SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-KSB

[x] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIESEXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2001

OR

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934 (NO FEE REQUIRED)

For the transition period from to

Commission file number 333-75137

PASW, INC.

(formerly Pacific Softworks, Inc.)

(Name of Small Business Issuer in Its Charter)

California	**77-0390628**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
2007 Simsbury Court	
Thousand Oaks, California	**91360**
(Address of Principal Executive Offices)	(Zip Code)

Issuer's Telephone Number: (805) 492-6623

Securities registered under Section 12(b) of the Exchange Act:

None

Securities registered under Section 12(g) of the Exchange Act:

Common Stock, $0.001 Par Value

(Title of class)

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

Check if disclosure of delinquent filers in response to Item 405 of Regulation S-B is not contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB

The issuer's revenues for the most recent fiscal year were $ 595,353.

The aggregate market value of the voting and non-voting common equity held by non-affiliates, based upon the average bid and asked prices of the Common Stock on March 25, 2002 was $ 99, 845. Shares of Common Stock held by each officer and director and by each person who owns 5% or more of the outstanding Common Stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

The number of shares outstanding of the issuer's Common Stock, as of March 25, 2002 was 4,997,400.

PART I

ITEM 1. **DESCRIPTION OF BUSINESS**

GENERAL DEVELOPMENT OF BUSINESS

PASW, Inc., ("PASW", the "Company", "we" and "our"), was incorporated in California in November 1992 as a developer and licensor of Internet and Web related software and software development tools. Our operations are conducted principally from an office in Southern California and we have a sales office in Japan. The Company completed an initial public offering of 950,000 units consisting of one share of common stock and one warrant on July 29, 1999. An additional 142,500 units representing the underwriter's overallotment was sold on September 13, 1999.

The Company has historically developed and licensed software that enabled Internet and web based communications. Our software products were embedded into systems and developed or manufactured by others.

The Company refined its strategic focus in the Fourth Quarter 1999 in order to enhance our positioning and flexibility in the rapidly growing market for Internetworking technology and to improve the utilization of our assets and competencies. Key elements of the business strategy involved the segregation of our core technology into separate business units and identifying strategic investment opportunities and/or associations with other operating companies. In conjunction with this strategy at the annual meeting on May 26, 2000 we changed our name to PASW, Inc.

Realizing that general market conditions both in the public and private markets had been deteriorating since late spring 2000 we embarked on an aggressive program to find a suitable merger/acquisition opportunity.

On August 31, 2000 the Company and NetSilicon, Inc. ("NSI") entered into an agreement whereby we sold the assets of our Internet and Web software technology to NSI. The purchase price for the assets was 90,000 shares of NSI's common stock. In addition NSI agreed to grant a non-exclusive, royalty-free license for the acquired technology, to PASW and its affiliates, subject to certain limitations.

Alera Systems, Inc.

During 1999 we also established Alera Systems, Inc., formerly iApplianceNet.com ("Alera"), a development stage company and a wholly owned subsidiary. Alera was in the process of developing proprietary technology that would allow potential business customers to greatly improve the management of their distributed remote assets.

In March 2000 we began a private solicitation program and in April a private placement of 140,000 shares of Series A redeemable convertible preferred stock for net proceeds of $350,000 was completed. On August 17, 2000 an additional 20,000 shares were issued for net proceeds of $50,000.

Although Alera continued to meet performance objectives for the development and marketing of its products, capital market conditions deteriorated to the point that the additional private funding required for the Alera program could not be completed. Concurrently, the approximately $2.3 million in NSI stock received from the sale of our Internet and Web software to NetSilicon depreciated by 80% from August 31st to December 31st. This combination of factors materially impacted our ability to continue funding Alera operations and our administrative operations. During December 2000 we closed the administrative office and at the end of December ceased further development operations at Alera.

Proposed Simmons Energy Services Inc. ("SES") Merger

In February 2001, PASW entered into a letter of intent to acquire the operations of Simmons Energy Services Inc. ("SES"), a privately held Alberta (Canada) company. Under the terms of the proposed transaction, PASW would issue shares of its common stock, Series B preferred stock and Series C convertible preferred stock to acquire SES in a transaction to be accounted for as a reverse acquisition. A definitive combination agreement between PASW and SES was executed in March 2001. A term of the agreement called for PASW to initiate a private placement offering of 5,000,000 units at $4.00 per unit for an aggregate-offering price of $20,000,000.

On July 18, 2001 the Company was verbally notified by Simmons Energy Services Inc that the efforts by SES to secure the $20 million private placement were not progressing and that it appeared to SES that current market conditions could delay or curtail any future efforts to complete the private placement in time to cure the NADSAQ deficiencies in a timely manner. SES concluded that it therefore appeared that the Company could face delisting and notified the Company of its intent to terminate the combination agreement. On July 23, 2001 the Company received formal notification from SES of its intent to terminate the agreement.

Appointment of New Director and Chairman

On August 21, 2001 the Board of Directors received the resignation of Reg J. Greenslade as a member of the board of directors. Mr. Greenslade submitted his resignation subsequent to termination of negotiations with Simmons Energy Services Inc citing the need to concentrate his efforts on other business activities. The board nominated Glenn P. Russell to replace Mr. Greenslade and to assume the position of Chairman. Concurrent with Mr. Russell's election as Chairman William E. Sliney resigned his position as Chairman but continues his positions as President and Chief Financial Officer.

Repricing of Registered Warrants

In March 2001 the Board of Directors announced the repricing of the Company's registered warrants (NASDAQ:PASWW). The exercise price of the warrants was reduced from $7.50 to $4.00 per share. In September 2001 the Board of Directors amended the terms to extend the exercise date to November 30, 2001 and to reduce the price to $1.00 on a pre-reverse split basis. In September 2001 the Board of Directors further amended the terms to reduce the price to twenty five ($0.25) cents per share and extend the exercise date to November 30, 2002.

Notification of Delisting from NASDAQ.

In April 2001 NASDAQ notified the Company that at December 31, 2000 it was not in compliance with the Net Tangible Asset requirements of NASDAQ Market Place Rule 4310 (c)(2)(B) in that PASW failed to have a minimum of $2 million in net tangible assets. At the same time PASW was notified that in light of the "going concern" opinion from our auditors we may not be able sustain compliance with the continued listing requirements of the NASDAQ Stock Market. In May 2001 the Company was notified that is not in compliance with the minimum bid price requirements of NASDAQ Market Place Rule 4310(c)(8)(B) in that the closing bid price of the Company's common stock did not meet or exceed $1.00 over 30 consecutive trading days. The Company was given until August 22, 2001 to achieve compliance. At September 30, 2001 the Company was not in compliance with any of the rules and, although notification has not been received from NASDAQ, the Company believes it is not in compliance with Market Place Rule 4310(c)(7) in that it has not maintained a minimum market value of public float of $1,000,000 over 30 consecutive trading days. On October 1, 2001 the Company received notification from The NASDAQ Stock Market, Inc. that it was not in compliance with the Net Tangible Assets or Net Equity requirements for continued listing as set forth in Market Place Rule 4310(c)(2)(B) as modified by SR-NASD-01-14 and that its securities will be delisted from The NASDAQ National/Small Cap Market at the opening of business on October 9, 2001. The securities were removed form NASDAQ and subsequent to that date the PASW Common Stock (PASW) and Warrants (PASWW) have been trading on the OTC Bulletin Board Market (OTCBB).

Conversion of Preferred Stock in Subsidiary to PASW Common Stock

On October 19, 2001 the Company converted 480,000 shares of Convertible Preferred Stock of its Alera Systems Inc. ("Alera"), a wholly owned subsidiary, to shares of the Company’s Common Stock. The preferred stock was issued in April and July 2000 as part of a private placement to provide funding for the Alera technology development activities. Each share of preferred is convertible into one share of Alera at $2.50 per share at any time within two years from closing date of the private placement or, if Alera did not become a public company or be sold to an outside party within this two year period, the holders of the preferred stock would be entitled to exchange their preferred shares into shares of PASW common stock at Eighty-five percent (85%) of its then current market price subject to a collar limit of One Dollar ($1.00) per share and a maximum of Fifteen Dollars ($15.00) per share. Operations of Alera were terminated in December 2000 and subsequently all preferred shareholders elected to convert in 2001 at One Dollar per share. The conversion increase’s the outstanding common shares of PASW from 4,517,400 to 4,997,400.

Appointment of new Corporate Secretary

On December 31, 2001 the Company received the resignation of Joseph Lechman as the corporate secretary of the Company. On that date the directors elected William E. Sliney as corporate secretary in addition to his other duties as President and Chief Financial Officer.

Operating Companies

We operate through two wholly owned subsidiaries: Alera Systems, Inc and Network Research Corporation Japan ("NRCJ"). We operate in one business segment and our fiscal year ends on December 31.

