Surna Inc.
Form 10-K
April 16, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2012

Commission File Number: 333-164578

SURNA INC.

(Exact name of registrant as specified in its charter)

Nevada	**27-3911608**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
Suite S3, 414 Block B, Goldway Industrial Centre	
2 Wing Kin Road, Kwai Tsing	**N/A**
Hong Kong	
(Address of principal executive offices)	*(ZIP Code)*

+852.3721.3668

(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:	Securities registered pursuant to section 12(g) of the Act:
NONE	**Common Stock, par value $0.0001 per share**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. **YES** [ ] **NO** [X]

Indicate by check mark if the registrant is required to file reports pursuant to Section 13 or Section 15(d) of the Act: **YES** [X] **NO** [ ]

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 of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. **YES** [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** [X] **NO** [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not 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-K or any amendment to this Form 10-K.

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). **YES** [ ] **NO** [X]

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was sold, or the average bid and asked price of such common equity, as of June 30, 2012: $ 27,350,000.

At April 15, 2013, 99,375,000 shares of the registrant s common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

None.

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CHANGE IN FISCAL YEAR-END

On March 19, 2012 the Board of Directors approved a change of our fiscal year end from November 30 to December 31 of each year. With the change effective this 2012 fiscal year, which now ended December 31, 2012, there is a one fiscal month transition period covering the fiscal month of December 2011. Results for this transition period are reported in this Annual Report along with the results for the new fiscal year of January 1, 2012 through December 31, 2012.

CERTAIN CONVENTIONS

Except where the context otherwise requires and for purposes of this annual report only:

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China or PRC refers to the People s Republic of China, and excludes Hong Kong, Macau and Taiwan;

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we , us , our company and our refer to Surna Inc., and, unless the context requires otherwise, its wholly-owned subsidiaries, including Surna Media Inc., a British Virgin Islands company, Surna Hongkong Limited and Qoo Games Limited, Hong Kong companies, and Flying Cloud Information Technology Co. Ltd., a PRC company.

FORWARD-LOOKING INFORMATION

This annual report contains statements of a forward-looking nature. These statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from those expressed or implied by the forward-looking statements. These statements are made under the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. You can identify these forward-looking statements by terminology such as may, will, expects, anticipates, future, intend, plan, b estimate, is/are likely to or other similar expressions. The accuracy of these statements may be impacted by a number of risks and uncertainties that could cause actual results to differ materially from those projected or anticipated. Such risks and uncertainties include, but are not limited to, the following:

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We have limited financial resources and accordingly may not be able to continue to operate as a going concern unless we obtain additional financing;

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Our lack of resources may make it difficult or impossible to stabilize our position as a game developer and publisher, both inside and outside of China;

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We may not be successful in our efforts to develop and launch additional games;

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Our various initiatives to implement our business strategies may not prove successful despite the costs incurred to pursue them;

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Our competitors have significantly more resources than we do, and as a result we might not be able to compete successfully; and

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The regulatory environment in China and other countries relating to the Internet and Internet content providers, including online game developers and operators, may hinder or impair our ability to conduct our online gaming business as we intend.

These risks are not exhaustive. We operate in an emerging and evolving environment. New risk factors emerge from time to time and it is impossible for our management to predict all risk factors, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results of this annual report to differ materially from those contained in any forward-looking statement.

We would like to caution you not to place undue reliance on forward-looking statements and you should read these statements in conjunction with the risk factors disclosed under Item 1A. Risk Factors of this annual report. We do not undertake any obligation to update or revise the forward-looking statements except as required under applicable law.

PART I

ITEM 1. INFORMATION ON THE COMPANY.

Development of the business

During the fiscal year 2012 Surna Inc. had two direct operating subsidiaries: Surna Media Inc., and its subsidiary companies, (Surna Media) and, until its sale on March 27, 2012, Surna Networks, Inc., and its subsidiary company, (Surna Networks). Surna Media s principal business is the development of web and mobile games and social networks. Surna Network s principal business was telecommunications services, IT support services and open-source software development.

We were incorporated in the State of Nevada on October 15, 2009. As a part of our business plan at inception, we had intended to develop commercial software applications related Complex Event Processing (or CEP), with a specific focus on enhancing existing open-source applications in the specialist field of Geospatial Complex Event Processing (GCEP). CEP is an information analysis technique that helps discover information that can be inferred by analyzing and correlating aspects of many other pieces of information, and the Geospatial component in GCEP adds a geographic-location based component to the correlations that can be made within different sets of data.

To support this development, on October 16, 2009 we sold 75,000,000 shares of common stock to 7bridge Capital Management Limited for $15,000. Beginning in September, 2010 and to November, 2010 the company placed 4,175,000 shares at $0.02 per shares to 51 new private shareholders and raised $83,500, excluding expenses. On May 16, 2011, we declared a stock dividend of 4 new shares for each 1 share held with a record date of May 18, 2011. These additional shares were issued immediately after the record date. On May 18, 2011 our Board of Directors and stockholders approved an increase in authorized capital from 100,000,000 common shares to 350,000,000 common shares.

The first software we developed, the open-source GCEP Engine Version 0.1 was released on April 22, 2010. The term open-source describes practices in the production, development and licensing of software that promote access to the product s source material and computer source code, and the end product is freely available to anyone, and anyone can use or modify the software within the restrictions of the particular license the software was distributed under. As an open source release we cannot charge, and are not charging, for the GCEP Engine itself. After this initial open source release we had planned to further develop commercial software applications and consulting services related to internal corporate software controls and real-time tracking of resources. However were unable to identify any specific markets or customers for these potential products, and we have not so far been able to develop any applications utilizing the GCEP Engine. We had intended to continue to explore opportunities in this field through our Surna Networks subsidiaries, but with the sale of this business in March 2012 we have no further plans for the development of the GCEP Engine or CEP software applications.

We completed two acquisitions from related parties during 2011 pursuant to which we expanded the scope of our business by entering the online gaming market in the PRC. First, on June 20, 2011 we completed an agreement for the purchase of computer equipment located in the PRC from Kopere Limited (Kopere), a Hong Kong company controlled by Cherry Ping-Wai Lim, one of our controlling shareholders and directors, in exchange for the issuance to Ms. Lim of 200,000 common shares. In September 2011, we entered the online gaming business by acquiring Flying Cloud Information Technology Co. Ltd. (Flying Cloud), a PRC Wholly Foreign-Owned Entity (a WFOE) operating in Guangzhou that is in the business of developing online and mobile games. We completed this acquisition through a share exchange with the shareholders of Surna Media Inc., a corporation organized under the laws of the British Virgin Islands (BVI) and the indirect parent company of the PRC entity. Through the share exchange, we issued 20,000,000 of our common shares in exchange for all the shares of Surna Media Inc. The prior shareholders of Surna Media Inc. included Lim Clarke & Co Limited, a company owned and controlled by our directors (Lim Clarke).

As a result of these acquisitions and disposals, we now operate in one reportable segment for financial reporting purposes, our online and mobile gaming business, though prior to 27 March, 2012 we had operated in two reportable segments, the other being our network services business. Further information regarding each segment is provided below.

Other significant developments in our business during our 2012 fiscal year included the following management changes. On March 15, 2012, Walter Hon-Chiu Lee was appointed Chief Financial Officer and principal accounting officer. Mr. Lee replaced Cherry Ping-Wai Lim, in those positions. On September 3, 2012 Walter Hon-Chiu Lee resigned as Chief Financial Officer and principal accounting officer and was replaced in these positions by Man-Chor Poon.

Operating segments

We currently operate in one distinct business segment through our international subsidiary Surna Media Inc. (Surna Media), although prior to March 27, 2012 we operated in two distinct business segments when including the business of or former international subsidiary Surna Networks Limited (Surna Networks). Surna Media s principal business is the development of online and mobile games and social networks. Surna Network s principal business is VoIP telecommunications services. For the year ended December 31, 2012 our online game business generated revenues of $310 and realized losses of $767,365, The following depicts the current structure of our operations:

Qoo Games Limited was incorporated in Hong Kong on February 21, 2012 and purchased by Surna Media Inc. in August, 2012. It was intended that this company operate as the publisher of mobile games, including for the iOS and Android operating systems, but to-date it has not commenced operations.

Game development and publishing

Our development efforts have focused on two main areas that span both the web and mobile platforms: firstly, games developed in conjunction with animated television series; and secondly, more traditional products targeted at a teenage and young-adult male audience. Of the online and mobile games we had in development in 2012, the games related to animated series are:

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Ori-Princess, a game 2D side-scrolling role-playing game with characters from the popular Chinese animated television series Ori-Princess, targeted primarily at teenaged girls and young women.

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Ori-Princess: Spring Cleaning, a single-player pattern-matching game for iPhone and Android mobile devices.

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Hamsterland, a social network and online game designed for young children and pre-teens with characters from a children s animated series.

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Hamsterland Mobile, a single-player game for iPhone and Android.

Of the online and mobile games we had in development in 2012, the traditionally-themed games for the PRC market are:

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Serica, an ARPG online game based on a Chinese fantasy theme and featuring realistic-style graphics and martial-art fighting.

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Demon Immortal a Chinese-mythology themed game in a super-deformed cartoon style (known as SD) designed to appeal to female and younger users.

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Qia Ke Zhong Shi (Legend of the Kung-Fu Masters), an ARPG game utilizing game-play elements from Demon Immortal but with a narrative and style influenced by kung-fu novels, and targeted at a more general audience.

Contractual arrangements for character licensing and game development

The development of *Hamsterland* has been contracted to Flying Cloud by Shuren Limited, a BVI corporation (Shuren), which is owned and controlled by Lim Clarke & Co Limited, a BVI corporation controlled by our Directors and which is the majority shareholder of Surna Inc (Lim Clarke). Shuren holds a license to utilize the hamster cartoon characters for online games, mobile games and social networks. Development work on *Serica* and *Qia Ke Zhong Shi* was contracted by Flying Cloud to YouQu Interactive (Beijing) Technology Co. Ltd., a company controlled by Yeah YE, a consultant to Flying Cloud (YouQu). The completion date to beta-test stage for *Serica* was April 2012 and for *Qia Ke Zhong Shi* in August 2012. Development work on *Ori-Princess: Spring Cleaning* was contracted by Flying Cloud to Guangzhou Nine Leaf Network Technology Co. Ltd.

Online Game publishing in the PRC

As the copyright ownership of online games that are to be distributed in the PRC is restricted to domestic PRC entities (that is, a natural person who is a citizen or corporations that are not foreign-invested), commercial distribution of any products that are the copyright of our subsidiary corporation in the PRC, Flying Cloud Information Technology Co. Ltd. (Flying Cloud) as a foreign-owned entity, would not be possible. Accordingly, the copyright, for the PRC only, for our online games is held in-trust for Flying Cloud by Jurun Information Technology (Shanghai) Co. Ltd. (Jurun). Jurun is incorporated in Shanghai and its equity interest is owned by two PRC citizens, who hold the company in-trust for a British Virgin Islands (BVI) corporation, Evident Games Limited (Evident), through a series of contractual arrangements that make Jurun a Variable Interest Entity (VIE) of Evident. Evident is in turn controlled by Lim Clarke & Co, the majority shareholder of Surna Inc.

Publishing rights for the Simplified Chinese versions of the game were licensed by Jurun to Beijing Kunlun World Wide Technology Share Co., Ltd., an enterprise organized under the laws of the PRC (Kunlun). On March 19, 2012, Flying Cloud entered into a Technical Services agreement (the Technical Services Contract) with Jurun, in a transaction that is effectively a licensing of the Simplified Chinese version of the game. An exclusive, global license to publish the Simplified Chinese version of the game has been granted by Jurun to Kunlun for a term of 5 years from date of the commencement of commercial operations, which was July 12, 2012 The terms of the Technical Services Contract between Jurun and Flying Cloud mirror the terms of Jurun s licensing agreement with Kunlun, and provide for Flying Cloud to receive the full economic benefit of the licensing of the Simplified Chinese version of the game. Under the terms of the contract for development work that was undertaken on the game, 20% of the income derived from the game by Surna is due to YouQu. It was expected at the time that licenses for the Traditional Chinese and Korean versions of the game would be granted to Kunlun as well, but in the end Jurun did not proceed with finalizing these agreements.

