

CHINA EDUCATION ALLIANCE INC.

Form 10-Q

August 14, 2014

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended June 30, 2014

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

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

Commission file number: **001-34386**

**CHINA EDUCATION ALLIANCE, INC.**

(Exact name of registrant as specified in its charter)

**North Carolina**

(State or other jurisdiction of incorporation or organization)

**56-2012361**

(I.R.S. Employer Identification No.)

**58 Heng Shan Road, Kun Lun Shopping Mall**

**Harbin, People's Republic of China**

(Address of principal executive offices)

**150090**

(Zip Code)

**86-451-8233-5794**

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant (1) has filed reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

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

## **APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY**

### **PROCEEDINGS DURING THE PRECEDING FIVE YEARS**

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13, or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes  No

**APPLICABLE ONLY TO CORPORATE ISSUERS**

Indicate the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date:

As of August 13, 2014, there were 10,582,530 shares of \$0.001 par value common stock issued and outstanding.

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CHINA EDUCATION ALLIANCE, INC.

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**PART I –FINANCIAL INFORMATION****Item 1. Financial Statements****China Education Alliance, Inc. and Subsidiaries****Consolidated Balance Sheets**

	June 30, 2014 (Unaudited)	December 31, 2013
<b>ASSETS</b>		
Current Assets		
Cash and cash equivalents	\$42,589,275	\$ 56,377,154
Accounts receivable	22,724	-
Other receivables	581,304	262,547
Prepaid expenses and other current assets	703,954	727,708
Total current assets	43,897,257	57,367,409
Non-current Assets		
Property and equipment, net	7,939,425	8,251,612
Intangibles and capitalized software, net	4,635,416	5,099,934
Total non-current assets	12,574,841	13,351,546
Total Assets	\$56,472,098	\$ 70,718,955
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities		
Accounts payable and accrued expenses	\$435,365	\$ 1,076,625
Deferred revenue	1,172,637	854,027
Income tax and other taxes payable	218,348	111,500
Total current liabilities	1,826,350	2,042,152
Commitments and Contingent Liabilities	-	-
Stockholders' Equity		

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Common stock (\$0.001 par value, 150,000,000 shares authorized, 10,582,530 and 10,582,530 issued as of June30, 2014 and December 31, 2013, respectively; 137,512 and 137,512 shares held in treasury, as of June30, 2014 and December 31, 2013, respectively)	10,583	10,583
Additional paid-in capital	40,942,009	40,942,009
Statutory reserve	3,792,161	3,792,161
Retained earnings	(1,852,176 )	11,516,661
Accumulated other comprehensive income	12,253,850	12,705,287
Less: Treasury stock	(977,072 )	(977,072 )
Stockholders' equity - CEAI and Subsidiaries	54,169,355	67,989,629
Noncontrolling interests in subsidiaries	476,393	687,174
Total stockholders' equity	54,645,748	68,676,803
Total Liabilities and Stockholders' Equity	\$56,472,098	\$ 70,718,955

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

## China Education Alliance, Inc. and Subsidiaries

## Consolidated Statements of Operations and Comprehensive Income

(Unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Revenue				
Online education revenue	\$ 130,383	\$ 767,888	\$ 257,647	\$ 1,394,599
Training center revenue	459,155	1,142,759	1,056,585	2,958,580
Total revenue	589,538	1,910,647	1,314,232	4,353,179
Cost of Revenue				
Online education costs	1,072,595	1,409,183	2,107,464	2,763,504
Training center costs	377,479	570,107	775,004	1,286,952
Total cost of revenue	1,450,074	1,979,290	2,882,468	4,050,456
Gross Profit/(Loss)				
Online education gross profit/(loss)	(942,212 )	(641,295 )	(1,849,817 )	(1,368,905 )
Training center gross profit	81,676	572,652	281,581	1,671,628
Total gross profit/(loss)	(860,536 )	(68,643 )	(1,568,236 )	302,723
Operating Expenses				
Selling expenses	1,185,254	1,236,637	2,395,702	2,336,139
Administrative expenses	5,001,944	1,846,937	8,704,791	3,496,898
Depreciation and amortization	523,968	785,847	1,016,164	1,594,219
Total operating expenses	6,711,166	3,869,421	12,116,657	7,427,256
Loss from operations	(7,571,702 )	(3,938,064 )	(13,684,893)	(7,124,533 )
Other Income (Expense)				
Other income(expenses), net	9,967	(1,090 )	38,023	(2,807 )
Loss on disposal of property and equipment	(10,709 )	(7,363 )	(16,162 )	(10,132 )
Impairment loss on intangible assets	-	-	-	(606,032 )
Interest income	42,284	58,678	87,870	110,394
Total other income/(Expense), net	41,542	50,225	109,731	(508,577 )
Net Loss Before Provision for Income Tax	(7,530,160 )	(3,887,839 )	(13,575,162)	(7,633,110 )

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Income taxes:				
Current	-	-	-	-
Deferred	-	-	-	-
Net Loss	(7,530,160 )	(3,887,839 )	(13,575,162)	(7,633,110 )
Net Loss attributable to the noncontrolling interests	(138,388 )	(147,991 )	(206,325 )	(190,243 )
Net Loss - attributable to CEAI and Subsidiaries	\$(7,391,772 )	\$(3,739,848 )	\$(13,368,837)	\$(7,442,867 )
Net Loss per common stock-basic and diluted	\$(0.70 )	\$(0.35 )	\$(1.26 )	\$(0.70 )
Weighted Average Shares Outstanding-basic and diluted	10,582,530	10,582,530	10,582,530	10,582,530
The Components of Other Comprehensive Income				
Net Loss	\$(7,391,772 )	\$(3,739,848 )	\$(13,368,837)	\$(7,442,867 )
Foreign currency translation adjustment	60,654	1,271,719	(451,437 )	1,789,284
Comprehensive Loss	\$(7,331,118 )	\$(2,468,129 )	\$(13,820,274)	\$(5,653,583 )

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



**China Education Alliance, Inc. and Subsidiaries****Consolidated Statements of Cash Flows****(Unaudited)**

	Six Months ended June 30,	
	<b>2014</b>	<b>2013</b>
Cash flows from operating activities		
Net loss	\$(13,575,162)	\$(7,633,110)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization - operating expenses	1,016,164	1,496,222
Depreciation and amortization - cost of revenue	875,902	1,375,335
Loss on disposal of fixed assets	16,162	10,132
Bad debt written off on other receivables	-	-
Impairment loss on intangible assets	-	606,032
Stock based compensation	-	794
Net changes in operating assets and liabilities		
Accounts receivable	(22,586 )	(76,128 )
Prepaid expenses and other receivables	(300,171 )	237,990
Deferred tax assets	-	-
Accounts payable and accrued liabilities	(631,355 )	(137,570 )
Income tax and other taxes payable	106,848	(67,984 )
Deferred revenue	322,784	(97,793 )
Net cash used in operating activities	(12,191,414)	(4,286,080)
Cash flows from investing activities		
Purchases of property and equipment	(1,205,116 )	(35,235 )
Loan received back from NIT	-	8,013,462
Proceeds from disposal of property and equipment	2,602	1,186
Net cash (used in) provided by investing activities	(1,202,514 )	7,979,413
Cash flows from financing activities		
Dividend paid to noncontrolling shareholders	-	(352,592 )
Net cash used in financing activities	-	(352,592 )
Effect of exchange rate changes on cash	(393,951 )	1,380,701
Net increase (decrease) in cash and cash equivalents	(13,787,879)	4,721,442
Cash and cash equivalents at beginning of period	56,377,154	64,172,917
Cash and cash equivalents at end of period	\$42,589,275	\$68,894,359

Supplemental disclosure of cash flow information

Income tax paid	\$-	\$93,858
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The accompanying notes are an integral part of these consolidated financial statements.

## China Education Alliance, Inc. and Subsidiaries

### Notes to Unaudited Consolidated Financial Statements

#### 1. Description of Business

**Nature of organization** - China Education Alliance, Inc. (the “Company”), formerly known as ABC Realty Co., was organized under the laws of the State of North Carolina on December 2, 1996. ABC Realty Co.’s primary purpose was to act as a broker or agent in residential real estate transactions. On September 15, 2004, ABC Realty Co., pursuant to a Plan of Exchange, acquired Harbin Zhong He Li Da Education Technology, Inc. (“ZHL D”), a corporation formed on August 9, 2004 in the City of Harbin in the Heilongjiang Province, People’s Republic of China (the “PRC”), with an authorized capital of \$60,386 (Renminbi (“RMB”) 500,000).

On September 15, 2004, ABC Realty Co. entered into a Plan of Exchange with ZHL D and Duane C. Bennett, the former Chairman of ABC Realty Co., pursuant to which the shareholders of ZHL D exchanged all of their registered capital of \$60,386 for 18,333,334 shares of common stock of the Company, or approximately 95% of the Company’s then issued and outstanding common stock. On November 17, 2004, the Company changed its name to China Education Alliance, Inc. On December 13, 2004, the Company consummated the Plan of Exchange with ZHL D and ZHL D’s shareholders. As a result of the Plan of Exchange, the transaction was treated for accounting purposes as a recapitalization of ZHL D.

ZHL D is a technology company engaged in the online education industry in the PRC. Its mission is to promote online exam preparation services in the PRC, to improve the efficiency and effectiveness of elementary education, secondary education, vocational education, skill education, continuing education, and professional training programs, and to integrate with the international education system.

ZHL D’s subsidiary, Heilongjiang Zhonghe Education Training Center (“ZHTC”) was registered in the PRC on July 8, 2005 with a registered capital of RMB0.5 million (approximately \$60,788) and is accounted for as a wholly owned subsidiary of ZHL D. ZHL D owns 99% of ZHTC with 1% held in trust by Mr. Xiqun Yu, the Company’s CEO, for the benefit of ZHL D. In December 2013, ZHTC increased its share capital to RMB1 million (approximately \$142,412).

