

CHINA EDUCATION ALLIANCE INC.  
Form 10QSB  
August 18, 2006

United States  
Securities and Exchange Commission  
Washington, D.C. 20549  
Form 10-QSB

QUARTERLY REPORT UNDER SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2006

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 333-101167

China Education Alliance, Inc.  
(Exact name of small business issuer as  
specified in its charter)

North Carolina  
(State or other jurisdiction of  
incorporation or organization)

56-2012361  
(I.R.S. Employer Identification No.)

80 Heng Shan Rd. Kun Lun Shopping Mall  
Harbin, P.R. China 150090  
(Address of principal executive offices)

001-86-451-8233-5794  
(Issuer's telephone number)

N/A  
(Former name, former address and former fiscal year, if changed since last report)

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

**APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY  
PROCEEDINGS DURING THE PRECEDING FIVE YEARS**

Check whether the registrant filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Exchange Act after the distribution of securities under a plan confirmed by a court. Yes  No

**APPLICABLE ONLY TO CORPORATE ISSUERS**

State the number of shares outstanding of each of the issuer's classes of common equity as of the latest practicable date: 57,915,000 shares as of August 16, 2006

Transitional Small Business Disclosure Format (check one): Yes  No

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CHINA EDUCATION ALLIANCE, INC.  
INDEX

PART I. FINANCIAL INFORMATION

Item 1. Financial Information:

Condensed Consolidated Balance Sheet as of June 30, 2006

Condensed Consolidated Statements of Operations for the three months and six months ended June 30, 2006 and 2005

Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2006 and 2005

Notes to the Condensed Consolidated Financial Statements

Item 2. Management's Discussion and Analysis or Plan of Operations

Item 3. Controls and Procedures

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 3. Defaults upon Senior Securities

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

Item 5. Other Information

Item 6. Exhibits

Signatures

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**PART I. FINANCIAL INFORMATION**

## ITEM 1. FINANCIAL STATEMENTS

|  |              |
|--|--------------|
| Current Assets   |              |
| Cash and Cash Equivalents (Note 5)   | \$ 2,774,961 |
| Inventories (Note 6)   | 1,166        |
| Prepaid Expense  | 115,549      |
| Other Receivable   | -            |
| Total Current Assets   | 2,891,676    |
| Property and Equipment   |              |
| Fixed Assets, Net of Accum. Depreciation (Note 7)  | 3,832,515    |
| Total Property and Equipment   | 3,832,515    |
| Total Assets   | \$ 6,724,191 |
| Current Liabilities  |              |
| Accounts Payable and Accrued Expenses (Note 8)   | \$ 7,989     |
| Advances on Accounts (Note 9)  | 290,016      |
| Loan from Shareholder (Note 15)  | 229,423      |
| Wages Payable  | 4,567        |
| Welfare Payable  | 6,575        |
| Taxes Payable (Note 10)  | 65,594       |
| Total Current Liabilities  | 604,164      |
| Total Liabilities  | 604,164      |
| Shareholders' Equity   |              |
| Preferred Stock (\$0.001 par value, 5,000,000 shares authorized, none issued and outstanding)      | -            |
| Common Stock (\$0.001 par value, 150,000,000 shares authorized, 57,915,000 issued and outstanding) | 57,915       |
| Additional Paid-in Capital   | 2,407,969    |
| Currency Conversion Adjustment (Note 3)  | 77,767       |
| Retained Earnings  | 3,576,376    |
| Total Shareholders' Equity   | 6,120,027    |
| Total Liabilities and Shareholders' Equity   | \$ 6,724,191 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

**CHINA EDUCATION ALLIANCE AND SUBSIDIARIES**  
**Condensed Consolidated Statements of Operations**  
**for the three months and six months ended June 30, 2006**  
**(Expressed in US dollars)**  
**(Unaudited)**

|  | For the Three Months Ended June 30, |            | For the Six Months Ended June 30, |            |
|--|-------------------------------------|------------|-----------------------------------|------------|
|  | 2006                                | 2005       | 2006                              | 2005       |
| <b>REVENUES (Note 3)</b>   |                                     |            |                                   |            |
| Sales and Tuition  | \$ 2,166,854                        | \$ 285,411 | \$ 3,514,257                      | \$ 364,028 |
| Less: Cost of Good Sold  | 663,612                             | 30,656     | 1,157,363                         | 56,294     |
| Gross Profit   | 1,503,242                           | 254,755    | 2,356,894                         | 307,734    |
| <b>OPERATING EXPENSES</b>  |                                     |            |                                   |            |
| Selling , General and Administrative Expenses                                  | 204,309                             | 33,815     | 378,905                           | 78,261     |
| Total Operating Expenses   | 204,309                             | 33,815     | 378,905                           | 78,261     |
| <b>OTHER EXPENSES (INCOME)</b>   |                                     |            |                                   |            |
| Finance Costs (Income)   | (4,026)                             | 2,219      | (4,922)                           | 6,159      |
| Total Other Expenses (Income)  | (4,026)                             | 2,219      | (4,922)                           | 6,159      |
| Net Income before Income Taxes   | 1,302,959                           | 218,721    | 1,982,911                         | 223,314    |
| Less:Provision for Income Taxes (Note 11)                                      | -                                   | 74,101     | -                                 | 77,714     |
| Net Income   | \$ 1,302,959                        | \$ 144,620 | \$ 1,982,911                      | \$ 145,600 |
| <b>Earnings per share attributed to China Education Alliance common stock:</b> |                                     |            |                                   |            |
| <b>Basic income per share</b>  | \$ 0.0225                           | \$ 0.0025  | \$ 0.0342                         | \$ 0.0025  |
| <b>Diluted income per share</b>  | \$ 0.0225                           | \$ 0.0025  | \$ 0.0342                         | \$ 0.0025  |
| <b>Basic weighted average shares outstanding</b>                               | 57,915,000                          | 57,915,000 | 57,915,000                        | 57,915,000 |

The accompanying notes are an integral part of these condensed consolidate financial statements.