Mobile game publishing in the PRC

There are no similar restrictions in the PRC on the publishing of games for mobile devices, and therefore these games are the copyright of Surna Inc. worldwide, including in China, and will be published on the Apple Appstore and Google Play and other Android app markets by Surna. It is our intention to transition these operations to our newly incorporated subsidiary Qoo Games Limited in 2013.

Game engines

The 2.5D ARPG games (except *Serica*) use our *Tempest* game and client engines. Game engines are a core software component for online games running on the web server, and provide the main processing functions for the computation and display of on-screen action. Our Tempest game engine is written in the C++ programming language and its features include load balancing, module message distribution, attributes server, particle effects and real-time data backup. The client engine features centralized management and monitoring, map editors, dynamic map loading and rendering and custom attributes. Serica utilizes an engine we refer to as *Tempest A (MudRV)* that was developed by YouQu, and for which we have been granted a license for its use in the game. An updated *Tempest 2* engine was in development, but work on this was suspended along with the cessation of other game development efforts.

Current status of games

Results from our game development business in the PRC have to-date been very disappointing.

Ori-Princess

The Ori-Princess role-playing game was being developed by our team in Shenzhen, with work commencing in April 2012. Development progress through September had not kept pace with the planned milestones, and there were significant disagreements between management and the development team regarding the expected and specified game design, game features, and its visual style. With management having little confidence that the development team would be able to deliver a product in-line with the original expectations, and with no readily available supplement or substitute for the functions they performed, the project was suspended indefinitely on November 9, 2012, and the employment of all development staff terminated. It is our intention to explore options for either working with other game developers to complete this project or engaging new development personnel to restart the development program, but so far we have not reached any arrangements for this.

Ori-Princess: Spring Cleaning

Development of the iPhone version was completed in October 2012 and it was published on the Apple Appstore from 25 October, 2012. Sales from release through December 31, 2012 totaled $23. This product was intended to be a market teaser and audience driver for the online role-playing game. With the suspension of development of the online game, and no date for its release, there is little independent rational for expending funds on a marketing effort for this product at this time. We have had discussions with third-party mobile publishers in the PRC about publishing an advertising supported version of the game, but to date these have not resulted in any final contracts.

Hamsterland

The Hamsterland animated TV series, on which the online social network and game was based, was originally intended to air in the PRC during March 2012. After repeated delays it was not actually released on China Central Television s (CCTV) national animation channel until July 23, 2012, and was then pulled by CCTV after only one week.

Several Flash mini-games from the *Hamsterland* online social network and game were launched on leading mini-game publishing sites in the PRC, and met with a very favorable audience response. However, given the short lead-time available in the run-up to the final air-date, it was not possible to organize any significant online marketing campaign to accompany the game s launch in coordination with the TV series. With the early termination of the TV series by CCTV, the online game also lost the key driver for new-user creation and was unable to develop any critical mass necessary to develop its social functionality. Given these developments we have determined that it is not worthwhile expending further resources on this product at this time, and on-going development work and operations for the game were suspended indefinitely in December 2012.

Hamsterland Mobile

Development work on this mobile game was stopped with the suspension of the *Hamsterland* online social network and game. There are currently no plans to continue with the development of this product unless the online game resumes operations.

Serica

Publishing rights for the Simplified Chinese version of the game were licensed to Kunlun (through Jurun) in March 2012, with the first payment of RMB 300,000 due on April 1, 2012, and with subsequent payments of RMB 500,000 in May and RMB 200,000 in July, 2012. Kunlun commenced charging for the game on July 12, 2012, which constituted the start of commercial operations. To-date no payment has been received from Kunlun for any part of the licensing of the game. On January 7, 2013 Jurun, as the official licensor, engaged Receivables Management Services (HK), Limited (RMS) to attempt to recover all or some of the amounts owed. RMS s collection efforts have to-date not met with success, and we are currently considering what further actions it would be beneficial for us to pursue regarding this game.

Demon Immortal

The game was first published in Hong Kong from June 30, 2011 but did not achieve significant results in what was expected to be a key market for this style of game. It is our view that, in light of the continual failure of the game to find an audience, along with its now dated game-play features (due largely to the fact that it has not been significantly updated for over a year), means that it is not worthwhile expending further effort on the development or marketing of this product.

Qia Ke Zhong Shi (Legend of the Kung-Fu Masters)

As of August 2012 development work on this game had largely been completed, however YouQu refused to continue any further with its contracted development work or provide the game or agree to support the finished product. Flying Cloud requested from YouQu delivery or return of all the contracted work product, including up-to-date source code, documentation and art work on September 25, 2012; but to date this has not been forthcoming. We are currently considering what further actions it would be beneficial for us to pursue regarding this game, including its continued development, and licensing or selling it to a third-party developer or publisher.

Our former network services business

Our former subsidiary Surna Networks was established to develop and provide a range of information technology and network services for potential customers, including game companies inside and outside of the PRC, but its business has focused solely on wholesale carrier services utilizing VoIP telecommunications, which is also referred to as International Simple Resale (ISR). We had approximately 30 ISR customers who were a mix of Tier-1 and Tier-2 carriers, and also calling-card operators, but results of this business were disappointing and we did not foresee it being self-supporting or profitable without further significant investment.

Upon further review during the first quarter of 2012 the Board determined that it was not relevant to our core business or future plans, and that the best strategy was the sale or winding-up of this business line. On March 27, 2012, having determined that there was no intrinsic value in the current ISR operations, we entered into a Share Sale Agreement with Kam-Ming Chan for the sale of all of the issued and outstanding shares of Surna Networks, Inc. for the par value of the issued shares of US$1.

Strategy

Online and mobile gaming strategy

All of these games are expected to be free-to-play for the user, with revenue being generated through the purchase by the player of in-game items and upgrades. Depending on the negotiated commercial terms, game publishers would normally undertake to support marketing and other operating costs, and the game developer would receive a revenue and/or profit share from them. If we cannot secure any such contractual arrangements, or if the publishers are not successful in their efforts, we will not be able to derive any significant revenues from these games.

We intend to pursue opportunities to grow our business by continuing to work with third-party publishers to market the games we have developed, primarily in the PRC, Taiwan and Hong Kong. If resources become available, we may restart development of some or all of the products which are currently suspended; or, if we are able to secure favorable terms, we may work with other developers to finish or modify them.

Revenue

We are a start-up company and to-date have not realized significant revenues. Our revenues for the year ended December 31, 2012 was $310.

Target Markets

At present we have limited financial resources and this may restrict or render ineffective the marketing and advertising program that we will need to undertake to market our products, which may materially effect our operations. It is our intention to focus on the PRC and overseas markets. Our primary target customers for online and mobile gaming are young adults, female game players, students and office workers. As game developers we intend to reach the end-user for online games through the licensing of our products to independent publishers, however we may at some point choose to supplement there efforts with online advertising, including display ads, paid search ads, and social media marketing campaigns. For mobile games we publish directly to the customer through the major mobile applications marketplaces.

Proprietary Rights

We have no patents or trademarks to protect our software. We hold the copyright on the online games we have developed through Surna Hongkong Limited, but we protect these products this only to the extent we can keep the source code a secret.

Publishing and copyright of games in China

The copyright ownership of online products, including online games, that are to be distributed in the PRC is restricted to domestic PRC entities (that is, a natural person who is a citizen or corporations that are not foreign-invested). As a WFOE, products that are the copyright of Flying Cloud in the PRC would not be permitted to be the subject of commercial distribution. To avoid this, the copyright for the PRC for Flying Cloud products is held in trust by a domestic PRC company, Jurun Information Technology (Shanghai) Co. Ltd. (Jurun).

Jurun is incorporated in Pudong, Shanghai and its equity interest is owned by two PRC citizens, who hold the company in-trust for a BVI company, Evident Games Limited (Evident), through a series of contractual arrangements that make Jurun a Variable Interest Entity (VIE) of Evident. Evident is in turn 52% owned and controlled by Lim Clarke. Jurun owns the entire equity interest of another PRC company, Shenzhen Tengyu Network Technology Co. Ltd. (Tengyu), which holds the licenses necessary to publish online products in the PRC.

Insurance

We do not maintain any insurance and do not intend to maintain insurance in the future. Because we do not have any insurance if we are made a party to a liability action we may not have sufficient funds to defend the litigation. If that occurs a judgment could be rendered against us that could cause us to cease operations.

Market strategies and risks

See Risk Factors and Special Note Regarding Forward-Looking Statements for a discussion of these and other risks and uncertainties associated with our business and investing in our ordinary shares.

Properties

We own no property. We maintain an executive office in Hong Kong where the space dedicated to Surna is approximately 50 sq/ft and is taken on a month-to-month basis. All previous office leasing arrangements in the PRC were terminated in December 2012.

Limited operating history; liquidity and capital resources; need for additional capital

We are a start-up company and have not yet generated significant revenues from our business operations. Our auditors have issued a going concern opinion; this means that our auditors believe there is substantial doubt that we can continue as an on-going business for the next twelve months unless we obtain additional capital. Accordingly, we must raise cash from sources other than operations. Our only other source of funds at this time is further investment by existing shareholders or others in our company. We are seeking equity financing to provide for the capital required to implement our operations. We have no assurance that future financing will be available to us on acceptable terms. If financing is not available on satisfactory terms, we may be unable to continue, develop or expand our operations. Equity financing could result in additional dilution to existing shareholders. If we cannot raise additional funds, we will either have to suspend operations until we raise sufficient capital, or cease operations entirely.

There is no historical financial information about us upon which to base an evaluation of our performance. Our business is subject to risks inherent in the establishment of a new business enterprise, including limited capital resources and possible cost overruns due to price and cost increases in services and products, and we cannot guarantee we will be successful in our business operations.

To become profitable and competitive, we have to locate and negotiate agreements with game publishers and other partners to have them offer our products for sale on acceptable terms.

Seasonality and Cyclicality

We do not believe we will be impacted by seasonal changes, however; expenditures by direct marketers and advertisers tend to vary in cycles that reflect overall economic conditions as well as budgeting and buying patterns. It is possible that we may see some fluctuation in future revenues derived from online game products played by school-aged children in the PRC in that online playing time is likely to peak during summer and winter school vacation periods, which usually occur in the first and third quarters of each year. We may also expect the Chinese New Year holidays, which occurs in the first quarter of each year, to affect playing time and online expenditure by players, especially children who may have extra pocket money at these times.

Competition

Online game development

There is strong and increasing competition in the online game market, both in China and overseas. Larger online game developers and operators in China include companies such as: Shanda Games, NetEase, Changyou, Giant Interactive, The9, Tencent, Kingsoft, NetDragon, and Perfect World. Other competitors include smaller game developers and operators in China and the overseas markets where we plan to offer our games.

We believe that there are a number of competing developers and operators in China providing games and virtual worlds and other forms of online and offline entertainment to young adults and children. Given the relatively low capital requirements and entry barriers to operating virtual worlds, we expect more companies to enter the online gaming industry in China and a wider range of internet games targeting a similar group of players to be introduced to the China market in a relatively short period of time.

Many of our existing and potential competitors have significantly greater financial and marketing resources than we do, and we may not be able to grow or maintain our revenues or achieve profitability as we operate in a highly competitive industry and compete against many companies.