ZHL D also owns 70% of the equity interests of Beijing Hua Yu HuiZhong Technology Development Co., Ltd. (“BHYHZ”). BHYHZ was formed on September 30, 2006 in the PRC. At the time of its organization, we transferred a 30% interest in this subsidiary to the National Vocational Education Association of China, a non-profit, quasi-government entity, for no consideration to enable us to work with the Association’s network to expand our business.

On January 4, 2009, ZHLD entered into an agreement with Mr. Guang Li to jointly incorporate and invest in a joint venture company, Zhong He Li Da (Beijing) Management Consultant Co., Ltd. ("ZHLDBJ"). ZHLD contributed RMB425,000 (approximately \$62,107), and Mr. Guang Li contributed RMB 75,000 (approximately \$10,960) towards the registered capital of ZHLDBJ, amounting to a total registered capital of RMB500,000 (approximately \$73,067). In return for their respective contributions, ZHLD owns an 85% equity interest, and Mr. Guang Li owns a 15% equity interest in ZHLDBJ. ZHLD has entrusted Mr. Xiqun Yu to hold 20% of its equity interest of ZHLDBJ on its behalf. ZHLDBJ will be involved in the vocational training business, which includes IT engineering, and accounting training. In February 2010, the Company, through ZHLD, incorporated a new company in the PRC, Beijing New Shifan Education & Technology Co., Ltd. ("New Shifan") with a registered capital of RMB1.95 million (approximately \$291,132). ZHLD owned a 65% equity interest in New Shifan and the other equity holders together owned a 35% equity interest in New Shifan. In September 2011, New Shifan changed its name to Beijing Hua Yu Pin Xue Education Technology Co., Ltd ("HYPX"). In October 2011, ZHLD took over the 35% equity interest from the other equity holders of HYPX without any consideration, and entrusted Mr. Xiqun Yu to hold the 35% equity interest on behalf of ZHLD. In November 2011, HYPX increased its share capital to RMB2 million (approximately \$298,567). In January 2012, due to changes in government regulations, the Company authorized Mr. Yu to hold the 100% equity interest on behalf of ZHLD. In 2012, HYPX established a wholly owned school - Beijing Xicheng District Hua Yu Pin Xue Training School, and together with a previously established wholly owned subsidiary of the Company - Beijing Shifanxuezhitang Information Science Institute, established the Company's new brand image and reputation in several districts in Beijing. HYPX focuses on expansion of our training centers in Beijing, as well as developing extensive marketing strategy to establish new markets in other main cities.

On March 4, 2011, the Company entered into a management agreement with Nanchang Institute of Technology (“NIT”), a vocational training institution based in Nanchang, PRC. Pursuant to the agreement, the Company would assist in managing the daily operations of NIT for ten years for an annual management fee of RMB 10 million (approximately \$1,461,347). The management fee was payable on a quarterly basis and in the event of late payment, a late fee would be imposed. Additionally, a liquidated damage of RMB 50 million (approximately \$7,935,122) would be paid by any party that defaulted on the agreement.

In connection with the management agreement, the Company entered in to a loan agreement, pursuant to which the Company loaned NIT RMB 50 million (approximately \$7,935,122) to build training facilities and NIT would repay the RMB 50 million (approximately \$7,935,112) in ten years from the date NIT received the principal. The loan had an annual interest rate of 20% and the Company would waive the interest if NIT made all payments under the management agreement in a timely manner. We received 20% annual interest income due each quarter, therefore, the management fee was waived. The assets of certain guarantors secured the loan. On March 29, 2013, NIT repaid the loan principal of RMB50 million and accrued interests and the loan agreement was terminated. On the same day, the management agreement with NIT was also terminated.

On February 25, 2011, the Company entered into a share transfer agreement with the shareholder of Harbin Tianlang Culture and Education School (“Tianlang”), a tutoring school with 5,000 students, based in Harbin, PRC. Pursuant to the share transfer agreement, the Company purchased 60% of the equity interests of Tianlang for RMB 35 million (approximately \$5.3 million). The shareholder and the Company also provided RMB 2 million (approximately \$0.3 million) and RMB 3 million (approximately \$0.5 million) as working capital for Tianlang, respectively. Tianlang had established a new board of directors with five directors, of which three directors were appointed by the Company and two directors were appointed by the shareholder. The acquisition of Tianlang was completed in April 2011. We are currently co-managing Tianlang with the previous majority owner. The Company and the previous majority owner will be entitled to 60% and 40%, respectively, of the profits of Tianlang.

On May 31, 2011, the Company entered into share transfer agreements with the shareholders (the “Shareholders”) of Changchun City Chaoyang District Nuoya Foreign Languages School (“Changchun Nuoya”) and Harbin City Nangang District Nuoya Foreign Languages School (“Harbin Nuoya”), two foreign language schools based in the PRC.

Pursuant to the agreements, the Company purchased 100% of the two schools for an aggregate of RMB 16 million (approximately \$2.5 million), and all consideration had been paid up. The Shareholders’ obligations under the agreements are guaranteed by a guarantor who will be jointly and severally liable in the event of a breach by the Shareholders. The acquisition of Changchun Nuoya and Harbin Nuoya was completed by the end of May 2011 and their financial statements had been consolidated with the Company’s financial statements since May 2011. The Company did not foresee that the investment cost in Harbin Nuoya and Changchun Nuoya is recoverable in the near future. As a result, the Company fully impaired its investment in the two schools. As there is little demand for non-English classes at the time being, the Company has suspended the operation of both schools.

In June 2012, the Company, through ZHLD, incorporated a new company in the PRC, Harbin Zhong He Li Da Information Technology Co., Ltd. (“ZHLGIT”) with a registered capital of RMB2 million. Mr. Yu has been entrusted to hold the 100% equity interest on behalf of ZHLD. ZHLGIT was established to initiate and design a platform for online education programs, and provide this effective and efficient communication service to all the teachers and students.

## **2 Basis of Preparation of Financial Statements**

The consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America (“GAAP”). The consolidated financial statements include the financial statements of the Company and its subsidiaries. All significant inter-company transactions and balances have been eliminated in consolidation. The portion of the income applicable to noncontrolling interests in subsidiaries undertakings is reflected in the consolidated statement of operations.

The consolidated interim financial information as of June 30, 2014 and for the three and six month periods ended June 30, 2014 and 2013 have been prepared without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). Certain information and footnote disclosures, which are normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) have not been included. The consolidated interim financial information should be read in conjunction with the Financial Statements and the notes thereto, included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2013, previously filed with the SEC.

In the opinion of management, all adjustments (which include normal recurring adjustments) necessary to present a fair statement of the Company’s consolidated financial position as of June 30, 2014, its consolidated results of operations and cash flows for the three and six month periods ended June 30, 2014 and 2013, as applicable, have been made. The interim results of operations are not necessarily indicative of the operating results for the full fiscal year or any future periods.

## **3. Summary of Significant Accounting Policies**

**Use of estimates** - The preparation of these financial statements in conformity with GAAP requires management to make estimates and assumptions that affect 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 include values, classification, useful lives assigned to and impairment of acquired intangible assets, the useful lives and impairment of property and equipment, collectability of accounts receivable, reserves for allowances 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 a maturity period of three months or less to be cash or cash equivalents. The carrying amounts reported in the accompanying unaudited condensed consolidated balance sheets for cash and cash equivalents approximate their fair value. All of the

Company's cash that is held in bank accounts in the PRC is not protected by Federal Deposit Insurance Corporation ("FDIC") insurance or any other similar insurance in the PRC. The cash that the Company maintains in US banks is insured up to \$250,000 at each bank as of June 30, 2014 and December 31, 2013. The Company's cash at their US banks is in excess of statutorily insured limits at \$979,433 and \$1,282,348, as of June 30, 2014 and December 31, 2013, respectively.

**Property and equipment** - Property and equipment is stated at the historical cost, less accumulated depreciation and impairments. Depreciation on property and equipment is provided using the straight-line method over the estimated useful lives of the assets as follows:

Buildings	20 years
Communication equipment	10 years
Transportation vehicles	5 years
Furniture and fixtures	5 years
Leasehold improvements	over unexpired lease terms

Expenditures for renewals and betterments are capitalized while repairs and maintenance costs are normally charged to the statement of operations in the period/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 and impairment of such asset are removed from their respective accounts and any gain or loss is recorded in the statements of operations.

The Company reviews the carrying value of property and equipment for impairment whenever events and circumstances indicate that the carrying value of an asset may not be recoverable from the estimated future cash flows expected to result from its use and eventual disposition. In cases where undiscounted expected future cash flows are less than the carrying value, an impairment loss is recognized equal to an amount by which the carrying value exceeds the fair value of assets. The factors considered by management in performing this assessment include current operating results, trends and prospects, the manner in which the property and equipment are used, and the effects of obsolescence, demand, competition, and other economic factors.

**Intangibles** - Intangibles consist of franchise rights on educational products, software, teacher list, student list, domain/brand name, course materials, goodwill, magazine rights and contest operation rights. Most intangible assets are amortized over the lives of the rights agreements, or their respective operational useful lives.

The Company evaluates the carrying value of intangible assets during the second quarter of each year and between annual evaluations if events occur, or circumstances change, that would more likely than not reduce the fair value of the intangible asset below its carrying amount. For the three and six months ended June 30, 2014 and 2013, the Company recorded \$0 and \$0, \$0 and \$606,032, respectively, as impairment loss.

In April 2011, the Company purchased 60% equity interest of Tianlang for RMB35 million (approximately \$5.3 million) and 100% ownership of Changchun Nuoya and Harbin Nuoya. These three schools' net assets included identifiable intangible assets such as domain name/brand name, cost of materials, student list, course materials and teacher lists. The economic useful life for domain name/brand name is estimated to be 10 years and the others are estimated to be 3 years.