Employees

As of December 31, 2001, the Company employed two individuals. We are not represented by a labor union nor are we subject to a collective bargaining agreement. We have never experienced a work stoppage. We believe that relations with our employees are good.

ITEM 2. DESCRIPTION OF PROPERTY

PASW conducts its operations from a business office located in Thousand Oaks, California. In Japan we have subleased space of approximately 700 square feet at a monthly rate of approximately $2,000 on a month-to-month basis.

We believe that these facilities are adequate for our current needs at this time.

ITEM 3. LEGAL PROCEEDINGS

In April 1999 we were notified that a merchant banker, Golenberg & Co., has asserted rights under a June 1998 letter agreement to purchase 10% of our then outstanding common stock for $400,000. In June 1999 counsel for Golenberg & Co. reiterated this demand and advised us that these claims were being evaluated for possible legal action. To date no action has been taken by Golenberg & Co.

The Company is not a party to any other pending legal proceedings that management believes could have a material adverse effect on its financial position. There can be no assurance, however, that third parties will not assert infringement or other claims against us in the future, which, regardless of the outcome, could have an adverse impact on the Company as a result of defense costs, diversion of management resources and other factors.

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

There have been no matters submitted to a vote of security holders during the quarter ended December 31, 2001.

EXECUTIVE OFFICERS AND DIRECTORS

Name	Age	Position
Glenn P. Russell	47	Chairman
William E. Sliney	. 63	President, Chief Financial Officer, Secretary and Director
Wayne T. Grau	53	Director

Glenn P. Russell. Mr. Russell was our chairman from 1992 to October 2000. He was reelected chairman in August 2001. He also served as president and chief executive officer from 1992 to 1999. Before 1992 he had various sales and marketing positions at IBM, Unisys and Network Research Corporation, a predecessor of PASW. Mr. Russell is also an officer and director of Luke Systems International, a distributor of electronic components. Luke Systems International is controlled by Mr. Russell's spouse. Mr. Russell was educated in the United Kingdom.

William E. Sliney. Mr. Sliney has been our president since August 2001. He was chairman from October 2000 to August 2001. Prior to that he was president since December 1999, chief financial officer since April 1999 and was elected secretary in December 2001. Before joining us, Mr. Sliney was the chief financial officer for Legacy Software Inc. from 1995 to 1998. From 1993 to 1994, Mr. Sliney was chief executive officer for Gumps. Mr. Sliney received his masters in business administration from the University of California at Los Angeles

Wayne T. Grau. Mr. Grau has been a director of PASW since January 1999. He has been the president and chief executive officer of Fielding Electric, Inc. since 1981. Mr. Grau is currently a member of the Los Angeles Chapter membership committee of the National Electrical Contractors Association, a trustee for the Joint Apprenticeship Training Committee and a trustee for the Los Angeles Electrical Training Trust.

-

PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The Company's Common Stock and warrants began trading on the NASDAQ SmallCap Market under the symbol "PASW" and "PASWW" on July 29, 1999, respectively. On October 9, 2001 the Company was delisted from the NASDAQ Small Cap and began trading on the OTC Bulletin Board Market. The following table sets forth the high and low bid prices as reported on NASDAQ and the OTC Bulletin Board for the periods indicated below.

Year ending December 31,1999

Quarter	High	Low
09/30/99 Common Stock	10.125	6.625
09/30/99 Warrants	2.063	1.875
12/31/99 Common Stock	9.875	4.625
12/31/99 Warrants	2.875	1.733

Year ending December 31,2000

03/31/00 Common Stock	13.50	5.6875
03/31/00 Warrants	6.75	1.75
06/30/00 Common Stock	7.75	2.2812
06/30/00 Warrants	4.50	0.75
09/30/00 Common Stock	6.0625	2.125
09/30/00 Warrants	1.25	0.5312
12/31/00 Common Stock	2.25.	0.1875
12/31/00 Warrants	0.75	0.0938

Year ending December 31,2001

03/31/00 Common Stock	1.0312	0.2812
03/31/00 Warrants	0.3438	0.0625
06/30/00 Common Stock	1.04	0.5312
06/30/00 Warrants	0.4375	0.125
09/30/00 Common Stock	0.95	0.04
09/30/00 Warrants	0.16	0.01
12/31/00 Common Stock	0.10.	0.05
12/31/00 Warrants	0.08	0.01

Number of Holders of Common Stock

At December 31, 2001 there were approximately twenty stockholders of record of the Company's Common Stock. Based on information obtained from the Company's transfer agent, the Company believes that the number of beneficial owners of its Common Stock is approximately 1,700.

Dividends

The Company has never paid cash dividends on its Common Stock. The Company currently intends to retain earnings for use in its business and, therefore, does not anticipate paying cash dividends on its Common Stock in the foreseeable future.

Recent Sales of Unregistered Securities

In March 2001 the Board of Directors of the Company approved a resolution changing the terms of the Company’s registered public warrants exercise price from $7.50 to $1.00 per share and extended the expiration date from July 29, 2001 to November 30, 2001. In September 2001 the Company reduced the exercise price to $0.25 and extended the expiration date to November 30, 2002. Also in September 2001 the Company repirced all outstanding non-public options and warrants to an exercise price of $0.25, fully vested, with an expiration date of September 17, 2006.

On October 19, 2001 the Company converted 480,000 shares of Convertible Preferred Stock of its Alera Systems Inc. ("Alera"), a wholly owned subsidiary, to shares of the Company’s Common Stock. The preferred stock was issued in April and July 2000 as part of a private placement to provide funding for the Alera technology development activities. Each share of preferred is convertible into one share of Alera at $2.50 per share at any time within two years from closing date of the private placement or, if Alera did not become a public company or be sold to an outside party within this two year period, the holders of the preferred stock would be entitled to exchange their preferred shares into shares of PASW common stock at Eighty-five percent (85%) of its then current market price subject to a collar limit of One Dollar ($1.00) per share and a maximum of Fifteen Dollars ($15.00) per share. Operations of Alera were terminated in December 2000 and subsequently all preferred shareholders elected to convert in 2001 at One Dollar per share. The conversion increase’s the outstanding common shares of PASW from 4,517,400 to 4,997,400.

<u>ITEM 6.</u> <u>MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION</u>

Cautionary Note Regarding Forward-Looking Statements

Except for historical information contained herein, the statements in this report (including without limitation, statements indicating that the Company "expects," "estimates," anticipates," or "believes" and all other statements concerning future financial results, product offerings, proposed acquisitions or combinations or other events that have not yet occurred) are forward-looking statements that are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, Section 21E of the Securities Exchange Act of 1934, as amended, and Section 27A of the Securities Act of 1933, as amended. Forward-looking statements involve known and unknown factors, risks and uncertainties, which may cause the Company’s actual results in future periods to differ materially from forecasted results. Those factors, risks and uncertainties include, but are not limited to: the positioning of the Company’s products in the Company’s market segments; the Company’s ability to effectively manage its various businesses in a rapidly changing environment; the timing of new product introductions; sell-through of the Company’s products; the continued emergence of the internet resulting in new competition and changing customer demands; the Company’s ability to adapt and expand its product offerings in light of changes to and developments in the internet environment; growth rates of the Company’s market segments; variations in the cost of, and demand for, customer service and technical support; price pressures and competitive environment; the possibility of programming errors or other "bugs’ in the Company’s software; the timing and customer acceptance of new product releases and services (including current users’ willingness to upgrade from older versions of the Company’s products); the consummation of possible acquisitions or combinations; and the Company’s ability to integrate acquired or combined operations with its existing business and otherwise manage growth; and the Company’s ability to generate or obtain additional capital resources to fund its operations and growth. Additional information on these and other risk factors are included in the "Factors That May Affect Future Results" section in the Company’s Annual Report on Form 10-KSB filed with the SEC on March 29, 2000, the risk factors included in this filing under "Factors That May Affect Future Results" and the risks discussed in the Company’s other filings with the SEC. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management’s analysis, judgement, belief and expectations only as of the date hereof The Company undertakes no obligation to publicly revise these forward-looking statements to reflect events or circumstances that arise after the date hereof.

Overview

PASW, Inc., ("PASW", the "Company", "we" and "our"), was incorporated in California in November 1992 as a developer and licensor of Internet and Web related software and software development tools. Our operations are conducted principally from an office in Southern California and we have a sales office in Japan. The Company completed an initial public offering of 950,000 units consisting of one share of common stock and one warrant on July 29, 1999. An additional 142,500 units representing the underwriter’s overallotment was sold on September 13, 1999.

The Company has historically developed and licensed software that enabled Internet and web based communications. Our software products were embedded into systems and developed or manufactured by others.