Research and Development

We only conduct research and development in so far as we have developed the source code and functionality of online games, mobile games or game engines. These software products are written in the C++ or Objective-C programming languages, which are then integrated with an HTML and/or Flash front-end user interface.

Government Regulation

We are not currently subject to direct federal, state or local regulation other than regulations applicable to businesses generally or directly applicable to electronic commerce. However, the Internet is increasingly popular. As a result, it is possible that a number of laws and regulations may be adopted with respect to the Internet. These laws may cover issues such as user privacy, freedom of expression, pricing, content and quality of products and services, taxation, advertising, intellectual property rights and information security. Furthermore, the growth of electronic commerce may prompt calls for more stringent consumer protection laws. Several states have proposed legislation to limit the uses of personal user information gathered online or require online services to establish privacy policies. The Federal Trade Commission has also initiated action against at least one online service regarding the manner in which personal information is collected from users and provided to third parties. We will not provide personal information regarding our users to third parties. However, the adoption of such consumer protection laws could create uncertainty in Web usage and reduce the demand for our products.

We not certain how business may be affected by the application of existing laws governing issues such as property ownership, copyrights, encryption and other intellectual property issues, taxation, libel, obscenity and export or import matters. The vast majority of such laws were adopted prior to the advent of the Internet. As a result, they do not contemplate or address the unique issues of the Internet and related technologies. Changes in laws intended to address such issues could create uncertainty in the Internet market place. Such uncertainty could reduce demand for services or increase the cost of doing business as a result of litigation costs or increased service delivery costs.

In addition, because our products will be available over the Internet in multiple states and foreign countries, other jurisdictions may claim that we are required to qualify to do business in each such state or foreign country. Our failure to qualify in a jurisdiction where it is required to do so could subject it to taxes and penalties. It could also hamper our ability to enforce contracts in such jurisdictions.

Employees

We have 3 part-time staff who are based in Hong Kong. All other staff, which numbered 27 and were PRC residents who were engaged by our subsidiaries Surna HK or Flying Cloud, though a PRC outsourced services company, Beijing Foreign Enterprise Human Resources Service Co., Ltd (FESCO), were dismissed on November 9, 2012.

ITEM 1A.

RISK FACTORS.

A.

Risks associated with our Company:

1.

Because our auditors have issued a going concern opinion and because our officers and directors might not loan any additional money to us, we may not have enough money to continue and may have to cease operations.

Our auditors have issued a going concern opinion. This means that there is doubt that we will be an ongoing business for the next twelve months. Because our officers and directors might at any point be unwilling to loan or advance any additional capital to us we may not have enough money to continue operating and may have to either raise more money in the future or cease operations entirely, and you may lose all or part of your investment.

2.

We are solely dependent upon the funds we have raised so far and the support of our majority shareholders to continue our operations, which may be insufficient to achieve significant revenues, and we may need to obtain additional financing which may not be available to us.

We may require additional cash resources to finance our continued growth or other future developments, including any investments or acquisitions we may decide to pursue. We may need additional funds to complete further development of our business plan to achieve a sustainable sales level where ongoing operations can be funded out of revenues.

3.

We may be unable to secure additional funding in the future or to obtain such funding on favorable terms.

The amount and timing of such additional financing needs will vary principally depending on the timing of new product launches, investments and/or acquisitions, and the amount of cash flow from our operations. If our resources are insufficient to satisfy our cash requirements, we may seek to issue additional equity or debt securities or obtain a credit facility. The issuance of additional equity securities or securities convertible into our ordinary shares could result in additional dilution to our shareholders. The incurrence of indebtedness would result in increased debt service obligations and could result in operating and financing covenants that would restrict our operations. Our ability to obtain additional capital on acceptable terms is subject to a variety of uncertainties. Financing may not be available in amounts or on terms acceptable to us, if at all, especially if there is a recession or other events causing volatilities in the capital markets worldwide.

4.

Even if we obtain more customers, there is no assurance that we will make a profit.

Even if we obtain more customers, there is no guarantee that we will be able to attract enough customers to buy our products and services for us to operate profitably. Because we are a small company and do not have much capital, we must limit our products services. Because we will be limiting our marketing activities, we may not be able to attract enough customers to buy our products to operate profitably. If we cannot operate profitably, we may have to suspend or cease operations.

5.

Because our officers and directors have limited formal training or experience in financial accounting and management, there may not be effective disclosure and accounting controls to comply with applicable laws and regulations which could result in fines, penalties and assessments against us.

Our officers and directors have limited formal training or experience in financial accounting and management, however, they responsible for our managerial and organizational structure which will include preparation of disclosure and accounting controls under the Sarbanes Oxley Act of 2002. While our principal financial officer has limited formal training in financial accounting matters, they have been preparing the financial statements that have been audited and reviewed by our auditors. When the disclosure and accounting controls referred to above are implemented, he will be responsible for the administration of them. Should he not have sufficient experience, he may be incapable of creating and implementing the controls. Lack of proper controls could cause our financial statements to be inaccurate which will give us an incorrect view of our financial condition and mislead us into believing our operations are being conducted correctly. As a result, investors will be misled about our financial condition and the quality of our operations. This inaccurate reporting could cause us to be subject to sanctions and fines by the SEC which ultimately could cause you to lose your investment, however, because of the small size of our expected operations, we believe that he will be able to monitor the controls he will have created and will be accurate in assembling and providing information to investors.

6.

If we fail to establish or maintain an effective system of internal controls over financial reporting, we may be unable to accurately report our financial results or prevent fraud, and investor confidence and the market price of our shares may, therefore, be adversely impacted.

Our reporting obligations as a public company will place a significant strain on our management, operational and financial resources and systems for the foreseeable future. We will be required to prepare a management report on our internal controls over financial reporting containing our management s assessment of the effectiveness of our internal controls over financial reporting. In addition, depending on our market capitalization, our independent registered public accounting firm may be required to attest to and report on our management s assessment of the effectiveness of our internal controls over financial reporting. Our management may conclude that our internal controls over our financial reporting are not effective. Moreover, even if our management concludes that our internal controls over financial reporting are effective, our independent registered public accounting firm may still decline to attest to our management s assessment or may issue a report that is qualified if it is not satisfied with our controls or the level at which our controls are documented, designed, operated or reviewed, or if it interprets the relevant requirements differently from us.

7.

Our principal shareholders have substantial influence over our company and their interests may not be aligned with the interests of our other holders of our ordinary shares.

Our current officers and directors will be able to elect all of our directors and control our operations, which could decrease the price and marketability of the shares. Our directors, Mr. Richard Clarke and Ms. Cherry Ping-Wai Lim, beneficially own respectively 78.99% and 79.19% of our outstanding shares, or a combined total of 79.19% of the outstanding shares of our common stock. This concentration of ownership may discourage, delay or prevent a change in control of our company, which could deprive our shareholders of an opportunity to receive a premium for their shares as part of a sale of our company and might reduce the price of our shares. Alternatively, these principal shareholders may cause a merger, consolidation or change of control transaction even if it is opposed by our other shareholders.

As disclosed in more detail in this Annual Report on Form 10-K under Item 13, we have engaged in several transactions since our inception with affiliates of Mr. Clarke and Ms. Lim. These transactions have been negotiated and valued by Mr. Clarke and Ms. Lim without the benefit of independent directors or financial or legal advisors separately representing the interests of our Company. As a result, no assurance can be made that the prices paid or to be paid by the Company for the assets acquired or to be acquired were fair to our Company or its shareholders.

8.

We have a limited insurance coverage which could expose us to significant costs and business disruption.

We have not purchased any insurance to cover our assets, property and business. If we were to incur substantial losses or liabilities due to fire, explosions, floods, a wide range of other natural disasters or accidents or business interruption, our results of operations could be materially and adversely affected.

9.

Because the SEC imposes additional sales practice requirements on brokers who deal in shares that are penny stocks, some brokers may be unwilling to trade them. This means that you may have difficulty reselling your shares and this may cause the price of the shares to decline.

Our shares are classified as penny stocks and are covered by Section 15(g) of the Securities Exchange Act of 1934 and the rules promulgated thereunder which impose additional sales practice requirements on brokers/dealers who sell our securities in this offering or in the aftermarket. For sales of our securities, the broker/dealer must make a special suitability determination and receive from you a written agreement prior to making a sale for you. Because of the imposition of the foregoing additional sales practices, it is possible that brokers will not want to make a market in our shares. This could prevent you from reselling your shares and may cause the price of the shares to decline.

10.

Stock prices of companies with significant operations in China have fluctuated widely in recent years, and the trading prices of our shares are likely to be volatile, which could result in substantial losses to investors.

The trading prices of our shares are likely to be volatile and could fluctuate widely in response to factors beyond our control. In particular, the performance and fluctuation of the market prices of technology and other companies with business operations mainly in China that have listed their securities in the United States may affect the volatility in the price of and trading volumes for our ordinary shares. In recent years a number of PRC companies have listed their securities on U.S. stock markets. Some of these companies have experienced significant volatility, including significant price declines following their initial public offerings. The trading performances of these PRC companies securities at the time of or after their offerings may affect the overall investor sentiment towards PRC companies listed in the United States and consequently may impact the trading performance of our ordinary shares. These broad market and industry factors may significantly affect the market price and volatility of our ordinary shares, regardless of our actual operating performance.

In addition to market and industry factors, the price and trading volume for our ordinary shares may be highly volatile for specific business reasons. Factors such as variations in our revenues, earnings and cash flow, announcements of new investments, cooperation arrangements or acquisitions, and fluctuations in market prices for our services could cause the market price for our ordinary shares to change substantially. Any of these factors may result in large and sudden changes in the volume and price at which our ordinary shares will trade. We cannot give any assurance that these factors will not occur in the future.

B.

Risks associated with our Games business

1.

Our limited operating history makes it difficult to evaluate our business and prospects. We have incurred losses in the past and may experience losses in the future. If we cannot generate sufficient revenues to operate profitably, we may suspend or cease our operations.

We were incorporated on October 15, 2009 and since that date have not realized significant revenues. We started in the online gaming businesses in 2011 and have no operating history upon which an evaluation of our future success or failure can be made. Even if we generate revenues in the future, our limited operating history may not be able to provide a meaningful basis for you to evaluate our business.

It is also difficult to evaluate our prospective business, because we may not have sufficient experience to address the risks frequently encountered by early stage companies operating in a new and rapidly evolving industry, which may adversely affect our business and results of operations. These risks may include our potential failure to:

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retain existing users and attract new users;

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develop, license, or acquire additional games and virtual worlds that are appealing to users;

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anticipate and adapt to changing user preferences;

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adapt to competitive market conditions;

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timely respond to technological changes or resolve unexpected network interruptions;

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adequately and efficiently operate, upgrade and develop our online entertainment community;

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maintain adequate control of our expenses; and

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attract and retain qualified personnel.

Based upon current plans, we expect to incur operating losses in future periods. We expect to incur substantial costs and expenses to develop market and operate internet games and may not collect revenues in connection with the games for some time after its commercial launch or at all. Any failure or delay in generating revenues could result in material operating losses and harm our financial condition.

We cannot guarantee that we will be successful in generating revenues in the future. Accordingly, you should not rely on the results of any specific period as an indication of our future operating performance. Failure to generate revenues will likely cause us to suspend or cease operations.

2.

It is likely that we will depend on a limited number of internet games for the majority of our revenues, and if any of these games incur any adverse developments or if we are unable to develop, purchase or license additional games or virtual worlds that are attractive to users and result in overall revenue growth, our business, financial condition and results of operations may be materially and adversely affected.