**Long-lived assets** - The Company reviews its long-lived assets for impairments when changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Long-lived assets under certain circumstances are reported at the lower of carrying amount or fair value. Assets to be disposed of and assets not expected to provide any future service potential to the Company are recorded at the lower of carrying amount or fair value less cost to sell. To the extent carrying values exceed fair values; an impairment loss is recognized in operating results.

**Foreign Currency** - The Company's principal country of operations is the PRC. The financial position and results of operations of the Company are recorded in USD as the functional currency, and the financial position and results of operations of the Company's PRC subsidiaries are recorded in RMB as the functional currency. The results of operations denominated in foreign currency are translated at the average rate of exchange during the respective

reporting period.

Assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the market rate of exchange at that date. The registered equity capital denominated in the functional currency is translated at the historical rate of exchange at the time of capital contribution. All translation adjustments resulting from the translation of the financial statements into the reporting currency (“U.S. Dollars” or “US\$”) are recorded in accumulated other comprehensive income, a separate component within shareholders’ equity. The accompanying consolidated financial statements are presented in US\$. The functional currency of the Company is RMB. The consolidated financial statements are translated into US\$ from RMB at year-end exchange rates as to assets and liabilities and average exchange rates as to revenues and expenses. Capital accounts are translated at their historical exchange rates when the capital transactions occurred. The resulting translation adjustments are recorded as a component of shareholders’ equity included in other comprehensive income. Gains and losses from foreign currency transactions are included in profit or loss. There were no gains and losses from foreign currency transactions during the quarters ended June 30, 2014 and 2013.

	As of	
	30 June 2014	31 December 2013
RMB: US\$ exchange rate	6.1565	6.1122

	Six Months	
	Ended June	
	30,	
	2014	2013
Average RMB: US\$ exchange rate	6.1419	6.2395

The RMB is not freely convertible into foreign currency and all foreign exchange transactions must take place through authorized institutions. No representation is made that the RMB amounts could have been, or could be, converted into US\$ at the rates used in translation.

**Noncontrolling interest** - Noncontrolling interest in the Company’s subsidiaries are recorded in accordance with the provisions of Financial Accounting Standard Board (“FASB”) Codification 810 Consolidation (“ASC 810”) and are reported as a component of equity, separate from the parent’s equity. Purchase or sales of equity interests that do not result in a change of control are accounted for as equity transactions. Results of operations attributable to the noncontrolling interest are included in our consolidated results of operations and, upon loss of control, the interest sold, as well as interest retained, if any, will be reported at fair value with any gain or loss recognized in earnings.

**Revenue recognition** - Revenue is 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 when customers download prepaid study materials.

Prepaid debit cards allow the Company’s subscribers to purchase a predetermined monetary amount of download materials downloadable from its website. The Company tracks usage of the debit card and records revenue when the debit card is used.

At the time that the prepaid debit card is purchased, the receipt of cash is recorded as deferred revenue. Revenues are recognized in the month when card is used. Unused value relating to debit cards is recognized as revenues when the prepaid debit card expires.

Tuition from courses is recognized ratably over the period that fees are earned, typically the life of the course. The Company offers credits to students if they should withdraw, or are unable to complete their courses. Historically the issuances of credits have not been high with regards to tuition fees. The Company offers cash refunds on a limited basis based on individual circumstances.

The Company engages an advertisement agency to manage its on-line advertisement revenue. Pursuant to the contract with this agency, upon posting of an on-line advertisement on the Company's website, the Company is entitled to share with the agency 50% of the amount charged to the on-line advertiser.

The Company recognizes advertising revenue monthly on receipt of the confirmation from the agent. The agency is responsible for collection of all ad revenue from advertisers. The agency is required to make their remittance for on-line advertising six months after on-line ads are posted on the Company's website.

Deferred revenue reflects the unearned portion of debit cards sold and tuition payments received. Tuition is recognized as revenue ratably over the periods in which it is earned, generally the term of the program or as the debit card is used.

**Deferred revenue** - Deferred revenue reflects the unearned portion of debit cards sold and tuition payments received. Deferred revenue as of June 30, 2014 and December 31, 2013 was \$1,172,637 and \$854,027, respectively.

**Advertising** - The Company expenses advertising costs at the time they are published on the newspaper and for all other advertising the first time the respective advertising takes place. These costs are included in selling and administrative expenses. The total advertising expenses incurred for the three and six months ended June 30, 2014 and 2013 were \$459,152 and \$881,620, \$915,936 and \$1,315,966, respectively.

**Taxation** - Taxation on profits earned in the PRC are calculated on the estimated assessable profits for the year at the rates of taxation prevailing in the PRC after taking into effect the benefits from any special tax credits or “tax holidays” allowed in the PRC.

The Company does not accrue United States income tax on unremitted earnings from foreign operations, as it is the Company’s intention to invest these earnings in foreign operations for the foreseeable future. All of the Company’s revenues are generated in the PRC. The Company’s US operations provide corporate and administrative functions for the entire Company. The Company’s tax provisions for the three and six months ended June 30, 2014 and 2013 are related to the Company’s PRC operations.

If the Company should have an uncertainty in accounting for income taxes, the Company evaluates a tax position in a two-step process. The first step is to determine whether it is more-likely-than-not that a tax position will be sustained upon examination, including the resolution of any related appeals or litigation based on the technical merits of the position. The second step is to measure the tax position that meets the more-likely-than-not threshold to determine the amount of provision or benefit to be recognized in the financial statements. A tax position is measured at the largest amount of provision or benefit where there is a greater than 50% likelihood of being realized upon ultimate settlement.

Tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first subsequent period in which the threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not criteria should be de-recognized in the first subsequent reporting period in which the threshold is no longer met.

### **Income Tax**

Private schools or colleges operated for reasonable returns, such as our subsidiary Tianlang, are subject to income taxes at 25% after January 1, 2008, but were sometimes subject to deemed amounts or preferential tax arrangement of income tax to be determined by the relevant tax authorities. Our subsidiary Tianlang had not yet been charged income taxes under current regulation. The Company is unable to accurately estimate the chance of having the Tianlang’s tax position being challenged by PRC tax authorities; therefore the Company did not record any tax liabilities in respect of Tianlang’s profits.

Based on all known facts and circumstances and current tax law, the Company believes that the total amount of unrecognized tax provisions or benefits as of June 30, 2014, is not material to its results of operations, financial condition or cash flows. The Company also believes that the total amount of unrecognized tax provisions or benefits as of June 30, 2014, if recognized, would not have a material effect on its effective tax rate. The Company further believes that there are no tax positions for which it is reasonably possible, based on current PRC tax laws and policies,

that the unrecognized tax provisions or benefits will significantly increase or decrease over the next 12 months producing, individually or in the aggregate, a material effect on the Company's results of operations, financial condition or cash flows.

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets, including tax loss and credit carry forwards, and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

The effect of deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred income tax expense represents the change during the period in the deferred tax assets and deferred tax liabilities. The components of the deferred tax assets and liabilities are individually classified as current and non-current based on their characteristics. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. The Company had no deferred tax assets as of June 30, 2014 and December 31, 2013.

#### *Value added tax*

The Provisional Regulations of the People's Republic of China Concerning Value Added Tax ("VAT") 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 VAT is imposed on goods sold in or imported into the PRC and on processing, repair and replacement services provided within the PRC.

VAT payable in the PRC 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 VAT included in the price or charges, less any deductible VAT already paid by the taxpayer on purchases of goods and services. The Company records all revenues net of VAT.

**Stock-based compensation** - The Company records compensation expense associated with stock-based awards and other forms of equity compensation. Such compensation would include the recording of cost resulting from all stock-based payment transactions including shares issued under its stock option plans. The Company records expense over the vesting period in connection with stock options granted. The compensation expense for stock-based awards includes an estimate for forfeitures and is recognized over the expected term of the award on a straight-line basis.

The Company recorded stock-based compensation expenses of \$0 and \$198, respectively, for the three months ended June 30, 2014 and 2013. The Company also recorded stock-based compensation expenses of \$0 and \$793, respectively, for the six months ended June 30, 2014 and 2013.

**Fair value of financial instruments** - The Company has adopted newly issued generally accepted accounting principles with regards to fair value measurement for assets and liabilities that establishes a common definition for fair value to be applied to existing generally accepted accounting principles that require the use of fair value measurements, establishes a framework for measuring fair value and expands disclosure about such fair value measurements. The adoption of these principles did not have an impact on the Company's financial position or operating results, but did expand certain disclosures.

Fair value is defined fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Additionally, current standards require the use of valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. These inputs are prioritized below:

- Level 1: Observable inputs such as quoted market prices in active markets for identical assets or liabilities
- Level 2: Observable market-based inputs or unobservable inputs that are corroborated by market data
- Level 3: Unobservable inputs for which there is little or no market data, which require the use of the reporting entity's own assumptions.

The Company did not have any assets or liabilities valued using Level 2 or Level 3 inputs as of June 30, 2014 and December 31, 2013, respectively.

**Treasury stock** - We account for treasury stock under the cost method and include treasury stock as a component of stockholders' equity. When retired, the excess of the cost of treasury stock over its par value is allocated between retained earnings and additional paid-in capital.

**Recent accounting pronouncements** - Management does not believe that any recently issued, but not yet effective, accounting standards or pronouncements, if currently adopted, would have a material effect on the Company's consolidated financial statements.

#### **4. Concentrations of business and credit risk**

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

The Company is operating in the PRC, which may give rise to significant foreign currency risks from fluctuations and the degree of volatility of foreign exchange rates between the US\$ and the RMB.



