CHINA FIRE & SECURITY GROUP, INC.
Form 10-Q
August 13, 2008

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

FORM 10-Q

(Mark one)

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

For the Quarterly Period Ended June 30, 2008

or

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

Commission File Number 000-50491

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

Florida	**65-1193022**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
B-2508 TYG Center, C2 Dongsanhuanbeilu, Chaoyang District, Beijing 100027, People's Republic of China	**100027**
(Address of principal executive offices)	**(Zip Code)**

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

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

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. (Check one):

Large accelerated filer o	Accelerated filer o
Non-accelerated filer o	
(Do not check if smaller reporting company)	Smaller reporting company x

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

As of August 12, 2008, the Registrant had 27,560,527 shares of common stock outstanding.

China Fire & Security Group, Inc.

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CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
AS OF JUNE 30, 2008 AND DECEMBER 31, 2007

ASSETS

		June 30, 2008		December 31, 2007
CURRENT ASSETS:		(Unaudited)		
Cash	$	20,518,916	$	17,110,449
Restricted cash		4,563,344		3,829,927
Accounts receivable, net of allowance for doubtful accounts of $2,827,972 and $2,483,359 as of June 30, 2008 and December 31, 2007, respectively		18,321,528		16,525,161
Notes receivable		6,209,671		3,315,811
Other receivables		1,182,323		748,195
Other receivable - related party		325,177		-
Inventories		5,548,967		4,048,283
Costs and estimated earnings in excess of billings		25,067,016		13,068,036
Employee advances		776,472		1,307,433
Employee advances - officers and directors		25,438		18,682
Prepayments and deferred expenses		3,203,575		2,218,391
Total current assets		85,742,427		62,190,368
PLANT AND EQUIPMENT, net		7,559,581		6,568,250
OTHER ASSETS:				
Accounts receivable - retention		776,859		193,029
Deferred expenses - non current		30,049		21,234
Advances on building and equipment purchases		185,395		366,317
Investment in joint ventures		1,166,326		1,156,294
Intangible assets, net of accumulated amortization		1,150,733		1,150,935
Total other assets		3,309,362		2,887,809
Total assets	$	96,611,370	$	71,646,427

LIABILITIESANDSHAREHOLDERS' EQUITY

CURRENT LIABILITIES:				
Accounts payable	$	6,892,119	$	6,327,182
Customer deposits		13,105,751		4,757,179
Billings in excess of costs and estimated earnings		2,820,444		4,882,217
Other payables		988,413		168,868
Accrued liabilities		6,315,280		4,214,530
Taxes payable		1,470,764		1,088,335
Total current liabilities		31,592,771		21,438,311
COMMITMENTS AND CONTINGENCIES		-		-
SHAREHOLDERS' EQUITY:				

Common stock, $0.001 par value, 65,000,000 shares authorized, 27,560,527 and 27,556,893 shares issued and outstanding as of June 30, 2008 and December 31, 2007, respectively		27,560		27,556
Additional paid-in-capital		19,350,287		19,317,287
Statutory reserves		5,067,061		5,067,061
Retained earnings		33,644,975		22,228,095
Accumulated other comprehensive income		6,928,716		3,568,117
Total shareholders' equity		65,018,599		50,208,116
Total liabilities and shareholders' equity	$	96,611,370	$	71,646,427

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

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CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME AND OTHER COMPREHENSIVE INCOME
FOR THE THREE MONTHS AND SIX MONTHS ENDED JUNE 30, 2008 AND 2007
(UNAUDITED)

	For the Three Months Ended June 30, 2008	For the Three Months Ended June 30, 2007	For the Six Months Ended June 30, 2008	For the Six Months Ended June 30, 2007
REVENUES				
System contracting projects	$ 14,557,008	$ 9,887,878	$ 25,886,388	$ 17,164,386
Products	1,533,965	1,538,049	4,415,136	3,639,805
Maintenance services	562,751	121,258	1,048,826	242,456
Total revenues	16,653,724	11,547,185	31,350,350	21,046,647
COST OF REVENUES				
System contracting projects	5,971,745	4,379,902	11,541,955	8,024,570
Products	217,498	811,081	1,059,380	1,639,783
Maintenance services	280,188	46,689	520,327	56,874
Total cost of revenues	6,469,431	5,237,672	13,121,662	9,721,227
GROSS PROFIT	10,184,293	6,309,513	18,228,688	11,325,420
OPERATING EXPENSE				
Selling and marketing	1,676,315	1,210,100	3,010,041	1,761,509
General and administrative	1,126,074	1,174,309	2,753,120	2,185,353
Depreciation and amortization	154,688	133,056	321,950	259,539
Research and development	627,952	267,626	894,601	317,921
Total operating expense	3,585,029	2,785,091	6,979,712	4,524,322
INCOME FROM OPERATIONS	6,599,264	3,524,422	11,248,976	6,801,098
OTHER INCOME (EXPENSE)				
Other income	110,237	323,702	221,643	327,998
Other expense	(85,332)	(2,146)	(85,388)	(6,417)
Interest income	63,384	24,915	91,744	44,170
Change in fair value of derivative instruments	-	371,628	-	1,205,791
Total other income	88,289	718,099	227,999	1,571,542
INCOME BEFORE PROVISION FOR INCOME TAXES	6,687,553	4,242,521	11,476,975	8,372,640
PROVISION FOR INCOME TAXES	11,453	-	60,095	-
NET INCOME	6,676,100	4,242,521	11,416,880	8,372,640

OTHER COMPREHENSIVE INCOME:								
Foreign currency translation adjustment		1,293,683		514,775		3,360,599		810,334
COMPREHENSIVE INCOME	$	7,969,783	$	4,757,296	$	14,777,479	$	9,182,974
BASIC EARNINGS PER SHARE								
Weighted average number of shares		27,557,297		26,461,678		27,557,095		26,461,678
Earnings per share	$	0.24	$	0.16	$	0.41	$	0.32
DILUTED EARNINGS PER SHARE								
Weighted average number of shares		28,200,785		27,164,207		28,179,595		27,085,807
Earnings per share	$	0.24	$	0.16	$	0.41	$	0.31

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

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CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