Accordingly, any of the following could materially and adversely affect our business, financial condition and results of operations:

- failure by us to make quality upgrades, enhancements or improvements to the existing games and virtual worlds in a timely manner;
- delay in or discontinuation of regular content updates;
- any reduction in or failure to grow the user base of these existing virtual worlds, any decrease in their popularity in the market due to intensifying competition or other factors;
- any decrease in or failure to grow the amount of revenues generated from the existing virtual worlds; or
- any breach of virtual world related software security, prolonged server interruption due to network failures, hacking activities or other factors or any other adverse developments relating to our existing virtual worlds.

In addition, in order to achieve our long-term profitability and financial and operational success, we must continually develop, purchase or license new internet games that are attractive to users. Although we currently have new games and virtual worlds in development, they may not be released on time, may not be profitable or popular among gamers in China.

3.

The success of our internally developed internet games will require additional investment prior to commercial launch. Furthermore, our ability to purchase or license successful internet games will depend on their availability on acceptable terms, including price, our ability to compete effectively against other potential purchasers or licensees to attract the developers of these virtual worlds, and our ability to obtain government approvals required for the purchase or licensing and operation of these virtual worlds.

The games that we develop, purchase or license may not be attractive to users, may be viewed by the regulatory authorities as not complying with content restrictions, may not be launched as scheduled or may not compete effectively with our competitors products. If we are not able to successfully develop, purchase or license virtual worlds appealing to users, our future profitability and growth prospects will decline.

4.

We may not be able to maintain our revenues and profitability as we operate in a competitive industry and compete against many companies.

We believe that there are a number of competing developers and operators in China providing games and virtual worlds and other forms of online and offline entertainment to young adults and children. Given the relatively low capital requirements and entry barriers to operating virtual worlds, we expect more companies to enter the online gaming industry in China and a wider range of internet games targeting a similar group of players to be introduced to the China market in a relatively short period of time. Potential competitors also include major Internet portal operators, other domestic and foreign virtual world developers and operators, media companies focused on internet games development and alliances between our existing and new competitors. Some of our competitors, especially major foreign and China-based publicly listed media and internet games operators, have significantly greater financial and marketing resources and name recognition than we have. Our competitors may adopt loss-leading pricing or other tactics or business models, and if these prove to be more attractive to players on a temporary or permanent basis, our users may switch to our competitors services and products at our expense. We cannot assure you that we will be able to compete successfully against any new or existing competitors, or maintain our user base and number of active paying accounts when competitors launch promotional campaigns targeting our user base, which could have a material adverse effect on our revenues and profitability.

5.

We face risks and uncertainties regarding the growth of the online game industry and market acceptance of our games and virtual items.

The internet game industry, from which we expect to derive a large percentage of our revenues, is a relatively new and evolving industry and concept. The growth of the internet game industry and the level of demand and market acceptance of our internet games are subject to a high degree of uncertainty. Our future operating results will depend on numerous factors, some of which are beyond our control. These factors include:

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the growth of personal computer, Internet and broadband users and penetration in China and other markets in which we offer our virtual worlds, and the rate of any such growth;

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whether the online entertainment market in China, and in particular the online entertainment market for games, continues to grow and the rate of any such growth;

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general economic conditions, particularly economic conditions adversely affecting discretionary spending on children s entertainment;

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the availability and popularity of other forms of entertainment, particularly console system games;

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and our ability to timely update our existing virtual worlds and other services and introduce new games and virtual worlds and other services that attract existing and new users.

6.

If we fail to anticipate and effectively manage these risks and uncertainties, our market share may decrease, our business, financial condition and results of operations may be materially and adversely affected.

Our new games may attract our users away from our earlier games, and enhancements and updates to our established games may result in certain users deciding not to participate in them, which could materially and adversely affect our business, results of operations and financial condition.

Our new internet games may attract our users away from our earlier internet games, particularly with respect to games with similar story lines. Although we intend to target different types of users with new games and therefore minimize users of our existing internet games migrating to later launched internet games, such movement may nevertheless occur and may lead to fewer active users, reduced network effect and lower spending on subscriptions and virtual items.

In addition, in order to retain our existing users and to attract new users, we periodically introduce new features and make changes to our established virtual worlds based on feedback gathered from our users. However, these changes may result in some of our existing users deciding not to participate in our internet games, either temporarily or permanently. Our users may not respond well to enhancements to our games or policy changes in our online entertainment community, which could materially and adversely affect our business, results of operations and financial condition.

7.

We have no control over our distributors or licensees except through agreements we entered into with them. Our brands and reputation could be harmed and our results of operations could suffer if our distributors or licensees fail to comply with our agreements with them.

We rely on licensees and their distributors to distribute prepaid cards and virtual currencies, through which our users pay subscription fees or purchase online virtual items. We also rely on our licensees to manufacture and distribute products of our licensed franchises. We have limited ability to manage the activities of our distributors and licensees, who are independent from us, except through the enforcement of agreements with them. If a significant number of our distributors or licensees fail to comply with our agreements with them, such as distribution targets, brand and service promotion arrangements, quality control standards, or protocols on approving the presentation or portrayal of our franchises, our brands and reputation could be harmed and our results of operations could suffer as a result.

8.

We may not be successful in effectively promoting our brand or enhancing our brand recognition, and any negative publicity, regardless of its veracity, may harm our brand.

There is no assurance that we will be able to effectively promote or develop our brand and if we fail to do so, our growth may be adversely affected. In addition, negative publicity or disputes regarding our brand, products and services, company or management could materially and adversely affect public perception of our brand and the virtual worlds and other products and services we offer. Any negative publicity in relation to our services or products, regardless of its veracity, could harm our brand image among children and their parents and, in turn, result in decreases in the number of users and average net revenues per paying account from the operation of our online business. Any impact on our ability to effectively promote our brand and any significant damage to the public perception of the Surna brand or our internet games could materially and adversely affect our prospects and results of operations.

9.

Unauthorized use of our intellectual property by our distributors, licensees or third parties, and the expenses incurred in protecting our intellectual property rights, may harm our brands and reputation and adversely affect our business.

We regard our copyrights, trademarks and other intellectual property as critical to our success. Unauthorized use of our intellectual properties may harm our brands and reputation and adversely affect our business.

Although our contracts with distributors and licensees will prohibit the unauthorized use of our franchises, brands and other intellectual property rights, we cannot assure you that they will always comply with these terms. Although we presently enter into confidentiality agreements with most of our employees, we cannot assure you that these confidentiality agreements will not be breached, that we will have adequate remedies for any breach, or that our proprietary technology, know-how or other intellectual property will not otherwise become known to, or be independently developed by, third parties.

We currently have no trademark registrations in China. However, we have registered more than 10 domain names, including surna.com, our primary operation website. While we actively take steps to protect our proprietary rights, such steps may not be adequate to prevent the infringement or misappropriation of our intellectual property. In addition, we cannot assure you that any trademark applications will ultimately proceed to registration or will result in registration with adequate scope for our business. If our trademark applications, were we to make any, are not successful we may have to use different marks for affected products or services, or seek to enter into arrangements with any third parties who may have prior registrations, applications or rights, which might not be available on commercially reasonable terms, if at all.

Implementation of intellectual property laws in China has historically been lacking, primarily because of ambiguities in the laws and difficulties in enforcement. Accordingly, intellectual property right protection in China may not be as effective as in the United States or other countries. Policing unauthorized use of our proprietary technology, trademarks and other intellectual property is difficult and expensive, and litigation may be necessary in the future to enforce our intellectual property rights. Future litigation could result in substantial costs and diversion of our resources, and could disrupt our business, as well as have a material adverse effect on our financial condition and results of operations.

10.

We will rely on a distribution network for a significant portion of our revenues. If we fail to effectively manage our distributor relationships or our distributors fail to adhere to our agreements with them, our results of operations could suffer as a result.

Online payment systems in China are still in a relatively early stage of development. Also, compared to adult online users, children have fewer means to make payment through online payment channels. As a result, although we make prepaid cards and top-up available for purchase online using an online payment system, our business is expected to be dependent on the performance of distributors. Maintaining relationships with a significant number of distributors may be difficult and time-consuming. If we fail to maintain good relationships with, or to effectively manage, our distributors, if these distributors do not strictly adhere to our agreements with them or provide targeted distribution in locations frequented by target users, or if the distributors promote our competitors service and products at our expense, our results of operations could suffer as a result.

11.

Unauthorized character enhancements, other hacking or cheating activities, and undetected programming errors or defects in our virtual worlds could harm our online business and reputation and materially and adversely affect our results of operations.

With the increase in the number of players users in China, game operators have increasingly encountered problems arising from the use of unauthorized character enhancements, theft of user account passwords and other hacking or cheating activities. We expect to detect a number of users who may gain an unfair advantage by installing hacking or cheating tools to facilitate character progression. In response to these activities, we plan to install detection mechanisms in our games and virtual worlds to identify various hacking and cheating activities, and have expanded our technical team dedicated to detecting unauthorized character enhancements and resolving other hacking issues.

In addition, our internet games may contain undetected programming errors or other defects. Continued occurrences of unauthorized character enhancements, other hacking or cheating activities, and undetected errors or defects in our games may negatively impact the image of our games and users perception of their reliability, decrease the number of users, reduce the users interest in purchasing virtual items, shorten the life span of the games and adversely affect our results of operations. A constant recurrence of these activities may require us to shift our management s and personnel s attention from research and development and other operations to focus instead primarily on anti-hacking programs and activities, which could hurt our ability to develop and launch new games and could materially and adversely affect our business, financial condition and results of operations.

12.

If we fail to successfully execute our growth strategies, including our current expansion into other business areas, our future results of operations and growth prospects may be materially and adversely affected.

As part of our growth strategy, plan to enter into more media fields or license to makers broader categories of consumer products. We may adopt the business model of procuring and re-selling products bearing our franchises, instead of licensing our franchises. Expansion into these or other new businesses or adoption of these and other new business models present operating and marketing challenges that are different from those that we currently encounter. We face competition from existing players within these markets who may have more experience and resources. We may need to satisfy different regulatory requirements and obtain additional licenses or permits from relevant regulatory authorities. If we cannot successfully address these new challenges and compete effectively in these markets or under these business models, we may not be able to enter into or operate these offline businesses, attract a sufficiently large number of audience or customers, or recover costs incurred for developing and marketing these products or services, and our future results of operations and growth strategies could be materially and adversely affected as a result. Pursuing these and other growth strategies may also require us to expand our operations through internal development efforts and through partnerships, joint ventures, investments and acquisitions. If we are unable to successfully implement our growth strategies, our revenue and profitability may not grow as we expect, and our competitiveness may be materially and adversely affected.

13.

We may undertake acquisitions, investments, joint ventures or other strategic alliances, which could have a material adverse effect on our ability to manage our business. In addition, such undertakings may not be successful.

Our strategy includes plans to grow both organically and through acquisitions, joint ventures or other strategic alliances. Joint ventures and strategic alliances may expose us to new operational, regulatory and market risks, as well as risks associated with additional capital requirements. We may not be able to identify suitable future acquisition candidates or alliance partners. Even if we identify suitable candidates or partners, we may be unable to complete an acquisition or alliance on terms commercially acceptable to us. If we fail to identify appropriate candidates or partners, or complete desired acquisitions, we may not be able to implement our strategies effectively or efficiently.

In addition, our ability to successfully integrate acquired companies may be adversely affected by a number of factors. These factors include diversion of management s attention, difficulties in retaining personnel of the acquired companies, unanticipated legal liabilities, and tax and accounting issues in association with the acquisition and business combination. If we fail to integrate acquired companies efficiently, our earnings, revenues growth and business could be negatively affected.

Furthermore, the acquired companies may not perform to our expectations for various reasons, including legislative or regulatory changes that affect the products in which the acquired companies specialize, and the loss of personnel. If we are not able to realize the benefits envisioned for such acquisitions, our business and results of operations could be materially and adversely affected.

14.