Financial instruments that potentially subject the Company to concentration of credit risk consist principally of cash and accounts receivable, the balances of which are stated on the balance sheet. The Company places its cash in high credit quality financial institutions; however, such funds are not insured in the PRC. As of June 30, 2014 and December 31, 2013, the Company maintains cash in the US, in a financial institution insured by the FDIC that has approximately \$979,433 and \$1,282,348, respectively, in funds in excess of FDIC insured amounts.

For the three and six months ended June 30, 2014 and 2013, no sales to a single customer accounted for 10% or more of our revenue.

Our subsidiaries, ZHTC, Changchun Nuoya and Harbin Nuoya, are private schools not operated for reasonable returns; therefore, are not allowed to distribute dividends. As of June 30, 2014 and December 31, 2013, the total un-distributable net assets of ZHTC, Changchun Nuoya and Harbin Nuoya amounted to \$33,300,654 and \$34,041,297, respectively.

## 5. Cash and cash equivalents

Cash and cash equivalents consist of the following:

	June 30, 2014 (Unaudited)	December 31, 2013
Cash on Hand -China	\$384,915	\$384,189
Bank Deposits-China	40,974,927	54,460,617
Bank Deposits-US	1,229,433	1,532,348
	\$42,589,275	\$56,377,154

## 6. Other Receivables

Other receivable consist of the following:

	June 30, 2014 (Unaudited)	December 31, 2013
Deposits	\$ 560,623	\$257,061

Staff Borrowings	20,681	5,486
	\$ 581,304	\$ 262,547

**7. Prepaid expenses and other current assets**

Prepaid expenses consist of the following:

	June 30, 2014 (Unaudited)	December 31, 2013
Prepaid rent	\$ 438,211	\$ 517,375
Prepaid teachers and online material	203,174	172,128
Prepaid services and professional fees	6,768	16,349
Other prepaid expenses	55,801	21,856
	\$ 703,954	\$ 727,708

**8. Property and equipment, net**

Property and equipment consist of the following:

	June 30, 2014 (Unaudited)	December 31, 2013
Buildings	\$ 1,443,680	\$ 1,454,144
Transportation vehicles	106,773	107,547
Communication equipment	9,923,492	10,353,715
Furniture and fixtures	5,575,492	5,600,492
Leasehold improvement	5,160,417	4,006,759
	22,209,854	21,522,657
Less: Accumulated Depreciation	(14,270,429 )	(13,271,045 )
Property and Equipment, net	\$ 7,939,425	\$ 8,251,612

For the three and six months ended June 30, 2014 and 2013, depreciation expenses totaled \$746,614 and \$927,308, \$1,463,227 and \$2,051,529, respectively. For the three and six months ended June 30, 2014 and 2013, loss on disposal of fixed assets was \$10,709 and \$7,363, \$16,162 and \$10,132, respectively.

**9. Intangibles and capitalized software, net**

Intangibles of the Company consisted of franchise rights on educational products, software, magazine rights, contest operation rights, domain name/brand name, course materials, student list and teacher list, and goodwill.

Franchise rights

The franchise rights owned by the Company consist of the following:

- The ACCP training course is an authority for training software engineers under training procedures with textbooks;
- The BENET training course is an authority for training internet engineers under training procedures with textbooks.

Capitalized software

The capitalized software of the Company consists of all the Company's software, among which two main ones are the following:

The usage rights for job seekers is software to help university students to search jobs, post their resumes, and communicate with potential employers;

The usage right for learners is software to help elementary and secondary students to do assignments, test papers, and get instructions from teachers.

#### Intangible assets on acquisitions

In March 2011, the Company acquired a 60% controlling interest in Tianlang for a purchase price of RMB 35 million (approximately \$5.3 million). The school had insignificant tangible assets or liabilities at the acquisition date. The entire estimated fair value of approximately \$8.9 million has been allocated to the net identifiable assets of Tianlang; the intangible assets recorded are all subject to amortization.

In May 2011, the Company acquired a 100% ownership in Changchun Nuoya and Harbin Nuoya. The aggregate purchase price for the two schools was RMB 16 million (approximately \$2.5 million). The schools had insignificant tangible assets or liabilities at the acquisition date. The entire estimated fair value of approximately \$2.5 million has been allocated to the net identifiable assets of Changchun Nuoya and Harbin Nuoya; the intangible assets recorded are all subject to amortization.

The Company did not foresee that the investment cost is recoverable in the near future, and concluded for the group reporting that certain triggering events had occurred which could result in it being more likely than not that the fair value of each reporting unit would be less than its carrying value. As a result, the Company conducted the impairment test for intangible assets, which resulted in impairment expenses for the three and six months ended June 30, 2014 and 2013 were \$0 and \$0, \$0 and \$606,032, respectively.

Intangibles and capitalized software consist of the following:

	June 30, 2014 (Unaudited)	December 31, 2013
ACCP training course	\$ 818,647	\$ 824,580
BENET training course	57,338	57,753
Usage rights- Job Seekers	487,290	490,822
Usage rights- Learners	324,860	327,214
Others	2,504,524	2,515,352
Domain names	9,621,707	9,677,038
Course materials	544,393	547,663
Student list	804,993	809,702
Teacher list	1,060,590	1,066,476
	16,224,342	16,316,600
Less: Impairments	(4,133,929 )	(4,142,169 )
Less: accumulated amortization	(7,454,997 )	(7,074,497 )
Intangible and Capitalized Software, net	\$ 4,635,416	\$ 5,099,934

For the three and six months ended June 30, 2014 and 2013, amortization expenses were \$213,572 and \$398,256, \$428,839 and \$820,028, respectively.

Amortization of intangibles and capitalized software over the next five years is as follows:

Years ending December 31,	
2014	\$426,618
2015	818,052
2016	722,804
2017	627,751

2018  
627,751  
\$3,222,976

**10. Accounts payable and accrued expenses**

Accounts payable and accrued expenses consist of the following:

	June 30, 2014 (Unaudited)	December 31, 2013
Accrued payroll	\$ 130,232	\$ 108,492
Accrued expenses	56,661	153,162
Other payables	248,472	814,971
	\$ 435,365	\$ 1,076,625

**11. Deferred revenue**

Deferred revenues include subscriber prepayments and education fee prepayments. Subscriber prepayments represent deferred revenue for the purchase of debit cards used to pay for the online downloading of education materials. The Company recognizes revenue when the card is used to download material. During the period between the purchase and use of debit cards, the unused portion of the debit card is treated as deferred revenue to the Company. Education fee prepayments represent payments for tuition for the Company's training schools, which are amortized over the term of the course. As of June 30, 2014 and December 31, 2013, the Company had deferred revenue of \$1,172,637 and \$854,027, respectively.

**12. Stockholders' Equity**

The Company had no significant equity transactions during the quarter ended June 30, 2014.

**13. Warrants and options**Stock Options

During the quarters ended June 30, 2014 and 2013, the Company did not issue any stock options. The total stock based compensation was \$0 and \$198 respectively, related to the vesting of previously granted options.

The Company measures the fair value of options at the end of each reporting period until options are exercised, cancelled or expire unexercised. As of June 30, 2014, there were no stock options outstanding. As of June 30, 2014, there was no unrecognized compensation expense related to stock options.

Stock option activity for the quarter ended June 30, 2014 is summarized as follows:

	Shares underlying options	Weighted average exercise price
Outstanding as of December 31, 2013	52,667	\$ 2.67
Granted	-	-

Exercised	-	-
Expired / cancelled / forfeited	(52,667 )	2.67
Outstanding as of June 30, 2014	-	\$ -
Exercisable and vested as of June 30, 2014	-	\$ -

#### 14. Earnings per share

Per GAAP the Company reconciles the numerator and denominator of the basic and diluted earnings per share (EPS) computations.

For the quarters ended June 30, 2014 and 2013, dilutive shares include shares attributable to exercisable options only if such inclusion would be dilutive.



The following reconciles the components of the EPS computation:

	Six Months Ended June 30,	
	2014	2013
Net loss to common shareholders	\$(13,368,837)	\$(7,442,867)
Weighted average shares outstanding - basic	10,582,530	10,582,530
Weighted average shares outstanding - diluted	10,582,530	10,582,530
Loss per share – basic and diluted	\$(1.26)	\$(0.70)

	Three Months Ended June 30,	
	2014	2013
Net loss to common shareholders	\$(7,391,777)	\$(3,739,848)
Weighted average shares outstanding - basic	10,582,530	10,582,530
Weighted average shares outstanding - diluted	10,582,530	10,582,530
Loss per share – basic and diluted	\$(0.70)	\$(0.35)

During the three and six months ended June 30, 2014 and 2013, options to purchase 52,667 and 52,667 shares of common stock with exercise prices greater than the average fair market value of the Company's stock were not included in the calculation because the effect is anti-dilutive.

## 15. Commitments and contingencies

### *Employee Benefits*

The full time employees of subsidiaries based in the PRC are entitled to employee benefits including medical care, welfare subsidies, unemployment insurance and pension benefits through a Chinese government mandated multi-employer defined contribution plan. The Company is required to accrue for those benefits based on certain percentages of the employees' salaries and make contributions to the plans out of the amounts accrued for medical and pension benefits. The total provision and contributions made for such employee benefits for the three and six months ended June 30, 2014 and 2013 were \$30,998 and \$44,967, \$60,411 and \$82,222, respectively. The Chinese government is responsible for the medical benefits and the pension liability to be paid to these employees.

*Minimum Lease Commitments*

The Company has office leases and training center leases which expire at various dates from July 2014 through June 2018. The Company recorded an aggregate of \$382,883 and \$304,244, \$777,361 and \$734,700 as rent expenses for the three and six months ended June 30, 2014 and 2013, respectively. Rental commitments as of June 30, 2014 are as follows:

Years ending December 31, 2014	\$655,018
2015	1,144,147
2016	721,059
2017	490,314
2018	443,249
	\$3,453,787

## 16. Operating Risk

### (a) Country risk

Currently, the Company's revenue is mainly derived from sale of educational products and services in the PRC. The Company hopes to expand its operations in the PRC, however, there are no assurances that the Company will be able to achieve such an expansion successfully. Therefore, a downturn or stagnation in the economic environment of the PRC could have a material adverse effect on the Company's financial condition.

