CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC.
Form 10-Q
October 28, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10 Q

(Mark One)

[X] **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended: September 30, 2009

[ ] **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ________ to ________

Commission File Number: 001-33774

CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	**98-0509431**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Empl. Ident. No.)

13/F, Shenzhen Special Zone Press Tower, Shennan Road
Futian District, Shenzhen, 518034
People s Republic of China
(Address of principal executive offices, Zip Code)

(86) 755-8351-0888
(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities 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 [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes [ ] No [ ]

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

Large Accelerated Filer	[ ]	Accelerated Filer	[X]
Non-Accelerated Filer (Do not check if a smaller reporting company)	[ ]	Smaller reporting company	[ ]

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

Yes [ ] No [X]

The number of shares outstanding of each of the issuer s classes of common equity, as of October 26, 2009 is as follows:

Class of Securities	Shares Outstanding
Common Stock, $0.0001 par value	67,861,729

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PART I
FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
AS OF SEPTEMBER 30, 2009 (UNAUDITED) AND DECEMBER 31, 2008
Expressed in thousands of U.S. dollars
(Except for share and per share amounts)

		September 30, 2009 (Unaudited)		December 31, 2008
ASSETS				
CURRENT ASSETS				
Cash and cash equivalents	$	100,983	$	47,779
Accounts receivable, net		227,161		148,205
Inventories, net		95,510		117,042
Prepayments and deposits		6,577		7,280
Advances to suppliers		29,187		17,120
Other receivables		10,407		14,065
Deferred tax assets - current portion		--		32
Total current assets		469,825		351,523
Deposits for acquisition of subsidiaries, intangible assets and properties		6,360		7,855
Property, plant and equipment, net		75,806		74,523
Land use rights		7,750		7,675
Intangible assets		56,127		56,913
Contingently returnable acquisition consideration		1,176		1,176
Goodwill		75,529		73,216
Deferred financing cost		1,966		1,082
Deferred tax assets - non-current portion		233		253
TOTAL ASSETS	$	694,772	$	574,216
LIABILITIES AND EQUITY				
CURRENT LIABILITIES				
Notes payable - short term	$	42,466	$	10,242
Obligation under product financing arrangements - short term		5,063		2,469
Convertible notes payable - short term		82,780		--
Accounts and bills payable		56,708		50,756
Accrued expenses		13,508		10,263
Advances from customers		35,242		28,621
Taxes payable		8,685		4,115
Payable for acquisition of businesses, properties and land use rights		6,843		11,915
Deferred income		1,334		1,207
Total current liabilities		252,629		119,588
LONG - TERM LIABILITIES				
Notes payable - long term		--		2,853

Obligation under product financing arrangements - long term		7,882		4,214
Convertible notes payable - long term		43,470		143,342
Total liabilities		303,981		269,997
EQUITY				
Preferred stock, $0.0001 par value; 10,000,000 shares authorized, 0 shares issued and outstanding				
Common stock, $0.0001 par value; 290,000,000 shares authorized, 58,502,581 (September 30, 2009) and 49,142,592 (December 31, 2008) shares issued and outstanding		6		5
Additional paid-in capital		222,548		164,806
Retained earnings		139,924		109,405
Statutory reserves		804		804
Accumulated other comprehensive income		27,524		29,167
Total shareholders' equity of the Company		390,806		304,187
Noncontrolling interest		(15)		32
Total equity		390,791		304,219
TOTAL LIABILITIES AND EQUITY	$	694,772	$	574,216

See the accompanying notes to condensed consolidated financial statements

CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008
Expressed in thousands of U.S. dollars
(Except for share and per share amounts)

	Three Months Ended September 30, 2009 (Unaudited)	Three Months Ended September 30, 2008 (Unaudited)	Nine Months Ended September 30, 2009 (Unaudited)	Nine Months Ended September 30, 2008 (Unaudited)
Revenues	$ 159,820	$ 119,289	$ 398,151	$ 283,806
Cost of goods sold (including depreciation and amortization for the three and nine months ended September 30, 2009 and 2008 of $259, $738, $230 and $516, respectively)	124,484	87,280	306,773	199,085
Gross profit	35,336	32,009	91,378	84,721
Selling and marketing	3,102	3,376	8,850	8,509
General and administrative (including non-cash employee compensation for the three and nine months ended September 30, 2009 and 2008 of $4,743, $13,319, $3,596 and $9,662, respectively)	12,071	11,023	36,078	29,269
Depreciation and amortization	2,958	2,283	8,690	6,230
Income from operations	17,205	15,327	37,760	40,713
Interest income	41	65	127	171
Gain on modification of convertible notes	9,315	--	9,315	--
Interest expense	(5,175)	(5,949)	(17,792)	(15,598)
Other income, net	441	480	1,670	1,167
Income before income taxes	21,827	9,923	31,080	26,453
Income taxes	145	(775)	(608)	(5,104)
Net income	21,972	9,148	30,472	21,349
Add: Net loss attributable to the noncontrolling interest	33	--	47	31
Net income attributable to the Company	22,005	9,148	30,519	21,380
Foreign currency translation (loss) gain	(1,535)	4,402	(1,643)	19,832
Comprehensive income attributable to the Company	20,470	13,550	28,876	41,212
Comprehensive loss attributable to the noncontrolling interest	(33)	--	(47)	(31)
COMPREHENSIVE INCOME	$ 20,437	$ 13,550	$ 28,829	$ 41,181
NET INCOME PER SHARE ATTRIBUTABLE TO THE COMPANY S COMMON SHAREHOLDERS				
BASIC	$ 0.46	$ 0.20	$ 0.65	$ 0.49
DILUTED	$ 0.41	$ 0.20	$ 0.60	$ 0.48

WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING				
BASIC	48,352,451	45,655,617	46,636,198	44,003,994
DILUTED	53,487,010	46,151,827	50,972,401	44,615,552

See the accompanying notes to condensed consolidated financial statements

CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2009 (UNAUDITED)
Expressed in thousands of U.S. dollars
(Except for share and per share amounts)

	The Company s Shareholders							
	Common Stock							
	Shares	Par Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Statutory Reserves	Noncontrolling Interest	Total Equity
BALANCE AT JANUARY 1, 2009	49,142,592	$ 5	$ 164,806	$ 109,405	$ 29,167	$ 804	$ 32	$ 304,219
Issuance of restricted stock under Equity Incentive Plan and recognition of stock-based compensation	1,920,430	--	13,319	--	--	--	--	13,319
Common stock issued for acquisition of DIT Industry (H.K.) Limited	139,573	--	906	--	--	--	--	906
Common stock issued for acquisition of Shenzhen Coson Electronic Co., Ltd.	341,228	--	1,669	--	--	--	--	1,669
Common stock issued to new investors	4,056,000	1	23,909	--	--	--	--	23,910
Common stock issued for settlement of convertible notes	2,902,758	--	17,939	--	--	--	--	17,939
Foreign currency translation loss	--	--	--	--	(1,643)	--	--	(1,643)
Net income (loss) for the period	--	--	--	30,519	--	--	(47)	30,472
BALANCE AT SEPTEMBER 30, 2009	58,502,581	$ 6	$ 222,548	$ 139,924	$ 27,524	$ 804	$ (15)	$ 390,791

See the accompanying notes to condensed consolidated financial statements

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CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008
Expressed in thousands of U.S. dollars
(Except for share and per share amounts)

	Nine Months Ended September 30, 2009 (Unaudited)	Nine Months Ended September 30, 2008 (Unaudited)
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 30,472	$ 21,349
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	9,428	6,746
Provision for doubtful accounts	1,587	345
Amortization of consultancy services	11	101
Amortization of deferred financing cost	333	102
Non-cash employee compensation	13,319	9,662
Redemption accretion and imputed interest on convertible notes and other	15,161	14,090
Gain on modification of convertible notes	(9,315)	--
Deferred taxes	52	104
Changes in operating assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	(79,061)	(60,155)
Related party receivables	--	373
Inventories	22,278	(31,933)
Prepayments and deposits	948	(2,233)
Advances to suppliers	(12,023)	(18,779)
Other receivables	3,960	(2,723)
Increase (decrease) in:		
Accounts and bills payable, and accrued expenses	7,712	21,153
Advances from customers	6,587	12,543
Taxes payable	4,376	(1,375)
Deferred income	126	82
Net cash provided by (used in) operating activities	15,951	(30,548)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Additions to property, plant and equipment	(3,520)	(13,877)
Additions to intangible assets	(1,932)	(1,651)
Additions to land use rights	(174)	(5,101)
Deposits paid for acquisition of subsidiaries	(367)	(4,761)
Deposits refunded for acquisition of subsidiaries	--	11,898
Payments for business acquisitions	(8,398)	--
Net cash inflow (outflow) for acquisition of subsidiaries	273	(6,013)
Proceeds from disposal of land use rights and properties	--	3,379
Net cash used in investing activities	(14,118)	(16,126)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Warrants exercised	--	277
Issuance of common stock, net of issuing expenses	23,910	9,700

New borrowings, net of issuance costs		48,299		11,534
Repayment of borrowings		(18,939)		(13,987)
New borrowings from obligation under product financing arrangements, net of issuance costs		8,362		6,705
Repayment of obligation under product financing arrangements		(3,321)		(566)
Repayment of convertible notes payables		(5,000)		--
Net cash provided by financing activities		53,311		13,663
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		55,144		(33,011)
Effect of exchange rate changes on cash and cash equivalents		(1,940)		9,866
Cash and cash equivalents, beginning of period		47,779		89,071
CASH AND CASH EQUIVALENTS, END OF PERIOD	$	100,983	$	65,926