Our limited resources may affect our ability to manage our growth.

Our growth to date has placed, and our anticipated further expansion will continue to place, a significant strain on our management, systems and resources. We intend to increase our employee headcount even further by adding development personnel and customer service representatives. To accommodate our growth pursuant to our strategies, we anticipate that we may need to implement and maintain a variety of new and upgraded operational and financial systems, procedures and controls, and to improve our accounting and other internal management systems, all of which require substantial management efforts. We also will need to continue to expand, train, manage and motivate our workforce, and manage our relationships with our users, our distributors and third-party product and service providers. All of these endeavors will require substantial management effort and skill and the incurrence of additional expenditures. We cannot assure you that we will be able to efficiently or effectively implement our growth strategies and manage the growth of our operations, and any failure to do so may limit our future growth and hamper our business strategy.

15.

Our failure to anticipate or successfully implement new technologies could render our game engines, development platforms or games unattractive or obsolete, and reduce our revenues and market share.

Our proprietary engines for powering our games and our software framework are critical to our success. The game and virtual world industry is subject to rapid technological changes. We need to anticipate the emergence of new technologies and assess their market acceptance. We also need to invest significant resources, including financial resources, in research and development to keep pace with technological advances in order to make our development capabilities and our virtual worlds competitive in the market. However, development activities are inherently uncertain, and we might encounter practical difficulties in commercializing our development results. Our expenditures on research and development may not generate corresponding benefits. Given the fast pace with which game and virtual world technology has been and will continue to be developed, we may not be able to timely upgrade our engines or the software framework for our virtual world development in an efficient and cost-effective manner, or at all. New technologies in virtual world programming or operations could render our technologies, our existing virtual worlds or the virtual worlds that we are developing or expect to develop in the future obsolete or unattractive, thereby limiting our ability to recover related product development costs, purchase costs and licensing fees, which could result in a decline in our revenues and market share.

16.

We may be subject to intellectual property infringement claims, which could be time-consuming and costly to defend and may result in diversion of our financial and management resources and our inability to continue providing some of our existing virtual worlds.

We cannot assure you that our game and virtual world characters, our plots, or other content posted on our websites, has not infringed or will not infringe upon patents, valid copyrights or other intellectual property rights held by third parties. We may be subject to legal proceedings and claims from time to time relating to the intellectual property of others in the ordinary course of our business within the relevant statute of limitation. If we are found to have violated the intellectual property rights of others, we may be enjoined from using such intellectual property, be forced to pay fines and damages, and we may incur licensing fees or be forced to develop alternatives. In addition, we may incur substantial expenses and diversion of our financial and management resources in defending against these third-party infringement claims, regardless of their merit. Successful infringement or other intellectual property rights claims against us may result in substantial monetary liabilities, which may disrupt our operations and materially adversely affect our business, results of operations and prospects.

Some of our employees were previously employed at other companies, including our current and potential competitors. We also intend to hire additional personnel to expand our development team and technical support team. To the extent these employees are involved in the development of content or technology similar to ours at their former employers, we may become subject to claims that such employees or we may have appropriated proprietary information or intellectual properties of the former employers of our employees. If we fail to successfully defend such claims against us, our results of operations could be materially and adversely affected.

17.

We could be liable for our users   privacy being compromised, which may have a material adverse effect on our reputation and business.

Although we seek to provide a safe playing environment for our users by implementing security mechanisms, our games and virtual worlds are likely to be subject to infiltrating from those who hack the accounts of our users to gain progression advantages, access these users   accounts, or for other purposes. A significant number of failures to prevent our users   exposure to such infiltration would severely harm our reputation and business.

18.

We could be liable for breaches of security of our website and third-party payment systems, which may have a material adverse effect on our reputation and business.

It is expected that some of our sales proceeds collected will be generated from sales of virtual currency through third-party payment systems. In such transactions, secure transmission of confidential information, such as users   debit and credit card numbers and expiration dates, personal information and billing addresses, over public networks, including our official website, is essential for maintaining user confidence. We currently provide password protection for all of our users   accounts. While we have not experienced any breach of our security to date, we still must prevent future breaches and current security measures may be inadequate. In addition, we expect that an increasing number of our sales will be conducted over the Internet as a result of the expanded user base and the growing use of online payment systems. We also expect that associated online crime will likely increase accordingly. We must therefore be prepared to increase our security measures and efforts so that our users have confidence in the reliability of the online payment systems that we use. We do not have control over the security measures of our third-party payment operators, and their security measures may not be adequate at present or may not be adequate with the expected increased usage of online payment systems. We could be exposed to litigation and possible liability if we fail to safeguard confidential user information, which could harm our reputation and our ability to attract users and may have a material adverse effect on our business.

19.

The successful operation of our business depends on the performance and reliability of the Internet infrastructure and fixed telecommunications networks in China.

Our business depends on the performance and reliability of the Internet infrastructure in China, and between China and the rest of the world. Almost all access to the Internet is maintained through state-owned telecommunication operators under the administrative control and regulatory supervision of the Ministry of Industry and Information Technology, or the MIIT. In addition, the national networks in China are connected to the Internet through international gateways controlled by the PRC government. These international gateways are the only channels through which a domestic user can connect to the Internet. Although the PRC government has pledged to improve the Internet infrastructure in China as part of its stimulus packaged introduced in the first quarter of 2009, a more sophisticated Internet infrastructure may not be developed in China. We or the users of our games and virtual worlds may not have access to alternative networks in the event of disruptions, failures or other problems with China s Internet infrastructure.

20.

Unexpected network interruptions, network security breaches or computer virus attacks could have a material adverse effect on our business, financial condition and results of operations.

Any failure to maintain the satisfactory performance, reliability, security and availability of our network infrastructure may cause significant harm to our reputation and our ability to attract and maintain users. All of the servers operating our games and virtual worlds, all of the servers handling log-in, billing and data back-up matters for us, and some of our backup servers are likely to be hosted and maintained by third-party service providers. Major risks involved in such network infrastructure include any break-downs or system failures resulting in a sustained shutdown of all or a material portion of our servers, including failures that may be attributable to sustained power shutdowns, or efforts to gain unauthorized access to our systems causing loss or corruption of data or malfunctions of software or hardware.

Our servers may experience unexpected outages and occasional slower performance in a number of locations in China as a result of failures by third-party service providers. Our network systems are also vulnerable to damage from fire, flood, power loss, telecommunications failures, computer viruses, hacking and similar events. Any network interruption, virus or other inadequacy that causes interruptions in the availability of our virtual worlds or deterioration in the quality of access to our virtual worlds could reduce our users satisfaction and ultimately harm our business and results of operations.

21.

We face risks associated with the licensing of our games and virtual worlds overseas, and if we are unable to effectively manage these risks, they could impair our ability to expand our business internationally.

We may license our existing and new products in other countries and regions outside of greater China in the future. The offering of our products in the international markets could expose us to a number of risks, including:

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difficulties in identifying and maintaining good relationships with licensees who are knowledgeable about, and can effectively distribute and operate our products in, international markets;

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difficulties in maintaining the reputation of our company and our products, given that our virtual worlds are operated by licensees in the international markets pursuant to their own standards;

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difficulties in protecting our intellectual property rights internationally and the associated costs;

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difficulties and costs relating to compliance with the different commercial, legal and tax requirements of the international markets in which we offer our products, such as foreign ownership restrictions, game import regulatory procedures, taxes and other restrictions;

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difficulties in translation and recompiling software for different languages;

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fluctuations in currency exchange rates; and

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interruptions in cross-border Internet connections or other system failures.

22.

Our business depends substantially on the continuing efforts of our management and other key personnel. If we lose their services, we could incur significant costs in finding suitable replacements and our business may be severely disrupted.

Our future success heavily depends upon the continued services of our management and other key personnel. If any of our management or key personnel quits, joins a competitor or forms a competing company, we may lose users, distributors, know-how and key professionals and staff members. Each of our executive officers has entered into employment agreements and confidentiality agreements and the majority of them have entered into non-competition agreements with us. However, if any dispute arises between our officers and us, the non-competition provisions contained in their non-competition agreements may not be enforceable, especially in China, where most of these executive officers and key employees reside, and this may be on the grounds that we have not provided adequate compensation to these executive officers for their non-competition obligations, which is required under the relevant PRC regulations. If lose enough experienced personnel and we do not or are not able to hire anyone to replace them, we could fail in our plan of operations and have to suspend operations or cease operations entirely.

23.

We may not be successful in attracting and retaining qualified personnel and our business and results of operations could be negatively impacted.

We will need to hire and retain additional qualified employees to support our existing operations and planned expansion. Our ability to anticipate and effectively respond to changing user needs depends in part on our ability to attract and retain experienced personnel for our online and offline businesses in technology, graphic design, operation and other functions. The effective operation of our information technology system, call center, logistics and other back office functions also depends in part on our professional employees.

Since our industry is characterized by high demand and intense competition for talent, we may need to offer higher compensation and other benefits in order to retain key personnel in the future. We cannot assure you that we will be able to attract or retain the qualified key personnel that we will need to achieve our business objectives. In addition, as our business has grown rapidly, our ability to train and integrate new employees into our operations may not meet the increasing demands of our business. If we need additional experienced personnel and we do not hire them, we could fail in our plan of operations and have to suspend operations or cease operations entirely.

24.

Our operating results will likely fluctuate from period to period, making them difficult to predict and not be indicative of future performance.

Our operating results from period to period are highly dependent upon, and will fluctuate as a result of a variety of factors, including:

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seasonal trends in revenue generation as a result of seasonal fluctuations of online play time, which peaks during summer and winter school vacation periods, which usually occur in the first and third quarters of each year when children have more online playtime, and falls during second and fourth quarters of each year, and generally increases during the Chinese New Year holidays, which occurs in the first quarter of each year, when children are given extra pocket money;

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the introduction of virtual worlds and other online and offline services and products;

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the quality, variety, popularity and mix of virtual items and online and offline services and products available for purchase and related promotional efforts;

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the period of time over which we recognize revenue for some of our virtual items in our virtual worlds, which in the future many be based on the estimated lifespan of our virtual items, which may be adjusted from time to time;

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content development costs and licensing or royalty payments; and

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the expansion of our distribution network and the related discounts and rebates.

Due to these and other factors, our operating results will vary from period to period, will be difficult to predict for any given period, may be adversely affected from period to period and may not be indicative of our future performance.

C.

Risks Related to Doing Business in China

1.

Changes in economic and political policies of the PRC government could have a material adverse effect on the overall economic growth of China, which could adversely affect our business.

Substantially all of our business operations are conducted in China. Accordingly, our business, results of operations, financial condition and prospects are subject to a significant degree to economic, political and legal developments in China. Growth of the Chinese economy also slowed in the second half of 2008 and early 2009. Any prolonged slowdown in the Chinese economy, in particular the information technology industry, could have a negative impact on our business, operating results and financial condition in a number of ways. For example, our users may decrease spending on our products, while we may have difficulty expanding our user base fast enough, or at all, to offset the impact of decreased spending by our existing users.

Although the Chinese economy is no longer a planned economy, the PRC government continues to exercise significant control over China s economic growth through direct allocation of resources, monetary and tax policies, and a host of other government policies such as those that encourage or restrict investment in certain industries by foreign investors, control the exchange between RMB and foreign currencies, and regulate the growth of the general or specific market. These government involvements have been instrumental in China s significant growth in the past 30 years. If the PRC government s current or future policies fail to help the Chinese economy achieve further growth or otherwise negatively affect our business, our growth rate or strategy, our results of operations could be adversely affected as a result.

2.