Realizing that general market conditions both in the public and private markets had been deteriorating since late spring 2000 we embarked on an aggressive program to find a suitable merger/acquisition opportunity.

On August 31, 2000 the Company and NetSilicon, Inc. ("NSI") entered into an agreement whereby we sold the assets of our Internet and Web software technology to NSI. The purchase price for the assets was 90,000 shares of NSI's common stock. In addition NSI agreed to grant a non-exclusive, royalty-free license for the acquired technology, to PASW and its affiliates, subject to certain limitations.

During 1999 we also established Alera Systems, Inc., formerly iApplianceNet.com ("Alera"), a development stage company and a wholly owned subsidiary. Alera was in the process of developing proprietary technology that would allow potential business customers to greatly improve the management of their distributed remote assets.

Although Alera continued to meet performance objectives for the development and marketing of its products, capital market conditions deteriorated to the point that the additional private funding required for the Alera program could not be completed. Concurrently, the approximately $2.3 million in NSI stock received from the sale of our Internet and Web software to NetSilicon depreciated by 80% from August 31st to December 31st. This combination of factors materially impacted our ability to continue funding Alera operations and our administrative operations. During December 2000 we closed the administrative office and at the end of December ceased further development operations at Alera.

Results of Continuing Operations

The following table sets forth, for the periods indicated, the percentage relationship to net revenue of certain items in the consolidated statements of operations and comprehensive income:

	Year ended December 31,	
	2000	2001
Net revenue	100.00%	100.00%
	19.11	45.72

Cost of revenue	19.11	45.72
Gross profit	80.89	54.28
Selling, general and administrative	244.89	65.07
Research and development	111.92	0
Depreciation and amortization	5.54	1.26
Total operating expenses	362.35	66.33
Net loss from operations	(281.46)	(12.05)
Other income (expense)	(201.79)	(203.88)
Net loss from continuing operations	(483.25)	(215.93)
Income tax expense	0	0
Net gain (loss)from discontinued operations	150.44	(3.59)
Net loss	(332.81)	(219.52)
Other comprehensive unrealized gains and (losses)		
and foreign currency translation	(157.12)	205.00
Net loss	(489.93)%	(14.52)%

The following table sets forth, for the periods indicated, the percentage of net revenue by principal geographic area to total revenue:

	Year ended December 31,	
	2000	**2001**
United States	45%	0%
United Kingdom and Europe	8	0
Japan and Asia	46	100
Other	1	0
Total	100%	100%

Net revenue

Our net revenues from continuing operations decreased 24% to $595,352 from $785,156 from 2000 to 2001reflecting our sale of operations in the United States in 2000. Sales of licenses in Japan, our remaining selling operation, increased 10% from 2000 however royalty revenue in Japan decreased by 63% from 2000 to 2001 to $139,895 from $371,731.

We expect sales in Japan to continue to represent substantially all of net revenue. We generally price our foreign licenses in dollars. An increase in the relative value of the dollar against the Japanese Yen may reduce our revenue in dollar terms or could make our products more expensive

Cost of revenue

The cost of our revenue for the year 2001 was $272,219 or 46% of sales compared to $150,059 or 19% of sales in 2000. The increase in cost of sales related to higher distribution costs resulting from a new distribution agreement entered into upon the sale of operating assets to a third party in August 2000.

Selling, general and administrative

Selling, general and administrative expense decreased to $387,379 in 2001 from $1,922,826 in 2000. This decrease is the result of maintaining a sales office in Japan and eliminating all operations in the United States except for an administrative staff of one individual.

Research and development expense

Our research and development expense in 2001 was zero since all research operations were terminated in December 2000. Expenses of $878,758 in 2000 were attributable to a continuation of expenses associated with the initial operation of the Company's Alera subsidiary.

Depreciation and amortization

Depreciation and amortization decreased to $7,543 in 2001 from $43,466 in 2000. The depreciation in 2001 was incurred at our Japanese office whereas the depreciation in 2000 was attributable to expenditures of $124,739 in capital additions in 2000 used for continued development of the Alera subsidiary.

Other income and expense

In the year 2001 we incurred losses on sales of securities in the open market of $1,215,369. In 2000 losses on sales of securities aggregated $534,689.Also in 2000 we recorded a charge to comprehensive income of $1,183,184 to recognize the unrealized loss incurred from September to December resulting from the decrease in market price for the stock. At December 2000 we determined that our investment of $1,000,000 in Combio Corporation could be impaired in light of Combio's inability to secure additional funding for its operations therefore we reserved the full amount as an impaired asset.

Loss from discontinued operations

In 2001 we had a loss from discontinued operations of $21,356 from remaining expenses of our web-based technologies. In 2000 we completed the sale of certain assets of our PSI Technology subsidiary to NetSilicon, Inc. We received 90,000 shares of NetSilicon common stock that had a value of $2,328,750. The loss from operations of PSI Technology from January 1, 2000 through Augusts 31, 2000 was $1,147,529.

Provision for taxes

Commencing in 1995 the Company elected to be treated as a subchapter S corporation. Through 1998 all federal tax liabilities were recognized at the individual stockholder level. In February 1999 the Company terminated the S election and became subject to taxation at the corporate level. For the year 2001 the Company had no income tax liability.

Liquidity and capital resources

At December 31, 2001 and December 31, 2000 we had working capital of $39,100 and ($16,004) and cash and cash equivalents of $152,148 and $254,369.

We used $306,327 in cash flow from operating activities for the year 2001 compared to using $2,613,849 for 2000. The decrease in use of cash of $2,307,522 was the result of a decreased loss for the year of to $102,414 compared to a loss of $3,794,322 in 2000. Cash generated or used in operating activities principally reflect the loss from operations and the related changes in working capital components.

Our investing activities in year 2001 consisted of the purchase of marketable securities of $136,500 and the proceeds of the sale of marketable securities of $302,856 compared to the purchase of assets of $124,739 and the proceeds of the sale of marketable securities of $412,336 in 2000.

We had no financing activities in 2001. Financing activities in year 2000 consisted of the exercise of options and warrants in the Company of $569,250 and the investment of $400,000 through the private placement of preferred stock in our Alera subsidiary.

Factors That May Affect Future Results

This report, including Management's Discussion and Analysis or Plan of Operation, contains forward-looking statements and other prospective information relating to future events. These forward-looking statements and other information are subject to certain risks and uncertainties that could cause results to differ materially from historical or anticipated results, including the following:

We have received a Going Concern opinion from our auditors on our financial statements for the years ended December 31, 2001 and December 31, 2000. Those statements indicate that we have reported losses for our last two years and if we do not become profitable our business could be adversely affected.

We reported losses of $2,613,101 and $1306,954 for the years ending December 31, 2000 and 2001. We also have an accumulated deficit of $ 6,365,670 and a stockholders' equity of $50,590 as of December 31, 2001. We can provide no assurance that we will be profitable in the future and if we do not become profitable our business could be adversely affected.

We were delisted by the NASDAQ Stock Market on October 9, 2001 and our stock has been trading on the OTC Bulletin Board Market (OTCBB) since that time.

The NASDAQ National/Small Cap Market delisted our stock at the opening of business on October 9, 2001. The securities were removed form NASDAQ and subsequent to that date the PASW Common Stock (PASW) and Warrants (PASWW) have been trading on the OTC Bulletin Board Market (OTCBB). While we still have market makers for our securities there can be no assurance that we can continue to rely on our current market makers and that the price and trading volume of our securities could not b materially affected.

We have limited resources available to continue operations unless a successful transaction is completed with a merger partner or that additional funding can be obtained from outside sources.

At the present time we have limited resources available to continue operations other than maintaining day-to-day activities without any capabilities for expansion. The revenue received from our NRCJ subsidiary is sufficient to handle only maintenance administrative operations for the Company. While efforts are in process to seek a merger partner or other means of financing there is no assurance that any means can be obtained to permit the Company to resume any form of operations which could expand the business.

Because our operating subsidiary depends on a small number of large orders, the loss or deferral of orders may have a negative impact on revenue.

NRCJ is our only operating subsidiary and as such provides the majority of the funds required to operate the Company. Although none of its customers has accounted for 10% or more of total revenue in any fiscal year, a significant portion of software license revenue in each quarter is derived from a small number of relatively large orders. While we believe that the loss of any particular customer is not likely to have a material adverse effect on our business, our operating results could be materially adversely affected if our operating subsidiaries were unable to complete one or more substantial license sales in any future period.

Any decrease in the market acceptance of our operating subsidiary's Internet and web products or lack of acceptance of new products would decrease our revenue.