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CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008
Expressed in thousands of U.S. dollars
(Except for share and per share amounts)

SUPPLEMENTARY CASH FLOW INFORMATION:				
Interest paid	$	2,309	$	1,347
Income taxes paid	$	1,523	$	9,054

SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:

139,573 shares of common stock were issued in satisfaction of a payable of approximately $906 related to the acquisition of DIT Industry(H.K.) Limited (DIT) in February 2009. (Note 2(l))

341,228 shares of common stock were issued in satisfaction of the purchase price of approximately $1,669 in the acquisition of Shenzhen Coson Electronic Co. Ltd. (Coson) in February 2009. Additionally, the Company recorded a liability in the amount of $1,170 representing the estimated fair value of contingent consideration, to be payable in cash, issued in the acquisition. (Note 3)

2,902,758 shares of common stock were as part of the consideration for the restructuring of the $60,000 Guaranteed Senior Unsecured Convertible Notes Due 2012 and $50,000 Guaranteed Senior Unsecured Convertible Notes Due 2012. (Note 14)

See the accompanying notes to condensed consolidated financial statements

CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
Expressed in thousands of U.S. dollars
(Except for share and per share amounts)

1.

BASIS OF PRESENTATION

The accompanying financial statements, as of September 30, 2009 and for the three and nine months ended September 30, 2009 and 2008, have been prepared by CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC. (the Company) without an audit. Pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC), certain information and footnote disclosures normally included in the financial statements prepared in accordance with accounting principles generally accepted in the United States of America (US GAAP) have been condensed or omitted pursuant to such rules and regulations. These financial statements should be read in conjunction with the financial statements and the notes thereto included in the Company s audited annual financial statements for the year ended December 31, 2008, which are included in the Company s Annual Report on Form 10-K for the year ended December 31, 2008, filed with the SEC on March 5, 2009. Amounts as of December 31, 2008 are derived from these audited consolidated financial statements.

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities. Actual results could differ from these estimates.

In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position as of September 30, 2009, results of operations for the three and nine months ended September 30, 2009 and 2008, and cash flows for the nine months ended September 30, 2009 and 2008, have been made. The results of operations for the three and nine months ended September 30, 2009 are not necessarily indicative of the operating results for the full year.

2.

SUMMARY OF SELECTED SIGNIFICANT ACCOUNTING POLICIES

(a)

Accounting for Computer Software to Be Sold, Leased or Otherwise Marketed

The Company accounts for software development costs in accordance with Accounting Standards Codification (ASC) 985-20 *Costs of Software to Be Sold, Leased or Marketed* , previously Statement of Financial Accounting Standards (SFAS) No. 86. Costs related to establishing the technological feasibility of a software product are expensed as incurred as a part of research and development in general and administrative expenses. Costs that are incurred to produce the finished product after technological feasibility is established are capitalized and amortized over the estimated economic life of 5 years. The Company performs periodic reviews to ensure that unamortized program costs remain recoverable from future revenue.

As of September 30, 2009 and December 31, 2008, unamortized computer software costs were $4,253 and $2,776, respectively. During the three and nine months ended September 30, 2009 and 2008, $418, $1,130, $126 and $501 of amortization expense was charged to income, respectively.

(b)

Inventories

Inventories are stated at the lower of cost, determined on a weighted average basis, or net realizable value. Net realizable value is the estimated selling price in the ordinary course of business less the estimated cost of completion and the estimated costs necessary to make the sale.

When inventories are sold, their carrying amount is charged to expense in the year in which the revenue is recognized. Write-downs for declines in net realizable value or for losses of inventories are recognized as an expense in the year the impairment or loss occurs. There were no declines in net realizable value of inventory for the three and nine months ended September 30, 2009 and 2008.

As of September 30, 2009 and December 31, 2008, inventories held under the product financing arrangements were $12,952 and $6,689, respectively.

During the three and nine months ended September 30, 2009 and 2008, inventory purchases from the top five suppliers accounted for approximately 37%, 20%, 47%, and 23%, of total inventory purchases, respectively.

CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
Expressed in thousands of U.S. dollars
(Except for share and per share amounts)

2.

SUMMARY OF SELECTED SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(c)

Accounts Receivable

Trade receivables are recognized and carried at the original invoice amount less allowance for any uncollectible amounts. An estimate for doubtful accounts is made when collection of the full amount is no longer probable. Bad debts are written off as incurred.

No trade receivables due from any single individual customer exceeded 10% of total accounts receivable at September 30, 2009 and December 31, 2008.

