to the authorized capital stated in the certificate of incorporation. Our board of directors may choose to issue some or all of such shares to acquire one or more businesses or to provide additional financing in the future. The issuance of any such shares may result in a reduction of the book value or market price of the outstanding shares of our common stock. It will also cause a reduction in the proportionate ownership and voting power of all other stockholders. Further, any such issuance may result in a change of control of our corporation.

***We have a history of losses and negative cash flows, which is likely to continue unless our products gain sufficient market acceptance to generate a commercially viable level of sales.***

From inception through December 31, 2005, we have incurred aggregate net losses. There is no assurance that we will operate profitably or will generate positive cash flow in the future. In addition, our operating results in the future may be subject to significant fluctuations due to many factors not within our control, such as market acceptance of our products, the unpredictability of when customers will order products, the size of customers' orders, the demand for our products, and the level of competition and general economic conditions.

Although we anticipate that we will be able to increase revenues during the next 12 months, we also expect an increase in development and operating costs. Consequently, we expect to incur operating losses and net cash outflow

unless and until our existing products, and/or any new products that we may develop, gain market acceptance sufficient to generate a commercially viable and sustainable level of sales.

***Unless we can establish significant sales of our current products, our potential revenues may be significantly reduced.***

We expect that a substantial portion, if not all, of our future revenue will be derived from the sale of our sensor products. We expect that these product offerings and their extensions and derivatives will account for a majority, if not all, of our revenue for the foreseeable future. The successful introduction and broad market acceptance of our sensor products - as well as the development, introduction and market acceptance of any future enhancements - are, therefore, critical to our future success and our ability to generate revenues. Unfortunately, there can be no assurance that we will be successful in marketing our current product offerings, or any new product offerings, applications or enhancements. Failure to achieve broad market acceptance of our sensor products, as a result of competition, technological change, or otherwise, would significantly harm our business.

***We could lose our competitive advantages if we are not able to protect any proprietary technology and intellectual property rights against infringement, and any related litigation could be time-consuming and costly.***

Our success and ability to compete depends to a significant degree on our proprietary technology incorporated in our products. We have taken limited action to protect our proprietary technology and proprietary computer software. If any of our competitors copies or otherwise gains access to our proprietary technology or software or develops similar technologies independently, we would not be able to compete as effectively.

Further, the laws of foreign countries may provide inadequate protection of such intellectual property rights. We may need to bring legal claims to enforce or protect such intellectual property rights. Any litigation, whether successful or unsuccessful, could result in substantial costs and diversions of resources. In addition, notwithstanding any rights we have secured in our intellectual property, other persons may bring claims against us that we have infringed on their intellectual property rights, including claims based upon the content we license from third parties or claims that our intellectual property right interests are not valid. Any claims against us, with or without merit, could be time consuming and costly to defend or litigate, divert our attention and resources, result in the loss of goodwill associated with our service marks or require us to make changes to our website or other of our technologies.

***Our products may become obsolete and unmarketable if we are unable to respond adequately to rapidly changing technology and customer demands.***

Our industry is characterized by rapid changes in technology and customer demands. As a result, our products may quickly become obsolete and unmarketable. Our future success will depend on our ability to adapt to technological advances, anticipate customer demands, develop new products and enhance our current products on a timely and cost-effective basis. Further, our products must remain competitive with those of other companies with substantially greater resources. We may experience technical or other difficulties that could delay or prevent the development, introduction or marketing of new products or enhanced versions of existing products. Also, we may not be able to adapt new or enhanced products to emerging industry standards, and our new products may not be favorably received.

***If we fail to effectively manage our growth our future business results could be harmed and our managerial and operational resources may be strained.***

As we proceed with the commercialization of our products, we expect to experience significant and rapid growth in the scope and complexity of our business. We will need to add staff to market our products, manage operations, handle sales and marketing efforts and perform finance and accounting functions. We will be required to hire a broad range of additional personnel in order to successfully advance our operations. This growth is likely to place a strain on our management and operational resources. The failure to develop and implement effective systems, or to hire and retain sufficient personnel for the performance of all of the functions necessary to effectively service and manage our potential business, or the failure to manage growth effectively, could have a materially adverse effect on our business

and financial condition.

17

---

***Our plans for expansion and cost reduction are substantially dependent on our joint venture which involves the risk of doing business in China.***

Our PRC joint venture is subject to laws and regulations applicable to foreign investment in China in general and laws and regulations applicable to foreign-invested enterprises in particular. China has made significant progress in the promulgation of laws and regulations dealing with economic matters such as corporate organization and governance, foreign investment, commerce, taxation and trade. However, the promulgation of new laws, changes of existing laws and abrogation of local regulations by national laws may have a negative impact on our business and prospects.

The value of the Chinese currency, RMB, is subject to changes in PRC government policies and depends to a large extent on China's domestic and international economic, financial and political developments, as well as the currency's supply and demand in the local market. For over a decade from 1994, the conversion of RMB into foreign currencies, including the U.S. dollar, was based on exchange rates set and published daily by the People's Bank of China, the PRC central bank, based on the previous day's interbank foreign exchange market rates in China and exchange rates on the world financial markets. The official exchange rate for the conversion of RMB into U.S. dollars remained stable until RMB was revalued in July 2005 and allowed to fluctuate by reference to a basket of foreign currencies, including the U.S. dollar. Under the new policy, RMB will be permitted to fluctuate within a band against a basket of foreign currencies. This change in policy resulted initially in an approximately 2.0% appreciation in the value of Renminbi against the U.S. dollar. There remains significant international pressure on the PRC government to adopt a substantially more liberalized currency policy, which could result in a further and more significant appreciation in the value of RMB against the U.S. dollar. Further revaluations of RMB against the U.S. dollar may also occur in the future. A stronger RMB would increase our purchase price of raw material and parts.

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

There are no Off-Balance Sheet Arrangements to report.

**ITEM 7. FINANCIAL STATEMENTS.**

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM F-1

## FINANCIAL STATEMENTS

Consolidated Balance Sheet	F-2
----------------------------	-----

Consolidated Statements of Operations	F-3
---------------------------------------	-----

Consolidated Statements of Changes in Stockholders' Deficiency	F-4
--	-----

Consolidated Statements of Cash Flows	F-5
---------------------------------------	-----

NOTES TO THE FINANCIAL STATEMENTS	F-6
-----------------------------------	-----

**ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.**

None.

**ITEM 8A. CONTROLS AND PROCEDURES***Evaluation of Disclosure Controls and Procedures*

Our management evaluated, with the participation of our Chief Executive and Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Annual Report on Form 10-KSB. Based on this evaluation, our Chief Executive and Financial Officer has concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the Exchange Act)) are inadequate to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms. We are developing a plan to ensure that all information will be recorded, processed, summarized and reported on a timely basis. This plan is dependent, in part, upon reallocation of responsibilities among various personnel, possibly hiring additional personnel and additional funding. It should also be noted that the design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

*Changes in Internal Control over Financial Reporting*

There was no change in our internal control over financial reporting that occurred during the fourth fiscal quarter of the fiscal year covered by this Annual Report on Form 10-KSB that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**ITEM 8B. OTHER INFORMATION.**

None.