**CHINA EDUCATION ALLIANCE AND SUBSIDIARIES**  
**Consolidated Statements of Cash Flow**  
**For the Six Months Ended June 30, 2006**  
**(Unaudited)**

|  | For the six months ended |                   |
|--|--------------------------|-------------------|
|  | 6/30/06                  | 6/30/05           |
| <b>Cash flows from operating activities:</b>                                     |                          |                   |
| Net income   | \$ 1,302,959             | \$ 144,620        |
| Adjustments to reconcile net income to net cash provided by operating activities |                          |                   |
| Depreciation   | 78,477                   | 48,778            |
| Changes in assets and liabilities -  |                          |                   |
| Decrease in inventories  | 1,624                    | 5,042             |
| Increase in prepaid expense  | (1,865)                  | -                 |
| Decrease in other receivable   | 8,315                    | 362               |
| Decrease in accounts payable and accrued expenses                                | (14,071)                 | (22,409)          |
| Decrease in advance on account   | (243,262)                | -                 |
| Decrease in wages payable  | (1,095)                  | -                 |
| Decrease in welfare payable  | (1,221)                  | -                 |
| Increase in taxes payable  | 39,797                   | 72,215            |
| Net cash provided by operating activities  | 1,169,658                | 248,608           |
| <b>Cash flows from investing activities:</b>                                     |                          |                   |
| Purchases/(transfer) of fixed assets   | (1,955)                  | -                 |
| Net cash used by investing activities  | (1,955)                  | -                 |
| <b>Cash flows from financing activities:</b>                                     |                          |                   |
| Increase in loan from shareholders   | 52,065                   | 7,827             |
| Proceeds from stockholder  |                          | 10,000            |
| Net cash provided by financing activities  | 52,065                   | 17,827            |
| Currency conversion adjustments  | 8,534                    | -                 |
| <b>Net increase in cash</b>  | <b>1,228,302</b>         | <b>266,435</b>    |
| <b>Cash at beginning of year</b>   | <b>1,546,659</b>         | <b>156,863</b>    |
| <b>Cash at end of year</b>   | <b>\$ 2,774,961</b>      | <b>\$ 423,298</b> |

The accompanying notes are an integral part of these condensed consolidate financial statements.

**China Education Alliance and Subsidiaries**  
**Notes to the Consolidated Financial Statements**  
**June 30, 2006**  
**(Unaudited)**

**1. Description of Business**

**Nature of organization**

China Education Alliance, Inc. (CEDA), formerly known as ABC Realty Co., was originally organized under the laws of the State of North Carolina on December 2, 1996. The main function for the ABC Realty was to engage in residential real estate transactions as a broker or agent. On September 15, 2004, ABC Realty was reorganized pursuant to the Plan of Exchange to acquire Harbin Zhong He Li Da Education Technology, Inc. (“ZHL D”), a Corporation formed on August 9, 2004 in the city of Harbin of Heilongjiang Province, the People’s Republic of China, with an authorized capital of \$60,386 (RMB500,000).

On September 15, 2004, ABC Realty Co. executed a Plan of Exchange with ZHL D, and Duane C. Bennett, Chairman of ABC Realty Co., pursuant to which ZHL D exchanged all of its registered capital of \$60,386 for 55,000,000 shares, or approximately 95% of the common stock. On November 17, 2004, ABC Realty Co. changed its name to China Education Alliance, Inc. On December 13, 2004, China Education Alliance, Inc. consummated the Plan of Exchange with ZHL D. As a result of the Plan of Exchange, the transaction was treated for accounting purposes as a capital transaction and a recapitalization by the accounting acquirer, ZHL D and as reorganization by the accounting acquired, China Education Alliance, Inc.

China Education Alliance, Inc. is only a holding company, it has no revenues. The Company carries its business mainly through its wholly owned subsidiaries, ZHL D and the Zhonghe Education Training Center in the business of online education and training center in China.

ZHL D is a technology company engaged in the online education industry in China. Its mission is to impel the distance learning development in China, to improve the efficiency and effectiveness of elementary education, higher education, vocational education, skill education, continuing education, and professional training programs, and to integrate with the international education system. As a multiplicative, comprehensive, and authoritative education frontrunner, the Company has firmly occupied its hegemonic position in the online education industry through its abundant teachers, rich teaching knowledge, and plentiful teaching achievements.

Heilongjiang Zhonghe Education Training Center (“ZH TC”) was registered in the People’s Republic of China on July 8, 2005 with a registered capital of \$60,386, is the wholly owned subsidiary of ZHL D. ZHL D owns 99% of interest in the ZH TC with a *de minimis* number of 1% shares owned by present executive officer, Xi Qun Yu of ZHL D and ZH TC, as required by People’s Republic China’s Business Enterprise law.

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**1. Description of Business (Continued)**

The Company's online education business has established leading positions in several high growth segments, including supplemental education and the test preparation for grades kindergarten through high school.

The Company's products include on-line test preparation materials, teachers' materials, study guides and audio recordings of popular classes. It is a full range professional education resource service provider. The business scope includes distance learning technology, education resource development, education project planning and promoting, teaching platform, and the class development and schedule, education information, and technical service. The products cover all education ranges, including pre-school education, elementary and middle school education, vocational education, continuing education, enterprise training program, intelligence authentication, agricultural labor education, education for the disabled, first time employment education, re-employment education, study abroad, education for the aged people.

**2. Basis of Preparation of Financial Statements**

China Education Alliance is only a holding company; it has no revenues but only minor maintenance expenses. The functional currency for its subsidiaries is denominated in "Renminbi" ("RMB") or "Yuan". ZHLD and Zhonghe Education Training Center maintain its books and accounting records in Renminbi ("RMB"). It is the currency of the primary economic environment in which the entities operates, and in accordance with law and accounting requirements of People's Republic of China law and accounting practices.

The accompanying unaudited condensed consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) and in accordance with accounting principles generally accepted in the United States of America ("US GAAP").

**Principles of Consolidation** - The consolidated financial statements include the accounts of the Company and its subsidiary, China Education Alliance, ZHLD, and Zhonghe Education Training Center. All inter-company transactions and balances were eliminated.

**3. Summary of Significant Accounting Policies**

**Use of estimates** - The preparation of these financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affected the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of net sales and expenses during the reported periods.

Significant estimates included values and lives assigned to acquired intangible assets, reserves for customer returns and allowances, uncollectible accounts receivable, slow moving, obsolete and/or damaged inventory and stock option valuation. Actual results may differ from these estimates.



**Cash and cash equivalents** - The Company considers all highly liquid debt instruments purchased with maturity period of three months or less to be cash equivalents. The carrying amounts reported in the accompanying consolidated balance sheet for cash and cash equivalents approximate their fair value.

**Inventories** - inventories were accounted for using the first-in, first-out method and included freight-in, materials, packing materials, labor and overhead costs and were stated at the lower of cost or market, cost being determined by a moving weighted average. Provision is made for slow moving, obsolete and/or damaged inventory based on a periodic analysis of individual inventory items, including an evaluation of historical usage and/or movement, age, expiration date and general condition.