(d)

Revenue Recognition

Revenue from sales of surveillance and safety products and systems are recognized in accordance with Staff Accounting Bulletin (SAB) No. 104: *Revenue Recognition* (SAB 104) and related interpretations. Revenues are recognized when the following criteria are met:

(i)

Persuasive evidence of an arrangement exists The Company requires evidence of an agreement with a customer specifying the terms and conditions of the products to be delivered typically in the form of a signed contract or purchase order;

(ii)

Delivery has occurred For product sales, delivery generally takes place when titles to the products are shipped to or accepted by the customer;

(iii) The fee is fixed or determinable Fees are fixed or determinable based on the contract or purchase order terms; and

(iv) Collection is probable The Company performs a credit review of all customers with significant transactions to determine whether a customer is creditworthy and collection is probable.

The sales contracts generally provide a one to three-year product warranty to customers from the date of purchase. The Company estimates the costs of satisfying warranty claims based on an analysis of past experience and provide for the future claims in the period the revenue is recognized. As of September 30, 2009 and December 31, 2008, no material product warranty reserve was accrued. Warranty costs incurred by the Company have not been material.

The Company derives the bulk of its revenue from the supply and installation of surveillance and safety equipment and the two deliverables do not meet the separation criteria under ASC 605-25 *Multiple-Element Arrangements* , previously Emerging Issues Task Force (EITF) Issue 00-21. Revenue from the supply and installation of surveillance and safety equipment are recognized when the installation is completed and the customer acceptance is received. Approximately 1% of contract installation revenue is deferred for the repair work during the one year warranty period. The Company carefully monitors the warranty work requested by its customers, and has determined that very little warranty work has historically been requested to be performed. Management believes that this 1% warranty reserve appears adequate as of September 30, 2009 and December 31, 2008.

Repairs and maintenance service revenue is recognized when the service is performed.

The Company derives a portion of its revenue from one-year software upgrades. These services are typical post-contract service (PCS) arrangements according to ASC 985-605-25 *Revenue Recognition* , previously AICPA Statement of Position (SOP) 97-2. Under this guidance, PCS revenue may be recognized together with the initial licensing fee on delivery of the software if all of the following conditions are met:

CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
Expressed in thousands of U.S. dollars
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2.

SUMMARY OF SELECTED SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(d) Revenue Recognition continued

(i) The PCS fee is included with the initial licensing fee;

(ii) The PCS included with the initial license is for one year or less;

(iii) The estimated cost of providing PCS during the arrangement is insignificant; and

(iv) Unspecified upgrades/enhancements offered during PCS arrangements historically have been and are expected to continue to be minimal and infrequent.

Revenue from surveillance and safety system one year software upgrades is recognized when delivery occurs and the risk of ownership passes to the customers, as the Company believes it meets the conditions in compliance with the ASC guidance.

(e)

Research and Development Costs

Research and development costs are expensed as incurred. Research and development costs included in general and administrative expenses for the three and nine months ended September 30, 2009 and 2008 were $642, $2,038, $594 and $940, respectively.

(f)

Advertising Costs

The Company expenses advertising costs as incurred or the first time advertising takes place. During the three and nine months ended September 30, 2009 and 2008, the Company incurred approximately $102, $276, $133 and $410, respectively.

(g)

Retirement Benefits

Retirement benefits in the form of contributions under defined contribution retirement plans to the relevant authorities are charged to the consolidated statements of income as incurred. The retirement benefit expenses for the three and nine months ended September 30, 2009 and 2008 were $283, $809, $372 and $838, respectively, and are included in the selling and marketing expenses and general and administrative expenses.

(h)

Share-based Payments

On February 7, 2007, the Company adopted the 2007 Equity Incentive Plan (Plan), which has a five-year term and provides for grants of stock options, stock appreciation rights, performance units, restricted stock units and performance shares. The total number of shares which may be issued under the plan is 8,000,000 shares of common stock. These restricted stocks are share-based payments subject to the provisions of ASC 718 *Stock Compensation* , previously Revised SFAS No. 123 *Share-Based Payment* (SFAS 123 (R)). The fair values of these restricted stock awards are equal to the market value of the Company's stock on the date of grant, after taking into account certain discounts. Such restricted stock is subject to the risk of forfeiture upon the occurrence of certain events. During the three and nine months ended September 30, 2009 and 2008, the Company has recognized $4,743, $13,319, $3,596 and $9,662 of compensation expense under the Plan, respectively. As of September 30, 2009 and December 31, 2008, there was $49,375 and $52,616 of unrecognized compensation expense related to the nonvested restricted stock, respectively. These expenses are expected to be recognized over a four to five-year period.

CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
Expressed in thousands of U.S. dollars
(Except for share and per share amounts)

2.

SUMMARY OF SELECTED SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(i)

Other income

During the three and nine months ended September 30, 2009, in connection with research and development activities in a designated locale, the Company received approximately $0 and $756 as a subsidy from the local governmental agency in China, respectively. The Company has no continuing obligation under the subsidy provision. The amount is recorded as a component of Other Income in the consolidated statements of income.

(j)

Income taxes

The Company did not have any material unrecognized tax benefits.

The Company files income tax returns with the relevant government authorities in the U.S. and the People s Republic of China (PRC). The Company was not subject to U.S. federal tax examinations for years before 2006. The Company does not believe there will be any material changes in its unrecognized tax positions over the next 12 months.