### (b) Products risk

The Company competes with larger companies, who have greater funds available for expansion, marketing, research and development and the ability to attract more qualified personnel. There can be no assurance that the Company will remain competitive with larger competitors.

### (c) Exchange rate risk

The Company cannot guarantee that the current exchange rate will remain steady, therefore there is a possibility that the Company could post the same amount of profit for two comparable periods and because of a fluctuating exchange rate actually post higher or lower profit depending on exchange rate of RMB converted to US\$ on that date. The exchange rate could fluctuate depending on changes in the political and economic environments without notice.

### (d) Political risk

Currently, the PRC is in a period of growth and is openly promoting business development in order to bring more business into the PRC. Additionally, the PRC allows for certain Chinese corporation to be owned by a United States corporation. If the PRC government changes the laws or regulations, the Company's ability to operate in the PRC could be affected.

### (e) Key personnel risk

The Company's future success depends on the continued services of executive management in the PRC. The loss of any of their services would be detrimental to the Company and could have an adverse effect on business development. The Company does not currently maintain key-man insurance on their lives. Future success is also dependent on the ability to identify, hire, train and retain other qualified managerial and other employees. Competition for these individuals is intense and increasing.

(f) Non-compliance with financing requirements

The Company might need to obtain future financing that require timely filing of registration statements, and have declared effective those registration statements, to register the shares being offered by the selling stockholders in future financing. The Company might be subject to liquidated damages and other penalties if they continue to obtain future financing requiring registration statements, and not having those registration statements filed and declared effective in a prompt manner.

**17. Related Party Transactions**

For the three and six months ended June 30, 2014, the Company entered into transactions with a related party amounting to \$0 and \$960,503, respectively. As of June 30, 2014 and December 31, 2013, the Company owed a related party \$0 and \$689,720, respectively.

**18. Subsequent Events**

The Company has evaluated subsequent events through the issuance of the consolidated financial statements and no subsequent event is identified.

## **Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations.**

The following discussion of the results of our operations and financial condition should be read in conjunction with our consolidated financial statements and the related notes thereto, which appear elsewhere in this Quarterly Report. Except for the historical information contained herein, the following discussion, as well as other information in this report, contain “forward-looking statements,” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and are subject to the “safe harbor” created by those sections. Forward-looking statements include, but are not limited to, statements that express our intentions, beliefs, expectations, strategies, predictions or any other statements relating to our future activities or other future events or conditions. These statements are based on current expectations, estimates and projections about our business based, in part, on assumptions made by management. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may, and are likely to, differ materially from what is expressed or forecasted in the forward-looking statements due to numerous factors, including those discussed from time to time in this report, as well as any risks described in the “risk factors” section of our filings we make with the SEC. In addition, such statements could be affected by risks and uncertainties related to the ability to conduct business in the PRC, demand, including demand for our products resulting from change in the educational curriculum or in educational policies, our ability to raise any financing which we may require for our operations, competition, government regulations and requirements, pricing and development difficulties, our ability to make acquisitions and successfully integrate those acquisitions with our business, as well as general industry and market conditions and growth rates, and general economic conditions. Any forward-looking statements speak only as of the date on which they are made, should not be relied upon as representing our views as of any subsequent date and we do not undertake any obligation to update any forward-looking statement to reflect events or circumstances after the date of this report.

Our discussion and analysis of our financial condition and results of operations are based upon our 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, revenue and expenses. On an on-going basis, we evaluate these estimates, including those related to useful lives of property and equipment, bad debts, impairment, net 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.

### **Overview**

We are engaged in the business of distribution of educational resources through the Internet. Our website, [www.edu-chn.com](http://www.edu-chn.com), is a comprehensive education network platform which is based on network video technology and large data sources of education resources. We have a database comprising such resources as test papers for secondary education courses as well as video on demand. Our database includes more than 500,000 exams, test papers and

courseware for secondary and elementary schools. We generate revenue through our website by selling prepaid debit cards to our subscribers and sales of advertisement on our website.

We also provide on-site teaching and training services and have training facilities in Heilongjiang and Beijing, which can accommodate over 15,000 students each year. The courses cover primarily the compulsory education curriculum of junior, middle and high school. We also provide vocational training services and language training services. We charge tuition fees for these classes and services.

We have also introduced another online service aimed at students who want to attend vocational school. These students include high school students who do not intend to continue their education at universities and university graduates who are looking for employment. The core business for our vocation education will be in three main areas: vocation training, vocational certification, and career development for college graduates. We have collaborated with the National Vocational Education Association of China in setting up [www.360ve.com](http://www.360ve.com), which provides information regarding vocation training schools and vocation training both on-line and on-site at our training centers. We will also be involved in a project called the “Zhong He Win-Win Program”, which is designed to fit the needs of Chinese entrepreneurs and to improve their leadership, management and marketing skills. Our comprehensive business training initiatives integrate research-based, proprietary content with processes that are specifically connected to the critical business issues that most private Chinese companies are facing.

Beginning 2012, we started to design and build a web-based information platform for our online education program - "China Education Cloud Platform" to provide a stable long distance education network including video/audio courses, cloud-based network service for teachers, students, and parents and online educational administration services system. This platform is also intended to serve as a comprehensive cloud-based resource/space for educational institutions and individual teachers to store and share resources, market and sell their courses and services among themselves, including course management, video releases, examination system, courseware, study cards management system, etc. We will charge fees for the cloud storage and receive commissions for the courses/services the educational institutions or the teachers sell through our platform. This platform is in the final testing phase. We expect to launch this platform by the end of September, 2014 and are currently in discussions with several potential business partners/customers to optimize the functionality of the platform, as well as negotiating with advertisement companies to design a comprehensive marketing campaign to promote this platform.

Our current activities are primarily conducted in the northern part of the PRC. PRC has about 150 million students aged 6 -18, who are the target of our education services. There are about 10 million students in the 6-18 age group in the northeastern provinces of the PRC. Because we serve approximately 5% of the students in our primary market, we believe that we have great potential to grow. Our growth will depend on how we penetrate and expand our market. Our expansion may take the form of organic growth and/or acquisitions and the key to our growth will be increased student enrollment.

### **Significant Accounting Estimates and Policies**

The discussion and analysis of our financial condition and results of operations is based upon our financial statements, which have been prepared in accordance with GAAP. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities. On an on-going basis, we evaluate our estimates including the allowance for doubtful accounts, the salability and recoverability of our products, income taxes and contingencies. We base our estimates on historical experience and on other assumptions that we believe to be reasonable under the circumstances, the results of which form our basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Property and equipment are evaluated for impairment whenever indicators of impairment exist. Accounting standards require that if an impairment indicator is present, we must assess whether the carrying amount of the asset is unrecoverable by estimating the sum of the future cash flows expected to result from the asset, undiscounted and without interest charges. If the recoverable amount is less than the carrying amount, an impairment charge must be recognized based on the fair value of the asset.

Intangible assets and capitalized software, which we acquired from third parties, are amortized over the lives of the rights agreements, which are two to five years. We evaluate the carrying value of the franchise rights during the fourth quarter of each year and between annual evaluations if events occur or circumstances change that would more likely than not reduce the fair value of the intangible asset below its carrying amount.

As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes. This process involves estimating our current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities. Our deferred tax assets are from US corporate parent and have been fully reserved. Our US parent provides corporate and administrative functions for the entire consolidated Company. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income, and, to the extent we believe that recovery is not likely, we must establish a valuation allowance. To the extent that we establish a valuation allowance or increase this allowance in a period, we must include a tax provision or reduce our tax benefit in the statements of operations. We use our judgment to determine our provision or benefit for income taxes, deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. We believe, based on a number of factors including historical operating losses, which we will not realize the future benefits of a significant portion of our net deferred tax assets and we have accordingly provided a full valuation allowance against our deferred tax assets. However, various factors may cause those assumptions to change in the near term.



We cannot predict what future laws and regulations might be passed that could have a material effect on our results of operations. We assess the impact of significant changes in laws and regulations on a regular basis and update the assumptions and estimates used to prepare our financial statements when we deem it necessary.

We have determined the significant principles by consulting accounting policies that involve the most complex and subjective decisions or assessments. Our most significant accounting policies are those related to revenue recognition and deferred revenue.

Revenue is 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. We believe that these criteria are satisfied upon customers' download of prepaid study materials. Prepaid debit cards allow our subscribers to purchase a predetermined monetary amount of download materials posted on our website. Prepaid service contracts are amortized to income on a straight-line basis over the length of the service contract. These service contracts allow the user to obtain materials for a designated period of time. At the time that the prepaid debit card is purchased, the receipt of cash is recorded as deferred revenue.

Revenue is recognized in the month when services are actually rendered. Unused value relating to debit cards is recognized as revenue when the prepaid debit card has expired. Revenue from advertising on our website is recognized when the advertisement is run. Since advertising customers are billed monthly, there is no unearned advertising revenue.

The Company engages an advertisement agency to manage its on-line advertisement revenue. Per the contract with this agency, upon posting of an on-line advertisement on the Company's website, the Company is entitled to share with the agency 50% of the amount charged to the on-line advertiser. The Company recognizes revenue upon posting of an advertisement on their web-site. The agency is responsible for collection of all advertisement revenue from advertisers. The agency is required to make their remittance for on-line advertising within six months after on-line ads are posted on our website.

Prepaid expenses are primarily comprised of advance payments made for services to teachers for on-line materials and video, outdoor advertising and prepaid rent.