**Property and equipment** - Property and equipment are stated at the historical cost, less accumulated depreciation. Depreciation on property, plant and equipment is provided using the straight-line method over the estimated useful lives of the assets after taking into account estimated residual value of 5% of cost or valuation for both financial and income tax reporting purposes as follows:

|                                     |          |
|-------------------------------------|----------|
| Buildings                           | 20 years |
| Communication Equipments            | 10 years |
| Motor vehicles                      | 5 years  |
| Furniture, Fixtures, and Equipments | 5 years  |

Expenditures for renewals and betterments were capitalized while repairs and maintenance costs are normally charged to the statement of operations in the year in which they are incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the asset, the expenditure is capitalized as an additional cost of the asset.

Upon sale or disposal of an asset, the historical cost and related accumulated depreciation or amortization of such asset were removed from their respective accounts and any gain or loss was recorded in the Consolidated Statements of Operations.

Property and equipment are evaluated for impairment in value annually or whenever an event or change in circumstances indicates that the carrying values may not be recoverable. If such an event or change in circumstances occurs and potential impairment is indicated because the carrying values exceed the estimated future undiscounted cash flows of the asset, the Company would measure the impairment loss as the amount by which the carrying value of the asset exceeds its fair value.

**Foreign currency translation** - These financial statements have been prepared in U.S. dollars. China Education Alliance is only a holding company; it has no revenues with minor expenses, except those related to its ownership interest in ZHLD and Zhonghe Education Training Center. The functional currency for the ZHLD and Zhonghe Education Training is denominated in "Renminbi" ("RMB") or "Yuan". ZHLD and Zhonghe Education Training maintain its books and accounting records in Renminbi ("RMB"). It is the currency of the primary economic environment in which the entities operates.

FASB Statement of Financial Accounting Standards No. 52, "Foreign Currency Translation" requires differentials to be calculated and allocated using the current rate method if the foreign entity's functional and local currencies are the same. Non-monetary assets and liabilities are translated at historical exchange rates. Monetary assets and liabilities are translated at the exchange rates in effect at the end of the year. The income statement accounts are translated at average exchange rates.

The conversion gains and losses are not recognized in the income statement under the functional currency approach. They are accumulated in a separate account in stockholders' equity (i.e., the cumulative foreign exchange translation adjustments account). This treatment is based on the FASB's view that translation gains or losses are not directly related to the foreign entities' operating cash flows. As a result, the Company recognized in equity the effect of currency translation in the amount of \$77,767.

The official exchange rates as of June 30, 2006 for one US dollar, were 8.0065 RMB.

**Income recognition** - Revenue is recognized in accordance with Staff Accounting Bulletin No. 104, Revenue Recognition, which states that revenue should be recognized when the following criteria are met: (1) persuasive evidence of an arrangement exists; (2) the service has been rendered; (3) the selling price is fixed or determinable; and (4) collection of the resulting receivable is reasonably assured. The Company believes that these criteria are satisfied upon customers download prepaid debit card. Revenue is reduced by provisions for estimated returns and allowances, which are based on historical averages that have not varied significantly for the periods presented, as well as specific known claims, if any.

Prepaid debit cards allow our subscribers to make a predetermined monetary amount of download materials posted on our website. The Company new system is able to track usage of the debit card once the end user uses the debit cards for its service. At the time that the prepaid debit card is purchased, the receipt of cash is recorded as a subscriber prepayment. Revenues are recognized in the month when services are actually rendered. Unused value relating to debit cards is recognized as revenues when the prepaid debit card has expired.

Interest income is recognized when earned, taking into account the average principal amounts outstanding and the interest rates applicable

**Prepayments Account**-Prepaid expenses are primarily comprised of advance payments made for services to teachers for online materials and video.

**Other Receivable** - Other Receivable is prepaid account included advances to employees, that included cash prepaid to employees for their travel, entertainment and transportation expenditures.

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**Deferred Revenue/Subscriber Prepayments** - Deferred revenue related to subscription services represents the portion of unearned subscription revenue, which is amortized on a monthly, straight-line basis, as earned. Deferred revenue related to education service website advertising service, or technology services represents that portion of amounts billed by the Company, or cash collected by the Company, for which services have not yet been provided or earned in accordance with the Company's revenue recognition policy.

**Impairment of Long-Lived Assets** - The Company periodically evaluates the recoverability of the carrying amount of its long-lived assets in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". Whenever events or changes in circumstances indicate that the carrying amounts of those assets may not be recoverable, the Company compares the undiscounted net cash flows estimated to be generated by those assets to the carrying amount of those assets.

When these undiscounted cash flows are less than the carrying amounts of the assets, the Company will record impairment losses to write the asset down to fair value, measured by the discounted estimated net future cash flows expected to be generated from the assets. During the periods ended June 30, 2006, no such impairments have occurred.

**Advertising** - The Company expensed advertising costs the first time the respective advertising took place. These costs were included in selling, general and administrative expenses. The total advertising expenses incurred for period ended June 30, 2006 was \$24,878.

**Income Taxes** - Provision is made in the financial statements for taxation of profits in accordance with PRC legislation currently in force. The Company accounts for income taxes under the liability method in accordance with SFAS No. 109, "Accounting for Income Taxes". Under the liability method, deferred income taxes reflect the future tax consequences of temporary differences between the tax and financial statement basis of assets and liabilities and are measured using enacted tax rates applied to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in the tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is provided when it is more likely than not that some or all of the deferred tax assets will not be realized in the future. These evaluations are based on the expectations of future taxable income and reversals of the various taxable temporary differences.

Provision for The People's Republic of China enterprise income tax is calculated at the prevailing rate based on the estimated assessable profits less available tax relief for losses brought forward. As of June 30, 2006, The Company is still enjoyed the income tax exemption for 2 years and half for 3 years suitable as foreign invested company.

**Enterprise income tax**

Under the Provisional Regulations of The People's Republic of China Concerning Income Tax on Enterprises promulgated by the State, income tax is payable by enterprises at a rate of 33% of their taxable income. Preferential tax treatment may, however, be granted pursuant to any law or regulations from time to time promulgated by the State Council.

Enterprise income tax ("EIT") is provided on the basis of the statutory profit for financial reporting purposes, adjusted for income and expense items, which are not assessable or deductible for income tax purposes.

**Value added tax**

The Provisional Regulations of The People's Republic of China Concerning Value Added Tax promulgated by the State Council came into effect on January 1, 1994. Under these regulations and the Implementing Rules of the Provisional Regulations of the PRC Concerning Value Added Tax, value added tax is imposed on goods sold in or imported into the PRC and on processing, repair and replacement services provided within the PRC.