The Company s policy is to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. The Company did not have any accrued interest or penalties associated with any unrecognized tax benefits, nor was any interest expense recognized during the three and nine months ended September 30, 2009 and 2008. The Company s effective tax rate differs from the federal statutory rate primarily due to non-deductible expenses, temporary differences, and preferential tax treatment.

On March 16, 2007, the National People s Congress of the PRC adopted a new corporate income tax law in its fifth plenary session. The new corporate income tax law unifies the application scope, tax rate, tax deduction and preferential policy for both domestic and foreign-invested enterprises. The new corporate income tax law became effective on January 1, 2008. According to the new corporate income tax law, the applicable income tax rates for our operating subsidiaries were changed.

The Company is governed by the Income Tax Laws of the PRC. The PRC federal statutory tax rate is 25%. As of September 30, 2009, some of the Company s subsidiaries received the final income tax assessment from the PRC tax authority, related to their 2008 PRC income tax filings. Based on the tax assessment, certain other income was deemed not assessable and research expenses were allowed additional deductions from the PRC tax authority. The Company received a refund from the PRC tax authority of $447 during the three months ended September 30, 2009.

(k)

Use of Estimates

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Management makes these estimates using the best information available at the time the estimates are made; however actual results could differ materially from those estimates.

(l)

Earnings Per Share

ASC 260 *Earnings Per Share* , previously SFAS No. 128, requires dual presentation of basic and diluted earnings per share (EPS) with a reconciliation of the numerator and denominator of the basic EPS computation to the numerator and denominator of the diluted EPS computation. Basic EPS excludes dilution. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity.

Earning per basic share of common stock is based on the weighted average number of shares of common stock outstanding during each respective period. Earnings per diluted share of common stock adds to basic weighted shares the weighted average number of shares issuable under convertible securities, contingent issuances, stock options and warrants outstanding during each respective period, using the if-converted or treasury-stock methods.

For the purposes of the computation of net income per share, shares issued in connection with acquisitions that are returnable are considered contingently returnable shares. These contingently returnable shares, although classified as issued and outstanding, are not included in basic weighted average number of shares until all necessary conditions are met that no longer cause the shares to be contingently returnable. These contingently returnable shares are included in diluted weighted average number of shares as of the beginning of the period in which the conditions were satisfied (or as of the date of the agreement, if later).

CHINA SECURITY & SURVEILLANCE TECHNOLOGY, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
Expressed in thousands of U.S. dollars
(Except for share and per share amounts)

2.

SUMMARY OF SELECTED SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(l)

Earnings Per Share - continued

Unvested restricted shares issued under the 2007 Equity Incentive Plan are not included in basic weighted average number of shares but are considered to be outstanding as of the grant date for purpose of computing diluted EPS even though the shares are subject to vesting requirements.

The calculation of diluted EPS is based on the outstanding warrants for the three and nine months ended September 30, 2009 and 2008. As of September 30, 2009 and December 31, 2008, warrants were outstanding to acquire 1,188,515 and 174,515 shares of common stock, respectively. Warrants which were outstanding to acquire 1,158,509 and 144,509 shares of common stock, respectively, were not included in the dilutive calculation for the three months ended September 30, 2009 and 2008, as the effect would be anti-dilutive.

With respect to outstanding warrants, the dilutive impact on the weighted average number of shares was 19,492, 23,453, 20,251 and 21,311 for the three and nine months ended September 30, 2009, and 2008, respectively.

In 2008, the Company agreed to issue 139,573 shares of common stock in connection with the acquisitions of DIT. These shares were issued in February 2009. In 2008, the Company issued an aggregate of 2,470,116 in connection with the acquisitions of Guangdong Stonesonic Digital Technique Co., Ltd. (Stonesonic), Shenzhen Longhorn Security Technology Co., Ltd., Beijing Aurine Divine Land Technology Co., Ltd., Shenzhen Jin Lin Technology Co., Ltd. (Jin Lin), 100% beneficial interest of Huge Long Limited and the exclusive cooperation agreement with Beijing DM Security & Technology Co., Ltd., excluding contingently returnable shares of 339,949 shares of common stock. The impact of these shares has been included in the weighted average number of shares from the date of the closing of the acquisitions through the earlier of December 31, 2008 or the date the shares were issued.

As discussed in Note 14, the Company restructured its convertible debt in September 2009. Approximately 12,222,000, 12,222,000, 5,452,000 and 5,452,000 of shares of common stock that underlied the previous convertible debt were not included in the dilutive calculation for the three and nine months ended September 30, 2009 and 2008, respectively, as the effect would be anti-dilutive.

There are 5,000,000 shares of common stock underlying the new convertible debts.

The weighted average impact of these shares and the impact of adding back the related imputed interest on the debt, is not significant to diluted earnings per share.