Deferred revenue includes subscriber prepayments and education fee prepayments. Subscriber prepayments represents deferred revenue for the purchase of debit cards used to pay for the on-line downloading of education materials, including testing booklets, supplemental materials and teaching video clips. We value 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 revenue. Once the download takes place, the amount

is then transferred from advances on accounts to sales. Education fee prepayments represent tuition payments and payments for service contracts which are amortized over their respective terms.

We have granted options under the 2011 Incentive Stock Plan to our officers, directors or key employees to purchase 52,667 shares of common stock of the Company. To the extent that we do adopt such plans in the future, such grants will be valued at the grant date and expensed over the applicable vesting period.

### **Recent Accounting Pronouncements**

Management does not believe that any recently issued, but not yet effective, accounting standards or pronouncements, if currently adopted, would have a material effect on the Company's consolidated financial statements.

**Results of Operations****Comparison of the Three Months Ended June 30, 2014 and 2013**

The following table sets forth information from our statements of operations for the quarters ended June 30, 2014 and 2013:

	<b>Three Months Ended</b>			<b>June 30, 2013</b>		
	<b>June 30, 2014</b>			<b>(Unaudited)</b>		
	<b>(Unaudited)</b>			<b>(Unaudited)</b>		
Revenue	\$589,538	100.00	%	\$1,910,647	100.00	%
Cost of revenue	1,450,074	245.97	%	1,979,290	103.59	%
Gross Loss	(860,536 )	-145.97	%	(68,643 )	-3.59	%
Selling expenses	1,185,254	201.05	%	1,236,637	64.72	%
Administrative expenses	5,001,944	848.45	%	1,846,937	96.67	%
Other income	41,542	7.05	%	50,225	2.63	%
Loss from operations	(7,571,702)	-1,284.35	%	(3,938,064)	-206.11	%
Net loss before provision for income tax	(7,530,160)	-1,277.30	%	(3,887,839)	-203.48	%
Provision for income taxes	-	0.00	%	-	0.00	%
Net loss - attributable to CEAI and Subsidiaries	(7,391,772)	-1,253.82	%	(3,739,848)	-195.74	%

**Revenue**

Revenue for the three months ended June 30, 2014 (the “June 30, 2014 Quarter”) decreased by \$1,321,109, or 69%, to \$589,538 from \$1,910,647 for the three months ended June 30, 2013(the “June 30, 2013 Quarter”).

Revenue from the online education division includes revenue generated from online examination orientated material downloads, tutorial exercise downloads, and advertisement income. Revenue generated by the online education division decreased by \$637,505, or 83%, to \$130,383, for the June 30, 2014 Quarter from \$767,888 for the June 30, 2013 Quarter.

Revenue from the training center division is mostly from after school tutoring for primary and middle school students. Revenue generated by the training center division decreased by \$683,604, or 60% to \$459,155 for the June 30, 2014 Quarter from \$1,142,759 for the June 30, 2013 Quarter.

The decline in revenue for the June 30, 2014 Quarter was a result of decline in revenue across all of our business. We believe the main reason was our continuously weakening brand recognition in the main targeted market and the inability of our existing online education products to meet changing market demand. In addition, the lack of experience of our newly opened centers in on-site training, limited expansion capacity, coupled with fierce competition from the top education brands, make it very difficult to establish our brand value in a short period of time.

At present, online education is more widely recognized and accepted by students and educational institutions. We believe online education will gain more popularity in the next three to five years. Therefore, we have spent the past few years building the online education platform - "China Education Cloud Platform" and are currently in the process of testing the platform. Many students and teachers have participated in the testing and like the platform for its complete functions and advanced technologies. The platform is expected to be officially launched by the end of September this year. During the initial operation of the platform, we will offer free access to the platform to teachers and students in the first six months or a year to quickly develop the user base and establish a large database. After this initial promotion period, we will share with teachers the platform usage fee and service fee paid by students. We believe that our revenue will improve following the initial promotion period of this platform. In addition, instead of setting up more new training centers, we changed our strategy to focus on integrating and optimizing our existing resources in the training center division in order to maintain our current market share in an increasingly competitive environment.

## Cost of Revenue

Our overall cost of revenue decreased by \$529,216 or 27% to \$1,450,074 for the June 30, 2014 Quarter, from \$1,979,290 for the June 30, 2013 Quarter.

Cost of revenue for the online education business comprises cost of obtaining new materials to offer students, depreciation related to computer equipment, amortization related to software, and direct labor cost. Direct labor cost in connection with the maintenance and operation of our websites are fixed costs whereas the costs for purchase of materials and depreciation of equipment and software are variable costs. While the direct labor cost usually stays stable, the costs for purchase of materials and depreciation of equipment and software vary as we purchase new materials, equipment and software. The cost of revenue for the purchase of new materials, equipment and software does not directly correlate with revenue. We constantly have to invest in and update our content to be competitive and current in spite of falling revenue in the online education business. In addition, in light of the launch of the platform by the end of September 2014, the cost of revenue for online education division, mainly salaries and maintenance costs, is expected to increase for the following year.

The cost of revenue for the online education division decreased by \$336,588 or 24% to \$1,072,595 for the June 30, 2014 Quarter, from \$1,409,183 for the June 30, 2013 Quarter. The decrease was primarily due to the decrease in purchase of study materials and decrease in depreciation costs resulting from decreased expenditure on fixed assets. While we strive to provide high-quality and update-to-date online materials, we continue to control cost of revenue for the online education division by closely monitoring the variable costs while maintaining fixed costs at a stable level.

The principal components of cost of revenue at our training centers are rentals, direct labor costs and the depreciation expense. While the rental expenses are fixed and depreciation usually remains stable, the costs for direct labor (i.e. teachers' salary) vary. Cost of revenue for the training center division decreased by \$192,628 or 34% to \$377,479 for the June 30, 2014 Quarter from \$570,107 for the June 30, 2013 Quarter. The decrease in cost of revenue was mainly due to a decrease in teachers' salary as our teachers are paid by the number of classes they teach and there was a decrease in classes we offered during the June 30, 2014 Quarter as compared to the June 30, 2013 Quarter. However, the rental cost for our onsite training centers are comparatively stable and fixed, therefore, the cost of revenue for the June 30, 2014 Quarter did not decrease proportionately with the decrease in revenue.

## Gross Profit (Loss)

The following table sets forth information as to the gross profit (loss) and gross margin for our two lines of business for the quarters ended June 30, 2014 and 2013:

	<b>Three Months Ended</b>			
	<b>June 30, 2014</b>	<b>June 30, 2013</b>		
	<b>(Unaudited)</b>	<b>(Unaudited)</b>		
Online Education	\$	\$		
Revenue	130,383	767,888		
Cost of revenue	1,072,595	1,409,183		
Gross profit	(942,212 )	(641,295 )		
Gross margin	-723 %	-84 %		
Training Center Revenue				
Revenue	459,155	1,142,759		
Cost of revenue	377,479	570,107		
Gross profit	81,676	572,652		
Gross margin	18 %	50 %		

The gross margin for online education division is negative 723% for the June 30, 2014 Quarter as compared with negative 84% for the June 30, 2013 Quarter. The significant drop in gross margin was because there was a significant decrease in revenue from online education while the cost of revenue did not decrease proportionately.

The gross margin for our training center division decreased to 18% for the June 30, 2014 Quarter from 50% for the June 30, 2013 Quarter because cost of revenue did not decrease as much as revenue due to reasons discussed above.

### **Selling Expenses**

Selling expenses include advertising expense, consulting fees, sales commissions, and other expenses. Selling expenses decreased by \$51,383 or 4% to \$1,185,254 for the June 30, 2014 Quarter, from \$1,236,637 for the June 30, 2013 Quarter. The decrease in selling expenses was mainly due to the decrease in labor costs as a result of cut down in the number of sales and marketing personnel. During the June 30, 2014 Quarter, we continue to focus on rebuilding our brand name and reputation, through advertising via media, online and onsite promotion, handouts, brochures, etc. We expect our selling expenses to increase because we will incur marketing and advertising expenses to promote our new platform and develop a larger user base.

### **Administrative Expenses**

Administrative expenses increased by \$3,155,007 or 171%, to \$5,001,944 for the June 30, 2014 Quarter, from \$1,846,937 for the June 30, 2013 Quarter. This was mainly due to the research and development expenses relating to the development of the web-based platform, office expenses, and labor costs throughout the period. In the future we expect the administrative expenses to continue to increase because: 1) we will incur maintenance expenses for the web-based platform after it being successfully launched; 2) we will incur expenses associated with the expansion of our onsite training centers for purposes of gaining more market shares.

### **Other Income (Expense)**

Other income or expense includes loss on disposal of property and equipment, interest income and impairment loss on intangible assets. Net other income was \$41,542 for the June 30, 2014 Quarter, a decrease of \$8,683, as compared to \$50,225 for the June 30, 2013 Quarter. This is mainly due to decrease in interests received as a result of decrease in bank deposits in the June 30, 2014 Quarter, as compared with June 30, 2013 Quarter.

### **Income Taxes**

The provision for income tax was nil for the June 30, 2014 Quarter and June 30, 2013 Quarter. In 2014, the applicable income tax rate is 15% for ZHLD, as ZHLD has been approved by the local government as being involved in a high technology industry. Otherwise, the regular PRC statutory tax rate is 25%. ZHTC, Tianlang, Changchun Nuoya, Harbin Nuoya and Beijing Xicheng District Hua Yu Pin Xue Training School are currently exempt from PRC taxation, as they operate as a business enterprise engaged in educational opportunities. The Company's other subsidiaries: BHYHZ, ZHLDBJ, HYPX, ZHLDIT and Beijing Shifanxuezhitang Information Science Institute are taxed at the PRC regular statutory rate (25%), and have not accrued taxes since inception due to recurring losses or not having generated income since inception.

### **Net Loss**

As a result of the foregoing, we had net loss attributable to the Company and its subsidiaries of \$7,391,772, or negative return of \$0.70 per share basic and diluted, for the June 30, 2014 Quarter, as compared to net loss of \$3,739,848 or negative return of \$0.35 per share basic and diluted, for the June 30, 2013 Quarter.