Our future results depend heavily on continued market acceptance of our operating subsidiary's products in existing and new markets. Our NRCJ subsidiary is a distributor for products supplied by Net Silicon, Inc. Revenue from licenses of the suite of Internet and Web products and sales of services accounted for substantially all of its revenue in the years ended December 31, 2000 and 2001. There is no assurance that Net Silicon will continue to fund the research required to keep our subsidiary supplied with state of the art products, that Net Silicon will continue the Distribution Agreement with NRCJ beyond its current termination date or that our subsidiary will have sufficient funds to properly advertise and market their product lines as an independent distributor. Any of these factors could have a material effect on our continued operations and financial results.

Because our ownership is concentrated, our officers and directors and independently our majority stockholder will be able to control all matters requiring stockholder approval including delaying or preventing a change in our corporate control or taking other actions of which individual shareholders may disapprove.

Our officers, directors and independently the majority stockholder beneficially own approximately 60% of our outstanding common stock. These parties will be able to exercise control over all matters requiring stockholder approval and other investors will have minimal influence over the election of directors or other stockholder actions. As a result, our officers, directors and independently the majority stockholder could approve or cause the Company to take actions of which you disapprove or that are contrary to your interests.

Issuance of our authorized preferred stock could discourage a change in control, could reduce the market price of our common stock and could result in the holders of preferred stock being granted voting rights that are superior to those of the holders of common stock.

The Company is authorized to issue preferred stock without obtaining the consent or approval of stockholders. The issuance of preferred stock could have the effect of delaying, deferring, or preventing a change in control. Management also has the right to grant superior voting rights to the holders of preferred stock. Any issuance of preferred stock could materially and adversely affect the market price of the common stock and the voting rights of the holders of common stock. The issuance of preferred stock may also result in the loss of the voting control of holders of common stock to the holders of preferred stock.

You may experience dilution if we are compelled to litigate or arbitrate claims that have been asserted by Golenberg & Co. for the right to purchase 10% of the Company.

In April 1999 we were notified that a merchant banker, Golenberg & Co., has asserted rights under a June 1998 letter agreement to purchase 10% of our then outstanding common stock for $400,000. In June 1999 counsel for Golenberg & Co. reiterated this demand and advised us that these claims were being evaluated for possible legal action. Investors could be significantly diluted if Golenberg & Co. successfully brings a lawsuit against us.

Trading in our common stock and warrants may be limited and could negatively affect the ability to sell your securities.

A public market for our common stock and our warrants has only existed since July 29, 1999, the date of our initial public offering. We do not know how liquid the market for our stock and warrants will remain and if the market becomes illiquid, it may negatively affect your ability to resell your securities.

ITEM 7. FINANCIAL STATEMENTS

The Consolidated Financial Statements of the Company are attached as follows:

PASW, Inc. Financial Statements as of and

for the year ended December 31, 2001and 2000 F-2 through F-20

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

None

PART III

ITEM 9. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS; COMPLIANCE WITH SECTION 16(A) OF THE EXCHANGE ACT

-

EXECUTIVE OFFICERS AND DIRECTORS

Name	Age	Position
Glenn P. Russell	47	Chairman
William E. Sliney	63	President, Chief Financial Officer, Secretary and Director
Wayne T. Grau	53	Director

-

Glenn P. Russell. Mr. Russell was our chairman from 1992 to October 2000. He was reelected chairman in August 2001. He also served as president and chief executive officer from 1992 to 1999. Before 1992 he had various sales and marketing positions at IBM, Unisys and Network Research Corporation, a predecessor of PASW. Mr. Russell is also an officer and director of Luke Systems International, a distributor of electronic components. Luke Systems International is controlled by Mr. Russell's spouse. Mr. Russell was educated in the United Kingdom.

William E. Sliney. Mr. Sliney has been our president since August 2001. He was chairman from October 2000 to August 2001. Prior to that he was president since December 1999, chief financial officer since April 1999 and was elected secretary in December 2001. Before joining us, Mr. Sliney was the chief financial officer for Legacy Software Inc. from 1995 to 1998. From 1993 to 1994, Mr. Sliney was chief executive officer for Gumps. Mr. Sliney received his masters in business administration from the University of California at Los Angeles.

Wayne T. Grau. Mr. Grau has been a director of PASW since January 1999. He has been the president and chief executive officer of Fielding Electric, Inc. since 1981. Mr. Grau is currently a member of the Los Angeles Chapter membership committee of the National Electrical Contractors Association, a trustee for the Joint Apprenticeship Training Committee and a trustee for the Los Angeles Electrical Training Trust.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Exchange Act requires the Company's directors and executive officers, and persons who own more than 10 percent of a registered class of the Company's equity securities, to file with the Securities and Exchange Commission (the "SEC") initial reports of ownership and reports of changes in ownership of Common Stock and other equity securities of the Company. Officers, directors and greater than ten percent stockholders are required by SEC regulation to furnish the Company with copies of all Section 16(a) forms they file.

To the Company's knowledge, based solely on review of the copies of such reports furnished to the Company and written representations that no other reports were required, during the year ended December 31, 2001, all officers, directors and greater than ten percent beneficial owners listed in the above table complied with the following Section 16(a) filing requirements.

ITEM 10. EXECUTIVE COMPENSATION

EXECUTIVE COMPENSATION AND OTHER MATTERS

The following table sets forth the compensation earned for services rendered to PASW in all capacities for the three most recently completed years by our Chief Executive Officer and our other most highly compensated executive officers whose salary and bonus during the year ended December 31, 2001 exceeded $100,000.

Summary Compensation Table

Name and principal position	Year ended	Annual compensation Salary	Bonus	Long-term compensation awards Securities underlying options	All other compensation
-					
-					
-					
-					
-					
Glenn P. Russell (1)	2001	0		30,000	
Chairman	2000	168,345	-	30,000	-
	1999	190,000	-	30,000	-
William E. Sliney (2)	2001	46,875		187,000	15,000
President and	2000	105,313	-	87,000	-
Chief Financial Officer and	1999	87,087	-	312,000	-
Secretary					

(1) Mr. Russell resigned as Chairman in November 2000 and was re-appointed Chairman in August 2001.

(2) Mr. Sliney commenced employment in April 1999 and became Chairman in November 2000. He resigned as Chairman in August 2001. His annual salary is $125,000. In the year ended December 31,2000, 300,000 of the options granted to Mr. Sliney in 1999 were canceled and replaced with 75,000 fully vested options at $2.50 expiring in November 2004. In September 2001 the 87,000 outstanding options were repriced to $0.25 and additionally he was granted 100,000 fully vested options at $0.25. All options expire on September 17, 2006. The additional compensation to Mr. Sliney is in the form of a management fee after he ceased being an employee of the Company in March 2001.

Option Grants in Last Fiscal Year

The following table sets forth certain information with respect to stock options granted to Executive Officers in 2001. The figures representing percentages of total options granted to employees in the fiscal year 2001 are based on an aggregate of 287,500 options granted by us during the year ended December 31, 2001to our employees and consultants, including the Named Executive Officers.

In the table potential realizable values are based on assumed rates of appreciation over the term of the option from the date of grant. These values are calculated assuming the fair market value of common stock on the date of grant appreciates at the indicated annual rate compounded annually for the entire term of the option and that the option is exercised and sold on the last day of the term for the appreciated stock price. These assumed rates are based on Securities and Exchange Commission requirements and do not reflect our projections or estimates of future stock price growth. Actual gains, if any, will depend on the future performance of our common stock.

Unless otherwise indicated the options in this table were granted under the 1998 equity incentive program, have 5-year terms and are fully vested. All of the options have exercise prices equal to the fair market value of our common stock on the date of grant.

Option Grants during Year Ended December 31, 2001

Number of securities	Percent of total options	Expiration	Potential realizable value at assumed

	underlying options	granted to employees in	Exercise		annual rates of stock price appreciation for option term	
Name	Granted	fiscal year	price	Date	5% ($)	10% ($)
William E. Sliney	100,000	35%	$0.25	9/17/06	$31,907	$40,263

Aggregate Option Exercises in Last Fiscal Year

The following table summarizes the value of options held at December 31, 2001 by our Executive Officers. The value of unexercised in-the-money options in the right-hand columns are based on the difference between the fair market value of $0.05 per share at year-end and the per-share exercise price, multiplied by the number of shares issued upon exercise of the option.

	Number of shares acquired	Value	Number of securities underlying unexercised options at year end		Value of unexercised in-the-money options at year end	
Name	Upon exercise	Realized	Exercisable	Unexercisable	Exercisable	Unexercisable
Glenn P. Russell	-	-	30,000		-	-
William E. Sliney	-	-	100,000		-	-

REPORT OF THE COMPENSATION COMMITTEE

Appointed in February 1999, the Compensation Committee is charged with the responsibility of reviewing all aspects of the Company's executive compensation programs and administering the Company's stock option plans. The Compensation Committee did not meet during 2001.

ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth information regarding the beneficial ownership of our common stock as of December 31, 2001 for:

each person who is known to own beneficially more than 5% of our outstanding common stock,

each of our executive officers and directors and

all executive officers and directors as a group.

The percentage of beneficial ownership for the following table is based on 4,997,400 shares of common stock outstanding on December 31, 2001.

Unless otherwise indicated below, to our knowledge, all persons and entities listed below have sole voting and investment power over their shares of common stock, except to the extent that individuals share authority with spouses under applicable law.

Shares of common stock not outstanding but deemed beneficially owned because an individual has the right to acquire the shares of common stock within 60 days are treated as outstanding when determining the amount and percentage of common stock owned by that individual and by all directors and executive officers as a group. Each person has sole voting and investment power with respect to the shares of common stock shown.

-	**Number of shares beneficially owned**	**Percentage of shares outstanding**
Name and address of beneficial owner		
Glenn P. Russell	3,030,000	60.6%

William E. Sliney	187,500	3.8%
Wayne T. Grau	15,000	*
All directors and executive officers as a group (3)	3,232,500	64.4%

* Less than 1%.

The address of each officer and director for PASWS, Inc. is 2007 Simsbury Court, Thousand Oaks, California 91360.

-

ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

In March 1996, PASW agreed with a former officer, director and principal stockholder to a buyout of his employment agreement and Glenn P. Russell agreed to purchase all of that former officer's shares of common stock of PASW. PASW and that former officer also entered into a consulting agreement and that former officer agreed not to compete with PASW. PASW paid the former officer $ 257,143 and $314,286 for 1999 and 1998, respectively. As of December 31, 2001 the Company has satisfied its obligations to the former officer in full.

In December 1998, Luke Systems International, a company controlled by the spouse of Glenn P. Russell, loaned PASW $100,000 interest free. In March 1999, PASW repaid the loan.

During 1998 and a portion of 1999 Company subleased a portion of the premises to Luke Systems International. The Company believes that the terms of Luke’s occupancy are favorable to the Company. This affiliated company relocated to other premises before September 30, 1999.

At July 1, 1999 the Company owed a bank approximately $250,000 for advances that were obtained under a line of credit. Glenn P. Russell has provided our bank with his personal guarantee and the Company has collateralized our accounts receivable as security for these advances. This amount was repaid in August 1999.

During 1996, 1997 and 1998 we employed Glenn P. Russell’s mother, a resident of the United Kingdom, to perform various administrative and managerial tasks for us within that country. We paid her $105,769 in 1998. She ceased to be our employee in the fall of 1998.

In February 2001 Luke Systems International loaned the Company $32,075 which remains outstanding at December 31, 2001.

PASW believes that the transactions described above, other than the employment of the mother of Glenn P. Russell, were made on terms no less favorable to PASW than could have been obtained from unaffiliated third parties.

-

ITEM 13. EXHIBITS AND REPORTS ON FORM 8-K

Exhibits

Exhibit No. Description Page

2.1 Combination Agreement among PASW, Inc. Glenn P. Russell and Simmons Energy Services Inc. (4)

2.2 Voting Trust and Exchange Rights Agreement among PASW, Inc. [#2] Alberta Ltd., Shareholders and Montreal Trust Company of Canada (4)

2.3 Support Agreement among PASW, Inc. and [#2] Alberta Ltd.(4) 2.4 Share Capital Provisions to be Included in the Articles of Incorporation of [#2] Alberta Ltd.

3.1 Articles of Incorporation of the Registrant, as amended to date (4)

3.2 Bylaws of the Registrant (1)

4.2 Specimen Warrant (1)

4.3 Form of Warrant Agreement (1)

4.4 Specimen Common Stock Certificate (1)

4.5 Form of Lock Up Agreement (1)

4.6 Form of Underwriter's Option for Purchase of Units (1)

10.1 Form of Indemnification Agreements (1)

10.2 1998 Equity Incentive Program (1)

10.3 Security and Loan Agreement, dated September 15, 1998 between Bank of America National Trust and Savings

Association and Pacific Softworks (1)

10.4 Form of Invention Assignment and Proprietary Information Agreement (1)

10.5 Sublease, dated April 7, 1998 between SHR Perceptual Management and Pacific Softworks for the premises at 703

Rancho Conejo Blvd., Newbury Park, California (1)

10.6 Consulting Agreement dated March 8, 1996 between Kenneth Woodgrift and Pacific Softworks (1)

10.7 Letter from Golenberg & Co, merchant bankers, to Glenn Russell dated June 18, 1998 and Letter from Pacific

Softworks to Glenn Golenberg dated January 27, 1999 (1)

10.8 Letter of intent regarding investment in FSPNetwork dated October 25, 1999 (2).

10.9 Convertible 10% promissory note due from FSPNetwork (3)

10.10 Letter of intent regarding investment in RedFlag dated January 13, 2000(3)

10.11 NetSilicon sale of assets dated September 8, 2000

10.12 Letter of intent between PASW, Inc. and Simmons Energy Services dated February 9, 2001

21.1 Subsidiaries of the Registrant*

As filed on Form SB2 effective July 29, 1999.

As filed on Form 10-QSB on November 12, 1999.

As filed on Form 10KSB dated March 28, 2000

AS filed on Form 8-K effective March 29, 2001

* Filed herewith

(b) Reports on Form 8-K

None

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PASW, Inc.

(Registrant)

Date: March 26, 2002 By: William E. Sliney

President

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Signature	**Title**	**Date**
Glenn P. Russell	Chairman	03/26/02
William E. Sliney	President, Chief Financial Officer and Secretary	03/26/02
Wayne T. Grau	Director	03/26/02

PASW, INC. AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2001 AND 2000

PASW, INC. AND SUBSIDIARIES

FINANCIAL STATEMENTS

DECEMBER 31, 2001 AND 2000

-

CONTENTS

INDEPENDENT AUDITORS’ REPORT 1

CONSOLIDATED BALANCE SHEETS 2

CONSOLIDATED STATEMENTS OF OPERATIONS 3

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS 4

CONSOLIDATED STATEMENT OF STOCKHOLDERS’ EQUITY 5

CONSOLIDATED STATEMENTS OF CASH FLOWS 6 - 7

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS 8 - 20

INDEPENDENT AUDITORS' REPORT

TO THE STOCKHOLDERS AND BOARD OF DIRECTORS

PASW, INC. AND SUBSIDIARIES

We have audited the accompanying consolidated balance sheets of PASW, INC. AND SUBSIDIARIES as of December 31, 2001 and 2000, and the related consolidated statements of operations, comprehensive loss, stockholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of PASW, INC. AND SUBSIDIARIES as of December 31, 2001 and 2000, and the consolidated results of their operations and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As shown in the accompanying financial statements, the Company has incurred significant operating losses to date and has negative cash flows from operations. These factors raise substantial doubt as to the Company's ability to continue as a going concern. Management's plans with respect to those matters are discussed in Note 18 to the financial statements. These financial statements do not include any adjustments that might result from the outcome of this uncertainty.

MERDINGER, FRUCHTER, ROSEN & CORSO, P.C.

Certified Public Accountants

Los Angeles, California

February 16, 2002

PASW, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	December 31,	
ASSETS	2001	2000
Current assets		
Cash and cash equivalents	$ 152,148	$ 254,369
Accounts receivable, net of allowance for doubtful accounts of $-0-	43,855	157,381
Securities available for sale	-	198,541
Prepaid expenses and other current assets	-	30,867
Total current assets	196,003	641,158
Property and equipment, less accumulated		
depreciation and amortization of $50,584 and $43,852	5,847	12,784
Other assets	5,643	6,732
TOTAL ASSETS	$ 207,493	$ 660,674
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued expenses	$ 124,828	$ 657,162
Advances payable – stockholder	32,075	-
Total current liabilities	156,903	657,162
Commitments and contingencies	-	-
Stockholders' equity		
Preferred stock, $.01 par value; 10,000,000 shares authorized, no shares issued and outstanding	-	-
Common stock, $.001 par value; 50,000,000 shares authorized; 4,997,400 and 4,517,400 shares issued and outstanding	4,998	4,518
Additional paid-in capital	6,398,754	6,265,653
Accumulated deficit	(6,365,670)	(5,058,716)

Unrealized loss on marketable securities	-	(1,183,184)
Cumulative adjustment for foreign currency translation	12,508	(24,759)
Total stockholders' equity	50,590	3,512
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 207,493	$ 660,674