	Common Stock		Additional	Retained Earnings		Accumulated other comprehensive	
	Shares	Par value	paid-in-capital	Statutory reserves	Unrestricted	income	Totals
BALANCE, December 31, 2006	26,461,678	$ 26,462	$ 13,393,171	$ 4,030,627	$ 6,462,893	$ 1,065,522	$ 24,978,675
Net income					8,372,640		8,372,640
Warrants reclassified from liabilities			1,475,020				1,475,020
Options issued to employees			112,000				112,000
Adjustment to registered capital				(605,000)	605,000		-
Foreign currency translation adjustment						810,334	810,334
BALANCE, June 30, 2007 (Unaudited)	26,461,678	$ 26,462	$ 14,980,191	$ 3,425,627	$ 15,440,533	$ 1,875,856	$ 35,748,669
Net income					8,428,996		8,428,996
Issuance of common stock	984,680	983	4,164,214				4,165,197
Warrants exercised	110,535	111	(111)				-
Warrants issued for services			94,274				94,274
Options issued to employees			78,719				78,719
Adjustment to statutory reserves				1,641,434	(1,641,434)		-
Foreign currency translation adjustment						1,692,261	1,692,261
BALANCE, December 31, 2007	27,556,893	$ 27,556	$ 19,317,287	$ 5,067,061	$ 22,228,095	$ 3,568,117	$ 50,208,116
Net income					11,416,880		11,416,880
Options issued to employees			33,004				33,004
Warrants exercised	3,634	4	(4)				-
Foreign currency translation						3,360,599	3,360,599

adjustment												
BALANCE, June 30, 2008 (Unaudited)	27,560,527	$	27,560	$	19,350,287	$	5,067,061	$	33,644,975	$	6,928,716	$	65,018,599

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

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CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED JUNE 30, 2008 AND 2007
(UNAUDITED)

	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 11,416,880	$ 8,372,640
Adjustments to reconcile net income to cash provided by (used in) operating activities:		
Depreciation	326,548	268,868
Amortization of land use rights	6,970	6,735
Amortization of technology rights	30,438	10,146
Provision for doubtful accounts	180,061	208,324
Gain on disposal of equipment	(31,715)	-
Compensation expense for options issued to employees	33,004	112,000
Change in fair value of derivative instruments	-	(1,205,791)
Change in operating assets and liabilities:		
Accounts receivable	(1,450,799)	(1,632,577)
Notes receivable	(2,606,423)	(615,734)
Other receivables	(375,360)	(1,169,318)
Other receivables - related party	(316,128)	-
Inventories	(1,206,309)	(437,151)
Costs and estimated earnings in excess of billings	(10,849,628)	(2,964,789)
Employee advances	597,770	(489,184)
Employee advances from officers and directors	(5,402)	428,047
Prepayments and deferred expenses	(826,585)	(73,909)
Accounts payable	154,397	(287,314)
Accounts payable - related party	-	(324,532)
Customer deposits	7,819,403	5,476,662
Billings in excess of costs and estimated earnings	(2,309,053)	(6,672,629)
Other payables	786,202	423,280
Other payables - related party	-	(51,118)
Accrued liabilities	1,779,303	1,008,098
Taxes payable	303,874	(453,113)
Net cash provided by (used in) operating activities	3,457,448	(62,359)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of plant and equipment	(522,846)	(709,403)
Advances on building and equipment purchase	(180,236)	(884,657)
Proceeds from sale of equipment	39,545	7,183
Purchase of intangible assets	-	(608,745)
Payments for investment in Hubei Sureland Changjiang Fire Safety Technology Co., Ltd.	-	(147,869)
Proceeds from sale of investment in Tianjin Fire Safety Equipment Co., Ltd.	-	507,192
Proceeds from sale of Beijing Zhong Xiao Fire Safety Technology Co., Ltd	-	1,052,986
Net cash used in investing activities	(663,537)	(783,313)

CASH FLOWS FROM FINANCING ACTIVITIES:				
Change in restricted cash		(474,018)		759,629
Payments to Beijing Zhong Xiao Fire Safety Technology Co., Ltd.		-		(2,429,681)
Proceeds from Beijing Zhong Xiao Fire Safety Technology Co., Ltd		-		1,344,316
Net cash used in financing activities		(474,018)		(325,736)
EFFECTS OF EXCHANGE RATE CHANGE IN CASH		1,088,574		232,635
INCREASE (DECREASE) IN CASH		3,408,467		(938,773)
CASH, beginning of period		17,110,449		9,426,091
CASH, end of period	$	20,518,916	$	8,487,318
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION				
Income taxes paid	$	23,400	$	-
Interest paid	$	-	$	-
NON-CASH TRANSACTIONS INVESTING AND FINANCING ACTIVITIES:				
Reclassification of warrant liability to paid-in capital upon modification of warrants agreement	$	-	$	1,475,020
Reclassification of advances on building and equipment purchase to plant and equipment upon receipt of purchase	$	378,982	$	-

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

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CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2008
(Unaudited)

Note 1 - Background

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

Note 2 - Summary of significant accounting policies

The reporting entity

The consolidated financial statements of China Fire & Security Group Inc. and subsidiaries reflect its wholly-owned subsidiaries, each discussed briefly below.

China Fire Protection Group, Inc. ("CFPG") was incorporated in the British Virgin Islands as a limited liability company on June 2, 2006 as a holding company.

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

Beijing Hua An Times Fire Safety Technology Co., Ltd. ("Beijing Hua An") is a subsidiary of Sureland Industrial established in the PRC as a limited liability company on September 22, 2005 with a registered capital RMB 5,000,000 (approximately $619,500). Hua An is a software development company, principally engage in the design, development and manufacturing of fire protection software.

Sureland Industrial Fire Equipment Co., Ltd. ("Sureland Equipment") was established as a Sino-foreign equity joint venture in Beijing, the People's Republic of China (the PRC) on April 12, 2006 with a registered capital $660,000. Sureland Equipment principally engages in the manufacturing of fire protection products.

Tianjin Tianxiao Fire Safety Equipment Co., Ltd. ("Tianxiao Equipment") was established as a limited liability company in Tianjin, PRC on April 11, 2007 with a registered capital RMB 10,000,000 (approximately $1,295,000). Tianxiao Equipment principally engages in the manufacturing of fire protection products.

Basis of presentation

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

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

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CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2008
(Unaudited)

Use of estimates

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

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

Revenue recognition

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

1. Revenue from system contracting projects are recognized using the percentage-of-completion method of accounting and, therefore, take into account the costs, estimated earnings and revenue to date on contracts not yet completed. Revenue recognized is that percentage of the total contract price that cost expended to date bears to anticipated final total cost, based on current estimates of costs to complete. Contract costs include all direct material and labor costs and those indirect costs related to contract performance, such as indirect labor, supplies, tools, repairs, and depreciation costs. Selling, general, and administrative costs are charged to expense as incurred. At the time a loss on a contract becomes known, the entire amount of the estimated ultimate loss is recognized in the consolidated financial statements. Claims for additional contract costs are recognized upon a signed change order from the customer or in accordance with paragraphs 62 and 65 of the AICPA’S Statement of Position ("SOP") 81-1, "Accounting for Performance of Construction - Type and Certain Production - Type Contracts" ("SOP 81-1").