**PART III****ITEM 9. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.**

The name, age and position held by each of the directors and officers of our company are as follows:

<b>Name</b>	<b>Age</b>	<b>Position</b>
Michael Young	47	Chief Executive Officer and Chairman
Hanlin Chen	48	Director

All directors have a term of office expiring at the next annual general meeting, unless re-elected or earlier vacated in accordance with the Bylaws. All officers have a term of office lasting until their removal or replacement by the Board of Directors.

***Background of Officers and Directors***

MICHAEL YOUNG founded and has served for eight years as CEO of 3S. Previously, his 21-year career includes MEMS design, fabrication, packaging and applications development at Rosemount, Endevco, Hughes Aircraft and other firms. He is responsible for leading 3S given his technical expertise and a broad range of business experiences with 3S. He holds a Master of Science degree in Mechanical Engineering from Stanford University.

HANLIN CHEN began serving as the Chairman and CEO of China Automotive Systems, Inc. since 2003. Prior to this appointment, Mr. Chen was the general manager of Jiulong Power Steering Company Limited from 1992 to 1997. Mr. Chen holds a MBA from Barrington University and serves as a board member of Political Consulting Committee of Jingzhou city and vice president of Foreign Investors Association.

***Family Relationships***

There are no family relationships on the Board of Directors.

***Involvement in Certain Legal Proceedings***

To our knowledge, during the past five years, our officers and directors: have not filed a petition under the federal bankruptcy laws or any state insolvency law, nor had a receiver, fiscal agent or similar officer appointed by a court for the business or present of such a person, or any partnership in which he was a general partner at or within two years before the time of such filing, or any corporation or business association of which he was an executive officer within two years before the time of such filing; were not convicted in a criminal proceeding or named subject of a pending criminal proceeding (excluding traffic violations and other minor offenses); were not the subject of any order, judgment or decree, not subsequently reversed, suspended or vacated, of any court of competent jurisdiction, permanently or temporarily enjoining him from or otherwise limiting their respective activities.

***Compliance with Section 16 (a) of the Exchange Act***

Based solely upon a review of Forms 3 and 4 and amendments thereto furnished to us pursuant to Rule 16a-3(e) under the Securities Exchange Act of 1934 during our most recent fiscal year and Forms 5 and amendments thereto furnished to us with respect to our most recent fiscal year, all officers, directors and owners of 10% or more of our outstanding shares have filed all Forms 3, 4 and 5 required by Section 16(a) of the Securities Exchange Act of 1934.



***Audit Committee and Charter***

Due to the size of our Board of Directors we do not have an audit committee at this time.

***Audit Committee Financial Expert***

We have no financial expert.

***Code of Ethics***

We have adopted a corporate code of ethics. We believe our code of ethics is reasonably designed to deter wrongdoing and promote honest and ethical conduct; provide full, fair, accurate, timely and understandable disclosure in public reports; comply with applicable laws; ensure prompt internal reporting of code violations; and provide accountability for adherence to the code.

**ITEM 10. EXECUTIVE COMPENSATION.**

The following table sets forth information with respect to compensation paid by us to the chief executive officer since the Exchange. No other executive officer received compensation in excess of \$100,000 for the fiscal year ended December 31, 2005.

**Summary Compensation Table**

(a)	(b)	Annual Compensation		Awards			Long Term Compensation Payouts	
		(c)	(d)	(e)	(f)	(g)	(h)	(i)
Name and Principal Position	Year	Salary (\$)	Bonus (\$)	Other Annual Compensation (\$)	Restricted Stock Award(s) (\$)	Securities Underlying Options /SARs (#)	LTIP Payouts (\$)	All Other Compensation (\$)
Michael Young, CEO	2005	108,500	N/A	-	-	-	-	-
Michael Young, CEO	2004	75,000	N/A	-	-	-	-	-
N/A	2003	N/A	N/A	-	-	-	-	-

There are no retirement, pension or profit sharing plans for the benefit of our officers and directors. A stock option plan was approved by the Board of Directors in March 2006 and options for 250,000 shares were granted to Michael Young.

***Option/SAR Grants***

No individual grants of stock options, whether or not in tandem with stock appreciation rights ("SARs") and freestanding SARs were made to any executive officer or any director prior to March 2006, accordingly, no stock options have been exercised by any of the officers or directors in fiscal 2005.

***Long-Term Incentive Plan Awards***

We do not have any long-term incentive plans that provide compensation intended to serve as incentive for performance to occur over a period longer than one fiscal year, whether such performance is measured by reference to

our financial performance, our stock price, or any other measure.

21

---

### *Compensation of Directors*

The directors did not receive any other compensation for serving as members of the board of directors. The Board has not implemented a plan to award options. There are no contractual arrangements with any member of the board of directors.

We do not intend to pay any additional compensation to our directors. As of the date hereof, we have not entered into employment contracts with any of our officers and we do not intend to enter into any employment contracts until such time as it profitable to do so.

### *Indemnification*

Nevada corporation law provides that:

- A corporation may indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative, except an action by or in the right of the corporation, by reason of the fact that he is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against expenses, including attorneys' fees, judgments, fines and amounts paid in settlement actually and reasonably incurred by him in connection with the action, suit or proceeding if he acted in good faith and in a manner which he reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe his conduct was unlawful;
- A corporation may indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action or suit by or in the right of the corporation to procure a judgment in its favor by reason of the fact that he is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against expenses, including amounts paid in settlement and attorneys' fees actually and reasonably incurred by him in connection with the defense or settlement of the action or suit if he acted in good faith and in a manner which he reasonably believed to be in or not opposed to the best interests of the corporation. Indemnification may not be made for any claim, issue or matter as to which such a person has been adjudged by a court of competent jurisdiction, after exhaustion of all appeals therefrom, to be liable to the corporation or for amounts paid in settlement to the corporation, unless and only to the extent that the court in which the action or suit was brought or other court of competent jurisdiction determines upon application that in view of all the circumstances of the case, the person is fairly and reasonably entitled to indemnity for such expenses as the court deems proper; and
- To the extent that a director, officer, employee or agent of a corporation has been successful on the merits or otherwise in defense of any action, suit or proceeding, or in defense of any claim, issue or matter therein, the corporation shall indemnify him against expenses, including attorneys' fees, actually and reasonably incurred by him in connection with the defense.
- Our bylaws provide that we will advance all expenses incurred to any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suite or proceeding, whether civil, criminal, administrative or investigative, by reason of the fact that he is or was our director or officer, or is or was serving at our request as a director or executive officer of another company, partnership, joint venture, trust or other enterprise, prior to the final disposition of the proceeding, promptly following request. This advanced of expenses is to be made upon receipt of an undertaking by or on behalf of such person to repay said amounts should it be ultimately determined that the person was not entitled to be indemnified under our bylaws or otherwise.



- Our bylaws also provide that no advance shall be made by us to any officer in any action, suit or proceeding, whether civil, criminal, administrative or investigative, if a determination is reasonably and promptly made: (a) by the board of directors by a majority vote of a quorum consisting of directors who were not parties to the proceeding; or (b) if such quorum is not obtainable, or, even if obtainable, a quorum of disinterested directors so directs, by independent legal counsel in a written opinion, that the facts known to the decision-making party at the time such determination is made demonstrate clearly and convincingly that such person acted in bad faith or in a manner that such person did not believe to be in or not opposed to our best interests.
- Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers and controlling persons of our company under Nevada law or otherwise, we have been advised the opinion of the Securities and Exchange Commission is that such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable. In the event a claim for indemnification against such liabilities (other than payment by us for expenses incurred or paid by a director, officer or controlling person of our company in successful defense of any action, suit, or proceeding) is asserted by a director, officer or controlling person in connection with the securities being registered, we will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction, the question of whether such indemnification by it is against public policy in said Act and will be governed by the final adjudication of such issue.

#### ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDERS MATTERS.

The following table sets forth, as of May 1, 2006, the beneficial shareholdings of persons or entities holding five percent or more of our common stock, each director individually, each named executive officer and all of our directors and officers as a group. Each person has sole voting and investment power with respect to the shares of common stock shown, and all ownership is of record and beneficial. Unless otherwise disclosed, the address of each person set forth below is that of the Company.

Name of Beneficial Owner	Amount and Nature Beneficial Owner	Position	Percent of Class (1)
Michael Young	10,620,186	Chief Executive Officer and Chairman	14%
Hanlin Chen	-	Director	*
Officers and Directors as a Group (2 persons)	10,620,186		14%
<b>Principal Shareholders</b>		<b>Address</b>	
Future Front International Co. Ltd.	14,479,093	6 G/F, Johnston Road Wanchai, Hong Kong	19%

\*Less than 1%

(1) Based on 76,586,112 shares outstanding at May 1, 2006.

**ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.**

Mr. Hanlin Chen, a Director of the Company is the Chief Executive Officer of China Automotive Systems, Inc. The Company has a Joint Venture with China Automotive Systems, Inc. - see Note 4 of Notes to Consolidated Financial Statements.

The Company has outstanding convertible notes payable to related parties, including \$300,665 to the sister of the Chief Executive Officer - see Note 6 of Notes to Consolidated Financial Statements.

**ITEM 13. EXHIBITS, LIST AND REPORTS ON FORM 8-K.**

**(a) Reports on Form 8-K**

There were no Reports filed on Form 8-K during the fourth quarter of 2005.

**(b) Exhibits**

**Exhibit No. Document Description**

- |      |   |
|------|---|
| 3.1  | Articles of Incorporation (1)   |
| 3.2  | Bylaws (1)  |
| 10.1 | Share Exchange Agreement and Plan of Reorganization (2)   |
| 10.2 | Joint Venture Agreement with Universal Sensors, Inc. (3)  |
| 23.1 | Consent of Weinberg & Company, P.A. (3)   |
| 31.1 | Certification of Principal Executive Officer and Principal Financial Officer pursuant to Rule 13a-14 and Rule 15d-14(a), promulgated under the Securities and Exchange Act of 1934, as amended. (3) |
| 32.1 | Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Chief Executive Officer). (3)   |

---

(1) Incorporated herein by reference from the Company's Form 10-QSB filed with the Securities and Exchange Commission, File No. 000-11991 on May 28, 2003.

(2) Incorporated herein by reference from the Company's Form 8-K Current Report and amendment thereto as filed with the Securities and Exchange Commission, on May 24, 2004.

(3) Filed herewith.

**ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.**

Weinberg & Company, P.A., was the Company's independent registered public accounting firm engaged to examine the financial statements of the Company for the fiscal years ended December 31, 2004 and 2005. Weinberg & Company, P.A. performed the following services and has been paid the following fees.

*Fiscal Years Ended December 31, 2005 and 2004*

**Audit Fees**

Weinberg & Company, P.A. was paid aggregate fees of approximately \$112,000 and \$54,500 for the fiscal years ended December 31, 2005 and 2004, respectively, for professional services rendered for the audit of the Company's annual financial statements and for the reviews of the financial statements included in the Company's interim quarterly reports.

**Audit-Related Fees**

Weinberg & Company, P.A. was not paid additional fees for the fiscal year December 31, 2005 for assurance and related services reasonably related to the performance of the audit or review of the Company's financial statements.

**Tax Fees**

Weinberg & Company, P.A. was not paid any fees for the fiscal year ended December 31, 2005 for professional services rendered for tax compliance, tax advice and tax planning. This service was not provided.

**All Other Fees**

Weinberg & Company, P.A. was paid no other fees for professional services during the fiscal year ended December 31, 2005.

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities and Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on this 15th day of May, 2006.

**SENSOR SYSTEM SOLUTIONS, INC.**

By: /s/ Michael Young  
Michael Young  
Chief Executive Officer and Principal  
Accounting Officer

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

<b>Signatures</b>	<b>Title</b>	<b>Date</b>
/s/ Michael Young Michael Young	Chief Executive Officer and Principal Accounting Officer	May 15, 2006
/s/ Hanlin Chen Hanlin Chen	Director	May 15, 2006

**SENSOR SYSTEM SOLUTIONS, INC. AND SUBSIDIARY**

**CONSOLIDATED FINANCIAL STATEMENTS**

**YEARS ENDED DECEMBER 31, 2005 AND 2004**

---

**SENSOR SYSTEM SOLUTIONS, INC. AND SUBSIDIARY**

**CONTENTS**

PAGE	F-1	REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM
PAGE	F-2	CONSOLIDATED BALANCE SHEET AS OF DECEMBER 31, 2005
PAGE	F-3	CONSOLIDATED STATEMENTS OF OPERATIONS FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004
PAGE	F-4	CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' DEFICIENCY FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004
PAGE	F-5	CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004
PAGES	F6 - F17	NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2005 AND 2004

---

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors of Sensor System Solutions, Inc.:

We have audited the accompanying consolidated balance sheet of Sensor System Solutions, Inc. and subsidiary as of December 31, 2005, and the related consolidated statements of operations, changes in stockholders' deficiency, and cash flows for the years ended December 31, 2005 and 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the 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 Sensor System Solutions, Inc. and subsidiary as of December 31, 2005, and the results of their operations and their cash flows for the years ended December 31, 2005 and 2004, in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated 2005 financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the consolidated financial statements, the Company incurred a net loss of \$2,729,273 and a negative cash flow from operations of \$928,809 for the year ended December 31, 2005, and had a working capital deficiency of \$2,004,770 and a stockholders' deficiency of \$1,695,890 at December 31, 2005. These matters raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 1. The accompanying consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

WEINBERG & COMPANY, P.A.

Boca Raton, Florida  
May 11, 2006

F-1

---

**SENSOR SYSTEM SOLUTIONS, INC. AND SUBSIDIARY**  
**CONSOLIDATED BALANCE SHEET**

As of December 31, 2005

## ASSETS

## CURRENT ASSETS

Cash	\$	172,732
Accounts receivable		230,440
Inventory		302,171
Prepays and other current assets		46,634
Total current assets		751,977

Property and equipment, net		233,862
-----------------------------	--	---------

Other assets		104,112
--------------	--	---------

Total assets	\$	1,089,951
--------------	----	-----------

## LIABILITIES AND STOCKHOLDERS' DEFICIENCY

## CURRENT LIABILITIES

Accounts payable and accrued expenses	\$	1,313,134
Notes payable		1,060,171
Notes payable, related parties		368,565
Current portion of capital lease obligations		8,877
Current portion of deferred rent concession		6,000
Total current liabilities		2,756,747

## LONG-TERM LIABILITIES

Capital lease obligations, net of current portion	25,322
Deferred rent concession, net of current portion	3,772
Total long-term liabilities	29,094

## Commitments and contingencies

## STOCKHOLDERS' DEFICIENCY

Preferred stock, \$.001 par value, 20,000,000 shares authorized, none outstanding	-
---	---

Common stock, \$.001 par value, 180,000,000 shares authorized, 61,705,019 shares issued and outstanding	61,705
---	--------

Common stock to be issued (14,479,093 shares)	550,000
---	---------

Additional paid-in capital	15,456,834
----------------------------	------------

Deferred compensation	(26,598)
-----------------------	----------

Accumulated deficit	(17,737,831)
---------------------	--------------

Total stockholders' deficiency	(1,695,890)
--------------------------------	-------------

Total liabilities and stockholders' deficiency	\$	1,089,951
--	----	-----------

See accompanying notes to consolidated financial statements.