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

PASW, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	For the Years Ended December 31,	
	2001	2000
Revenue		
Sales	$ 455,458	$ 413,425
Royalties and other	139,895	371,731
Total	595,353	785,156
Cost of revenue - purchases and royalty fees	272,219	150,059
Gross profit	323,134	635,097
Operating expenses		
Selling, general and administrative	387,379	1,922,826
Research and development	-	878,758
Depreciation and amortization	7,543	43,466
Total operating expenses	394,922	2,845,050
Loss from operations	(71,788)	(2,209,953)
Other income (expenses)		
Interest income	1,559	18,515
Interest expense	-	(1,286)
Other expense	-	(66,909)
Loss on sale of securities	(1,215,369)	(534,689)
Loss from impaired assets	-	(1,000,000)
Total other income (expense)	(1,213,810)	(1,584,369)
	(1,285,598)	

Loss from continuing operations before income taxes	(1,285,598)	(3,794,322)
Income tax expense	-	-
Loss from continuing operations	(1,285,598)	(3,794,322)
Discontinued operations:		
Loss from operations of internet and web software divisions (net of income taxes of $-0-)	(21,356)	(1,147,529)
Gain on disposal of internet and web software divisions (net of income taxes of ($-0-)	-	2,328,750
	(21,356)	1,181,221
Net loss	$ (1,306,954)	$(2,613,101)
Net loss per common share - Basic and diluted		
Continuing operations	$ (0.27)	$ (0.84)
Discontinued operations	(0.01)	0.26
Net loss per share	$ (0.28)	$ (0.58)
Weighted average common shares -Basic and diluted	4,617,400	4,487,337

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

PASW, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

	For the Years Ended December 31,	
	2001	2000
COMPREHENSIVE INCOME (LOSS)		
Net loss	$(1,306,954)	$(2,613,101)
Net unrealized loss on available for sale securities	1,183,184	(1,183,184)
Foreign currency translation adjustment	37,264	(50,407)
Comprehensive loss	$ (86,506)	$(3,846,692)

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

PASW, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

	Common Stock		Additional Paid-in	Accumulated	Unrealized Loss on	Cumulative Foreign Currency Translation	Total Stockholders'
	Shares	Amount	Capital	Deficit	Securities	Adjustment	Equity
Balance at January 1, 2000	4,402,500	$ 4,403	$ 5,042,624	$(2,445,615)	$ -	$ 25,578	$ 2,626,990
Exercise of options	31,500	31	95,594	-	-	-	95,625
Issue of Series A Convertible Preferred stock in subsidiary	-	-	400,000	-	-	-	400,000
Exercise of warrants	83,400	84	473,541	-	-	-	473,625
Warrants issued as compensation for services	-	-	36,000	-	-	-	36,000
Options issued to employees	-	-	217,894	-	-	-	217,894
Change in market value of available for sale securities and investments	-	-	-	-	(1,183,184)	-	(1,183,184)
Foreign currency translation adjustment	-	-	-	-	-	(50,337)	(50,337)
Net loss	-	-	-	2,613,101)	-	-	(2,613,101)
Balance at December 31, 2000	4,517,400	4,518	6,265,653	(5,058,716)	(1,183,184)	(24,759)	3,512
Conversion of preferred to common stock	400,000	400	(400)	-	-	-	-
Shares issued as compensation for services	80,000	80	8,720	-	-	-	8,800
Repricing of warrants	-	-	124,781	-	-	-	124,781
Sale of marketable securities	-	-	-	-	1,183,184	-	1,183,184
Foreign currency translation adjustment	-	-	-	-	-	37,267	37,267
Net loss	-	-	-	(1,306,954)	-	-	(1,306,954)
Balance at December 31, 2001	4,997,400	$ 4,998	$6,398,754	$(6,365,670)	$ -	$ 12,508	$ 50,590

PASW, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Years Ended December 31,	
	2001	2000
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	$ (1,285,598)	$ (3,794,322)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	7,543	43,466
Impairment of investment	-	1,000,000
Write-off of fixed assets	-	164,836
Loss on marketable securities	1,215,369	534,689
Stock-based compensation	133,581	246,544
(Increase) decrease in assets:		
Accounts receivable	113,526	18,370
Prepaid expenses and other current assets	-	44,886
Deposits and trademark	30,867	6,461
Increase (decrease) in liabilities:		
Accounts payable and accrued expenses	(532,334)	266,616
Related party payable	32,075	-
Deferred revenue	-	(149,872)
	(284,971)	(1,618,326)
Loss from discontinued operations	(21,356)	(995,523)
Net cash used in operating activities	(306,327)	(2,613,849)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisition of fixed assets	-	(124,739)
Purchase of marketable securities	(136,500)	-
Proceeds on sale of marketable securities	302,856	412,336
Net cash provided by investing activities	166,356	287,597
CASH FLOWS FROM FINANCING ACTIVITIES:		
Exercise of options and warrants	-	569,250
Sale of subsidiary stock	-	400,000
Net cash provided by financing activities	-	969,250

EFFECT OF EXCHANGE RATE CHANGES ON CASH	37,750	(50,337)
NET DECREASE IN CASH	(102,221)	(1,407,339)
CASH AND CASH EQUIVALENTS – BEGINNING	254,369	1,661,708
CASH AND CASH EQUIVALENTS - ENDING	$ 152,148	$ 254,369

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

PASW, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Years Ended December 31,	
	2001	2000
SUPPLEMENTAL CASH FLOW INFORMATION:		
Cash paid during the year for –		
Interest paid	$ -	$ 1,286
Income taxes paid	$ -	$ -

CASH FLOW STATEMENT

SCHEDULE OF NON-CASH ACTIVITIES:

During 2001,

The Company issued 80,000 shares of common stock, valued at $8,800, for services.

The Company issued 400,000 shares of common stock in conversion of subsidiary preferred stock.

The Company issued warrants as compensation for services. The warrants have been recorded at a value of $124,781.

During 2000,

The Company wrote off $35,794 in net book value in unused fixed assets.

The Company charged $129,042 for fixed assets relating to discontinued operations.

A note receivable in the amount of $1,000,000 was converted into equity securities.

The Company received equity securities valued at $2,328,750 as consideration for the sale of assets.

Equity securities valued at $253,894 were issued as compensation for services.

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

PASW, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2001 AND 2000

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

PASW, Inc., formerly Pacific Softworks, Inc., incorporated in California in November 1992, has historically developed and licensed Internet and Web related software and software development tools that enable communications, based on a set of rules known as protocols. The Company's products were embedded into systems and developed or manufactured by others. In August 2000, the Company sold all of the assets of its Internet and Web operations. Since that time, the Company's operations, consisting of sales of software and licenses, have been conducted principally through an administrative office in Southern California and a sales office in Japan.

Basis of Consolidation

The consolidated financial statements include the accounts of PASW, Inc. ("PSI") and its wholly owned subsidiaries:

Network Research Corp. Japan, Ltd. ("NRC");

Alera Systems, Inc. ("Alera"), formerly iApplianceNet.com ("iAppliance"), a California Corporation;

Pacific Acquisition Corporation ("PAC"), a California Corporation;

PSI Softworks Technology, Inc. ("PST"); and

PASW Europe Limited ("Europe"), a United Kingdom Corporation

All references herein to PSI or the "Company" include the consolidated results of PSI and its subsidiaries.

All significant intercompany accounts and transactions have been eliminated in consolidation.

Alera is a wholly owned subsidiary of PSI and was incorporated in California in August 1999. Alera was inactive during the period ended December 31, 1999, began operations in January 2000, and was inactive at December 31, 2001.

PAC and Europe were formed in 1999. PAC and Europe were inactive in 2001 and 2000.

PST was formed in 2000 and was sold on August 31, 2000.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles 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 period. Actual results could differ from those estimates.

Revenue Recognition

The Company is a licensor of software and generates revenue primarily from the one-time sales of licensed software. Generally, revenue is recognized upon shipment of the licensed software. For multiple element license arrangements, the license fee is allocated to the various elements based on fair value. When a multiple element arrangement includes rights to a post-contract customer support, the portion of the license fee allocated to each function is recognized ratably over the term of the arrangement.

Cash and Cash Equivalents

The Company considers all highly liquid investments purchased with original maturities of three months or less to be cash equivalents.

Concentration of Credit Risk

The Company places its cash in what it believes to be credit-worthy financial institutions. However, cash balances may exceed FDIC insured levels at various times during the year.

Accounts Receivable

For financial reporting purposes, the Company utilizes the allowance method of accounting for doubtful accounts. The Company performs ongoing credit evaluations of its customers and, if required, maintains an allowance for potential credit losses. The allowance is based on an experience factor and review of current accounts receivable. Uncollectible accounts are written off against the allowance accounts when deemed uncollectible.

Property and Equipment

Property and equipment are stated at cost. Depreciation is provided for in amounts sufficient to relate the cost of depreciable assets to operations over their estimated service lives, primarily on a straight-line basis. The estimated lived used in determining depreciation are five to seven years for furniture, fixtures and computer equipment. Purchased computer software costs are amortized over five years.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Property and Equipment (continued)

Maintenance and repairs are charged to expense as incurred; additions and betterments are capitalized. Upon retirement or sale, the cost and related accumulated depreciation of the disposed assets are removed and any resulting gain or loss is credited or charged to operations.