(m)

Fair Value

ASC 820 *Fair Value Measurements and Disclosures* , previously SFAS No. 157, which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. The statement clarifies that the exchange price is the price in an orderly transaction between market participants to sell the asset or transfer the liability in the market in which the reporting entity would transact for the asset or liability, that is, the principal or most advantageous market for the asset or liability. It also emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and that market participant assumptions include assumptions about risk and effect of a restriction on the sale or use of an asset.

This ASC guidance establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described below:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

Level 2: Quoted prices in markets that are not active, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability; and

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (supported by little or no market activity).

At September 30, 2009, the Company has no financial assets or liabilities subject to recurring fair value measurements. During the nine months ended September 30, 2009, the Company completed a business acquisition in which nonfinancial assets and nonfinancial liabilities were initially measured at fair value (see Note 3 for additional information) and completed a restructuring of convertible debt in which financial liabilities were initially measured at fair value (see Note 14 for additional information).

ASC 825-10 *Financial Instruments* , previously SFAS No. 159, allows entities to voluntarily choose to measure certain financial assets and liabilities at fair value (fair value option). The fair value option may be elected on an instrument-by-instrument basis and is irrevocable, unless a new election date occurs. If the fair value option is elected for an instrument, unrealized gains and losses for that instrument should be reported in earnings at each subsequent reporting date. The Company did not elect to apply the fair value option to any outstanding instruments.

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2.

SUMMARY OF SELECTED SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(m)

Fair Value - continued

The Company's financial instruments include cash and cash equivalents, accounts receivable, other receivables, accounts and bills payable, notes payable, obligation under product financing arrangements, and convertible notes payable. Management estimates that the carrying amounts of the non related party financial instruments approximate their fair values due to their short-term nature.

(n)

New Accounting Standards

Business Combinations
(Included in ASC 805 Business Combinations , previously SFAS No. 141(R))

This ASC guidance revised SFAS No. 141, Business Combinations and addresses the accounting and disclosure for identifiable assets acquired, liabilities assumed, and noncontrolling interests in a business combination. The Company accounted for its January 2009 business acquisition in accordance with this standard. (See Note 3 for additional disclosure).

Noncontrolling Interests
(Included in ASC 810 Consolidation , previously SFAS No. 160 Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51)

SFAS 160 establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. The Company adopted SFAS 160 on January 1, 2009. As a result, the Company has reclassified financial statement line items within the Company s Condensed Consolidated Balance Sheets and Statements of Income and Comprehensive Income for the prior period to conform to this standard.

Interim Disclosures about Fair Value of Financial Instruments
(Included in ASC 825 Financial Instruments , previously FSP SFAS No. 107-1)

This guidance requires that the fair value disclosures required for all financial instruments within the scope of SFAS 107, *Disclosures about Fair Value of Financial Instruments* , be included in interim financial statements. This guidance also requires entities to disclose the method and significant assumptions used to estimate the fair value of financial instruments on an interim and annual basis and to highlight any changes from prior periods. FSP 107-1 was effective for interim periods ending after September 15, 2009. The adoption of FSP 107-1 did not have a material impact on the Company s Consolidated Financial Statements.

Subsequent Events
(Included in ASC 855 Subsequent Events , previously SFAS No. 165)

SFAS No.165, *Subsequent Events* establishes accounting and disclosure requirements for subsequent events. SFAS 165 details the period after the balance sheet date during which the Company should evaluate events or transactions that occur for potential recognition or disclosure in the financial statements, the circumstances under which the Company should recognize events or transactions occurring after the balance sheet date in its financial statements and the required disclosures for such events. The Company adopted this statement effective June 1, 2009 and has evaluated all subsequent events through the filing date with the SEC.

Accounting for Transfers of Financial Assets
*(To be included in ASC 860 Transfers and Servicing , SFAS No. 166, Accounting for Transfers of Financial Asset*s *an Amendment of FASB Statement No. 140*)

SFAS 166 addresses information a reporting entity provides in its financial statements about the transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor s continuing involvement in transferred financial assets. Also, SFAS 166 removes the concept of a qualifying special purpose entity, limits the circumstances in which a transferor derecognizes a portion or component of a financial asset, defines participating interest and enhances the information provided to financial statement users to provide greater transparency. SFAS 166 is effective for the first annual reporting period beginning after November 15, 2009 and will be effective for the Company as of January 1, 2010. The Company is currently evaluating the impact on our consolidated financial statements upon adoption.

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2.