Uncertainties in PRC government policies and regulations regarding virtual worlds and online games and children s Internet use in China may adversely affect our business

In April 2007, the GAPP, the MII, the Ministry of Education, the Ministry of Public Security, and other relevant government authorities jointly issued a circular concerning the mandatory implementation of an addiction prevention program in virtual worlds and online games, which aims to protect the physical and psychological health of minors. This circular requires all virtual worlds to incorporate an addiction prevention program and an identity verification system, both of which limit the amount of time that a minor or other user may continuously spend participating in a virtual world or playing an online game. Failure to do so may subject us to certain penalties, such as suspension of Internet publishing operation and relevant Internet-access services or revocation of relevant licenses.

On June 3, 2010, the Ministry of Culture, or the MOC, adopted the Provisional Administration Measures of Online Games, or the Online Games Administration Measures, which became effective as of August 1, 2010. The MOC also issued a notice regarding the implementation of the Online Games Administration Measures. We are required to establish the identity verification systems within three months of the effectiveness of the Online Games Administration Measures for online games and virtual worlds which started operation after August 1, 2010, and within six months for those which started operation prior to August 1, 2010.

However, since the users of our internet games will in part be minors, the implementation of an identity verification system has practical difficulties, mainly because minors do not have PRC identity cards. We understand that the purpose of identity verification system required under the abovementioned circular issued in 2007 is to facilitate addiction prevention, hence, we plan to implement addiction prevention programs for all users of our games and virtual worlds.

In addition, a notice jointly issued by several central governmental agencies in February 2007 increased the punishment for Internet cafés admitting minors. As Internet cafés provide means for children to access the Internet especially in smaller cities, this restriction may adversely affect our plan for growth in these cities. Further strengthening of these regulations, or enactment by the PRC government of any additional laws to further tighten its administration over the Internet, online games, and, in particular, the Internet use and access to online games and virtual worlds by children, may result in less time spent by users or fewer users, which may materially and adversely affect our business results and prospects for future growth.

3.

The laws and regulations governing virtual worlds and online games in China are developing and are subject to future changes. If we or the third-party publishers we work with fail to obtain or maintain all applicable permits and approvals, our business and operations would be materially and adversely affected.

The online game industry in China is heavily regulated by the PRC government. Various regulatory authorities of the PRC central government, such as the State Council, the MIIT, the GAPP, the Ministry of Culture and the Ministry of Public Security, have the authority to issue and implement regulations governing various aspects of the online game industries.

As the online game industry is at an early stage of development in China, new laws and regulations may be adopted from time to time to require additional licenses and permits. As a result, uncertainties exist regarding the interpretation and implementation of current and future PRC laws and regulations applicable to games and virtual worlds. We may in the future be subject to various penalties, including fines and the discontinuation or restriction of our operations. Any such disruption in our business operations would materially and adversely affect our business, financial condition and results of operations. We cannot assure you that we will be able to timely obtain required licenses or any other new license required in the future, or at all. We cannot assure you that we will not be found in violation of any current or future PRC laws and regulations.

4.

Regulation and censorship of information disseminated over the Internet in China may adversely affect our business, and we may be liable for information displayed on, retrieved from, or linked to our Internet websites.

The PRC government has adopted certain regulations governing Internet access and the distribution of news and other information over the Internet. Under these regulations, Internet content providers and Internet publishers are prohibited from posting or displaying over the Internet content that, among other things, violates PRC laws and regulations, impairs the national dignity of China, or is obscene, superstitious, fraudulent or defamatory. Failure to comply with these requirements could result in the revocation of licenses and the closure of the concerned websites. The website operator may also be held liable for such prohibited information displayed on, retrieved from or linked to such website.

In addition, the MIIT has published regulations that subject website operators to potential liability for content included on their websites and the actions of users and others using their websites, including liability for violations of PRC laws prohibiting the dissemination of content deemed to be socially destabilizing. The Ministry of Public Security has the authority to order any local Internet service provider, or ISP, to block any Internet website maintained outside China at its sole discretion. Periodically, the Ministry of Public Security has stopped the dissemination over the Internet of information which it believes to be socially destabilizing. The State Secrecy Bureau, which is directly responsible for the protection of State secrets of the PRC government, is authorized to block any website it deems to be leaking state secrets or failing to meet the relevant regulations relating to the protection of state secrets in the dissemination of online information.

As these regulations are subject to interpretation by the relevant authorities, it may not be possible for us to determine in all cases the type of content that could result in liability for us as a content provider to the website operator. In addition, we may not be able to control or restrict the content of other Internet content providers linked to or accessible through our websites, or content generated or placed on our websites by our users, despite our attempt to monitor such content. To the extent that regulatory authorities find any portion of our content objectionable, they may require us to limit or eliminate the dissemination of such information or otherwise curtail the nature of such content on our websites, which may reduce our user traffic and have a material adverse effect on our financial condition and results of operations. In addition, we may be subject to significant penalties for violations of those regulations arising from information displayed on, retrieved from or linked to our websites, including a suspension or shutdown of our operations.

5.

There are currently no laws or regulations in the PRC governing property rights of virtual assets and therefore it is not clear what liabilities, if any, we may have relating to the loss of virtual assets by our users.

Users of our internet games acquire and accumulate some virtual assets, such as performance-enhancing items, clothing, accessories and other in-game items. Such virtual assets can be highly valued by users. In practice, virtual assets can be lost for various reasons, such as data loss caused by delay of network service by a network crash, or by hacking activities. There are currently no PRC laws and regulations governing property rights of virtual assets. As a result, it is unclear who the legal owner of virtual assets is and whether the ownership of virtual assets is protected by law. In addition, it is unclear under PRC law whether an operator of virtual worlds such as us would have any liability (whether in contract, tort or otherwise) for loss of such virtual assets by users. Based on several judgments regarding the liabilities of online game operators for loss of virtual assets by users, the courts have generally required the online game operators to provide well-developed security systems to protect such virtual assets owned by users. In the event of a loss of virtual assets, we may be sued by users and may be held liable for damages.

6.

Restrictions on virtual currency may adversely affect our game operations revenues.

Our game and virtual world operations revenues are likely to be collected through the sale of prepaid top-up cards and virtual currency. The Notice on the Reinforcement of the Administration of Online Games issued by the Ministry of Culture and other governmental authorities on February 15, 2007, directs the People s Bank of China to strengthen the administration of virtual currency in online games to avoid any adverse impact on the PRC economy and financial system. This notice provides that the total amount of virtual currency issued by online game operators and the amount purchased by individual users should be strictly limited, with a strict and clear division between virtual transactions and real transactions carried out by way of electronic commerce. This notice also provides that virtual currency should only be used to purchase in-game items. On June 4, 2009, Ministry of Culture and Ministry of Commerce jointly issued Notice on the Reinforcement of the Administration of Virtual Currency in Online Games, which defines what virtual currency is and requires that entities obtain the approval from the Ministry of Culture before issuing virtual currency and engaging in transactions using virtual currency in connection with online games. We have obtained the approval from the Ministry of Culture for the issuing of our virtual currency. These restrictions on virtual currency may result in lower sales of our prepaid cards, and could have an adverse effect on our revenues from online business.

7.

Our business could benefit from certain government tax incentives. Expiration, reduction or discontinuation of, or changes to, these incentives would increase our tax burden and reduce our net income.

Various local governments in China may provided discretionary preferential tax treatments to us. However, these local governments may decide to reduce or eliminate these preferential tax treatments at any time.

Furthermore, these local implementations of tax laws may be found to violate national laws or regulations and we may be subject to retroactive imposition of higher taxes as a result. Any expiration, reduction or discontinuation of, or changes to, these tax incentives will increase our tax burden and reduce our net income and thus have a material adverse effect on our operating results.

8.

Even if we are profitable, we will principally rely on dividends and other distributions on equity paid by subsidiaries, including those in the PRC, to fund any cash and financing requirements we may have, and any limitation on the ability of our PRC subsidiary to make payments to us, or the tax implications of making payments to us, could have a material adverse effect on our ability to conduct our business.

Even if our operations were profitable, we will rely principally on dividends and other distributions on equity from our subsidiary in China for our cash requirements, including the funds necessary to service any debt we may incur. Current PRC regulations permit our PRC subsidiary to pay dividends to us only out of its accumulated profits, if any, determined in accordance with Chinese accounting standards and regulations. In addition, our subsidiary in China is required to set aside at least 10% of its after-tax profits each year, if any, to fund a statutory reserve until such reserve reaches 50% of its registered capital. These reserves are not distributable as cash dividends. The registered capital of Flying Cloud is US$ 140,000. To date Flying Cloud has not made allocations to its statutory reserve fund in compliance with the applicable PRC laws and regulations.

Furthermore, if our subsidiary in China incurs debt on its own behalf in the future, the instruments governing the debt may restrict its ability to pay dividends or make other payments to us. Substantially all of our expected earnings and cash flows are likely to be attributable to our PRC subsidiary. If earnings from our PRC subsidiary were to decline, our earnings and cash flow would be materially and adversely affected. Our cash flows are principally derived from dividends paid to us by our PRC subsidiary. As a result, our ability to distribute dividends largely depends on earnings from our PRC subsidiary and its ability to pay dividends out of its earnings. Our PRC subsidiary does not have a history of paying dividends. We cannot assure you that our PRC subsidiary will generate sufficient earnings and cash flows in the near future to pay dividends or otherwise distribute sufficient funds to enable us to meet our obligations, pay interest and expenses or declare dividends.

In addition, under the PRC Enterprise Income Tax Law and the Implementing Rules, both of which became effective on January 1, 2008, dividends generated from the business of our PRC subsidiary after January 1, 2008 and payable to us may be subject to a 10% withholding tax if the PRC tax authorities determine that we are a non-resident enterprise, unless there is an applicable tax treaty with China that provides for a different withholding arrangement and we are deemed to be entitled to such favorable treatment.

9.

We may be classified as a resident enterprise for PRC enterprise income tax purposes, which could result in our global income becoming subject to 25% PRC enterprise income tax.

The PRC Enterprise Income Tax Law provides that enterprises established outside China whose effective management are located in China are considered resident enterprises and will generally be subject to the uniform 25% EIT rate as to their global income. Under the implementation regulations, effective management is defined as substantial and overall management and control over such aspects as the production and business, personnel, accounts and properties of an enterprise.

In April 2009, the State Administration of Taxation released a circular that sets out the standards and procedures for recognizing the location of the effective management of an enterprise registered outside of the PRC and funded by Chinese enterprises as controlling investors, or a Chinese Funded Enterprise. Under the circular, a Chinese Funded Enterprise is considered a resident enterprise if all of the following applies: (i) a Chinese Funded Enterprise s major management department and personnel who are responsible for carrying out daily operations are located in the PRC; (ii) the department or the personnel who have the right to decide or approve the Chinese Funded Enterprise s financial and human resource matters are located in the PRC; (iii) the major assets, account book, company seal and meeting minutes of the Chinese Funded Enterprise are located or stored in the PRC; and (iv) the directors or management personnel holding no less than 50% voting rights of the Chinese Funded Enterprise habitually reside in the PRC. The circular explicitly provides that the above standards apply to the enterprises which are registered outside the PRC and funded by Chinese enterprises as controlling investors, and therefore such standards may be cited for reference only and may not be directly adopted when considering whether our effective management is in the PRC or not. Accordingly, while we feel we would not qualify as a resident enterprise it is still uncertain whether we may be considered a resident enterprise under the PRC EIT Law in the future. If we were considered a resident enterprise and earn income other than dividends from our PRC subsidiary, we will be subject to a 25% PRC income tax on our global income and such 25% PRC EIT on our global income could significantly increase our tax burden and materially and adversely affect our cash flow and profitability.

10.

If we are classified as a resident enterprise for PRC enterprise income tax purposes, we may be subject to PRC withholding tax on dividends from us and to PRC income tax on gain realized on the transfer of our shares in the PRC.