Value added tax payable in The People's Republic of China is charged on an aggregated basis at a rate of 13% or 17% (depending on the type of goods involved) on the full price collected for the goods sold or, in the case of taxable services provided, at a rate of 17% on the charges for the taxable services provided, but excluding, in respect of both goods and services, any amount paid in respect of value added tax included in the price or charges, and less any deductible value added tax already paid by the taxpayer on purchases of goods and services in the same financial year.

**Contingent liabilities and contingent assets** - A contingent liability is a possible obligation that arises from past events and whose existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Company. It can also be a present obligation arising from past events that is not recognized because it is not probable that outflow of economic resources will be required or the amount of obligation cannot be measured reliably.

A contingent liability is not recognized but is disclosed in the notes to the financial statements. When a change in the probability of an outflow occurs so that outflow is probable, they will then be recognized as a provision.

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain events not wholly within the control of the Company.

Contingent assets are not recognized but are disclosed in the notes to the financial statements when an inflow of economic benefits is probable. When inflow is virtually certain, an asset is recognized.

**Related companies** - A related company is a company in which the director has beneficial interests in and in which the Company has significant influence.

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**Retirement benefit costs** - According to The People's Republic of China regulations on pension, the Company contributes to a defined contribution retirement scheme organized by municipal government in the province in which the Company was registered and all qualified employees are eligible to participate in the scheme.

Contributions to the scheme are calculated at 23.5% of the employees' salaries above a fixed threshold amount and the employees contribute 2% to 8% while the Company contributes the balance contribution of 21.5% to 15.5%. The Company has no other material obligation for the payment of retirement benefits beyond the annual contributions under this scheme.

**Fair value of financial instruments** - The carrying amounts of certain financial instruments, including cash, accounts receivable, commercial notes receivable, other receivables, accounts payable, commercial notes payable, accrued expenses, and other payables approximate their fair values as of June 30, 2006 because of the relatively short-term maturity of these instruments.

**Recent accounting pronouncements** -

In June 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections, replacement of APB Opinion NO. 20 and FASB Statements NO 3. SFAS NO. 154 applies to all voluntary changes in accounting principle, and changes the requirements for accounting for and reporting of a change in accounting principle. SFAS No. 154 requires retrospective application to prior periods' financial statements of a voluntary change in accounting principle unless it is impracticable. Accounting Principles Boards ("APB") Opinion No. 20 previously required that most voluntary changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. SFAS No. 154 requires that a change in method of depreciation, amortization, or depletion for long-lived, nonfinancial assets be accounted for as a change in accounting estimate that is affected by a change in accounting principle. APB Opinion No. 20 previously required that such a change be reported as a change in accounting principle. The Company adopted SFAS No. 154 on January 1, 2006. The adoption of the provisions of SFAS No. 154 had no material effect on the Company's consolidated financial statements.

In December 2004, the FASB issued SFAS No. 153, Exchanges of Non-monetary Assets-amendment of APB Opinion No. 29. SFAS No. 153 eliminates the exception to fair value for exchanges of similar productive assets and replaces it with a general exception for exchange transactions that do not have commercial substance, defined as transactions that are not expected to result in significant changes in the cash flows of the reporting entity. This statement is effective for exchanges of non-monetary assets occurring after June 15, 2005. Management believes adoption of this new statement will not have any significant effect on the Company's financial condition or results of operations.

**4. Concentrations of Business and Credit Risk**

Substantially all of the Company's bank accounts are in banks located in the PRC and are not covered by any type of protection similar to that provided by the FDIC on funds held in U.S banks.

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The Company is operating in China, which may give rise to significant foreign currency risks from fluctuations and the degree of volatility of foreign exchange rates between U.S. dollars and the Chinese currency RMB.

Financial instruments that potentially subject the Company to concentration of credit risk consist principally of cash and trade receivables, the balances of which are stated on the balance sheet. The Company places its cash in high credit quality financial institutions. Concentration of credit risk with respect to trade receivables are limited due to the Company's large number of diverse customers in different locations in China. The Company does not require collateral or other security to support financial instruments subject to credit risk. 90 percent the age of the Company's accounts receivable are less than 60 days.

## 5. Cash and Cash Equivalents

As of June 30, 2006, Cash and cash equivalents consist of the following:

|   | 06/30/06            |
|---|---------------------|
| <b><i>Cash and Cash Equivalents</i></b> |                     |
| Cash on Hand                            | \$ 10,168           |
| Bank Deposits                           | 2,764,793           |
| <b>Total Cash and Cash Equivalents</b>  | <b>\$ 2,774,961</b> |

## 6. Inventories

The Company values its inventories at the lower of cost or market method. Inventories are accounted for using the first-in, first-out method. Inventories in the balance sheet include finished products.

As of June 30, 2006, Inventories consist of the following:

|                         | 06/30/06        |
|-------------------------|-----------------|
| <b><i>Inventory</i></b> |                 |
| Debit Cards & materials | \$ 1,166        |
| <b>Total Inventory</b>  | <b>\$ 1,166</b> |

## 7. Property and Equipment

As of June 30, 2006, Property and Equipment consist of the following:

|                                      | 06/30/06            |
|--------------------------------------|---------------------|
| <b><i>Property and Equipment</i></b> |                     |
| Buildings                            | \$ 2,766,787        |
| Transportation Vehicles              | 113,390             |
| Office Equipments                    | 328,273             |
| Machinery                            | 1,030,638           |
| <b>Total Property and Equipment</b>  | <b>4,239,088</b>    |
| Less: Accumulated Depreciation       | (406,573)           |
| <b>Property and Equipment, Net</b>   | <b>\$ 3,832,515</b> |

For the year ended June 30, 2006, depreciation expenses totals \$78,477.



**8. Accounts Payable and Accrued Expense**

As of June 30, 2006, Total Accounts Payable and Accrued Expense consist of the following:

|  | <b>06/30/06</b> |
|--|-----------------|
| <b><i>Total Accounts Payable and Accrued Expense</i></b> |                 |
| Accounts Payable and Accrued Expense                     | \$ 7,989        |
| Wages Payable  | 5,662           |
| Welfare Payable  | 7,796           |
| Total Accounts Payable and Accrued Exp                   | \$ 21,447       |

**9. Advances on accounts**

Advances on accounts include subscriber prepayments and education fee prepayments. Subscriber prepayments represents customer prepayments for the purchase of debit cards used to pay for the online downloading of education materials, including testing booklets, supplemental materials, and teaching video clips. The Company values the sales based on the actual occurrence of customer download. Therefore, the spare time between the purchase of debit cards and actual download is recorded under advances on accounts as deferred or unearned revenues to the Company. Once the download takes place, the amount is then transferred from advances on accounts to sales. Education fee prepayments represent customer prepayments for the service provided by the Company of teaching and educating the customers for their specific need at their desired education level. There are various levels existed for the customers to choose the best one that fits their individual needs. During the period, a great portion of advances were consumed and recognized as income, due to occurrences of several state-wide entrance exams for junior middle schools, high schools, and universities. During the period, more advances were paid by customers for the summer classes at the time of registration. As of June 30, 2006, the Company has \$290,016 on subscriber prepayment and prepayments instruction fees.