SUMMARY OF SELECTED SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(n)

New Accounting Standards - continued

Consolidation of Variable Interest Entities Amended
(To be included in ASC 810 Consolidation , SFAS 167 Amendments to FASB Interpretation No. 46(R))

SFAS 167 amends FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*, to require an enterprise to perform an analysis to determine the primary beneficiary of a variable interest entity; to require ongoing reassessments of whether an enterprise is the primary beneficiary of a variable interest entity and to eliminate the quantitative approach previously required for determining the primary beneficiary of a variable interest entity. SFAS 167 also requires enhanced disclosures that will provide users of financial statements with more transparent information about an enterprise s involvement in a variable interest entity. SFAS 167 is effective for the first annual reporting period beginning after November 15, 2009 and will be effective for the Company as of January 1, 2010. The Company is currently evaluating the impact on our consolidated financial statements upon adoption.

FASB Accounting Standards Codification
(Accounting Standards Update ASU) 2009-1)

In June 2009, the FASB approved its Accounting Standards Codification (Codification) as the single source of authoritative United States accounting and reporting standards applicable for all non-governmental entities, with the exception of the SEC and its staff. The Codification is effective for interim or annual financial periods ending after September 15, 2009 and impacts the Company s financial statements as all future references to authoritative accounting literature will be referenced in accordance with the Codification. There have been no changes to the content of the Company s financial statements or disclosures as a result of implementing the Codification during the quarter ended September 30, 2009.

As a result of the Company s implementation of the Codification during the quarter ended September 30, 2009, previous references to new accounting standards and literature are no longer applicable. In the current quarter financial statements, the Company will provide reference to both new and old guidance to assist in understanding the impacts of recently adopted accounting literature, particularly for guidance adopted since the beginning of the current fiscal year but prior to the Codification.

3.

BUSINESS ACQUISITIONS

On January 12, 2009, the Company entered into an equity transfer agreement with the shareholder of Multiwin International Holdings Limited (Multiwin) and acquired 100% ownership of Multiwin which is the holding company that owns all the outstanding equity of Coson. Coson is an intelligent access control solution provider and provides control access solutions to a wide ranging group of clients that include government buildings, banks, post offices, universities and large residential properties in China. Pursuant to the equity transfer agreement, the Company has agreed to pay total consideration up to RMB 51,768 (approximately $7,518) in exchange for 100% ownership of Multiwin, consisting of RMB 40,000 (approximately $5,849) in cash and RMB 11,768 (approximately $1,669) in the Company s shares of common stock. The number of shares issuable in satisfaction of the equity portion of the purchase price is 341,228 which were issued in February 2009. Under the terms of such agreement, 102,368 shares of the Company s common stock were to be returned if Coson did not meet certain net income targets in 2008. These targets were met in 2008. An additional 68,247 shares of the Company s common stock are to be returned if Coson does not meet certain net income targets in 2009. The Company will also pay the remaining cash consideration of RMB 8,000 (approximately $1,170) if the net income targets are met in 2009. The Company recorded approximately $293 and $1,170 related to the estimated fair value of the contingent equity and cash consideration, respectively. The operational control of Coson passed to the Company effective January 12, 2009. The results of Coson s operations from January 12, 2009 through September 30, 2009 are included in the Company s Consolidated Statements of Income and Comprehensive Income. The fair value of the contingent cash consideration was re-measured at September 30, 2009 and the change in the fair value from June 30, 2009 is minimal.

Approximately 436,110 shares of common stock related to net income targets for 2009 and 2010 for the acquisition of Coson (2009 acquisition) and Stonesonic, Jin Lin and DIT (2008 acquisitions) are returnable.

The Company estimated the fair values of the assets acquired and liabilities assumed at the acquisition date in accordance with ASC 805 and, except for cash and cash equivalents, fair value was estimated using level 3 inputs under ASC 820. Level 3 inputs for the nonfinancial assets included a valuation report (prepared by a third party appraisal firm) that primarily utilized an income approach valuation technique. Level 3 inputs for other assets and liabilities included present value techniques applied to receivables and payables, and estimated selling prices (less costs of disposal and profit allowance) for inventories.

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3.

BUSINESS ACQUISITIONS (CONTINUED)

The following represents the purchase price allocation at the date of the acquisition of Coson based on the valuation report which were prepared by a third party appraisal firm:

		Coson
Cash and cash equivalents	$	273
Other current assets		2,329
Property, plant and equipment		802
Intangible assets		3,435
Goodwill		2,314
Current liabilities		(1,635)
Total purchase price	$	7,518

On a pro forma basis, the results of operations for the Company for the three and nine months ended September 30, 2009 would not be significantly different than as reported since the acquisition of Coson occurred near the beginning of 2009.

The following tables show supplemental information of the results of operations on a pro forma basis for the three and nine months ended September 30, 2008 as if the acquisition of Coson had been completed at the beginning of the respective periods of 2008:

For the three months ended September 30, 2008 (Unaudited)

	Historical							
		CSST		Coson		Pro Forma Adjustment		Pro Forma
Revenues	$	119,289	$	1,013		--	$	120,302
Income from operations	$	15,327	$	8	$	(107)	$	15,228
Net income (loss)	$	9,148	$	(5)	$	(107)	$	9,036
Net income per share								
Basic	$	0.20					$	0.20
Diluted	$	0.20					$	0.19

For the nine months ended September 30, 2008 (Unaudited)

	Historical							
		CSST		Coson		Pro Forma Adjustment		Pro Forma
Revenues	$	283,806	$	2,585		--	$	286,391

Income from operations	$	40,713	$	470	$	(323)	$	40,860
Net income	$	21,349	$	388	$	(323)	$	21,414
Net income per share								
Basic	$	0.49					$	0.48
Diluted	$	0.48					$	0.48

The pro forma adjustments represent the amortization of the intangible assets arising upon the acquisition of Coson.