2. Revenue from product sales is recognized when the goods are delivered and title has passed. Product sales revenue is presented net of a value-added tax (VAT). All of the Company’s products that are sold in the PRC are subject to a Chinese value-added tax at a rate of 17% of the gross sales price. This VAT may be offset by VAT paid by the Company on raw materials and other materials included in the cost of producing their finished product.

CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2008
(Unaudited)

3. Revenue from the rendering of Maintenance Services is recognized over the service period on a straight line basis.

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

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

Shipping and handling

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

Foreign currency translation

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

Translation adjustments amounted to $6,928,716 and $3,568,117 as of June 30, 2008 and December 31, 2007, respectively. Asset and liability accounts at June 30, 2008 were translated at 6.85 RMB to $1.00 USD as compared to 7.29 RMB at December 31, 2007. Equity accounts were stated at their historical rate. The average translation rates applied to income statements accounts for the six months ended June 30, 2008 and 2007 were 7.05 RMB and 7.71 RMB, respectively. Cash flows are also translated at average translation rates for the period, therefore, amounts reported on the statement of cash flows will not necessarily agree with changes in the corresponding balances on the balance sheet.

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

CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2008
(Unaudited)

Plant and equipment

Plant and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets with 5% residual value. For the three months ended June 30, 2008 and 2007, depreciation expense amounted to $157,160 and $145,734 respectively. Depreciation expense amounted to $326,548 and $268,868 for the six months ended June 30, 2008 and 2007, respectively.

Estimated useful lives of the assets are as follows:

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

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

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

Long-term assets of the Company are reviewed periodically or more often if circumstances dictate, to determine whether their carrying value has become impaired. The Company considers assets to be impaired if the carrying value exceeds the future projected cash flows from related operations. The Company evaluates the periods of depreciation and amortization to determine whether subsequent events and circumstances warrant revised estimates of useful lives. As of June 30, 2008, the Company expects these assets to be fully recoverable.

CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2008
(Unaudited)

Plant and equipment consist of the following:

	June 30, 2008	December 31, 2007
Buildings and improvements	$ 5,403,273	$ 5,077,373
Transportation equipment	2,123,915	1,985,701
Machinery	1,104,471	970,500
Office equipment	1,164,634	1,047,350
Furniture	38,281	35,972
Construction in progress	638,511	-
Total	10,473,085	9,116,896
Less accumulated depreciation	(2,913,504)	(2,548,646)
Plant and equipment, net	$ 7,559,581	$ 6,568,250

Concentration of risk

Cash includes cash on hand and demand deposits in accounts maintained with state owned banks within the People’s Republic of China and Hong Kong. The Company maintains balances at financial institutions which, from time to time, may exceed Hong Kong Deposit Protection Board insured limits for the banks located in Hong Kong. Balances at financial institutions or state owned banks within the PRC are not covered by insurance. As of June 30, 2008 and December 31, 2007, the Company had deposits (including restricted cash balances) totaling to $25,257,549 and $20,940,016, that are not covered by insurance, respectively. The Company has not experienced any losses in such accounts and believes it is not exposed to any risks on its cash in bank accounts.

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

The Company had one major customer who represents approximately 28% and15% of the Company’s sales for the three months and six months ended June 30, 2008, respectively. Accounts receivable from this customer was $0 as of June 30, 2008. The Company had one major customer who represents approximately 21% and 23% of the Company’s sales for the three months and six months ended June 30, 2007, respectively. Accounts receivable from this customer was $0 as of June 30, 2007.

The Company had no major suppliers accounted for more than 10% of the Company’s total purchase and total accounts payable as of and for the three months and six months ended June 30, 2008 and 2007, respectively.

Cash and cash equivalents

CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2008
(Unaudited)

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

Restricted cash

Restricted cash represents cash required to be deposited in a separate bank account subject to withdrawal restrictions by its system contracting projects and product sales customers to guarantee its contracts will be performed. The deposit cannot be drawn or transferred by the Company until the restriction period has expired. The amounts are $4,563,344 and $3,829,927 as of June 30, 2008 and December 31, 2007, respectively.

	June 30, 2008	December 31, 2007
Restricted Cash		
Products sales	$ 410,220	$ 102,355
System contracting projects	4,153,124	3,727,572
Total Restricted Cash	$ 4,563,344	$ 3,829,927

Inventories

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

	June 30, 2008	December 31, 2007
Raw materials	$ 798,599	$ 310,255
Finished goods	3,389,910	2,617,638
Work in progress	1,360,458	1,120,390
Total	$ 5,548,967	$ 4,048,283

Raw materials consist primarily of materials used in production. Finished goods consist primarily of equipment used in product sales and system contracting projects. The costs of finished goods include direct costs of raw materials as well as direct labor used in production. Indirect production costs such as utilities and indirect labor related to production such as assembling, shipping and handling costs are also included in the cost of inventory. The Company reviews its inventories periodically to determine if any reserves are necessary for potential obsolescence. As of June 30, 2008 and December 31, 2007 the Company determined no reserves are necessary.

Accounts receivable

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

CHINA FIRE & SECURITY GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2008
(Unaudited)

Accounts receivable consists of the following:

	June 30, 2008	December 31, 2007
Accounts receivable:		
System contracting projects	$ 11,107,591	$ 10,296,762
Maintenance services	2,047,613	670,357
Products sales	8,771,155	8,234,430
Total accounts receivable	21,926,359	19,201,549
Allowance for bad debts	(2,827,972)	(2,483,359)
Accounts receivable, net	19,098,387	16,718,190
Accounts receivable - non-current retentions	(776,859)	(193,029)
Accounts receivable - current	$ 18,321,528	$ 16,525,161

The activity in the allowance for doubtful accounts for trade accounts receivable for the six months ended June 30, 2008 and the year ended December 31, 2007 is as follows:

	June 30, 2008	December 31, 2007
Beginning allowance for doubtful accounts	$ 2,483,359	$ 1,252,947
Additional charged to bad debt expense	180,061	1,111,051
Write-off charged against the allowance	-	(12,700)
Foreign currency translation adjustment	164,552	132,061
Ending allowance for doubtful accounts	$ 2,827,972	$ $2,483,359

<u>Costs and estimated earnings in excess of billings</u>

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

	June 30, 2008	December 31, 2007
Contract costs incurred plus recognized profits less recognized losses to date	$ 74,045,677	$ 50,877,880
Less: progress billings	48,978,661	37,809,844
Costs and estimated earnings in excess of billings	$ 25,067,016	$ 13,068,036