**10. Taxes Payable**

As of June 30, 2006, taxes payable consist of the following:

|                                    | <b>06/30/06</b> |
|------------------------------------|-----------------|
| <b><i>Taxes Payable</i></b>        |                 |
| Value Added Tax                    | \$ 46,689       |
| Operation Tax                      | 5,978           |
| Stamp Tax                          | 175             |
| Individual Income Tax              | 11,852          |
| Flood and Security Prevention Fund | 884             |
| Living Garbage Fees                | 16              |
| Total Taxes Payable                | \$ 65,594       |

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**11. Income Taxes**

The Company commences business in the PRC which is governed by the Income Tax Law of the PRC concerning Enterprises and various local income tax laws (the "Income Tax Laws"). Under the Income Tax Laws, enterprises generally are subject to an income tax at an effective rate of 33% (30% state income taxes plus 3% local income taxes) on income as reported in their statutory financial statements after appropriate tax adjustments unless the enterprise is located in specially designated regions or cities for which more favorable effective rates apply.

On September 15, 2004, China Education Alliance executed a Plan of Exchange with Zhong He Li Da Education Technology, Inc. ("ZHL D"), a corporation organized and existing under the laws of People's Republic of China. ZHL D applied to be as a foreign invested company right after the merger, which business license has been approved as a foreign invested company on April 8, 2005. According to Chinese taxation policy, there is income tax exemption for 2 years and half for 3 years suitable to foreign invested company, advanced Technology Company or software Development Company. ZHL D is a Company under the category of all three. Therefore the Company enjoys this income tax exemption policy from April 8, 2005 the date approval as a foreign invested company. The formal documents about income tax exemption in advance issued on December 26, 2005. The Company was still enjoyed the income tax exempt status as of June 30, 2006.

**12. Capital Reserves**

As stipulated by the relevant laws and regulations applicable to China's foreign investment enterprises, the Company is required to make appropriations from net income as determined under accounting principles generally accepted in the PRC ("PRC GAAP") to non-distributable reserves which include a general reserve, an enterprises expansion reserve and employee welfare and bonus reserves. In accordance with the provisions of the Company's Memorandum and Articles of Association, the Company is required to appropriate 10% of the net distributable profit after enterprises income tax to capital reserve.

The general reserve is used to offset future extraordinary losses as defined under PRC GAAP. The Company may, upon a resolution passed by the owners, convert the general reserve into capital. The employee welfare and bonus reserve is used for the collective welfare of the employees of the Company. The enterprise expansion reserve is used for the expansion of the Company and can be converted to capital subject to approval by the relevant authorities. The Company recorded reserves of capital of \$130,296 on June 30, 2006. No such adjustments are required under accounting principles generally accepted in the United States of America in 2006.

**13. Employee Retirement Benefits and Post Retirement Benefits**

According to the Heilongjiang Provincial regulations on State pension scheme, both employees and employers have to contribute pension. The pension contributions are ranging from 8% that was contributed by individuals (employees) and the Company is required to make contributions to the state retirement plan based on 20% of the employees' monthly basic salaries. Employees in the PRC are entitled to retirement benefits calculated with reference to their basic salaries on retirement and their length of service in accordance with a government managed benefits plan. The PRC government is responsible for the benefit liability to these retired employees.

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**14. Commitments and Contingencies**

In the event that the Company succeeds in its business strategy, in all likelihood, competition will develop. The degree of competition cannot presently be ascertained. However, there can be no assurances that the Company will have the resources to compete effectively, especially to the extent that the market experiences rapid growth.

No government approvals are required to conduct the Company's principal operations, and the Company is not aware of any probable governmental regulation of our business sectors in the near future. Although management believes that the Company is in material compliance with the statutes, laws, rules and regulations of every jurisdiction in which it operates, no assurance can be given that the Company's compliance with the applicable statutes, laws, rules and regulations will not be challenged by governing authorities or private parties, or that such challenges will not lead to a material adverse effect on the Company's financial position, results of operations or cash flows.

The Company is not involved in any legal matters arising in the normal course of business. While incapable of estimation, in the opinion of the management, the individual regulatory and legal matters in which it might involve in the future are not expected to have a material adverse effect on the Company's financial position, results of operations or cash flows.

**15. Loans from Shareholder**

In connection with ABC Realty Merger (see Note 1), the shareholder, Xiqun Yu loaned the Company for \$100,000 at a 9% interest rate originally signed in December 2004. Annual amount of interest is payable together with principal. The shareholder pays all necessary oversea consulting and advising fees, lawyer fees, and accounting fees from period to period out of his own personal bank accounts in the United States due to the strict laws and regulations imposed by the Chinese government on out-going foreign currency wire transfers. The amount outstanding as of June 30, 2006 is \$229,423. The loan matures in end of 2006. The loan from shareholder has the option to convert in two years to company common stock at the market price on the date the Company incurred the loan.

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATIONS**

The following discussion should be read in conjunction with the Consolidated Financial Statements of the Company and the notes thereto included elsewhere herein.

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The statements contained in this report include forward-looking statements about information of possible or assumed results of operations, business strategies, financing plans, competitive position and potential growth opportunities. Forward-looking statements include all statements that are not historical facts and are generally accompanied by words such as “may,” “will,” “intend,” “anticipate,” “believe,” “estimate,” “expect,” “should” or similar expressions or the negation of such words or expressions. These statements also relate to the Company’s contingent payment obligations relating to acquisitions, future capital requirements, potential acquisitions and the Company’s future development plans and are based on current expectations. Forward-looking statements involve various risks, uncertainties and assumptions. The Company’s actual results may differ materially from those expressed in these forward-looking statements.

Our discussion and analysis of our financial condition and results of operations are based upon our unaudited consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. On an on-going basis, we evaluate these estimates, including those related to useful lives of real estate assets, cost reimbursement income, bad debts, impairment, net lease intangibles, contingencies and litigation. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. There can be no assurance that actual results will not differ from those estimates.