Under the PRC Enterprise Income Tax Law and related implementation regulations, PRC EIT withholding tax at the rate of 10% is applicable to dividends payable to investors that are non-resident enterprises, which do not have an establishment or place of business in the PRC, or which have such establishment or place of business if the relevant income is not effectively connected with the establishment or place of business, to the extent such dividends have their sources within the PRC. In addition, any gain realized on the transfer of shares by such investors is subject to 10% PRC income tax if such gain is regarded as income derived from sources within the PRC unless a treaty otherwise provides. If we are considered a PRC resident enterprise, it is unclear whether dividends we pay with respect to our PRC subsidiaries would be treated as income derived from sources within the PRC and be subject to PRC tax. If our PRC subsidiaries are required under the PRC EIT Law to withhold PRC income tax on dividends payable to our non-PRC entities that are non-resident enterprises, the value of your investment in our shares may be materially and adversely affected.

11.

Uncertainties with respect to the PRC legal system could have a material adverse effect on us.

We conduct our business primarily through our subsidiary in China, where our operations are governed by PRC laws and regulations. Since 1979, PRC legislation and regulations have significantly enhanced the protections afforded to various forms of foreign investments in China. However, China has not developed a fully integrated legal system and recently enacted laws and regulations may not sufficiently cover all aspects of economic activities in China. In particular, because these laws and regulations are relatively new, and because of the limited volume of published decisions and their nonbinding nature, the interpretation and enforcement of these laws and regulations involve uncertainties. In addition, the PRC legal system is based in part on government policies and internal rules (some of which are not published on a timely basis or at all) that may have a retroactive effect. As a result, we may not be aware of our violation of these policies and rules until sometime after the violation. Dispute settlement in China, whether through litigation or arbitration, may be protracted and result in substantial costs and diversion of resources and management attention. In addition, it may not always be possible to enforce judgments, whether through the local courts or authorities, which could result in further diversion of resources and management attention and extra costs.

12.

PRC regulation of loans and direct investment by offshore holding companies to PRC entities may delay or prevent us from making loans or providing additional capital contributions to our PRC operating subsidiary, which could materially and adversely affect our liquidity and our ability to fund and expand our business.

In utilizing the proceeds of any future offering we may make loans to our PRC subsidiary or subsidiaries at the time, or we may make additional capital contributions to our PRC subsidiary. Loans by us to our subsidiary in China, which is a foreign-invested enterprise, to finance its activities cannot exceed statutory limits and must be registered with the State Administration of Foreign Exchange, or SAFE, or its local counterpart. Capital contributions must be approved by the PRC Ministry of Commerce or its local counterpart. We may not be able to obtain these government approvals on a timely basis, if at all, with respect to future capital contributions by us to our PRC subsidiary. If we fail to receive such approvals, our ability to use the proceeds of this offering and to capitalize our PRC operations may be negatively affected, which could adversely affect our liquidity and our ability to fund and expand our business.

13.

Restrictions on currency exchange may limit our ability to receive and use our revenues effectively.

A large percentage of our cash inflows and outflows are likely to be denominated in Renminbi (RMB). We may convert a portion of our revenues derived in the PRC into other currencies to meet our foreign currency obligations such as payment of dividends declared. Under China s existing foreign exchange regulations, our PRC subsidiary is able to make payments of current accounts, like dividends to its offshore holding companies, in foreign currencies, without prior approval from SAFE, by complying with certain procedural requirements. However, we cannot assure you that the PRC authorities will not take further measures in the future to restrict access to foreign currencies for current account transactions. We may also have different views with the PRC authorities with respect to certain foreign exchange transactions. These and other uncertainties with respect to currency exchange controls may have a material adverse impact on our operations and financial condition.

14.

Governmental control of currency conversion may affect the value of your investment.

The PRC government imposes controls on the convertibility of the RMB into foreign currencies and, in certain cases, the remittance of currency out of China. We receive substantially all of our revenues in RMB. Under our current corporate structure, our income is primarily derived from dividend payments from our PRC subsidiary. Shortages in the availability of foreign currency may restrict the ability of our PRC subsidiary to remit sufficient foreign currency to pay dividends or other payments to us, or otherwise satisfy its foreign currency denominated obligations. Under existing PRC foreign exchange regulations, payments of current account items, including profit distributions, interest payments and expenditures from trade-related transactions, can be made in foreign currencies without prior approval from SAFE by complying with certain procedural requirements. However, approval from appropriate government authorities is required where RMB is to be converted into foreign currency and remitted out of China to pay capital expenses such as the repayment of loans denominated in foreign currencies. The PRC government may also at its discretion restrict access in the future to foreign currencies for current account transactions. If the foreign exchange control system prevents us from obtaining sufficient foreign currency to satisfy our currency demands, we may not be able to pay dividends in foreign currencies to our shareholders, including holders of our shares.

15.

We may be subject to penalties, including restriction on our ability to inject capital into our PRC subsidiary and our PRC subsidiary s ability to distribute profits to us, if our PRC resident shareholders or beneficial owners fail to comply with relevant PRC foreign exchange rules.

SAFE issued a public notice in October 2005 requiring PRC residents to register with the local SAFE branch before establishing or controlling any company outside of China for the purpose of capital financing with assets or equities of PRC companies, referred to in the notice as an offshore special purpose vehicle. PRC residents that are shareholders and/or beneficial owners of offshore special purpose companies established before November 1, 2005 were required to register with the local SAFE branch before March 31, 2006. In addition, any PRC resident that is a shareholder of an offshore special purpose vehicle is required to amend its SAFE registration with respect to that offshore special purpose company in connection with any increase or decrease of capital, transfer of shares, merger, division, equity investment or creation of any security interest over any assets located in China or other material changes in share capital. In May 2007, SAFE issued relevant guidance to its local branches with respect to the operational process for SAFE registration, which standardized more specific and stringent supervision on the registration relating to the SAFE notice.

We cannot provide any assurance that all of our shareholders and beneficial owners who are PRC residents will comply with our request to make, obtain or update any applicable registrations or comply with other requirements required by the SAFE notice or other related rules. In case of any non-compliance on any of our PRC resident shareholders or beneficial owners, our PRC subsidiary and such shareholders and beneficial owners may be subject to fines and other legal sanctions, including restriction on our ability to contribute additional capital into our PRC subsidiary and our PRC subsidiary s ability to distribute dividends to our offshore holding companies, which will adversely affect our business.

16.

All employee participants in our share incentive plans, should we have such a plan, who are PRC citizens may be required to register with SAFE. We may also face regulatory uncertainties that could restrict our ability to adopt additional option plans for our employees under PRC law.

In December 2006, the People s Bank of China promulgated the Administrative Measures for Individual Foreign Exchange, which set forth the respective requirements for foreign exchange transactions by PRC individuals under either current account or the capital account. In January 2007, SAFE issued the Implementation Rules of the Administrative Measures for Individual Foreign Exchange, which, among other things, specified approval requirements for certain capital account transactions such as a PRC citizen s participation in the employee stock ownership plans or stock option plans of an overseas publicly-listed company. On March 28, 2007, SAFE promulgated the Processing Guidance on Foreign Exchange Administration for Domestic Individuals Participating in Employee Stock Ownership Plans or Stock Option Plans of Overseas-Listed Companies, or the Stock Option Rule. Under the Stock Option Rule, PRC citizens who are granted stock options by an overseas publicly-listed company are required, through a qualified PRC domestic agent or PRC subsidiary of such overseas publicly-listed company, to register with SAFE and complete certain other procedures.

Our PRC citizen employees participating in a stock incentive plan may be subject to the Stock Option Rule. Failure to comply with the Stock Option Rule and other relevant rules will subject us or our PRC citizen employees participating in our stock incentive plan to fines and other legal or administrative sanctions and impose restrictions on our execution of option plans, including the grant of options under such plans to our employees, which could adversely affect our business operations.

17.

Fluctuation in the value of the RMB may have a material adverse effect on the value of your investment.

The value of the RMB against the U.S. dollar and other currencies may fluctuate and is affected by, among other things, changes in political and economic conditions. On July 21, 2005, the PRC government changed its decade-old policy of pegging the value of the RMB to the U.S. dollar. Under the new policy, the RMB is permitted to fluctuate within a narrow and managed band against a basket of certain foreign currencies. This change in policy resulted in an over 20% appreciation of the RMB against the U.S. dollar over the following three years. For almost two years after reaching a high against the U.S. dollar in July 2008, however, the RMB traded within a narrow band against the U.S. dollar, remaining within 1% of its July 2008 high. As a consequence, the RMB fluctuated sharply since July 2008 against other freely traded currencies, in tandem with the U.S. dollar. In June 2010, the PRC government announced that it would increase RMB exchange rate flexibility. However, it remains unclear how this flexibility might be implemented. There remains significant international pressure on the PRC government to adopt a more flexible currency policy, which could result in greater fluctuation of the RMB against the U.S. dollar. Substantially all of our revenues and costs are denominated in RMB, and a significant portion of our financial assets are also denominated in RMB. We principally rely on dividends and other distributions paid to us by our subsidiary in China. Any significant revaluation of the RMB may materially and adversely affect our cash flows, revenues, earnings and financial position, and the value of, and any dividends payable on, our shares in U.S. dollars. Any fluctuations of the exchange rate between the RMB and the U.S. dollar could also result in foreign currency translation losses for financial reporting purposes.

18.

The approval of the China Securities Regulatory Commission, or the CSRC, may be required in connection with future offerings under a PRC regulation. The regulation also establishes more complex procedures for acquisitions conducted by foreign investors that could make it more difficult for us to grow through acquisitions.

On August 8, 2006, six PRC regulatory agencies, including the Ministry of Commerce, the State Assets Supervision and Administration Commission, or SASAC, the State Administration for Taxation, the State Administration for Industry and Commerce, the CSRC, and SAFE, jointly adopted the Regulations on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, or the New M&A Rule, which became effective on September 8, 2006. If CSRC approval is required for an offering, our failure to obtain or delay in obtaining the CSRC approval for it may subject us to sanctions imposed by the CSRC and other PRC regulatory agencies, which could include fines and penalties on our operations in China, restrictions or limitations on our ability to pay dividends outside of China, and other forms of sanctions that may materially and adversely affect our business, results of operations and financial condition.

The new regulations also established additional procedures and requirements that are expected to make merger and acquisition activities in China by foreign investors more time-consuming and complex, including requirements in some instances that the Ministry of Commerce be notified in advance of any change-of-control transaction in which a foreign investor takes control of a PRC domestic enterprise, or that the approval from the Ministry of Commerce be obtained in circumstances where overseas companies established or controlled by PRC enterprises or residents acquire affiliated domestic companies. We may grow our business in part by acquiring other companies operating in our industry. Complying with the requirements of the new regulations to complete such transactions could be time-consuming, and any required approval processes, including approval from Ministry of Commerce, may delay or inhibit our ability to complete such transactions, which could affect our ability to expand our business or maintain our market share.

19.

We face risks of health epidemics and other disasters, which could severely disrupt our business operations.

Our business could be materially and adversely affected by the outbreak of H1N1, or swine influenza, avian influenza, severe acute respiratory syndrome, or SARS, or another epidemic. In 2009 and early 2010, there were outbreaks of swine influenza in certain regions of the world, including China. Any adverse public health developments in China could require the temporary closure of our offices. Such closures could severely disrupt our business operations and adversely affect our results of operations.

Our operations are vulnerable to interruption and damage from man-made or natural disasters, including wars, acts of terrorism, earthquakes, fire, floods, environmental accidents, power loss, communications failures and similar events, all of which may disrupt our business. If any significant man-made or natural disaster were to occur in the future, our ability to operate our business could be seriously impaired.

20.

The enforcement of labor contract law and increase in labor costs in the PRC may adversely affect our business and our profitability.