<u>Billings in excess of costs and estimated earnings</u>

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

	June 30, 2008	December 31, 2007
Progress billings	$ 11,684,088	$ 15,713,786
Less: contracts costs incurred plus recognized profits less recognized losses to date	8,863,644	10,831,569

Billings in excess of costs and estimated earnings	$ 2,820,444	$ 4,882,217

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At June 30, 2008 and December 31, 2007, retentions held by customers of system contracting projects included in the Company's accounts receivable as following:

	June 30, 2008	December 31, 2007
Retentions		
Current	$ 2,112,045	$ 2,829,250
Non-current	776,859	193,029
Total retentions	$ 2,888,904	$ 3,022,279

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

Research and development

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

Warranties

Generally, the Company's products are not covered by specific warranty terms. However, it is the Company's policy to replace parts if they become defective within one year after deployment at no additional charge. Historically, failure of product parts due to materials or workmanship is rare. Therefore, at June 30, 2008 and December 31, 2007, the Company made no provision for warranty claims for our products. Management continuously evaluates the potential warranty obligation. Management will record the expenses related to the warranty obligation when the estimated amount become material at the time revenue is recorded.

Fair value of financial instruments

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

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

The Company invested $166,326 to Hubei Shou An Changjiang Fire Protection Co., Ltd for 19% ownership and invested $1,000,000 to King Galaxy Investments Limited for 5% ownership. Total investment as of June 30, 2008 amounted to $1,166,326. Since there is no quoted or observable market price for the fair value of similar long term in joint venture, the Company then used the level 3 inputs for its valuation methodology. The determination of the fair value was based on the cost of the capital contribution to the joint ventures.

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

Intangible assets

Land use rights - All land in the People's Republic of China is owned by the government. However, the government grants the user "land use rights". The Company acquired land use rights in 2001 for $635,757. The land use rights expire in 2051. The costs of these rights are being amortized over fifty years using the straight-line method. As of June 30, 2008 and December 31, 2007, accumulated amortization amounted to $164,049 and $137,672, respectively. Amortization expense amounted to $3,341 and $3,386 for the three months ended June 30, 2008 and 2007, and $ 6,970 and $6,735 for the six months ended June 30, 2008 and 2007, respectively.

Technology rights - In May 2007, the Company acquired two technology rights to manufacture fire protection products for $608,745. The costs of these rights are being amortized over ten years using the straight-line method. As of June 30, 2008 and December 31, 2007, accumulated amortization amounted to $71,021 and $40,583, respectively. Amortization expense amounted to $15,218 and $10,146 for the three months ended June 30, 2008 and 2007, respectively. Amortization expense amounted to $30,438 and $10,146 for the six months ended June 30, 2008 and 2007, respectively.

Intangible assets of the Company are reviewed annually to determine whether their carrying value has become impaired. The Company considers assets to be impaired if the carrying value exceeds the future projected cash flows from related operations. The Company also evaluates the periods of amortization to determine whether subsequent events and circumstances warrant revised estimates of useful lives. As of June 30, 2008, the Company expects these assets to be fully recoverable.

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Income taxes

The Company adopted Statement of Financial Accounting Standards No. 109, “Accounting for Income Taxes” (SFAS 109). SFAS 109 requires the recognition of deferred income tax liabilities and assets for the expected future tax consequences of temporary differences between income tax basis and financial reporting basis of assets and liabilities. Provision for income taxes consist of taxes currently due plus deferred taxes. There are no deferred tax amounts at June 30, 2008 and December 31, 2007.

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

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

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

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

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

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

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

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

Value Added Tax

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

VAT on sales and VAT on purchases amounted to $1,753,759 and $1,328,652 for the three months ended June 30, 2008, and $1,379,908 and $1,466,771 for the three months ended June 30, 2007 respectively. VAT on sales and VAT on purchases amounted to $2,718,120 and $2,070,716 for the six months ended June 30, 2008, and $2,626,243 and $2,426,434 for the six months ended June 30, 2007 respectively. Sales and purchases are recorded net of VAT collected and paid as the Company acts as an agent for the government. VAT taxes are not impacted by the income tax holiday.

Stock based compensation

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

Recently issued accounting pronouncements

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

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

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

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

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In March 2008, the FASB issued SFAS No. 161, “Disclosures about Derivative Instruments and Hedging Activities - An Amendment of SFAS No. 133” (“SFAS 161”). Effective on January 1, 2009, SFAS 161 seeks to improve financial reporting for derivative instruments and hedging activities by requiring enhanced disclosures regarding the impact on financial position, financial performance, and cash flows. To achieve this increased transparency, SFAS 161 requires (1) the disclosure of the fair value of derivative instruments and gains and losses in a tabular format; (2) the disclosure of derivative features that are credit risk-related; and (3) cross-referencing within the footnotes. The Company is in the process of evaluating the new disclosure requirements under SFAS 161.

In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles" ("SFAS 162"). FAS 162 is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with U.S. GAAP for nongovernmental entities. SFAS 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, "The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles." The Company is in the process of evaluating the impact of adoption of this statement on the results of operations, financial position or cash flows.

In June 2008, the FASB issued Emerging Issues Task Force Issue 07-5 “Determining whether an Instrument (or Embedded Feature) is indexed to an Entity’s Own Stock” (“EITF No. 07-5”). This Issue is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early application is not permitted. Paragraph 11(a) of SFAS No 133 “Accounting for Derivatives and Hedging Activities” (“SFAS 133”) specifies that a contract that would otherwise meet the definition of a derivative but is both (a) indexed to the Company’s own stock and (b) classified in stockholders’ equity in the statement of financial position would not be considered a derivative financial instrument. EITF No.07-5 provides a new two-step model to be applied in determining whether a financial instrument or an embedded feature is indexed to an issuer’s own stock and thus able to qualify for the SFAS 133 paragraph 11(a) scope exception. This standard triggers liability accounting on all options and warrants exercisable at strike prices denominated in any currency other than the functional currency of the operating entity in China (Renminbi). The Company is currently evaluating the impact of the adoption of EITF No. 07-5 on the Company’s consolidated financial statements.

Reclassifications

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

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Note 3 - Earnings per share

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

The following is a reconciliation of the basic and diluted earnings per share computation for the three months and six months ended June 30, 2008 and 2007:

	For the three months ended June 30, 2008	For the three months ended June 30, 2007	For the six months ended June 30, 2008	For the six months ended June 30, 2007
Net income for earnings per share	$ 6,676,100	$ 4,244,521	$ 11,416,880	$ 8,372,640
Weighted average shares used in basic computation	27,557,297	26,461,678	27,557,095	26,461,678
Diluted effect of stock options and warrants	643,488	702,529	622,500	624,129
Weighted average shares used in diluted computation	28,200,785	27,164,207	28,179,595	27,085,807
Earnings per share:				
Basic	$ 0.24	$ 0.16	$ 0.41	$ 0.32
Diluted	$ 0.24	$ 0.16	$ 0.41	$ 0.31

At June 30, 2008, all outstanding stock options and warrants were included in the calculation of diluted earnings per share.