The discussion that follows is based on our consolidated results of operations for the three months period ended June 30, 2006 and 2005.

## **OVERVIEW**

China Education Alliance, Inc. (“CEDA”), formerly known as ABC Realty, Inc., is registered in the state of North Carolina, USA. The company’s primary business activity is online education and on-site training services. It offers large scale of high-quality educational resources, and focuses on network education as well as on-site training. It is mainly operated through its wholly owned subsidiaries, Harbin Zhonghelida Education Technology Company Limited with registered website domain [www.edu-chn.com](http://www.edu-chn.com) for its online education and Heilongjiang Zhonghe Education Center for its on-site training services.

China Education Alliance, Inc. dedicates to develop IT education industry and offer network solution for the education course of China. As an excellent education resources provider and operator, CEDA has a leading interactive business platform. It made full use of the network resources, and broke through the time and space limits of the traditional teaching methods and the face-to-face constraints on high-quality resources. Through the physical integrations and successful case spreading, it serves to change the uneven education resources distribution and create a better sharing of education resources across China. Meanwhile, it is promoting the Chinese education by opening schools and training agencies. It has shaped [www.edu-chn.com](http://www.edu-chn.com) to become a leading functional portal website, through the enforcement of the “on-site” training business. It has become a network and physical training agency.

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As a provider and operator of high-quality education resources, China Education Alliances, Inc., based on its know-how of the educational market in China and its own strengths, currently takes the exam-oriented education in junior middle and high school as its core business. The company combined its superior network operating experience with rich education resources integrating experience, and takes the company's website as a platform to carry out services like "Famed Instructors Test Paper Store" through its service charging system by way of rechargeable learning cards. The learners can study via online classrooms or materials downloading for offline education. The company also provides on-site teaching services under the "Big Classroom of the Famed Instructors" program through its state-of-the-art training center.

www.edu-chn.com is a major functional education resources portal website in China. It provides plenty of client resources and strong brand promotion for business developing. Under the website, there are four modules, eight alliances, nine platforms and eight columns of interactive entertainment columns. It provides informative education products through the updated communication tools under www.edu-chn.com. It provides multi-media resources such as college school, middle school and elementary school test papers, courseware, and video data since 1980s, owning intellectual property rights for more than 300,000 sets of courseware and test papers. www.edu-chn.com is a major enterprise-class comprehensive education network platform which based on the network video technology and the large data sources of elementary education resources. It provides online education and material download for customers by integrating "the big classroom of the famed instructors". By the end of 2005, more than 3 million visitors had viewed the website.

Heilongjiang Zhonghe Education Center engages in the on-site training services and face-to-face tutorship under "The Big Classroom of the Famed Instructors" program and its VOD courseware resources. The usable area for the training center is about 3400 square meters, with 17 modern classrooms that has capacity of 1,200 students. The courses covered each phases of compulsory education, and take the junior middle and high school as the key part.

While the company is focusing on the exam-oriented education in junior middle and high school as its core business, it is also developing new services to fulfill the blanks of online vocational training services. www.360ve.com is a "high-quality vocational teaching resource supermarket" to be launched in the coming future. Based on the body of joint enrollment of vocational education, the portal website will join China Vocational Education Society to conduct online vocation training and the relevant certificate offering services. It aims to forge an "online supermarket" for vocation trainees, as well as vocational training agencies. While www.360ve.com is a "selling mall" of network platform which combines its own educational resources with other authenticable educational resources, it almost concludes content in every sector so as to meet the different needs of different vocation learners. CEDA will integrate the vocational education resources in www.edu-chn.com, and join the China Vocation Education Society to set up www.360ve.com. In the future, it will become a powerful search engine for the vocational education enrollment and a guider for the learners. The core business is to offer network-based marketing and promoting solutions for training agencies, and to hold display and all-round promotions for training agencies. Meanwhile, with the assistance of China Vocational Education Society, www.360ve.com will establish cooperating agencies with provincial education bureau as well as Branch Society of China Vocational Education to attract investment and carry out strategic cooperation with the outstanding training agencies in local area, especially in the aspects of joint enrollment, resources exchanging and on-site training agencies establishment. www.360ve.com is expected to become a dominant media and battlefield for China's vocation education. It would present the trend and states of the vocational education to the public so as to create a dynamic and interactive vocation training system. Once it is fully integrated, the vocation certificating center is expected to be an essential part of CEDA business. Through the authorizing of China Vocation Education Society, the vocational certificating center will contact and coordinate education ministry, labor ministry and other authorized government agencies to draw up benchmark for different education training sectors and organize performance evaluation.

The Company has formed several strategic alliances with the Chinese vocational education society, the government educated information center, the authentication training center, and other multitudinous government department and education department to enhance the influence of the Company, as well as its products and services provided.

The Company has carried out various level cooperation with over one thousand professors in their respective expertise fields, more than two thousand membership schools, school principals exceeding three thousand, and school teachers in excess of fifty thousand, as well as over one hundred news media and twenty scholarly research organizations.

In order for the company to continue developing products, expanding services, and growing in the long-term, CEDA plans to finance \$6 million through equity financing in the international capital market. About \$4 million will be used to duplicate exam-oriented model from regional to national. The balance will be used as initial input for vocational market development and its “Millions of College Students Employment Crossroad” program. The fund will also used to better assist the utilizing of unlimited space of network to promote resource sharing network solutions featured with on-line instructors teaching and resource downloading to put down the barriers among different markets. With www.edu-chn.com is building instructors’ resource base, an overall business operations can be completed as the on-site training offered. The Regional Development will start with the establishment of the regional instructors’ resource base to build local tutorship centers by rental or cooperation. Once complete, it will start to install local www.edu-chn.com station that is consisted of 15 to 20 servers to spread the educational resources and promoting the company. With the completion of Exam-oriented-education market layout to be set nationwide. CEDA will take every chance to integrate existing vocation education resource and come up with the solution of vocation education resource sharing.