**Comparison of the Six Months Ended June 30, 2014 and 2013**

The following table sets forth information from our statements of operations for the six months ended June 30, 2014 and 2013:

	<b>Six Months Ended</b>				
	June 30, 2014		June 30, 2013		
	<b>(Unaudited)</b>		<b>(Unaudited)</b>		
Revenue	\$1,314,232	100.00 %	\$4,353,179	100.00 %	
Cost of revenue	2,882,468	219.33 %	4,050,456	93.05 %	
Gross Loss	(1,568,236 )	-119.33 %	302,723	6.95 %	
Selling expenses	2,395,702	182.29 %	5,968,478	137.11 %	
Administrative expenses	8,704,791	662.35 %	3,496,898	80.33 %	
Other income	109,731	8.35 %	(508,577 )	-11.68 %	
Loss from operations	(13,684,893)	-1,041.28 %	(7,124,533)	-163.66 %	
Net loss before provision for income tax	(13,575,162)	-1,032.93 %	(7,633,110)	-175.35 %	
Provision for income taxes	-	0.00 %	-	0.00 %	
Net loss - attributable to CEAI and Subsidiaries	(13,368,837)	-1,017.24 %	(7,442,867)	-170.98 %	

**Revenue**

Revenue for the six months ended June 30, 2014 decreased by \$3,038,947, or 70%, to \$1,314,232 from \$4,353,179 for the six months ended June 30, 2013.

Revenue from the online education division includes revenue generated from online examination orientated material downloads, tutorial exercise downloads, and advertisement income. Revenue generated by the online education division decreased by \$1,136,952, or 82%, to \$257,647, for the six months ended June 30, 2014 from \$1,394,599 for the six months ended June 30, 2013.

Revenue from the training center division is comprised of tuition from examination-orientated after school training classes, language training classes, vocational training classes etc. Starting from the second quarter of 2014, revenue from our training center division mainly came from after school tutoring for primary and middle school students. Revenue generated by the training center division decreased by \$1,901,995, or 64% to \$1,056,585 for the six months ended June 30, 2014 from \$2,958,580 for the six months ended June 30, 2013.

The decline in revenue for the six months ended June 30, 2014 was a result of decline in revenue across all of our business. We believe the main reason was our continuously weakening brand recognition in the main targeted market and the inability of our existing online education products to meet changing market demand. In addition, the lack of experience of our newly opened centers in on-site training, limited expansion capacity, coupled with fierce competition from the top education brands, make it very difficult to establish our brand value in a short period of time.

At present, online education is more widely recognized and accepted by students and educational institutions. We believe online education will gain more popularity in the next three to five years. Therefore, we have spent the past few years building the online education platform and are currently in the process of testing the platform. Many students and teachers have participated in the testing and like the platform for its complete functions and advanced technologies. The platform is expected to be officially launched by the end of September 2014. During the initial operation of the platform, we will offer free access to the platform to teachers and students in the first six months or a year to quickly develop the user base and establish a large database. After this initial promotion period, we will share with teachers the platform usage fee and service fee paid by students. We believe that our revenue will improve following the initial promotion period of this platform. In addition, instead of setting up more new training centers, we changed our strategy to focus on integrating and optimizing our existing resources in the training center division in order to maintain our current market share in an increasingly competitive environment.

#### **Cost of Revenue**

Our overall cost of revenue decreased by \$1,167,988 or 29% to \$2,882,468 for the six months ended June 30, 2014, from \$4,050,456 for the six months ended June 30, 2013.

Cost of revenue for the online education business comprises cost of obtaining new materials to offer students, depreciation related to computer equipment, amortization related to software, and direct labor cost. Direct labor cost in connection with the maintenance and operation of our websites are fixed costs whereas the costs for purchase of materials and depreciation of equipment and software are variable costs. While the direct labor cost usually stays stable, the costs for purchase of materials and depreciation of equipment and software vary as we purchase new materials, equipment and software. The cost of revenue for the purchase of new materials, equipment and software does not directly correlate with revenue. We constantly have to invest in and update our content to be competitive and current in spite of falling revenue in the online education business. In addition, in light of the launch of the platform by the end of the third quarter, the cost of revenue for online education division, mainly salaries and maintenance costs, is expected to increase for the following year.

The cost of revenue for the online education division decreased by \$656,040 or 24% to \$2,107,464 for the six months ended June 30, 2014, from \$2,763,504 for the six months ended June 30, 2013. The decrease was primarily due to the decrease in purchase of study materials and decrease in depreciation costs resulting from decreased expenditure on fixed assets. While we strive to provide high-quality and update-to-date online materials, we continue to control cost of revenue for the online education division by closely monitoring the variable costs while maintaining fixed costs at a stable level.

The principal components of cost of revenue at our training centers are rentals, direct labor costs and the depreciation expense. While the rental expenses are fixed and depreciation usually remains stable, the costs for direct labor (i.e. teachers' salary) vary. Cost of revenue for the training center division decreased by \$511,948 or 40% to \$775,004 for the six months ended June 30, 2014 from \$1,286,952 for the six months ended June 30, 2013. The decrease in cost of revenue was mainly due to a decrease in teachers' salary as our teachers are paid by the number of classes they teach and there was a decrease in classes we offered during the six months ended June 30, 2014 as compared to the six months ended June 30, 2013. However, the rental cost for our onsite training centers are comparatively stable and fixed, therefore, the cost of revenue for the six months ended June 30, 2014 did not decrease proportionately with the decrease in revenue.

### Gross Profit (Loss)

The following table sets forth information as to the gross profit (loss) and gross margin for our two lines of business for the six months ended June 30, 2014 and 2013:

	<b>Six Months Ended</b>	
	<b>June 30, 2014</b>	<b>June 30, 2013</b>
	(Unaudited)	(Unaudited)
Online Education	\$	\$
Revenue	257,647	1,394,599
Cost of revenue	2,107,464	2,763,504
Gross profit	(1,849,817)	(1,368,905)
Gross margin	-718 %	-98 %
Training Center Revenue		
Revenue	1,056,585	2,958,580
Cost of revenue	775,004	1,286,952
Gross profit	281,581	1,671,628
Gross margin	27 %	57 %

The gross margin for online education division is negative 718% for the six months ended June 30, 2014 as compared with negative 98% for the six months ended June 30, 2013. The significant drop in gross margin was because there was a significant decrease in revenue from online education while the cost of revenue did not decrease proportionately.

The gross margin for our training center division decreased to 27% for the six month ended June 30, 2014 from 57% for the six months ended June 30, 2013 because cost of revenue did not decrease as much as revenue due to reasons discussed above. As part of our growth strategy, we plan to expand our onsite training network in Beijing and other major cities in order to increase our brand awareness and reputation. With the launch of our new training centers, we expect gross margin for our training center division to continue to decrease as the newly established centers may not generate sufficient revenue during the early stage.

### **Selling Expenses**

Selling expenses include advertising expense, consulting fees, sales commissions, and other expenses. Selling expenses increased by \$59,563 or 3% to \$2,395,702 for the six months ended June 30, 2014, from \$2,336,139 for the six months ended June 30, 2013. The increase in selling expenses was mainly due to the increase expenditures relate to the outsourced advertising, marketing and promoting activities. During the period, we incurred advertising, marketing and promoting expense amounting to \$1,315,966, as compared with \$915,936 for the same period of in 2013. We will continue to focus on rebuilding our brand name and reputation in the near future, through advertising via media, online and onsite promotion, handouts, brochures, etc. We expect our selling expenses to increase because we will incur marketing and advertising expenses to promote our new platform and develop a large user base.

### **Administrative Expenses**

Administrative expenses increased by \$5,207,893 or 149%, to \$8,704,791 for the six months ended June 30, 2014, from \$3,496,898 for the six months ended June 30, 2013. This was mainly due to the research and development expenses relating to the development of the web-based platform, office expenses, and labor costs throughout the period. In the future we expect the administrative expenses to continue to increase because: 1) we will incur maintenance expenses for the web-based platform after it being successfully launched; 2) we will incur expenses associated with the expansion of our onsite training centers for purposes of gaining more market shares. The office and administrative expenses associated with the newly-opened onsite training centers also contributed to the increase in administrative expenses.

### **Other Income (Expense)**

Other income or expense includes loss on disposal of property and equipment, interest income and impairment loss on intangible assets. Net other income was \$109,731 for the six months ended June 30, 2014, an increase of \$618,308, as compared to net other expense of \$508,577 for the six months ended June 30, 2013. This is mainly due to no impairment expenses in the six months ended June 30, 2014, as compared with impairment expense of \$606,032 in the six months ended June 30, 2013.

### **Income Taxes**

The provision for income tax was nil for the six months ended June 30, 2014 and 2013. In 2014, the applicable income tax rate is 15% for ZHLD, as ZHLD has been approved by the local government as being involved in a high technology industry. Otherwise, the regular PRC statutory tax rate is 25%. ZHTC, Tianlang, Changchun Nuoya, Harbin Nuoya and Beijing Xicheng District Hua Yu Pin Xue Training School are currently exempt from PRC taxation, as they operate as a business enterprise engaged in educational opportunities. The Company's other subsidiaries: BHYHZ, ZHLDBJ, HYPX, ZHLDIT and Beijing Shifanxuezhitang Information Science Institute are taxed at the PRC regular statutory rate (25%), and have not accrued taxes since inception due to recurring losses or not having generated income since inception.

### **Net Loss**

As a result of the foregoing, we had net loss attributable to the Company and its subsidiaries of \$13,368,837, or negative return of \$1.26 per share basic and diluted, for the six months ended June 30, 2014, as compared to net loss

of \$7,442,867 or negative return of \$0.70 per share basic and diluted, for the six months ended June 30, 2013.