Note 4 - Notes receivable

Notes receivable represents trade accounts receivable due from various customers where the customers' bank has guaranteed the payment of the receivable. This amount is non-interest bearing and is normally paid within three to six months. The Company has the ability to submit their request for payment to the customer's bank earlier than the scheduled payment date. However, the Company will incur an interest charge and a processing fee when they submit the payment request early. The Company's notes receivable totaled $6,209,671 and $3,315,811 as of June 30, 2008 and December 31, 2007, respectively.

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Note 5 - Other receivable from related party

The Company has other receivable from Hubei Shou An Changjiang Fire Protection Co., Ltd. (“Hubi Shou An”), which the Company has 19% interest in. Receivable due from Hubei Shou An was $325,177 and $0 as of June 30, 2008 and December 31, 2007, respectively. This balance was for the operating cash flow in Hubei Shou An and expected to be repaid by December 31, 2008 in cash. Receivable is non-interest bearing and unsecured.

Note 6 - Prepayments and deferred expenses

Prepayments and deferred expenses are monies deposited with or advanced to subcontractors to perform services on System Contracting Projects. Some subcontractors require a certain amount of money to be deposited as a guarantee payment in order for them start performing the services. Prepayments and deferred expenses also include monies deposited or advanced to vendors on future inventory purchases to ensure timely delivery. The total outstanding amount was $3,203,575 and $2,218,391 as of June 30, 2008 and December 31, 2007, respectively.

Note 7 - Investment in joint ventures

During the second quarter of 2007, the Company invested $166,326 for a 19% interest in Hubei Shou An Changjiang Fire Protection Co., Ltd., located in China Hubei, PRC. Investment is recorded under cost method.

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

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

Note 8 - Customer deposits

Customer deposits represent amounts advanced by customers on products orders, maintenance services deposits and system contracting projects deposits. The product or service normally is shipped or performed within six months after receipt of the advance payment and the related sale is recognized in accordance with the Company’s revenue recognition policy. As of June 30, 2008 and December 31, 2007, customer deposits amounted to $13,105,751 and $4,757,179, respectively.

Note 9 - Accrued liabilities

Accrued liabilities represent subcontractors’ expenses incurred as of balance sheet date for system contracting projects. As of June 30, 2008 and December 31, 2007, accrued liabilities amounted to $6,315,280 and $4,214,530, respectively.

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Note 10 - Income taxes

Prior to January 1, 2008, under the Income Tax Laws of PRC, the Company's subsidiaries are generally subject to an income tax at an effective rate of 25% on income reported in the statutory financial statements after appropriate tax adjustments, unless the enterprise is located in a specially designated region where it allows enterprises a three-year income tax exemption and a 50% income tax reduction for the following three years or the enterprise is a manufacturing related joint venture with a foreign enterprise or a wholly owned subsidiary of a foreign enterprise, where it allows enterprises a two-year income tax exemption and a 50% income tax reduction for the following three years.

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

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

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

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

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

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

The key changes are:

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

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

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

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

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

The provision for income taxes for the three months ended June 30, 2008 and 2007 amounted to $11,453 and $0, respectively and $60,095 and $0 for the six months ended June 30, 2008 and 2007, respectively.

The following table reconciles the U.S. statutory rates to the Company's effective tax rate for the three months and six months ended June 30:

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

The estimated tax savings for the three months ended June 30, 2008 and 2007 amounted to $1,955,426 and $1,300,563, respectively. The net effect on basic earnings per share if the income tax had been applied would decrease basic earnings per share for the three months ended June 30, 2008 and 2007 by $0.07 and $0.12, respectively. The estimated tax savings for the six months ended June 30, 2008 and 2007 amounted to $3,196,996 and $2,486,028, respectively. The net effect on basic earnings per share if the income tax had been applied would decrease basic earnings per share for the six months ended June 30, 2008 and 2007 by $0.12 and $0.22, respectively.

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China Fire & Security Group, Inc. was incorporated in the United States and has incurred net operating losses of $0 for income tax purposes for the six months ended June 30, 2008. The net operating loss carry forwards for United States income taxes amounted to $1,004,414 which may be available to reduce future years' taxable income. These carry forwards will expire, if not utilized, beginning in 2025 and continue through 2027. Management believes that the realization of the benefits from these losses appears uncertain due to the Company's limited operating history and continuing losses for United States income tax purposes. Accordingly, the Company has provided a 100% valuation allowance on the deferred tax asset benefit to reduce the asset to zero. The accumulated valuation allowance as of June 30, 2008 amounted to $341,501. Management will review this valuation allowance periodically and make adjustments as warranted.

Taxes payable

Taxes payable as of June 30, 2008 and December 31, 2007 consisted of the following:

		June 30, 2008		December 31, 2007
VAT taxes (credit) payable	$	(63,939)	$	71,367
Income taxes payable		45,462		5,915
Sales taxes		1,467,109		979,999
Other taxes payable		22,132		31,054
Total	$	1,470,764	$	1,088,335

Note 11 - Retirement plan

The Company and its subsidiaries are required to participate in a central pension scheme operated by the local municipal government. The Company is required to contribute 20% of its payroll costs to the central pension scheme in 2008 and 2007. The contributions are charged to the income statement of the Company as they become payable in accordance with the rules of the scheme. The aggregate contributions of the Company to retirement benefit schemes amounted to $74,147 and $38,691 for the three months ended June 30, 2008 and 2007, respectively. The aggregate contributions of the Company to retirement benefit schemes amounted to $124,927 and $75,687 for the six months ended June 30, 2008 and 2007, respectively.

Note 12 - Statutory reserves

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

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Surplus reserve fund

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

The transfer to this reserve must be made before distribution of any dividend to shareholders. For the six months ended June 30, 2008 and 2007, the Company did not make any contribution to this fund. The surplus reserve fund is non-distributable other than during liquidation and can be used to fund previous years' losses, if any, and may be utilized for business expansion or converted into share capital by issuing new shares to existing shareholders in proportion to their shareholding or by increasing the par value of the shares currently held by them, provided that the remaining reserve balance after such issue is not less than 25% of the registered capital.

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

Enterprise fund

The enterprise fund may be used to acquire plant and equipment or to increase the working capital to expend on production and operation of the business. No minimum contribution is required and the Company did not make any contribution to this fund for the six months ended June 30, 2008 and 2007.