**SENSOR SYSTEM SOLUTIONS, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**For the years ended December 31, 2005 and 2004**

	<b>2005</b>	<b>2004</b>
Sales, net	\$ 1,324,872	\$ 661,340
Cost of goods sold	878,216	579,790
Gross profit	446,656	81,550
Operating expenses	1,869,896	1,292,072
Amortization of discount on notes payable	531,033	651,868
Stock-based compensation costs	775,000	1,800,000
Total operating expenses	3,175,929	3,743,940
Net loss	\$ (2,729,273)	\$ (3,662,390)
Loss per common share, basic and diluted	\$ (.05)	\$ (0.46)
Weighted average shares outstanding, basic and diluted	59,809,253	7,920,079

See accompanying notes to consolidated financial statements.

Sensor System Solutions, Inc.  
Consolidated Statements of Changes in Stockholders' Deficiency  
For the years ended December 31, 2005 and 2004

	Sensor Common stock		ACSI Common stock		Common stock to be issued		Treasury stock	Additional paid-in capital	De
	Shares	Amount	Shares	Amount	Shares	Amount			
Balance January 1, 2004			2,584,895	\$ 3,639,513			\$ (10,000)	\$ 585,936	\$
Common stock of Sensor outstanding when Advanced Custom Sensors, Inc was merged into Sensor, Inc.	1,391,962	\$ 1,392						(1,392)	
Exchange of Advanced Custom Sensors, Inc. common stock for Sensor, Inc. common stock	2,584,906	2,585	(2,584,895)	(3,639,513)			10,000	3,626,928	
Stock options issued to employees								19,800	
Intrinsic value of common stock warrants issued with notes payable								636,518	
Amortization of deferred compensation									
Stock to be issued for settlement of note payable					200,000	\$ 300,000			

Edgar Filing: SENSOR SYSTEM SOLUTIONS INC - Form 10KSB

Compensatory stock to be issued					1,500,000	1,800,000		
Stock dividend to be issued					6,000,000	7,200,000		
Net loss Balance December 31, 2004	3,976,868	3,977	-	-	7,700,000	9,300,000	-	4,867,790
Forfeiture of stock options								(122,100)
Compensatory stock issued	1,500,000	1,500			(1,500,000)	(1,800,000)		1,798,500
Stock dividend issued	6,000,000	6,000			(6,000,000)	(7,200,000)		7,194,000
Warrants exercised by shareholders from merger	47,802,373	47,802						(47,802)
Amortization of deferred compensation								
Stock to be issued for settlement of note payable					14,479,093	550,000		
Stock issued for settlement of notes payable and exercise of warrants	925,778	926			(200,000)	(300,000)		327,586
Warrants issued with notes payable								665,360
Warrants issued as compensation								10,000

Stock issued as compensation for a Standby Equity Distribution Agreement	1,500,000	1,500					763,500
--	-----------	-------	--	--	--	--	---------

Net loss Balance December 31, 2005	61,705,019 \$	61,705	- \$	-	14,479,093 \$	550,000 \$	- \$ 15,456,834 \$
---	---------------	--------	------	---	---------------	------------	--------------------

See accompanying notes to consolidated financial statements.

F-4

---

**SENSOR SYSTEM SOLUTIONS, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**For the years ended December 31, 2005 and 2004**

	2005	2004
Cash flows from operating activities:		
Net loss	\$ (2,729,273)	\$ (3,662,390)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation costs	775,000	1,800,000
Costs related to settlement of note payable	--	140,000
Depreciation and amortization	93,355	109,954
Amortization of discount on notes payable	531,033	651,868
Amortization of deferred compensation	37,702	54,170
Changes in operating assets and liabilities:		
Accounts receivable	(129,910)	(32,992)
Inventory	(81,726)	(20,913)
Prepays and other current assets	(22,082)	(20,445)
Accounts payable and accrued expenses	653,091	370,685
Other assets	(50,000)	-
Deferred rent (amortization) concession	(5,999)	15,770
Net cash used in operating activities	(928,809)	(594,293)
Cash flows from investing activities:		
Purchase of property and equipment	(6,500)	(3,957)
Cash flows from financing activities:		
Proceeds from notes payable	1,648,745	590,000
Principal payments on notes payable	(600,000)	-
Proceeds from notes payable, related parties	50,000	20,000
Principal payments on capital leases	(7,819)	(5,347)
Net cash provided by financing activities	1,090,926	604,653
Net increase in cash and cash equivalents	155,617	6,403
Cash and cash equivalents, beginning of the year	17,115	10,712
Cash and cash equivalents, end of the year	\$ 172,732	\$ 17,115
Supplemental disclosure of cash flow information		
Cash paid for:		
Interest	\$ 50,637	\$ 14,458
Taxes	\$ 800	\$ 800
Non-cash investing and financing activities:		
Acquisition of equipment through capital lease obligations	\$ -	\$ 47,365
(Cancellation) issuance of stock options	(122,100)	19,800
Accrued interest added to notes payable principal	60,774	12,500
Discount related to warrants and convertible notes	665,360	636,518
Common stock issued and to be issued in settlement of note payable	578,512	160,000
Stock dividend	-	7,200,000

See accompanying notes to consolidated financial statements.

**SENSOR SYSTEM SOLUTIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004**

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of business

Sensor System Solutions, Inc. (the "Company") is a manufacturer and assembler of sensors and micro systems, and its products include thin film sensors, thin film pressure sensors and micro machined pressure sensors, and micro systems that may include sensors, signal conditioning circuits, LCD display, computer interface and molded housing specifically designed to the customers needs. The Company was incorporated in Nevada in April 1982 under the name The Enchanted Village, Inc.

Merger

On May 24, 2004, Sensor System Solutions (formerly known as Spectre Industries, Inc.,) a Nevada corporation, entered into an agreement and plan of merger (the Merger) with Advanced Custom Sensors, Inc. (ACSI). Sensor issued 2,584,906 shares of its common stock and warrants (the Merger Warrants) to purchase up to 47,802,373 shares of its common stock to the shareholders of ACSI in exchange for all the issued and outstanding shares of ACSI. The transaction was accounted for as a recapitalization with ACSI deemed to be the accounting acquirer and Spectre the legal acquirer. All financial information included in these financial statements prior to the Merger is that of ACSI, as if ACSI had been the registrant. The financial information since the Merger is that of ACSI and Sensor consolidated.