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4.

ACCOUNTS RECEIVABLE

The Company provides an allowance for doubtful accounts related to its receivables. The receivables and allowance balances at September 30, 2009 and December 31, 2008 are as follows:

		September 30, 2009		December 31, 2008
Accounts receivable	$	228,347	$	149,244
Less: provision for doubtful accounts		(1,186)		(1,039)
Accounts receivable, net	$	227,161	$	148,205

For the nine months ended September 30, 2009, a local Chinese bank holds RMB123,046 (approximately $18,000) of accounts receivable purchased from the Company on a without-recourse-basis in return for RMB113,000 (approximately $16,530) resulting in a net of RMB10,046 (approximately $1,470) which has been recorded in general and administrative expenses. The Company has accounted for the sale of receivables to the local Chinese bank in accordance with ASC 860.

5.

INVENTORIES

Inventories consist of the following as of September 30, 2009 and December 31, 2008:

		September 30, 2009		December 31, 2008
Raw materials	$	17,387	$	16,205
Work in progress		2,997		4,392
Finished goods		35,883		24,408
Installations in process		40,421		73,019
Total		96,688		118,024
Less: allowance for obsolete inventories		(1,178)		(982)
Inventories, net	$	95,510	$	117,042

6.

PREPAYMENTS AND DEPOSITS

Prepayments and deposits consist of the following as of September 30, 2009 and December 31, 2008:

	September 30, 2009	December 31, 2008

Current portion	$ 6,577	$ 7,280
Non current portion		
- Deposits paid for acquisition of subsidiaries	4,136	5,619
- Deposits paid for acquisition of intangible assets and properties	2,224	2,236
	$ 6,360	$ 7,855

The deposits paid for acquisition of subsidiaries and properties are refundable. There are no commitments to acquire the subsidiaries, properties and intangible assets.

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7.

ADVANCE PAYMENTS

The Company has made payments to unrelated suppliers in advance of receiving merchandise. The advance payments are meant to ensure preferential pricing and delivery. The amounts advanced under such arrangements totaled $29,187 and $17,120 as of September 30, 2009 and December 31, 2008, respectively.

8.

PLANT AND EQUIPMENT

At September 30, 2009 and December 31, 2008, plant and equipment, at cost, consist of:

		September 30, 2009		December 31, 2008
Buildings	$	62,073	$	60,480
Leasehold improvements		2,726		2,017
Plant and equipment		7,845		6,544
Electronic equipment		9,253		8,640
Motor vehicles		4,900		4,528
		86,797		82,209
Less: accumulated depreciation		(10,991)		(7,686)
Plant and equipment, net	$	75,806	$	74,523

Depreciation expense for the three and nine months ended September 30, 2009 and 2008 was $1,055, $3,099, $745 and $2,265, respectively.

9.

LAND USE RIGHTS

Land use rights consist of the following as of September 30, 2009 and December 31, 2008:

		September 30, 2009		December 31, 2008
Cost of land use rights	$	8,525	$	8,371
Less: Accumulated amortization		(775)		(696)
Land use rights, net	$	7,750	$	7,675

Amortization expense for the three and nine months ended September 30, 2009 and 2008 was $42, $128, $22 and $43, respectively.

Amortization expense for the next five years and thereafter is as follows:

2009 (for the remaining three months)	$	43
2010		172
2011		172
2012		172
2013		172
Thereafter		7,019
Total	$	7,750

The Company disposed of land use rights and properties for a total consideration of RMB119,000 (approximately $16,119) in December 2007. The remaining proceeds of RMB24,000 (approximately $3,379) were received in January 2008.

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10.

INTANGIBLE ASSETS

As of September 30, 2009 and December 31, 2008, intangible assets, at cost, consist of:

		September 30, 2009		December 31, 2008
Trademarks (life of 11 to 25 years)	$	17,222	$	16,508
Exclusive cooperation agreements (life of 20 years)		13,632		13,632
Customer base (life of 5 to 10 years)		10,448		9,587
Patents (life of 10 years)		4,542		4,542
Technical know-how (life of 9 to 10 years)		17,030		15,168
Non-compete agreements (life of 5 years)		1,303		1,303
Contracts in progress (life of 2 to 9 months)		410		410
Surveillance software (life of 5 years)		8,630		6,671
Surveillance recording system (life of 5 years)		500		