Note 13 - Shareholders' equity

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

On December 5, 2006, under the SPA, the Company issued 923,078 units of common stock at $3.25 per share, Series A warrants expiring on December 5, 2011 to acquire 184,617 shares at $3.58 per share and Series B warrants also on December 5, 2011 to acquire 184,617 shares at $4.88 per share. The Company issued 69231 warrants at exercise price of $3.25 per share, expiring December 5, 2011.

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

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

Warrants

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

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

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

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

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

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

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

On June 23, 2008, a total of 5,000 warrants were converted into 3,634 shares of common stock by the warrants holders using the cashless exercise options.

The Company's warrant activity is as follows:

	Warrants Outstanding	Warrants Exercisable		Weighted Average Exercise Price	Average Remaining Contractual Life
Outstanding, December 31, 2006	1,169,306	1,169,306	$	4.23	4.58
Granted	50,000		$	4.25	
Forfeited					
Exercised	(1,164,306)	(1,164,306)	$	4.23	
Outstanding, December 31, 2007	55,000	5,000	$	4.19	4.08
Granted		50,000	$	4.25	
Forfeited					
Exercised	(5,000)	(5,000)	$	3.25	
Outstanding, June 30, 2008	50,000	50,000	$	4.25	3.58

Note 14 - Options issued to employees

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

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The Company's stock was not traded when the options were granted. Therefore, the Company had to estimate the market value of its shares. There was no significant change in the business between July and October 2006, therefore, the Company used the fair value from the October 27 transaction of $2.26 and took a discount of 30%, to estimate a market price of $1.58. At that market price, the 750,000 employee options had a fair value of approximately $834,000. Because 50% of the options vested immediately, the related compensation expense was recognized as the options vest, rather than on a straight-line basis over the total vesting period, as the amount recognized at any point in time must be at least equal to the portion vested. For the three months ended June 30, 2008 and 2007, the expense recognized amounted to $7,000 and $47,000, respectively. The expense recognized for the six months ended June 30, 2008 and 2007 amounted to $21,000 and $112,000, respectively.

On April 20, 2007, CFPG issued 9,500 options to the Company's four independent directors as part of their compensation. The options will vest immediately after one year from the issuance date. The fair value of these warrants was determined to be $19,428 using the Black Sholes model with the following assumptions: volatility 45%; risk free interest rate 4.57%; dividend yield of 0% and expected term of 5 years. Options were vested immediately at exercise price of $4.51 per share which was the close price of the Company's stock on April 19, 2007. Because the services that the independent directors are to provide started from the second quarter of 2007 and will last for one year, the related compensation expense is recognized on a straight-line basis over the total service period. The compensation expense for the three months ended June 30, 2008 and 2007 was $4,856 and $0, respectively. The compensation expense for the six months ended June 30, 2008 was $4,856 and $4,857, respectively.

On July 1, 2007, CFPG issued 20,000 options to Mr. Yuan, Xiaoyuan, who joined the Company as Chief Accounting Officer on the same day. The options will vest evenly each quarter over the following four years, starting from the third quarter of 2007. The Company used the Black Sholes model to value the options at the time they were issued, based on the exercise price of $6.70, which was the close price of the Company's stock on June 30, 2007 and expiration dates of the instruments and using a risk-free rate of 4.84% and the volatility of 40% that was estimated by analyzing the trading history of the Company's stock. At that market price, the 20,000 employee options had a fair value of $57,178. Because the options will vest each quarter over the following four years, the related compensation expense is recognized on a straight-line basis over the total vesting period. The expense recognized for the three months and six months ended June 30, 2008 was $3,574 and $7,148, respectively.

The Company has stock options as follows:

	Options Outstanding	Weighted Average Exercise Price	Aggregate Intrinsic Value
Outstanding, December 31, 2006	750,000	$ 1.25	2,250,000
Granted	29,500	$ 5.99	
Forfeited			
Exercised			
Outstanding, December 31, 2007	779,500	$ 1.43	8,925,615
Granted			
Forfeited			
Exercised			

Outstanding, June 30, 2008	779,500	$ 1.43	5,160,290

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Following is a summary of the status of options outstanding at June 30, 2008:

Outstanding Options			Exercisable Options		
Number of Options	Exercise Price	Average Remaining Contractual Life	Number of Options	Exercise Price	Average Remaining Contractual Life
750,000	1.25	3.00	703,125	1.25	3.00
9,500	4.51	3.83	9,500	4.51	3.83
20,000	6.70	4.00	5,000	6.70	4.00

Note 15 - Restructuring of subsidiaries

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

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

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

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

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

Overview

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

Reorganization

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

On September 1, 2006, we entered into a share exchange agreement, pursuant to which we acquired all of the outstanding capital shares of China Fire Protection Group Inc. in exchange for a controlling interest in our common shares. The transaction was completed on Oct 27, 2006.

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

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

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

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

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

By December 31, 2007, Sureland operates more than 30 sales and liaison offices in China.

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

Critical Accounting Policies and Estimates

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

Revenue recognition

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

1. Revenue from system contracting projects are recognized using the percentage-of-completion method of accounting and, therefore, take into account the costs, estimated earnings and revenue to date on contracts not yet completed. Revenue recognized is that percentage of the total contract price that cost expended to date bears to anticipated final total cost, based on current estimates of costs to complete. Contract costs include all direct material and labor costs and those indirect costs related to contract performance, such as indirect labor, supplies, tools, repairs, and depreciation costs. Selling, general, and administrative costs are charged to expense as incurred. At the time a loss on a contract becomes known, the entire amount of the estimated ultimate loss is recognized in the consolidated financial statements. Claims for additional contract costs are recognized upon a signed change order from the customer or in accordance with paragraphs 62 and 65 of AICPA Statement of Position 81-1, "Accounting for Performance of Construction - Type and Certain Production - Type Contracts" ("SOP 81-1")

2. Revenue from product sales is recognized when the goods are delivered and title has passed. Product sales revenue represents the invoiced value of goods, net of a value-added tax (VAT). All of the Company's products that are sold in the PRC are subject to a Chinese value-added tax at a rate of 17 percent of the gross sales price. This VAT may be offset by VAT paid by the Company on raw materials and other materials included in the cost of producing their finished product.

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

4. Dividend income is recognized when the shareholders' right to receive payment has been established.

5. Provision is made for foreseeable losses as soon as they are anticipated by management.

6. Where contract costs incurred to date plus recognized profits less recognized losses exceed progress billings, the surplus is treated as an amount due from contract consumers. Where progress billings exceed contract costs incurred to date plus recognized profits less recognized losses, the surplus is treated as an amount due to contract customers.

Foreign currency translation

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

Plant and equipment

Plant and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets with 5 percent residual value.