All references to "Sensor", "Spectre" and "ACSI", mean Spectre or ACSI separately prior to the Merger and Sensor (the Company) after the Merger.

The Company agreed that it would "spin-off" certain assets and liabilities included in Spectre in connection with the Merger on May 24, 2004. These assets and liabilities were transferred to Spectre Holdings, Inc. (Spectre Holdings), a wholly-owned subsidiary of the Company. On December 15, 2004, in consideration for making and guaranteeing certain representations, warranties and obligations in connection with the Agreement and Plan of Merger dated March 13, 2004 by and between the Company and ACSI, the Company transferred 20,878,081 shares of common stock, which are all of the issued and outstanding shares of Spectre Holdings to Ian Grant, a Director of the Company and shareholder in Spectre. As the Company never had direct or indirect control of those assets and liabilities, Spectre Holdings was not considered owned at the date of the Merger.

Going concern

The Company incurred a net loss of \$2,729,273 and a negative cash flow from operations of \$928,809 for the year ended December 31, 2005, and had a working capital deficiency of \$2,004,770 and a stockholders' deficiency of \$1,695,890 at December 31, 2005. These matters raise substantial doubt about its ability to continue as a going concern. Without realization of additional capital, it would be unlikely for the Company to continue as a going concern. Management believes that actions are presently being taken to revise the Company's operating and financial requirements in order to improve the Company's financial position and operating results. However, given the levels of its cash resources and working capital deficiency at December 31, 2005, management believes cash to be generated by operations will not be sufficient to meet anticipated cash requirements for operations, working capital and capital expenditures during 2006. The Company completed a merger and recapitalization on May 20, 2004, with Spectre Industries, Inc., a public company, to gain access to the United States and European capital markets, but there can be no assurances that the Company will ultimately be successful in this regard. The accompanying consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Principles of consolidation

The 2005 and 2004 consolidated financial statements include the accounts and operations of Sensor System Solutions Inc. and its wholly-owned subsidiary. Intercompany accounts and transactions have been eliminated in consolidation.

F-6

---

**SENSOR SYSTEM SOLUTIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004**

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Accounts receivable

The Company performs ongoing credit evaluations of its customers and generally does not require collateral. An appropriate allowance for doubtful accounts is included in accounts receivable.

Inventory

Inventory is stated at the lower of cost (first-in, first-out method) or market.

Property and equipment

Property and equipment are stated at cost less accumulated depreciation and amortization. Expenditures for additions, renewals and improvements are capitalized. Costs of repairs and maintenance are expensed when incurred. Depreciation is provided using the straight-line method over the estimated useful lives of the assets, which range from three to seven years. Leasehold improvements are amortized over the shorter of the lease term or the asset's useful life.

Impairment of long-lived assets

Property and equipment and other long-lived assets are evaluated for impairment whenever events or conditions indicate that the carrying value of an asset may not be recoverable. If the sum of the expected undiscounted cash flows is less than the carrying value of the related asset or group of assets, a loss is recognized for the difference between the fair value and carrying value of the asset or group of assets. Such analyses necessarily involve significant judgment. There were no impairment losses recorded in 2005 or 2004.

Note payable debt discount cost

The Company has issued warrants to investors and related parties in conjunction with notes payable. The discounts allocated to the warrants are being treated as additional consideration for notes payable and are being amortized over the life of the note as additional interest cost using the straight-line method.

Revenue recognition

The Company recognizes revenue when risk of loss and title to the product is transferred to the customer, which occurs at shipment.

Income taxes

The Company accounts for income taxes under the asset and liability method. Under this method, deferred tax assets and liabilities are recognized and measured using enacted tax rates at the balance sheet date. Deferred tax expense or

benefit is the result of changes in deferred tax assets and liabilities. Valuation allowances are established when necessary to reduce net deferred taxes to amounts that are more likely than not to be realized.

F-7

---

**SENSOR SYSTEM SOLUTIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004**

Stock - based compensation

The Company has adopted the disclosure-only provisions of Statement of Financial Accounting Standards (SFAS) No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosures" as well as those outlined in SFAS No. 123, "Accounting for Stock-Based Compensation". As permitted by SFAS 148 and SFAS 123, the Company continues to apply the provisions of Accounting Principles Board Opinion (APB) No. 25, "Accounting for Stock issued to Employees" and related interpretations in accounting for the Company's stock option plan. Accordingly, compensation cost for stock options is measured as the excess, if any, of the estimated fair value of the Company's stock at the date of the grant, over the amount an employee must pay to acquire the stock. Stock based awards for non-employees are accounted for at fair value equal to the excess of the estimated fair value of the Company's stock over the option price using an estimated interest rate to calculate the fair value of the option. There were no stock based awards to non-employees in 2005 or 2004.

Had compensation cost for all stock option grants been determined based on their fair value at the grant dates, consistent with the method prescribed by SFAS 148 and SFAS 123, our net loss and loss per share would have been adjusted to the pro forma amounts indicated below:

	<b>Year ended December 31,</b>	
	<b>2005</b>	<b>2004</b>
Net loss	\$ (2,729,273)	\$ (3,662,390)
Add: Stock based compensation costs included in net loss	37,702	54,170
Stock-based compensation costs	(52,160)	(58,880)
Pro forma net loss	\$ (2,743,731)	\$ (3,667,100)
Basic and diluted earnings per share:		
As reported	\$ (0.05)	\$ (0.46)
Pro forma under SFAS No. 123	\$ (0.05)	\$ (0.46)

Earnings (loss) per share

Basic earnings (loss) per common share (EPS) are based on the weighted average number of common shares outstanding during each period (see Note 9). Diluted earnings per common share are based on shares outstanding (computed as under basic EPS) and potentially dilutive common shares. As of December 31, 2005 and 2004, the Company had granted stock options for 76,000 and 96,500 shares of common stock, respectively, that are potentially dilutive common shares but are not included in the computation of loss per share because their effect would be anti-dilutive.

Comprehensive income (loss)

The Company has no items of other comprehensive income (loss) for the years ended December 31, 2005 and 2004.

Fair value of financial instruments

The Company believes that the carrying value of its cash, accounts receivable, accounts payable, accrued liabilities, notes payable and notes payable to related parties as of December 31, 2005 approximates their respective fair values due to the demand or short-term nature of those instruments. The carrying value of long-term obligations

approximates the fair value based on the effective interest rates compared to current market rates.

F-8

---

**SENSOR SYSTEM SOLUTIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004**

Concentration of credit risk

Financial instruments that are exposed to concentrations of credit risk consist principally of cash and accounts receivable. The Company places its cash in what it believes to be credit-worthy financial institutions. However, cash balances may have exceeded federally insured levels at various times during the year. The Company has not experienced any losses in such accounts and believes it is not exposed to any significant risk in cash.

The Company had two customers that accounted for 45% of sales and four customers that accounted for 29% of sales in the years ended December 31, 2005 and 2004, respectively. Approximately 90% of the Company's sales in the years ended December 31, 2005 and 2004 were to customers in North America.

Reclassification

Certain prior year amounts have been reclassified to conform to the current year presentation.