## Liquidity and Capital Resources

Our current assets primarily consist of cash, prepaid expenses, and other receivable. We do not have inventory. Because students who purchase our on-line programs purchase debit cards for the programs that they use and students who enroll in our training classes pay their tuition before starting classes, we do not have accounts receivable except some accounts receivable from our advertising business on our website. Our prepaid expenses are primarily advance payments made to teachers for on-line materials, prepaid advertisement expense, prepaid rent, and other prepayments.

As of June 30, 2014, we had working capital of \$42,070,907, a decrease of \$13,254,350, or 24% from working capital of \$55,325,257 as at December 31, 2013 due to significant net loss from operation. However, we still consider current working capital and borrowing capabilities adequate to cover our planned operating and capital requirements.

At June 30, 2014, we had cash and cash equivalents of \$42,589,275, a decrease of \$13,787,879 or 24%, from \$56,377,154 at December 31, 2013.

	<b>Six Months Ended</b>	
	June 30, 2014 (Unaudited)	June 30, 2013 (Unaudited)
Net cash (used in) provided by operating activities	\$(12,191,414)	\$(4,286,080)
Net cash (used in) provided by investing activities	(1,202,514 )	7,979,413
Net cash (used in) provided by financing activities	-	(352,592 )
Effect of exchange rate changes on cash	(393,951 )	1,380,701
Net increase (decrease) in cash and cash equivalents	(13,787,879)	4,721,442

### **Cash Flow in Operating Activities**

Our net cash used in operating activities was \$12,191,414 for the six months ended June 30, 2014, an increase of \$7,905,334 or 184% from \$4,286,080 for the six months ended June 30, 2013. This increase was due to the increase in net loss of \$5,942,052, from \$7,633,110 for the six months ended June 30, 2013 to net loss of \$13,575,162 for the six months ended June 30, 2014.

### **Cash Flow in Investing Activities**

Our cash used by investing activities was \$1,202,514 for the six months ended June 30, 2014, as compared with cash inflow of \$7,979,413 by investing activities for the six months ended June 30, 2013. Cash used in our investing activities was primarily for renovation of our new offices in Beijing for the six months ended June 30, 2014 while the cash inflow from investing activities in the six months ended June 30, 2013 primarily resulted from the repayment of a loan from NIT in 2013.

### **Cash Flow in Financing Activities**

Our cash used in financing activities was \$0 for the six months ended June 30, 2014, as compared to \$352,592 for the six months ended June 30, 2013. Cash used in financing activities primarily consisted of dividends paid to noncontrolling stockholders.

We believe that our working capital will be sufficient to enable us to meet our cash requirements for the next 12 months. However, we may incur additional expenses as we seek to expand our business to offer services in other parts of the PRC as well as to market and continue the development of our vocational training activities. We believe we have adequate working capital to fund future growth activities. Although we do not have any current plans to make any further acquisitions, it is possible that we may seek to acquire one or more businesses in the education field, and we may require financing for that purpose. We cannot assure you that funding will be available if and when we require funding.

### **Off-Balance Sheet Arrangements**

As of June 30, 2014, we have no off-balance sheet arrangements.

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

Not applicable.

**Item 4. Controls and Procedures.**

*Evaluation of Disclosure Controls and Procedures*

The Company maintains a set of disclosure controls and procedures designed to ensure that information required to be disclosed by the Company in the reports filed under the Securities Exchange Act, is recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms. Disclosure controls are also designed with the objective of ensuring that this information is accumulated and communicated to the Company's management, including the Company's chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

Pursuant to Rule 13a-15(b) under the Exchange Act, the Company carried out an evaluation with the participation of the Company's management, including Xiqun Yu, the Company's chief executive officer, and Cloris Li, the Company's chief financial officer, of the effectiveness of the Company's disclosure controls and procedures (as defined under Rule 13a-15(e) under the Exchange Act) as of the quarter ended June 30, 2014. Based upon that evaluation, the Company's chief executive officer and chief financial officer concluded that the Company's disclosure controls and procedures were effective.

*Changes in Internal Controls over Financial Reporting*

We regularly review our system of internal control over financial reporting and make changes to our processes and systems to improve controls and increase efficiency, while ensuring that we maintain an effective internal control environment. Changes may include such activities as implementing new, more efficient systems, consolidating activities, and migrating processes.

There have been no changes in our internal control over financial reporting during the quarter ended June 30, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.





## **PART II - OTHER INFORMATION**

### **Item 1. Legal Proceedings.**

On June 26, 2013, the Company served Sherb& Co. LLP (“Sherb”), its former auditor, with process in the matter captioned, China Education Alliance, Inc. v. Sherb& Co., LLP, Case # 1:13-cv-4381-RA, before the United States District Court for the Southern District of New York (the “District Court Action”). In this action, the Company alleged causes of action for: breach of contract, breach of contract implied in fact, professional negligence, negligent misrepresentation, and unjust enrichment due to Sherb’s failure to perform accounting and auditing services in compliance with PCAOB standards. The Company seeks at least \$500,000 in damages, as well as interest, attorney’s fees, costs, and expenses and disbursements incurred in bringing this action. Sherb was required to respond to these allegations on or before August 15, 2013.

On August 15, 2013, Sherb filed a motion to compel arbitration, arguing that the matter should be arbitrated in accordance with the “Dispute Resolution Procedure” contained within the engagement letters executed by the parties. After reviewing the “Dispute Resolution Procedure” contained within each of the parties’ engagement letters, which contained an arbitration clause, the parties agreed that the proper forum for the matter was arbitration before the American Arbitration Association (“AAA”). Therefore, on August 28, 2013, the parties executed a Stipulation of Dismissal (without prejudice), dismissing the District Court Action. In addition, the parties agreed to try and mediate the matter before submitting the case to arbitration before the AAA. The mediation took place in December 2013. Following the mediation, the parties are still attempting to settle. However, should the parties be unable to settle, the Company intends to file a suit against Sherb before the AAA and seek the same claims and damages as alleged in the prior District Court Action. Following the mediation, further settlement discussions ensued. The matter subsequently settled in July 2014.

### **Item 1A. Risk Factors**

Not applicable.

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

None.

**Item 3. Defaults Upon Senior Securities.**

None.

**Item 4. Mine Safety Disclosures.**

Not applicable.

**Item 5. Other Information.**

Not applicable.

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**Item 6. Exhibits.**

Copies of the following documents are included as exhibits to this report pursuant to Item 601 of Regulation S-K.

Exhibit	Description
No.	
3.1	Articles of Incorporation filed December 2, 1996 in the State of North Carolina are incorporated herein by reference to Exhibit 3.1 to the Form SB-2 Registration Statement of China Education Alliance, Inc. (File No. 333-101167) filed on November 13, 2002.
3.2	Articles of Amendment Business Corporation dated May 23, 2002 are incorporated herein by reference to Exhibit 3.2 to the Form SB-2 Registration Statement of China Education Alliance, Inc. (File No. 333-101167) filed on November 13, 2002.
3.3	Articles of Amendment Business Corporation filed November 17, 2004, changing the name of the Company from ABC Realty Co. to China Education Alliance, Inc. is incorporated herein by reference to Exhibit 3.3 filed with the Company's Form 10-KSB annual report for its fiscal year ended December 31, 2005.
3.4	Articles of Share Exchange of China Education Alliance, Inc. filed with the Department of The Secretary of State of the State of North Carolina on December 30, 2004 are incorporated herein by reference to Exhibit 3.1 filed with China Education Alliance, Inc.'s Form 10-QSB quarterly report for its quarter ended September 30, 2007 filed with the SEC on November 14, 2007.
3.5	Articles of Amendment to Articles of Incorporation filed with the Department of The Secretary of State of the State of North Carolina on October 4, 2007 are incorporated herein by reference to Exhibit 3.2 filed with China Education Alliance, Inc.'s Form 10-QSB quarterly report for its quarter ended September 30, 2007 filed with the SEC on November 14, 2007.
3.6	Articles of Amendment to Articles of Incorporation filed with the Department of The Secretary of State of the State of North Carolina on September 26, 2011 is incorporated herein by reference to Exhibit 3.6 to the Form 10-K filed with the SEC on April 16, 2012.
3.7	By Laws of China Education Alliance, Inc. are incorporated herein by reference to Exhibit 3.3 to the Form SB-2/A Registration Statement of China Education Alliance, Inc. filed on February 7, 2003 (File No. 333-101167).
4.1	China Education Alliance, Inc. 2009 Stock Incentive Plan is incorporated herein by reference to Exhibit 4.1 to the Post-Effective Amendment to Registration Statement on Form S-8 filed with the SEC on June 19, 2009.
4.2	China Education Alliance, Inc. 2011 Stock Incentive Plan is incorporated herein by reference to Exhibit 4.1 to Form S-8 filed with the SEC on July 1, 2011.
31.1	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
31.2	Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
32.1	Certification of the Principal Executive Officer pursuant to U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**
32.2	Certification of the Principal Financial Officer pursuant to U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**
101.INS	XBRL Instance Document*

101.SCH XBRL Taxonomy Extension Schema Document\*  
101.CAL XBRL Taxonomy Calculation Linkbase Document\*  
101.DEF XBRL Taxonomy Extension Definition Linkbase Document\*  
101.LAB XBRL Taxonomy Label Linkbase Document\*  
101.PRE XBRL Taxonomy Presentation Linkbase Document\*

\*Filed herewith.

\*\*Furnished herewith.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**CHINA EDUCATION ALLIANCE,  
INC.**

Date: August 14, 2014 By: */s/ Xiqun Yu*  
Xiqun Yu  
Chief Executive Officer and Chairman  
(Principal Executive Officer)

Date: August 14, 2014 By: */s/ Cloris Li*  
Cloris Li  
Chief Financial Officer  
(Principal Financial Officer)