Use of estimates

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

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

Inventories

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

Accounts receivable

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

Results of Operations

The following is a schedule showing results of our business.

Three Months Financial Results

Comparison of the three months ended on June 30, 2008 and 2007:

	Three months ended June 30,	
	2008	**2007**
Revenues	$ 16,653,724	$ 11,547,185
Cost of revenues	6,469,431	5,237,672
Gross profits	10,184,293	6,309,513
Operating expenses	3,585,029	2,785,091
Income from operations	6,599,264	3,524,422
Total other income(expense)	88,289	718,099
Change in fair value of derivative instruments	-	371,628
Income before income taxes and minority interest	6,687,553	4,242,521
Income taxes	11,453	-
Minority interest	-	-
Net profit (loss)	6,676,100	4,242,521
Foreign exchange adjustment	1,293,683	514,775
Comprehensive income	7,969,783	4,757,296
weighted average number of shares-basic	27,557,297	26,461,678
weighted average number of shares-diluted	28,200,785	27,164,207
earning per share-basic	0.24	0.16
earning per share-diluted	0.24	0.16

Total revenues were approximately $16.7 million for the three months ended June 30, 2008 as compared to approximately $11.5 million for the three months ended June 30, 2007, an increase of approximately $5.1 million or 44.2 percent. This increase was primarily due to increases in our revenues from system contracting projects and maintenance services during the period. The Company recognized revenues from 177 total solution, product sales and maintenance contracts for the three months ended June 30, 2008 as compared to 109 contracts for the three months ended June 30, 2007.

The revenues from total solution contracts increased by 47.2 percent to $14.6 million with 104 contracts executed for the three months ended June 30, 2008, compared to $9.9 million with 71 contracts executed for the same period of last year. The revenues from product sales were $1.5 million with 39 contracts executed for the three months ended June 30, 2008, compared to $1.5 million with 29 contracts executed for the same period of last year. The revenues from maintenance service increased by 364.1 percent to $0.6 million with 34 contracts executed for the three months ended June 30, 2008, compared to $0.1 million with 9 contracts executed for the same period of last year. In particular, the three largest customers were Capital Iron and Steel Group, Anshan Iron and Steel Group and Baotou Iron and Steel Group, which collectively contributed approximately $9.3 million of the revenues, representing 55.3 percent of our total revenues for this period.

Gross profit for the three months ended June 30, 2008 was approximately $10.2 million compared to $6.3 million for the three months ended June 30, 2007, an increase of approximately $3.9 million. Gross margin during this period was 61.2 percent, which is higher than the gross margin of 54.6 percent for the same period of 2007. The increase in the gross margin was mainly attributable to the execution of total solution contracts contributing higher gross margins and a higher percentage of revenue contribution from the sales of the Company’s self-manufactured proprietary products which enjoy higher gross margins.

Operating expenses were approximately $3.6 million for the three months ended June 30, 2008 compared to approximately $2.8 million for the three months ended June 30, 2007. This represents an increase of approximately $0.8 million or 28.7 percent. Compared to the same period of last year, the Company increased the number of employees and the expenditure in sales incentive compensation and raised the compensation for management to be in line with other US public companies. The increase in operating expenses is also attributable to increased R&D expenses in new product development and improvement in our existing product offerings.

Operating income was approximately $6.6 million for the three months ended June 30, 2008 as compared to approximately $3.5 million for the three months ended June 30, 2007, representing an increase of 87.2 percent. The improvement in operating income was mainly attributable to the increased revenues and improved gross margin during the period.

Total other income was $88,289 for the three months ended June 30, 2008, compared to $718,099 for the three months ended June 30, 2007, which included a one-time non-cash gain of $371,628 due to the change in fair value of derivative instruments in 2007.

Provision for income tax was $11,453 for the three months ended June 30, 2008, compared to no provisions for income tax for the three months ended June 30, 2007.

Net income was approximately $6.7 million for the three months ended June 30, 2008 as compared to approximately $4.2 million net income for the three months ended June 30, 2007, representing an increase of $2.4 million or 57.4 percent.

Excluding a one-time non-cash gain of $371,628 for the change in fair value of derivative instrument in the three months ended June 30, 2007, the non-GAAP net income for the three months ended June 30, 2007 was $3.9 million. Our GAAP net income for the three months ended June 30, 2008 increased 72.5 percent in comparison to the non-GAAP net income for the three months ended June 30, 2007. The reason for the increase in our net income was mainly due to the increase in the Company’s revenues and the improvement in gross margin.

Currency translation adjustments resulting from RMB appreciation process amounted to $1.3 million and $0.5 million for the three months ended June 30, 2008 and 2007, respectively.

The comprehensive income, which adds the currency adjustment to the net income, was approximately $8.0 million for the three months ended June 30, 2008 as compared to approximately $4.8 million comprehensive income for the three months ended June 30, 2007, representing an increase of $3.2 million or 67.5 percent.

Six Months Financial Results

Comparison of the six months ended on June 30, 2008 and 2007:

	Six months ended June 30, 2008	2007
Revenues	$ 31,350,350	$ 21,046,647
Cost of revenues	13,121,662	9,721,227
Gross profits	18,228,688	11,325,420
Operating expenses	6,979,712	4,524,322
Income from operations	11,248,976	6,801,098
Total other income(expense)	227,999	1,571,542

Change in fair value of derivative instruments	-	1,205,791
Income before income taxes and minority interest	11,476,975	8,372,640
Income taxes	60,095	-
Minority interest	-	-
Net profit (loss)	11,416,880	8,372,640
Foreign exchange adjustment	3,360,599	810,334
Comprehensive income	14,777,479	9,182,974
weighted average number of shares-basic	27,559,095	26,461,678
weighted average number of shares-diluted	28,179,595	27,085,807
earning per share-basic	0.41	0.32
earning per share-diluted	0.41	0.31

Total revenues were approximately $31.4 million for the six months ended June 30, 2008 as compared to approximately $21.0 million for the six months ended June 30, 2007, an increase of approximately $10.3 million or 49.0 percent. This increase was primarily due to increases in our revenues from system contracting projects and maintenance services during the period. The Company recognized revenues from 233 total solution, product sales and maintenance contracts for the six months ended June 30, 2008 as compared to 144 contracts for the six months ended June 30, 2007.

The revenues from total solution contracts increased by 50.8 percent to $25.9 million with 138 contracts executed for the six months ended June 30, 2008, compared to $17.2 million with 81 contracts executed for the same period of last year. The revenues from product sales were $4.4 million with 59 contracts executed for the six months ended June 30, 2008, compared to $3.6 million with 49 contracts executed for the same period of last year. The revenues from maintenance service increased by 332.6 percent to $1.0 million with 36 contracts executed for the six months ended June 30, 2008, compared to $0.2 million with 14 contracts executed for the same period of last year. In particular, the three largest customers were Capital Iron and Steel Group, Anshan Iron and Steel Group and Datang Tashan Power Plant, which collectively contributed approximately $11.8 million of the revenues, representing 37.7 percent of our total revenues for this period.