Recent accounting pronouncements

In November 2004, the FASB issued Statement of Financial Accounting Standards No. 151, "Inventory Costs". This Statement amends the guidance in ARB No. 43 Chapter 4 Inventory Pricing, to require items such as idle facility costs, excessive spoilage, double freight and rehandling costs to be expensed in the current period, regardless if they are abnormal amounts or not. This Statement will become effective for us in the first quarter of 2006. The adoption of SFAS No. 151 is not expected to have a material impact on the Company's consolidated financial statement.

In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standard ("SFAS") No. 123 (R), "Share-Based Payment" ("SFAS 123(R)"). SFAS No. 123 (R) revises SFAS 123, "Accounting for Stock-Based Compensation" and supersedes Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees." SFAS 123 (R) focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. SFAS 123 (R) requires companies to recognize in the statement of operations the cost of employee services received in exchange for awards of equity instruments based on the grant-date fair value of those awards (with limited exceptions). SFAS 123 (R) is effective as of the first interim or annual reporting period of the first fiscal year that begins after June 15, 2005 for small business issuers. Accordingly, the Company will adopt SFAS 123 (R) in its quarter ending March 31, 2006.

As permitted by SFAS 123, the Company currently accounts for share-based payments to employees using APB 25's intrinsic value method. Accordingly, adoption of SFAS 123R's fair value method will have an effect on results of operations, although it will have no impact on overall financial position. The impact of adoption of SFAS 123R cannot be predicted at this time because it will depend on levels of share-based payments granted in the future. However, had SFAS 123R been adopted in prior periods, the effect would have approximated the SFAS 123 pro forma net loss and loss per share disclosures as shown above. SFAS 123R also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as currently required, thereby reducing net operating cash flows and increasing net financing cash flows in periods after adoption.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections." This Statement replaces APB No. 20, "Accounting Changes" and FASB No. 3, "Reporting Accounting Changes in Interim Financial Statements", and changes the requirements for the accounting for and reporting of a change in accounting principle.

This Statement applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement includes specific transition provisions. When a pronouncement includes specific transition provisions, those provisions should be followed. This Statement requires retrospective application to prior periods' financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. The adoption of SFAS No. 154 did not have an impact on the Company's consolidated financial statements.

F-9

---

**SENSOR SYSTEM SOLUTIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004**

**NOTE 2 INVENTORY**

Inventory consists of the following as of December 31, 2005:

Raw materials	\$ 204,748
Finished goods	97,423
	\$ 302,171

**NOTE 3 PROPERTY AND EQUIPMENT**

Property and equipment consists of the following as of December 31, 2005:

Machinery and equipment	\$ 593,312
Office equipment	2,636
Furniture and fixtures	17,398
Equipment under capital leases	47,365
Leasehold improvements	143,637
	804,348
Less, accumulated depreciation and amortization	(570,486)
	\$ 233,862

Depreciation and amortization expense of \$93,355 and \$109,954 is reflected in Operating Costs in the accompanying Consolidated Statements of Operations for the years ended December 31, 2005 and 2004, respectively.

As of December 31, 2005 the Company maintained tooling assets with a net book value of approximately \$90,000 at its main supplier located in Taiwan. During the first quarter of 2006, these tooling assets were sold for approximately \$88,000 to Universal Sensors, Inc., a joint venture in which the Company owns 30% (see Note 4).

**NOTE 4 INVESTMENT IN AFFILIATED ENTITIES**Universal Sensors, Inc.

In April 2005, the Company, China Automotive Systems, Inc. (CAAS) and Shanghai Hongxi Investment Inc. (HX) formed Universal Sensors, Inc. (USI), a joint venture in the People's Republic of China to develop, produce and market sensor and related electronic products. The ownership percentages of USI are 30%, 60% and 10% to the Company, CAAS and HX, respectively. CAAS and HX will contribute cash, land and building and the Company will contribute technology. As there was no cash contributed by the Company and the technology it contributed is not recorded as an asset on the Company's books, the Company's investment in USI is recorded at zero. USI is in a start-up mode and had not begun operations as of December 31, 2005. USI has incurred cumulative losses at December 31, 2005 of approximately \$232,000. The Company has not recorded any loss from USI since its investment is zero. The Company will not record any income in the future until such time as USI is cumulatively profitable. During 2005, the Company had sales of approximately \$93,000 to USI.

**SENSOR SYSTEM SOLUTIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004**

TransOptix, Inc.

The Company had an investment in TransOptix, Inc. (TransOptix), that, when combined with the Company's Chief Executive Officer's ownership interest in TransOptix, resulted in the Company accounting for its investment in TransOptix under the equity method of accounting. The Company discontinued applying the equity method in 2002 when its share of losses of TransOptix exceeded its investment in TransOptix. There were no transactions between the Company and TransOptix in 2005 and 2004 and the Company did not record any income or loss from TransOptix in 2005 or 2004. The Company and TransOptix shared the same office and facility lease. TransOptix declared bankruptcy in August 2005 and the Company took over TransOptix's share of the facility lease (see Note 11).

## NOTE 5 NOTES PAYABLE

Notes payable consist of the following at December 31, 2005:

Two lines of credit, unsecured, interest payable monthly at 10.25% and 11.5% per annum, due on demand.	\$ 92,983
--	-----------

Note payable, unsecured, interest payable monthly at Prime + 3% per annum (prime rate at December 31, 2005 was 7.25%), due on demand.	40,000
---	--------

Note payable, unsecured, interest payable monthly at 10% per annum, payable as a percentage of any future private or public stock offerings.	90,000
--	--------

Four notes payable, secured by all assets of the Company, interest at 8% per annum, payable at various maturities through May 30, 2006. One note for \$200,000 was due February 21, 2006 and was converted into a note due August 21, 2006. Two notes for \$64,800 and \$32,400 were due on April 18, 2006 and April 20, 2006, respectively. The Company is currently negotiating an extension of these notes. The fourth note, for \$49,707, is due May 30, 2006. At maturity, the notes are convertible at the holder's option at a conversion price equal to 70% of the weighted average price of the common stock for the 30 trading days immediately preceding the conversion date. In addition, each note has warrants attached that, once the note is converted into stock, allow the holder to purchase stock at 85% of the weighted average price of the common stock for the 30 trading days immediately preceding the conversion date. Two of these notes were originally scheduled to mature in the fourth quarter of 2005. The notes and the accrued interest were rolled over into the new notes. The intrinsic value of the beneficial conversion feature of the notes and warrants, valued at \$223,012, has been recorded as loan discount costs and is being amortized over the life of the respective notes as additional interest cost.	346,907
---	---------

Note payable, secured by all assets of the Company, interest at 10% per annum, payable on December 23, 2006. The note is convertible, with some limitations, at the holder's option at a conversion price equal to the lesser of \$0.35 or 90% of the lowest volume weighted average price of the common stock for the 15 trading days immediately preceding the conversion date. In addition, the note has detachable warrants that allow the holder to buy 600,000 shares of common stock at \$0.2878 per share and another 600,000 shares at \$0.35 per share.	800,000
---	---------

Less, remaining debt discount	(309,719)
	\$ 1,060,171

F-11

---

**SENSOR SYSTEM SOLUTIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004**

## NOTE 6 NOTES PAYABLE, RELATED PARTIES

Notes payable to related parties consist of the following at December 31, 2005:

<p>Note payable to the sister of the Company's Chief Executive Officer, secured by all assets of the Company, interest at 14.25% per annum, due December 31, 2004. The note payable was originally issued by ACSI, which merged with the company in 2004. In connection with the note payable, ACSI issued warrants expiring September 17, 2008, to purchase 190,665 shares of ACSI's common stock at \$.50 per share (the ACSI warrant is convertible into 5,372,940 shares of the Company's stock). The intrinsic value of the warrants (\$190,665) was recorded as loan discount costs and was amortized over the life of the original note as additional interest cost. The Company is currently negotiating an extension of this note.</p>	<p>\$ 190,665</p>
<p>Note payable to the sister of the Company's Chief Executive Officer, secured by all assets of the Company, interest at 10.0% per annum, due March 15, 2005. The note payable was originally issued by ACSI in 2003, at which time ACSI issued a warrant expiring September 17, 2008, to purchase 100,000 shares of stock at \$.50 per share (the ACSI warrant is convertible into 2,817,215 shares of the Company's common stock. The intrinsic value of the original warrant (\$100,000) was recorded as loan discount costs and was amortized over the life of the original note as additional interest cost. The original note was due September 16, 2004. On September 16, 2004, a new note was issued to replace the original note. At maturity, the new note is convertible at the holder's option at a conversion price equal to 80% of the weighted average price of the common stock for the 30 trading days immediately preceding the conversion date. In addition, the note has warrants attached that, once the note is converted into stock, allow the holder to purchase stock at 85% of the weighted average price of the common stock for the 30 trading days immediately preceding the conversion date. The intrinsic value of the beneficial conversion feature of the note and warrants, valued at \$48,125, has been recorded as loan discount costs and is being amortized over the life of the note as additional interest cost. The Company is currently negotiating an extension of this note.</p>	<p>110,000</p>
<p>Note payable to an employee of the Company, secured by all assets of the Company, interest at 8.0% per annum, due May 30, 2006. At maturity, the note is convertible at the holder's option at a conversion price equal to 70% of the weighted average price of the common stock for the 30 trading days immediately preceding the conversion date. In addition, the note has warrants attached that, once the note is converted into stock, allow the holder to purchase stock at 85% of the weighted average price of the common stock for the 30 trading days immediately preceding the conversion date. The intrinsic value of the beneficial conversion feature of the note and warrants, valued at \$13,886, has been recorded as loan discount costs and is being amortized over the life of the note as additional interest cost. This note was due November 12, 2005, and the principal and accrued interest were converted into a new note due May 30, 2006.</p>	<p>21,600</p>
<p>Note payable to shareholder, secured by all assets of the Company, interest at 8.0% per annum, due February 3, 2006. The principal and accrued interest (\$4,000) were converted into a new note due April 3, 2006. That note was converted at maturity into 342,000 shares of the Company's common stock at a conversion price equal to 70% of the weighted average price of the common stock for the 30 trading days immediately preceding the conversion date. In</p>	<p>50,000</p>

addition, the note has warrants attached that, once the note is converted into stock, allow the holder to purchase stock at 85% of the weighted average price of the common stock for the 30 trading days immediately preceding the conversion date. The intrinsic value of the beneficial conversion feature of the note and warrants, valued at \$32,143, has been recorded as loan discount costs and is being amortized over the life of the note as additional interest cost.

Less, remaining debt discount	(3,700)
	\$ 368,565

F-12

---

**SENSOR SYSTEM SOLUTIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004**

**NOTE 7 CAPITAL LEASE OBLIGATIONS**

The Company leases certain equipment under two capital leases with monthly payments of \$360 and \$701, respectively, including interest at 12.75% per annum. Future minimum annual rental payments for capitalized leases are as follows:

Years ending December 31,	Amount
2006	\$ 12,732
2007	12,732
2008	12,732
2009	3,903
	42,099
Amount representing interest	(7,900)
Present value of minimum lease payments	34,199
Less: current portion	(8,877)
Non-current portion	\$ 25,322

**NOTE 8 INCOME TAXES**

There is no income tax provision due to continuing tax losses. Significant components of the Company's deferred income tax assets at December 31, 2005 and 2004 are as follows:

	2005	2004
Deferred income tax asset:		
Net operating loss carryforward	\$ 2,090,000	\$ 1,716,000
Valuation allowance	(2,090,000)	(1,716,000)
Net deferred income tax asset	\$ -	\$ -

Reconciliation of the effective income tax rate to the U.S. statutory rate is as follows:

	2005	2004
Tax expense at the U.S. statutory income tax rate	(34.0)%	(34.0)%
Increase in the valuation allowance	34.0	34.0
Effective income tax rate	-%	-%

Deferred taxes are recorded to give recognition to temporary differences between the tax bases of assets or liabilities and their reported amounts in the financial statements. Deferred tax assets generally represent items that can be used as a tax deduction or credit in future years. Deferred tax liabilities generally represent items that we have taken a tax deduction for, but have not yet recorded in the Consolidated Statements of Operations.

Net operating loss carryforwards totaling approximately \$4.7 million federal and \$1.7 million state amounts at December 31, 2005 are being carried forward. The net operating loss carryforwards expire at various dates through 2025 for federal purposes and 2015 for state purposes. A full valuation allowance has been established due to the lack of earnings as support for recognition of the deferred tax assets recorded.



**SENSOR SYSTEM SOLUTIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004**

**NOTE 9 STOCKHOLDERS' EQUITY**

On October 6, 2005, the Company secured financing through, among others, a Standby Equity Distribution Agreement (SEDA) with Cornell Capital Partners, LP (Cornell) to support the continued development and growth of the Company. In connection with the SEDA the Company issued 1,471,429 shares of the Company's common stock to Cornell and 28,571 shares of the Company's common stock to Monitor Capital for fees. The fair value of the shares issued was determined to be \$0.51 per share based on the OTC Bulletin Board (OTCBB) closing price for the Company's stock on October 6, 2005, for a total fair value of \$765,000. Also on October 6, 2005, the Company sold an aggregate of \$600,000 of convertible debentures to Cornell and issued a warrant to Cornell to purchase 600,000 shares of the Company's common stock, at \$0.35 per share, expiring October 6, 2009.

On December 23, 2005, the Company and Cornell terminated the SEDA and related agreements. The Company recorded the fair value of the shares of common stock issued to Cornell in relation to the SEDA as stock-based compensation expense in the accompanying financial statements. Also on December 23, 2005, the Company agreed to sell an aggregate of \$1,000,000 of convertible debentures to Cornell, of which \$610,000 of the initial \$800,000 proceeds was used to repay the convertible debentures issued to Cornell on October 6, 2005 plus accrued interest thereon of \$10,000. On February 14, 2006, Cornell advanced an additional \$200,000 on a convertible note payable to bring the total borrowing from Cornell to \$1,000,000. Cornell is entitled, at its option, to convert and sell all or any part of the principal amount of the \$1,000,000 convertible debentures, plus any and all accrued interest, into shares of the Company's common stock at a price equal to the lesser of (i) \$0.35 or (ii) 90% of the lowest volume weighted average price of the common stock, as defined, during the fifteen trading days immediately preceding the date of conversion as quoted by Bloomberg, LP. Also on December 23, 2005, the Company issued a warrant to Cornell to purchase 600,000 shares of the Company's common stock, at \$0.2878 per share, expiring December 23, 2010.