Research and Development

Costs incurred in research and development activities are charged to operations as incurred. All research and development activities are incurred in connection with the development of computer software products.

Fair Value of Financial Instruments

The Company's financial instruments consist of cash, accounts receivable, accounts payable and short-term debt. The carrying amounts of cash, accounts receivable, accounts payable and short-term debt approximate fair value due to the highly liquid nature of these short-term instruments at December 31, 2001 and 2000.

Long-Lived Assets

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the related carrying amount may not be recoverable. Recovery of assets to be held and used is measured by a comparison of the carrying amount of the assets to the future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less the cost to sell.

Income Taxes

Provisions for income taxes are based on taxes payable or refundable for the current year and deferred taxes on temporary differences between the amount of taxable income and pretax financial income and between the tax bases of assets and liabilities and their reported amounts in the financial statements. Deferred tax assets and liabilities are included in the financial statements at currently enacted income tax rates applicable to the period in which the deferred tax assets and liabilities are expected to be realized or settled as prescribed by Statement of Financial Accounting Standards ("SFAS") No. 109, "Accounting for Income Taxes." As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

Advertising Costs

Advertising costs, except for costs associated with direct-response advertising, are charged to operations when incurred. The costs of direct-response advertising, if any, are capitalized and amortized over the period during which future benefits are expected to be received.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Translation of Foreign Currency

The Company translates the foreign currency financial statements of its foreign subsidiaries in accordance with the requirements of SFAS 52, "Foreign Currency Translation." Assets and liabilities are translated at current exchange rates and related revenues and expenses are translated at average exchange rates in effect during the period. Resulting translation adjustments are recorded as a separate component in stockholders' equity. Foreign currency transaction gains and losses are included in determining net income.

Stock-Based Compensation

The Company uses the intrinsic value method of accounting for stock-based compensation for employees in accordance with Accounting Principles Board Opinion ("APB") No. 25. See Note 9 for proforma disclosure of net income and earnings per share under the fair value method of accounting for stock-based compensation as proscribed by SFAS No. 123.

Earnings Per Share

SFAS No. 128, "Earnings Per Share" requires presentation of basic earnings per share ("Basic EPS") and diluted earnings per share ("Diluted EPS").

The computation of basic earnings per share is computed by dividing earnings available to common stockholders by the weighted average number of outstanding common shares during the period. Diluted EPS gives effect to all dilutive potential common shares outstanding during the period. The computation of diluted EPS does not assume conversion, exercise or contingent exercise of securities that would have an anti-dilutive effect on losses.

Investment in Equity Securities

The Company accounts for its investments in equity securities under the provisions of SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities". This standard provides that available-for-sale investments in securities that have readily determinable fair values be measured at fair value in the balance sheet and that unrealized holding gains and losses for these investments be reported in a separate component of stockholders' equity until realized.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2001 AND 2000

NOTE 2 - INVESTMENT IN EQUITY SECURITIES

At December 31, 2000, marketable investments classified as available for sale are comprised as follows:

Common stock	
Market value	$ 198,541
Cost	(1,381,725)
Unrealized loss	$(1,183,184)

During the periods ended December 31, 2001 and 2000, the Company recognized realized losses as follows:

	2001	2000
Proceeds from sale	$ 302,856	$ 412,336
Cost	1,518,225	947,025
Realized loss	$(1,215,369)	$ (534,689)

<

The Company uses the average cost method in computing realized gains and losses, which are included in other income (expense), in the consolidated statement of operations.

NOTE 3 - NOTE RECEIVABLE

On December 3, 1999, the Company acquired for cash a $1,000,000 convertible promissory note bearing interest at 10% from Financial Services Provider Network, Inc. ("FSPN"). The note and accrued interest up to 6% is convertible into FSPN’s capital stock at the time of FSPN’s next equity based round of venture financing. Upon such conversion, this note shall be canceled and accrued interest in excess of 6% for the number of days elapsed shall be forfeited. On April 17, 2000, the note was converted into 715,084 shares of FSPN Series A Preferred Stock. The Company determined that this investment is fully impaired at December 31, 2000, and a loss of $1,000,000 has been charged to operations.

NOTE 4 - PROPERTY AND EQUIPMENT

Property and equipment consist of the following:

	December 31,	
	2001	2000
Furniture, fixtures and equipment	$ 31,431	$ 31,636

Computer software	25,000	25,000
	56,431	56,636
Less: accumulated depreciation and amortization	50,584	43,852
Fixed assets – net	$ 5,847	$ 12,784
Depreciation and amortization expense recorded in		
the statement of operations	$ 7,543	$ 87,804

NOTE 7 - COMMITMENTS AND CONTINGENCIES

The Company occupies facilities under terms of operating leases expiring in 2000 and 2001. It also occupies facilities in Japan on a month-to-month basis with a monthly rent of approximately $2,000. Rent expense included in the statement of operations totaled $21,260 and $98,121 in 2001 and 2000, respectively.

NOTE 8 - CAPITAL STOCK

The Company is authorized to issue 10,000,000 shares of Preferred Stock, par value $.01. Preferred shares may be issued from time to time in one or more series. The number of shares in each series and the designation of each series to be issued shall be determined from time to time by the board of directors of the Company.

During the year ended December 31, 2000, options and warrants were exercised into 114,900 shares of common stock. Proceeds to the Company aggregated $569,250.

In March 2000, Alera completed a private placement of 140,000 shares of its Series A redeemable convertible preferred stock for net proceeds of $350,000. On August 17, 2000, an additional 20,000 shares were issued for net proceeds of $50,000. The preferred shares carry a 5% dividend payable semi-annually in common shares of Alera valued at $2.50 per share.

In the event that Alera has not been sold or has not closed on underwritten public offering of not less than $5,000,000 within two years following the closing of the private placement, the preferred stockholders will have the option of converting their shares into common stock of the Company. The preferred shares will receive shares of PASW common stock based on the ratio of the cost of the preferred shares over 85% of the average per share closing price for the Company for 15 consecutive days. The value of Company shares used in the conversion calculation is limited to a range of $1.00 to $15.00. The preferred shares were converted into 400,000 shares of the Company’s common stock during 2001 at a conversion value of $1.00 per share.

NOTE 9 - STOCK-BASED COMPENSATION

On April 17, 1998, the Company adopted the 1998 Equity Incentive Program (the "Plan"). The Plan provides for the granting of the following Stock Awards: (i) Incentive Stock Options, (ii) Non-Statutory Stock Options, (iii) Stock Appreciation Rights, (iv) Stock Bonuses, and (v) Rights to acquire Restricted Stock. Persons eligible to receive Stock Awards are the employees, directors and consultants of the Company and its Affiliates, as defined. Incentive Stock Options may be granted only to employees. Stock awards other than Incentive Stock Options may be granted to all eligible persons.

The maximum term of any options granted is ten years. Vesting requirements may vary, and will be determined by the board of directors.

The number of shares reserved for issuance under the Plan is 451,740 shares.

In 1998, the Company granted certain non-statutory options to purchase shares of common stock to two employees. Each option is for 70,000 shares at an exercise price of $1.25 per share. The options vest on January 1, 1999 and expire December 31, 2003.

In 1999, the Company granted certain non-statutory options to purchase shares of common stock to three directors. Each option is for 15,000 shares at an exercise price of $5.00 per share, vest immediately, and expire in 2003.

On May 1, 1999, the Company granted stock options to certain employees, covering 283,000 shares. The options are exercisable for five years at a price of $5.00 per share for 253,000 shares and $5.50 per share for 30,000 shares. The options vest at a rate of 2% of the shares covered per month up to 36 months, at which time they will be fully vested.

On December 1, 1999, the president and chief financial officer of the Company were granted options to purchase 300,000 shares of common stock of the Company at an exercise price of $5.75 per share. These options expire on November 30, 2004. On October 5, 2000, these options were cancelled and 75,000 options were issued to the same individual. The options provide for an exercise price of $2.50 and expire on October 4, 2004. At the date of grant, the fair value of the common stock was $2.56 per share. Pursuant to APB 25 and related interpretations, compensation expense of $4,500 has been recorded in the financial statements. Additionally, these repriced options are accounted for as a variable plan. At December 31, 2000, the exercise price exceeded the market price of the stock; therefore, no compensation expense related to the variable nature of the options has been recorded in the financial statements.