Gross profit for the six months ended June 30, 2008 was approximately $18.2 million, as compared to $11.3 million for the six months ended June 30, 2007, an increase of approximately $6.9 million. Gross margin during this period was 58.1 percent, which is higher than the gross margin of 53.8 percent for the same period of 2007. The increase in the gross margin was mainly attributable to the execution of total solution contracts which contributed higher gross margins and a higher percentage of revenue contribution from the sales of the Company’s self-manufactured proprietary products which enjoy higher margins.

Operating expenses were approximately $7.0 million for the six months ended June 30, 2008, as compared to approximately $4.5 million for the six months ended June 30, 2007. This represents an increase of approximately $2.5 million or 54.3 percent. Compared to the same period of last year, the Company increased the number of employees, its expenditures in sales incentive compensation and raised the compensation for management to be in line with other US public companies. The increase in operating expenses is also attributable to increased R&D expenses in new product development and improvement in our existing product offerings.

Operating income was approximately $11.2 million for the six months ended June 30, 2008 as compared to approximately $6.8 million for the six months ended June 30, 2007, representing an increase of 65.4 percent. The improvement in operating income was mainly attributable to the increased revenues and improved gross margin during the period.

Total other income was $227,999 for the six months ended June 30, 2008, compared to $1,571,542 for the six months ended June 30, 2007, which included a one-time non-cash gain of $1,205,791 million due to the change in fair value of derivative instruments.

Provision for income tax was $60,095 for the six months ended June 30, 2008, compared to no provisions for income tax for the six months ended June 30, 2007.

Net income was approximately $11.4 million for the six months ended June 30, 2008 as compared to approximately $8.4 million net income for the six months ended June 30, 2007, representing an increase of $3.0 million or 36.4 percent. Excluding a one-time non-cash gain of $1.2 million for the change in fair value of derivative in the six months ended June 30, 2007, the non-GAAP net income for the six months ended June 30 of 2007 was $7.2 million. Our GAAP net income for the six months ended June 30, 2008 increased 59.3 percent in comparison to the non-GAAP net income for the six months ended June 30, 2007. The reason for the increase in the net income was mainly due to the increase in the Company’s revenues and improvement in gross margin.

Currency translation adjustments resulting from RMB appreciation process amounted to $3.4 million and $0.8 million for the six months ended June 30, 2008 and 2007, respectively.

The comprehensive income, which adds the currency adjustment to the net income, was approximately $14.8 million for the six months ended June 30, 2008 as compared to approximately $9.2 million comprehensive income for the six months ended June 30, 2007, representing an increase of $5.6 million or 60.9 percent.

Liquidity and Capital Resources

As of June 30, 2008, we had working capital of $54.1 million including cash and cash equivalents of $20.5 million. The following table sets forth a summary of our cash flows for the periods indicated:

Statement of Cash Flow

	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Net cash provided by (used in) operating activities	$ 3,457,448	$ (62,359)
Net cash (used in) investing activities	(663,537)	(783,313)
Net cash provided by financing activities	(474,018)	(325,736)
Effect of foreign currency translation on cash and cash equivalents	1,088,574	232,635
Net cash flow	$ 3,408,467	$ (938,773)

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Operating Activities

Net cash provided by operating activities was approximately $3.5 million for the six months ended June 30, 2008 as compared to $62,359 net cash used in operating activities for the same period in 2007. Net cash provided by operating activities in the six months ended June 30, 2008 was mainly due to the results of net income of $11.4 millions during the period, a $7.8 million increase in customer deposits and a $1.8 million increase in accrued liabilities, offset by a $1.5 million increase in account receivable, a $2.6 million increase in notes receivable, a $1.2 million increase in inventories, a $10.8 million increase in costs and estimated earnings in excess of billings and a $2.3 million decrease in billings in excess of costs and estimated earnings.

The increase of $10.8 million in costs and estimated earnings in excess of billings was mainly due to the increased number of projects where we have recognized revenues more than we have billed the customers for these projects, while the decrease of $2.3 million in billings in excess of costs and estimated earnings was mainly due to the decreased number of projects where we have billed our customers less than we have recognized revenues for these projects.

Investing Activities

Net cash used in investing activities in the six months ended June 30, 2008 was $663,537 as compared to net cash used in investing activities of $783,313 in the same period of 2007. The cash used in investing activities in the six months ended June 30, 2008 was mainly attributable to capital expenditure in the purchase of new equipments and the improvement of office and manufacturing facilities.

Financing Activities

Net cash used by financing activities in the six months ended June 30, 2008 totaled $474,018 as compared to $325,736 used in financing activities in the same period of 2007. The cash used by financing activities in the six months ended June 30, 2008 was mainly attributable to the increase in restricted cash during the period.

As a result of the total cash activities, net cash increased $3.4 million from December 31, 2007 to June 30, 2008. We believe that our currently available working capital of $54.1 million including cash and cash equivalents of $20.5 million should be adequate to sustain our operations at our current level and our anticipated expansion.

Off-Balance Sheet Arrangements

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

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Not required.

Item 4. Controls and Procedures.

a) *Evaluation of Disclosure Controls.* Brian Lin, our Chief Executive Officer and Robert Yuan, our Principal Accounting Officer evaluated the effectiveness of our disclosure controls and procedures as of the end of our second fiscal quarter 2008 pursuant to Rule 13a-15(b) of the Securities and Exchange Act. Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file under the Exchange Act is accumulated and communicated to our management, as appropriate to allow timely decisions regarding required disclosure. Based on their evaluations, Mr. Lin and Mr. Yuan concluded that our disclosure controls and procedures were effective as of June 30, 2008.

It should be noted that any system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system are met. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events. Because of these and other inherent limitations of control systems, there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

(b) *Changes in internal control over financial reporting.* Other than training our staff in US GAAP accounting skills and implementing stronger internal audit function during the last quarter, there have been no changes in our internal control over financial reporting that occurred during the last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. Our management team will continue to evaluate our internal control over financial reporting in 2008 as we implement our Sarbanes Oxley Act testing.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

None

Item 1A. Risk Factors

Not required.

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

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

Item 3. Defaults Upon Senior Securities

None

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

None

Item 5. Other Information

None

Item 6. Exhibits

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

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

SIGNATURES

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

CHINA FIRE & SECURITY GROUP, INC.

Dated: August 13, 2008

By: /s/ Brian Lin

Brian Lin
Chief Executive Officer