On October 19, 2005, the Company issued 725,778 shares of common stock to a lender for warrants exercised by the lender in March 2005.

On May 24, 2004 (the date of the Merger, see Note 1), the Company issued 2,584,905 shares of its common stock and warrants to purchase up to 47,802,373 shares of its common stock, to the shareholders of ACSI in exchange for all the issued and outstanding shares of ACSI. In January 2005, the warrants were exercised and the 47,802,373 shares of common stock were issued.

On December 4, 2004, the Company granted 7,500,000 shares of its common stock to five shareholders in Spectre, including two individuals who are also Directors of the Company, for providing services to the Company. 1,500,000 shares were treated as compensatory stock with a fair value \$1.20 per share, representing the most recent OTCBB closing price prior to that date, for a total of \$1,800,000 and was recognized as stock-based compensation expense in the accompanying financial statements. The remaining 6,000,000 shares were treated as a stock dividend. All share and per share amounts included herein have been restated to reflect the effects of the grant as if it had occurred at the date of the Merger. The 7,500,000 shares of common stock were issued in January 2005.

Effective June 8, 2004 the Board of Directors initiated a fifteen for one reverse split of the common stock. It also increased the authorized number of common stock shares from 100,000,000 to 180,000,000. All share and per share amounts included herein have been restated to reflect the effects of the split as if had occurred at the beginning of the period.

On September 3, 2004, the Company negotiated a settlement of an unsecured note payable for \$250,000 that was due March 9, 2004. Terms of the settlement require the Company to pay \$90,000 plus interest at 10% per annum, payable from future stock offerings. In addition, the Company agreed to issue 200,000 shares of common stock to the lender. The fair value of the shares to be issued was determined to be \$1.50 per share based on the OTC Bulletin Board (OTCBB) closing price for the Company's stock on September 3, 2004, for a total fair value of \$300,000. The Company recorded the difference between the net carrying amount of the extinguished note (\$250,000) and the settlement price (\$390,000) as settlement costs on note payable of \$140,000 as operating expenses in the accompanying financial statements. 200,000 shares of the Company's common stock were issued to the lender on October 20, 2005.

F-14

---

**SENSOR SYSTEM SOLUTIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004**

## NOTE 10 STOCK OPTIONS AND WARRANTS

## Stock Option Plan

The Company has a stock option plan, which provides for the granting of options to employees, independent representatives and directors of the Company. The Company is authorized to issue 200,000 shares of common stock. The exercise price is fixed by the plan administrator. The shares vest over 4 years upon the optionee's completion of service. The options expire ten years from the date of grant.

For the year ended December 31, 2004, in accordance with APB No. 25, the intrinsic value of the 10,000 stock options granted under this plan was \$19,800 and was recorded as deferred compensation and additional paid-in capital in the accompanying financial statements (and is being amortized over the vesting periods of the options). No options were granted in 2005. Amortization of the deferred compensation related to stock options totaled \$37,702 and \$54,170 in 2005 and 2004, respectively.

At December 31, 2005, options outstanding are as follows:

	Shares	Average Exercise Price
Balance at January 1, 2005	96,500	\$ .50
Granted	-	
Exercised	-	
Cancelled	(20,500)	.50
Balance at December 31, 2005	76,000	\$ .50

Additional information regarding options outstanding as of December 31, 2005 is as follows:

Exercise price	Options outstanding		Weighted average exercise price	Options exercisable	
	Number outstanding	Weighted average remaining contractual life (years)		Number exercisable	Weighted average exercise price
\$0.50	76,000	0.5	\$0.50	76,000	\$0.50

Subsequent to year end, the board of directors approved a new stock option plan. The above options were converted to 10 options for the Company's shares for each ACSI option outstanding and were repriced at the closing price of the Company's shares on March 3, 2006.

## Warrants

During 2004, in conjunction with the issuance of a note payable, the board of directors approved the issuance of warrants to purchase a total of 500,000 shares of ACSI's common stock. The warrants were exercised in 2005 and upon conversion of the note payable into the Company's stock, 14,479,093 shares of the Company's common stock were recorded as common stock to be issued.

On May 24, 2004, as part of the merger between the Company and ACSI, the Company issued warrants to purchase up to 47,802,373 shares of its common stock. The warrants were exercised in 2005 at \$.0001 per share.

During 2005, in conjunction with the issuance of a note payable, the board of directors approved the issuance of warrants to purchase a total of 1,286,866 shares of the Company's common stock at prices between \$0.2878 and \$0.35 per share. The warrants expire between October 2009 and December 2010.

F-15

---

**SENSOR SYSTEM SOLUTIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004**

At December 31, 2005, stock purchase warrants outstanding were as follows:

	Shares	Average Exercise Price
Balance at January 1, 2005	48,618,039	\$ .0080
Granted	1,286,866	.3168
Exercised	(48,327,373)	.0055
Converted to the Company's shares from ACSI shares	7,899,489	.0177
Balance at December 31, 2005	9,477,021	\$ .0584

Additional information regarding stock purchase warrants outstanding as of December 31, 2005 is as follows:

Exercise price	Warrants outstanding		Warrants exercisable		
	Number outstanding	Weighted average remaining contractual life (years)	Weighted average exercise price	Number exercisable	Weighted average exercise price
\$0.0177	8,190,155	2.7	\$0.0177	8,190,155	\$0.0177
\$0.2878	686,866	4.9	\$0.2878	686,866	\$0.2878
\$0.35	600,000	4.8	\$0.35	600,000	\$0.35

**NOTE 11 COMMITMENT AND CONTINGENCIES**

**Operating Leases**

The Company leases its office and facility through July 31, 2007 under a long-term operating lease agreement. Under terms of the lease, the Company pays the cost of repairs and maintenance. The office and warehouse facility was formerly shared with TransOptix, but since the bankruptcy of TransOptix the Company is liable for the entire lease obligation.

Future minimum lease commitments at December 31, 2005 are as follows:

Years ending December 31,	Amount
2006	\$ 250,900
2007	151,095
	\$ 401,995

Rent expense for the years ended December 31, 2005 and 2004 was \$185,924 and \$122,907 respectively.

**SENSOR SYSTEM SOLUTIONS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004**

NOTE 12 SUBSEQUENT EVENTS

In January 2006, a note payable for \$40,000 was converted from an interest only, due on demand note into a three-year note with even principal payments due monthly plus interest.

On February 3, 2006, a note payable for \$50,000 and accrued interest of \$4,000 was converted into a new note for \$54,000, due April 3, 2006 with interest payable at 8% per annum. The note was secured by all assets of the Company. At maturity, the note was converted into 342,000 shares of the Company's common stock.

On February 14, 2006, Cornell advanced an additional \$200,000 on a new convertible note payable in one year bringing the total borrowing from Cornell to \$1,000,000.

On February 22, 2006, a note payable for \$200,000 was issued to replace a note that matured on February 21, 2006. The note is secured by all assets of the Company, interest is payable at 8% per annum, and the note matures on August 21, 2006. At maturity, the note is convertible at the holder's option at a conversion price equal to 75% of the average closing bid price of the Company's common stock for the month of February 2006. In addition, the note has warrants attached that, once the note is converted into stock, allow the holder to purchase stock at 85% of the weighted average price of the common stock for the 30 trading days immediately preceding the date of notice of exercising.

F-17

---