NOTE 9 - STOCK-BASED COMPENSATION (Continued)

On April 19, 2000, the Company issued 87,000 options with an exercise price of $3.13 per share. The market price of the stock on the date of issuance was $3.69. Deferred compensation expense related to these options at the date of grant was $48,720. At December 31, 2000, 69,500 of these options had been cancelled. Compensation expense recorded in the statement of operations for the year ended December 31, 2000 was $7,856. Deferred compensation relating to these options at December 31, 2000 is $7,350.

Alera, a subsidiary, issued to employees 520,000 options to acquire Alera common stock with an exercise price of $2.50 per share. The options expire in three years. The fair value of these options, using the Black Sholes option pricing model with a risk-free interest rate of 5.5%, a life of 3 years, volatility of 0% and a dividend rate of 0%, is $195,280. This amount has been included in the proforma net loss presented below.

During 2001, the Company effectively cancelled all of its outstanding options by modifying the terms and issuing warrants, since the option holders are no longer employees of the Company (see Note 10 –

Warrants).

Plan and non-plan stock option activity is summarized as follows:

	December 31,	
	2001	2000
Outstanding at beginning of period	320,000	768,000
Options exercised at $1.25 per share	-	(16,500)
Options exercised at $5.00 per share	-	(15,000)
Options granted at an exercise price of $3.13 per share	-	87,000
Options granted at an exercise price of $2.50 per share	-	75,000
Options cancelled	(320,000)	(578,500)
Outstanding at end of period	-	320,000
Weighted average exercise price of options outstanding:		
January 1	2.86	4.66
December 31	-	2.86
Weighted average remaining contractual life of options outstanding	-	40 months

NOTE 9 - STOCK-BASED COMPENSATION (Continued)

The Company accounts for its stock option transactions with employees under the provisions of APB No. 25. The following proforma information is based on estimating the fair value of grants based upon the provisions of SFAS No. 123, "Accounting for Stock-Based Compensation." The fair value of each option granted during the year ended December 31, 2000, except for the subsidiary options described in item (f), has been estimated as of the date of grant using the Black-Scholes option pricing model with the following assumptions: risk: risk free interest rate of 5.5%, life of options of 2-5 years, volatility of 182% (except for the options described in item (d) above for which the volatility is 44%) and expected dividend yield of 0%. Under these assumptions, the weighted average fair value of options granted during the year ended December 31, 2000 was $2.62, except for the subsidiary options described in item (f).

The Company's proforma net loss and net loss per share assuming compensation cost was determined under SFAS No. 123 would have been the following:

	Year Ended December 31,	
	2001	2000
Net loss from continuing operations	$ (183,809)	$(4,197,729)
Net income (loss) from discontinued operations	(21,356)	1,181,221
Net loss	$ (205,165)	$(3,016,508)
Net loss per share – continuing operations	$ (0.04)	$ (0.93)
Net income (loss) per share – discontinued operations	(0.01)	0.26
Net loss per share	$ (0.05)	$ (0.67)

NOTE 10 - WARRANTS

In connection with its initial public offering in 1999, the Company issued common stock purchase warrants. At December 31, 2001, 1,134,100 warrants remain outstanding. None were exercised during 2001. During 2001, the Company extended the life of the warrants to November 30, 2002 and reduced the exercise price to $0.25 per share.

Additionally, the Company issued 560,000 fully vested common stock purchase warrants as compensation for services by professionals and consultants. The warrants have an exercise price of $0.25 per share and expire September 18, 2006.

The Company also canceled its outstanding employee options and other warrants, and issued 642,674 new fully vested warrants, with an exercise price of $0.25 per share expiring on September 18, 2006.

NOTE 10 - WARRANTS (Continued)

The Company has valued the 1,202,674 warrants issued in 2001 using the Black Sholes option pricing model with the following assumptions: interest rate of 4.5%, life of 5 years, volatility of 145% and expected dividend yield of -0-%. The per warrant fair value is $0.10 and a total expense of $124,781 has been recorded in the financial statements during 2001.

Warrants to purchase 20,000 shares were issued on October 5, 2000 for services. These warrants may be exercised at $2.50 per share until October 5, 2004. The fair value of the warrants using the Black Scholes pricinig model is $36,000 and has been charged to expense.

Warrants to purchase 1,180,000 shares had been issued to certain professionals who have rendered consulting services in connection with the Company's restructuring. Each of these warrants could be exercised at $5.75 per unit until November 2004. On October 5, 2000, these warrants were canceled. The Company issued 220,000 repriced warrants at an exercise price of $2.50, expiring on October 5, 2004. The fair value of the repriced options was less than the remaining fair value of the original warrants on the date of repricing.

NOTE 11 - RELATED PARTY TRANSACTIONS

During 2001, a company controlled by the spouse of the principal shareholder of PSI advanced funds to the Company aggregating $32,075. The advances bear no interest and are due on demand.

NOTE 12 - SEGMENT INFORMATION

The Company's assets are located principally in Japan.

Product sales are to the following geographic areas:

	2001	2000
United States and the Americas	0%	42%
Europe	0%	40%
Asia and Australia	100%	18%

NOTE 13 - INCOME TAXES AND S CORPORATION STOCKHOLDER DISTRIBUTIONS

-

The components of the provision for income taxes are as follows:

	December 31,	
	2001	2000
Current tax expense		
U.S. Federal	$ -	$ -
State and local	-	-
Total current	-	-
Deferred tax expense		
U.S. Federal	$ -	$ -
State and local	-	-
Total deferred	-	-
Total tax provision from continuing operations	$ -	$ -

The reconciliation of the effective income tax rate to the Federal statutory rate is as follows:

	December 31,	
	2001	2000
Federal income tax rate	(34.0)%	(34.0)%
Deferred tax charge (credit)	-	-
Effect of valuation allowance	34.0	34.0
State income tax, net of federal benefit	-	-
Effective income tax rate	0.0%	0.0%

At December 31, 2001 and 2000, the Company had a net carryforward operating loss of approximately $1,412,000 and $1,392,000, respectively. It also has a capital loss carryforward of approximately $2,750,000 at December 31, 2001. A valuation allowance equal to the tax benefit for deferred taxes has been established due to the uncertainty of realizing the benefit of the tax carryforward.

Deferred tax assets and liabilities reflect the net tax effect of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and amounts used for income tax purposes. Significant components of the Company’s deferred tax assets (liabilities) are as follows:

PASW, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2001 AND 2000

NOTE 13 - INCOME TAXES AND S CORPORATION STOCKHOLDER DISTRIBUTIONS (Continued)

	December 31, 2001	2000
Non-current deferred tax assets (liabilities):		
Loss carryforwards	$ 1,415,000	$ 995,000
Less: valuation allowance	(1,415,000)	(995,000)
Net deferred tax assets (liabilities)	$ -	$ -

The net operating loss carryforward expires in 2020.

NOTE 14 - EARNINGS PER SHARE

Securities that could potentially dilute basic earnings per share in the future, that were not included in the computation of diluted earnings per share because their effect would have been antidilutive, are as follows:

	December 31, 2001	2000
Warrants	2,336,774	1,896,774
Options	-	471,500
Total shares	2,336,774	2,368,274

NOTE 15 - ADVERTISING COSTS

Advertising costs incurred and recorded as expense in the statement of operations were $1,140 and $116,682, for the years ended December 31, 2001 and 2000, respectively.

NOTE 16 - INTEREST COSTS

Interest costs incurred were $-0- and $1,286 in 2001 and 2000, respectively, all of which were charged to operations.

NOTE 17 - DISCONTINUED OPERATIONS

On August 31, 2000, the Company and NETsilicon, Inc. ("NSIL") entered into an agreement whereby the Company sold the assets of its PSI Softworks Technology subsidiary ("PSI") to NSIL. The assets primarily consist of PSI’s Internet and Web software. The purchase price for the assets was 90,000 shares of NSIL’s common stock, valued at $2,328,750 (fair value on date of sale). In addition, NSIL has agreed to grant a non-exclusive, royalty-free license for the acquired technology to PASW and its affiliates, subject to certain limitations. NSIL is expected to retain substantially all of PSI’s personnel as part of a newly formed operating group. The operations sold are accounted for as discontinued operations for financial reporting purposes. Revenue attributable to discontinued operations was $-0- and $1,044,955 in 2001 and 2000, respectively.

NOTE 18 - GOING CONCERN

The accompanying financial statements have been prepared in conformity with generally accepted accounting principles, which contemplate continuation of the Company as a going concern. However, the Company has experienced net operating losses of $6,365,600 since inception and has a negative cash flow from operations. These factors raise substantial doubt about the Company’s ability to continue as a going concern. In view of the matters described above, recoverability of a major portion of the recorded asset amounts shown in the accompanying balance sheet is dependent upon the Company’s ability to raise sufficient capital to fund its working capital requirements until the Company can generate sufficient sales volume to cover its operating expenses. As of December 31, 2001, the Company is actively seeking a reverse merger candidate.