## RESULTS OF OPERATIONS

### Results from Operations - Comparison of Three-month Period Ended June 30, 2006 and 2005

|                          | June 30, 2006 | June 30, 2005 |
|--------------------------|---------------|---------------|
| Sales                    | \$ 2,166,854  | \$ 285,411    |
| Less: Cost of Goods Sold | 663,612       | 30,656        |
| Gross Profit             | \$ 1,503,242  | \$ 254,755    |

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**Revenues** increased by 659% in the second quarter to \$2,166,854 in 2006 from \$285,411 in 2005, resulting in net income of \$1,302,959 for the second quarter of 2006 compared to net income of \$292,822 for 2005. The company was in its initial state of operation on December 2004, prior to June 30, 2005, the company devoted to build up its business model, the business started expanding since then. In addition, this year the company started its marketing for the state-wide entrance exams for junior middle schools, high schools, and universities, those exams are held between May and July each year. More educational courses were viewed and more materials were downloaded during such span of time by the students. The income from the stimulation test download was around \$345,400. The training center was not in operation prior to June 30, 2005. Gross revenue from training center was around \$424,700 in the second quarter, 2006, the gross profit was around \$223,200 and the gross margin was 52% in the three months ended period ended June 30, 2006. The income was also attributable to the increase of advertising income earned. The company has contract with a reputable advertising company to handle its internet commercial accounts. The sales from advertising were around \$342,200.

**Cost of sales** increased by 2065% to \$663,612 in the second quarter of 2006 as compared to \$30,656 of 2005. This was primarily due to the increase of sales, which results the cost of teachers, booklets and simulation test material to increase.

**Gross profit margin** increased by 490% for the second quarter of 2006. Gross profit margins vary from product to product depending on a number of factors including: (a) cost of materials; (b) overall market demand and individual customer demand; (c) cost of intellectual property rights; and (d) competitor pricing policies.

**Selling and operating expenses** represented expenditures in connection with the distribution and selling of properties as well as expenses incurred for the operating of the business.

|                                     | June 30, 2006 | June 30, 2005 |
|-------------------------------------|---------------|---------------|
| Operating Expenses                  |               |               |
| Selling, General and Administrative | \$ 204,309    | \$ 33,815     |
| Total Operating Expenses            | 204,309       | 33,815        |
| Other Income (Expenses)             |               |               |
| Interest Income                     | 4,026         | (2,219)       |
| Total Other Income (Expenses)       | \$ 4,026      | \$ (2,219)    |

Selling, general and administrative expenses increased by \$170,494 or 504% from \$33,815 in the second quarter of 2005 to \$204,309 in the second quarter of 2006. The unfavorable variance was mainly attributed to the increases in business promotion, advertising events, and salaries to sales staffs.

Depreciation increased by \$29,699 or 60% to \$78,477 for the second quarter of 2006 compared to \$48,778 for 2005. This was mainly attributable to the increase in one building and the additional office equipments.

## LIQUIDITY AND CAPITAL RESOURCES

The company's assets primarily consist of its operating subsidiaries, marketable properties for sales, cash and cash equivalents.

The Company has \$2,774,961 in cash and cash equivalent at June 30, 2006 compares to \$285,411 at June 30, 2005. The Company's current ratio at June 30, 2006 was 4.79. Its primary sources of funds include cash balances, cash flow from operations, the potentially, the proceeds of prepayments made by customers, in addition, shareholder loaned to company to pay certain USA office maintenance fees. The management endeavors to ensure that the funds are always available to take advantage of new investment opportunity and they are sufficient to meet future liquidity and capital needs. Management considers current working capital and borrowing capabilities adequate to cover the Company's planned operating and capital requirements. For future operating, management plans to finance \$6 million through equity financing in the international capital market.

**Cash and cash equivalents** increased by \$2,351,663 or 556% to \$2,774,961 as of June 30, 2006 compared to \$423,298 as of June 30, 2005 were mainly due to the increase of sales.

There was no restrictive bank deposit pledged as of June 30, 2006 and 2005. Therefore, the Company did not have to maintain any minimum balance in the relevant deposit account as security.

**Inventories** decreased by \$3,568 or 75% to \$1,166 as of June 30, 2006 from \$4,734 as of June 30, 2005. The decrease in inventories is primarily due to the significant increase in sales. The cost of making debt cards is very small.

**Prepaid expense** recorded \$115,549 as of June 30, 2006 (2005: \$nil). Prepaid expenses are primarily comprised of advance payments made for services to teachers for online materials and video. The company was still in the initial stage of launching numeral programs. Prior to June 30, 2005, therefore, no prepaid expense occurred during the period prior to June 30, 2005.

**Properties and equipment** stated at cost less accumulated depreciation and amortization consist of:

|                                | June 30, 2006 | June 30, 2005 |
|--------------------------------|---------------|---------------|
| Property and Equipments        | 4,239,088     | 2,407,600     |
| Less: Accumulated Depreciation | (406,573)     | (130,077)     |
| Property and Equipment, Net    | \$ 3,832,515  | \$ 2,277,523  |

Net book value of fixed assets increased by \$1,554,992 or 68% to \$3,832,515 as of June 30, 2006 compared to \$2,277,523 as of June 30, 2005 was mainly attributable to the purchase of new building and office equipments and furniture in the amount of about \$1.8 million, less accumulated depreciation.

Depreciation expense for the three months ended June 30, 2006 was \$78,477.

|  | June 30, 2006     | June 30, 2005     |
|--|-------------------|-------------------|
| <b>Current Liabilities</b>             |                   |                   |
| Accounts payables and accrued expenses | \$ 7,989          | \$ 11,515         |
| Advances on accounts                   | 290,016           | -                 |
| Loan from shareholder                  | 229,423           | 97,365            |
| Wages payable                          | 4,567             | -                 |
| Welfare payable                        | 6,575             | -                 |
| Taxes payable                          | 65,594            | 77,714            |
| <b>Total Current Liabilities</b>       | <b>\$ 604,164</b> | <b>\$ 186,594</b> |

**Current liabilities** increased by \$417,570 or 224% to \$604,164 as of June 30, 2006 compared to \$186,594 as of June 30, 2005 were attributable to the increase in advances on accounts and other business expense payable. The shareholder pays all necessary oversea consulting and advising fees, lawyer fees, and accounting fees from period to period out of his own personal bank accounts in the United States due to the strict laws and regulations imposed by the Chinese government on out-going foreign currency wire transfers. The amount outstanding as of June 30, 2006 is \$229,423 compared to \$97,365 as June 30, 2005.

**Accounts payable and accrued expenses** decreased by \$3,526 or 31% to \$7,989 as of June 30, 2006 compared to \$11,515 as of June 30, 2005 was attributable to the decrease in accrued expense.

**Advances on accounts** recorded \$290,016 as of June 30, 2006 (2005: \$nil) was attributable to the usage of the prepaid debit card system. Advances on accounts are deferred revenues prepaid by customers for the future download of materials thru company website.

**Loan from shareholder** increased by \$132,058 or 135% to \$229,423 as of June 30, 2006 compared to \$97,365 as of June 30, 2005 was attributable to the shareholder payments on behalf of the company to oversea financial advisors, consultants and accounting fees for services provided.

**Capital reserve** represented that amount appropriated from net income after tax (Enterprise Income Tax) for the year. As stipulated by the relevant laws and regulations applicable to China's foreign invested enterprises, the company is required to make appropriations from net income as determined under accounting principles generally accepted in the PRC ("PRC GAAP") to the statutory surplus reserves which include a general reserve, an enterprises expansion reserve, and employee welfare and bonus reserves. Pursuant to the relevant PRC regulations and the provisions of the Company's Memorandum and Articles of Association, the Company is required to appropriate 10% of the net distributable profit after enterprise income tax to capital reserve, profit attributable to the shareholders shall be appropriated in the following sequence; the general reserve is used to offset future extraordinary losses as defined under PRC GAAP. The company may, upon a resolution passed by the owners, convert the general reserve into capital.



The employee welfare and bonus reserve is used for the collective welfare of the employees of the company. The enterprise expansion reserve is used for the expansion of the company and can be converted to capital subject to approval by the relevant authorities. The Company record reserves of \$130,296 for the three months ended June 30, 2006. No such adjustments are required under accounting principles generally accepted in the United States of America in 2006.

## **INDUSTRY AND MARKET OUTLOOK**

The education resources distribution is uneven in different areas across China; most of the excellent teachers are in the developed areas and key middle schools. Among the 15998 high schools in China, 847 of them are key schools, which account for 5.29%. Most of the excellent teachers' resources are in the key high schools, the ratio of college entrance of key high school is higher than 90%, but the national average ratio of college entrance is about 55%.

Most of high-quality resources of China elementary education often centralize in a few of key schools, and its amount and the scale are quite limited. Because the college entrance rate of key high schools is higher than that of the ordinary high schools, so, each student expects to enter the key high school where they can obtain the most excellent teaching resources. The students who have poor performance but want to enter into the key high school must pay additional "school selecting fees". According to the Chinese Nanfang Daily, in China the school selecting fees was more than RMB 27 billion in 2005, which is over \$3 billion. There are even about 20% students entering into high school through sponsorship and school selecting fee in China. Thus it can be noted that the China elementary and secondary education is in urgent need for high-quality education resources.

On the whole, the China online education market is still at the preliminary stage. In 2004, China online education market turnover reached RMB 14.4 billion, about \$1.8 billion. As China becomes more information-oriented, while people become increasingly aware of the network' function, the size of the online education market will increase dramatically. iResearch, a well-known market consulting firm, forecasts the China online market turnover in 2005, 2006, and 2007 will reach RMB 18.1 billion, RMB 23.3 billion, and RMB 29.6 billion respectively.

According to the China Network Information Center's statistics as of December 31, 2005, the total number of internet users in China was 111 million, ranked second over the world, a increase of 17 million compared with the same period a year earlier or 18.1% higher. The students account for 35.7%, about 39.627 million (objects of exam-oriented education); company staff accounted for 29.70%, about 32.967 million (objects of profession education); the jobless accounted for 6.9%, about 7.657 million (objects of vocational education); the China online education market is of great potential.

## **QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

As of June 30, 2006, the Company had no material derivative instruments. The Company may enter into derivative financial instrument transactions in order to mitigate its interest rate risk on a related financial instrument in the future.

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The Company's balance sheet includes amount of assets and liabilities whose fair values are subject to market risk. Market risk is the risk of loss arising from adverse changes in market prices or interest rates. Generally, the Company's borrowing is short to medium term in nature and therefore approximate fair value. The Company currently has interest rate risk as it related to its fixed maturity mortgage participation interest. The Company seeks to limit the impact of interest rate changes on earnings and cash flows and to lower its overall borrowing costs by closely monitoring its interest rate debt.

The Company's equity risk as it related to its marketable equity securities, and foreign currency risk as it relates to investments denominated in foreign currencies. The Company and its subsidiaries are mainly located in China, there were no significant changes in exchange rates, and however, unforeseen developments may cause a significant change in exchange rates. The Company is subject to commodity price risks arising from price of construction materials.

The Company's expansion risk is in connection with the rapid development of Internet and growth of its users. Online learning will become one of the dominant and efficient ways of learning for students. This is the main risk for business development, considering the habits of customers and the popularization of broadband business. The management team worked out a solution by direct communicating with students in forefront, lightening up the idea that training is far beyond face-to-face teaching, various of ways should be occupied, such as downloading learning, online learning and other ways to attract students to use, familiar with and rely on the internet and services, including but not limited to individual service and interactive entertainment service of [www.edu-chn.com](http://www.edu-chn.com).

The company's competition risk lies with its education resources. As the provider of education resource, the high-quality education resource is the core competitive power for education enterprises. Currently, Chinese high-quality elementary education resource is not balanced on a provincial-basis and locally focused featuring key schools. The schools that have the local education resource can open the local learning website, and have strong competitive power. CEDA will duplicate the regional model in national market, with the strong internet operational capability; it will build the national leading educational service system and top brand of education service; integrate the advanced resource of local education organizations by united means and provide partial educational resource for the public schools. Under the principle of providing operating platform, CEDA plans to build the regional educational organizations, and reach a win-win situation with public schools, and to realize the CEDA's ambition of sharing high-grade resources.

### ITEM 3. CONTROLS AND PROCEDURES

The Company's Chief Executive Officer/President and its Chief Financial Officer/principal accounting officer (collectively, the "Certifying Officers") are responsible for establishing and maintaining disclosure controls and procedures for the Company. Such officers have concluded (based upon their evaluation of these controls and procedures as of a date within 90 days of the filing of this report) that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in this report is accumulated and communicated to the Company's management, including its principal executive officers as appropriate, to allow timely decisions regarding required disclosure. The Certifying Officers also have indicated that there were no significant changes in the Company's internal controls or other factors that could significantly affect such controls subsequent to the date of their evaluation, and that there were no corrective actions necessary with regard to any significant deficiencies and material weaknesses.

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PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

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

None.

ITEMS 5. OTHER INFORMATION

N/A

ITEM 6. EXHIBITS

(a) Exhibits.

31.1 Certification of Xi Qun Yu

31.2 Certification of Wang Chunqing

32 Certification of Xi Qun Yu and Wang Chunqing

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SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**China Education Alliance, Inc.**

Date: August 17, 2006

By:

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Xi Qun Yu  
Chief Executive Officer and President

By:

\_\_\_\_\_

Wang Chunqing  
Chief Financial Officer

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