China adopted a labor contract law and its implementation rules effective on January 1, 2008 and September 18, 2008, respectively. The labor contract law and its implementation rules impose more stringent requirements on employers with regard to, among others, minimum wages, severance payment upon permitted termination of the employment by an employer and non-fixed term employment contracts, time limits for probation period as well as the duration and the times that an employee can be placed on a fixed term employment contract. Due to the limited period of effectiveness of the labor contract law and its implementation rules and the lack of clarity with respect to their implementation and potential penalties and fines, it is uncertain how they will impact our current employment policies and practices. Our employment policies and practices may violate the labor contract law or its implementation rules and we may be subject to related penalties, fines or legal fees. Compliance with the labor contract law and its implementation rules may increase our operating expenses, in particular our personnel expenses, as the continued success of our business depends significantly on our ability to attract and retain qualified personnel. In the event that we decide to terminate some of our employees or otherwise change our employment or labor practices, the labor contract law and its implementation rules may also limit our ability to effect those changes in a manner that we believe to be cost-effective or desirable, which could adversely affect our business and results of operations.

ITEM 1B.

UNRESOLVED STAFF COMMENTS.

We are a smaller reporting company as defined by Rule 12b-2 of the Exchange Act and are not required to provide the information under this item.

ITEM 2.

PROPERTIES.

We own no property. We maintain an executive office in Hong Kong where the space dedicated to Surna is approximately 50 sq/ft and is taken on a month-to-month basis. All previous office leasing arrangements in the PRC were terminated in December 2012.

ITEM 3.

LEGAL PROCEEDINGS.

We are not presently a party to any litigation.

ITEM 4.

MINE SAFETY DISCLOSURES

None.

PART II

ITEM 5.

MARKET FOR THE REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our shares of common stock are traded on the Bulletin Board operated by the Financial Industry Regulatory Authority (FINRA) under the symbol SRNA. Trading of our common stock began on April 5, 2011.

Fiscal Year 2012	**High**	**Low**
Fourth Quarter: October 1 to December 31, 2012	2.00	1.01
Third Quarter: July 1 to September 30, 2012	2.00	2.00
Second Quarter: April 1 to June 31, 2012	2.00	2.00
First Quarter: January 1 to March 31, 2012	2.00	2.00

Holders

There are 59 holders of record for our common stock. There are a total of 99,375,000 shares of common stock outstanding, 95,200,000 of which are restricted. One of our shareholders is Lim Clarke & Co Limited, which is owned and controlled by Richard Clarke, our Chairman, and Cherry Ping-Wai Lim, our Chief Executive Officer and a director.

Dividends

We have not declared any cash dividends nor do we intend to do so. We are not subject to any legal restrictions respecting the payment of dividends, except that they may not be paid to render us insolvent. Dividend policy will be based on our cash resources and needs and it is anticipated that all available cash will be needed for our operations in the foreseeable future.

Section 15(g) of the Securities Exchange Act of 1934

Our shares are covered by section 15(g) of the Securities Exchange Act of 1934, as amended that imposes additional sales practice requirements on broker/dealers who sell such securities to persons other than established customers and accredited investors (generally institutions with assets in excess of $5,000,000 or individuals with net worth in excess of $1,000,000 or annual income exceeding $200,000 or $300,000 jointly with their spouses). For transactions covered by the Rule, the broker/dealer must make a special suitability determination for the purchase and have received the purchaser s written agreement to the transaction prior to the sale. Consequently, the Rule may affect the ability of broker/dealers to sell our securities and also may affect your ability to sell your shares in the secondary market.

Section 15(g) also imposes additional sales practice requirements on broker/dealers who sell penny securities. These rules require a one page summary of certain essential items. The items include the risk of investing in penny stocks in both public offerings and secondary marketing; terms important to in understanding of the function of the penny stock market, such as id and offer quotes, a dealers spread and broker/dealer compensation; the broker/dealer compensation, the broker/dealers duties to its customers, including the disclosures required by any other penny stock disclosure rules; the customers rights and remedies in cases of fraud in penny stock transactions; and, FINRA s toll free telephone number and the central number of the North American Administrators Association, for information on the disciplinary history of broker/dealers and their associated persons.

Securities Authorized for Issuance Under Equity Compensation Plans

We have no equity compensation plans and accordingly we have no shares authorized for issuance under an equity compensation plan.

ITEM 6.

SELECTED FINANCIAL DATA

We are a smaller reporting company as defined by Rule 12b-2 of the Exchange Act and are not required to provide the information under this item.

ITEM 7.

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION.

You should read the following discussion and analysis of our financial condition and results of operations together with the information in our consolidated annual audited financial statements and the notes thereto, each of which are contained in Item 8 entitled Financial Statements and Supplementary Data , and other financial information incorporated by reference. Some of the information contained in this discussion and analysis includes forward-looking statements that involve risks and uncertainties. You should review the Risk Factors section for a discussion of important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements contained in the following discussion and analysis.

Liquidity and Capital resources

We are a start-up company and have not yet generated significant revenues from our business operations. Our auditors have issued a going concern opinion; this means that our auditors believe there is substantial doubt that we can continue as an on-going business for the next twelve months unless we obtain additional capital. Accordingly, we must raise cash from sources other than operations. Our only other source of funds at this time is further investment in our company by existing shareholders or others. If we need additional funds and cannot raise them, we will either have to suspend operations until we raise sufficient capital, or cease operations entirely.

Since inception, we have sold 75,000,000 shares of common stock to 7bridge Capital Management Limited for $15,000. From September through November, the company placed 4,175,000 shares to 51 individuals at $0.02 per shares and raised $83,500 excluding expenses.

We issued 79,175,000 shares of common stock, 75,000,000 shares pursuant to the exemption from registration contained in Regulation S of the Securities Act of 1933 and 4,175,000 shares pursuant to our public offering. Both were accounted for as sales of common stock. On May 16, 2011 we declared a stock dividend of 4 new shares for each 1 share held, with a record date of May 18, 2011. On May 18, 2011 our Board of Directors approved an increase in authorized capital from 100,000,000 common shares to 350,000,000 common shares.

There is limited historical financial information about us upon which to base an evaluation of our performance. We are in a start-up stage of operations and have not generated significant revenues and are subject to risks inherent in the establishment of a new business enterprise, including limited capital resources. We have no assurance that future financing will be available to us on acceptable terms. If financing is not available on satisfactory terms, we may be unable to continue, develop or expand our operations. Equity financing could result in additional dilution to existing shareholders.

As of November 30, 2011, our total current assets were $8,772 and our total current liabilities were $1,620,769, hence a working capital deficit of $1,611,997.

As of December 31, 2011, our total current assets were $9,118 and our total current liabilities were $1,709,008, hence a working capital deficit of $1,699,890.

As of December 31, 2012, our total current assets were $1,447 and our total current liabilities were $2,455,370, hence a working capital deficit of $2,453,923.

Results of Operations

We are a start-up stage corporation and have not generated or realized significant revenues from our business operations. To meet our initial need for cash we raised money from our public offering. Our only other source for cash at this time is investments by others in our company, and if we can not rely on loans from our officers, shareholders or others in order for us to maintain our operations we may need to find alternative sources, like a second public offering or a private placement of securities. At present, if we have not generated revenues sufficient to continue our development operations and if we do not secure any additional funding we may either have to suspend all operations until we do raise funds, or cease operations entirely.

One month transition period covering December 2011

Our revenues from continuing operation for the one fiscal month transition period covering the fiscal month of December 2011 (the transition period) were $335. The loss from continuing operations for the transition period was $84,176 of which includes $50,496 for Salaries, $13,256 for Product development cost and $20,759 for general and administration expense.

Years Ended December 31, 2012 and November 30, 2011

Our revenues from continuing operation for the fiscal year ended December 31, 2012 were $310, from our online games business. The loss from continuing operations for the year ended December 31, 2012 was $778,972 of which includes $563,597 for Salaries, $47,619 for Product development cost and $168,066 for general and administration expense.

Our revenues from continuing operation for the fiscal year ended November 30, 2011 were $938, from our online games business. The loss from continuing operations for the year ended November 30, 2011 was $1,593,872 of which includes $505,633 for Salaries, $769,231 for Compensation expenses, $135,424 for Product development cost, $174,522 for general and administration expense and $10,000 for loss on extinguishment of debt.

Factors affecting results of our operations in China

The Company's business, financial condition and results of operations may be influenced by the political, economic and legal environments, and by the general state of the PRC's economy and of the online games industry there. For example, while we may benefit from the overall economic growth in China in the past several years, which has resulted in increases in disposable income and discretionary consumer spending; the increasing use of the Internet; the growing popularity of online games in comparison with other forms of entertainment; and favorable demographic trends. Our results of operations may be adversely affected by an economic slowdown in China and other countries and regions where our games are operated, or the arrival of additional competition in the markets where we operate. They may be adversely affected by changes in governmental policies with respect to laws and regulations, anti-inflationary measures, currency conversion and remittance abroad, and rates and methods of taxation, among other things. Regulation imposed by the government of China and other countries on the online game industries may also have significant impact on our results of operations in the future.

Our operating results are more directly affected by company-specific factors including the following:

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our cost of developing and marketing online games;

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the speed at which we develop and launch new online games and related in-game items;

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the popularity of our games and in-game items compared with those of our competitors;

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the amount of our licensing revenues inside of China; and

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the success of investments and merger and acquisition activities.

Our future growth will depend significantly upon our ability to successfully develop and market additional online games that are attractive to players and to increase the monetization of our existing and future games in China; something which to-date we have not been successful in achieving.

Taxation

Nevada

Surna Inc. and Surna Networks, Inc. are each required to pay an annual fee to the Nevada Secretary of State of $165. Nevada has no corporate income taxes. Although the majority of our operations are outside the United States, we may be subject to federal or other U.S. taxation in the future.

British Virgin Islands

Surna Media is incorporated in the BVI. Under current laws, it is not subject to income or capital gains tax. In addition, payment of dividends to its shareholder, Surna Inc., is not subject to withholding tax.

Hong Kong

Our subsidiaries in Hong Kong are subject to a profit tax at the rate of 16.5% on assessable profit determined under relevant Hong Kong tax regulations.

According to the *Mainland and Hong Kong Special Administrative Region Arrangement on the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*, or the Tax Agreement, dividends paid by a foreign-invested enterprise in mainland China to its corporate shareholder in Hong Kong will be subject to withholding tax at a maximum rate of 5.0%, provided however that such Hong Kong company directly owns at least 25.0% of the equity interest in the mainland foreign-invested enterprise. However, under the new *Enterprise Income Tax Law* (EIT) and its implementation rules, as well as *Circular No. 601* issued by SAT in October 2009 (or Circular 601), dividends from our PRC subsidiary paid to us through Surna Hongkong Limited (Surna HK) may be subject to withholding tax at a rate of 10.0% if Surna HK is not considered to be the beneficial owner of the dividends distributed by a resident enterprise of the PRC.

Surna HK currently holds all the equity interest in our PRC operating company Flying Cloud. To the extent that Surna HK is considered a non-resident enterprise of the PRC under the Tax Agreement, dividends paid by Flying Cloud may be subject to a maximum withholding tax rate of 10.0%. Dividends paid by Surna HK to its shareholder will not be subject to any Hong Kong withholding tax.

China - PRC Enterprise Income Tax

Prior to January 1, 2008, companies established in China were generally subject to state and local EIT at statutory rates of 30% and 3% respectively. On March 16, 2007, the National People s Congress of China enacted a new regulation, the PRC *Enterprise Income Tax Law*, which took effect beginning January 1, 2008. On December 6, 2007, the State Council also adopted the *Implementing Rules for the Enterprise Income Tax Law*, or the Implementing Rules, which also took effect beginning January 1, 2008. Under the PRC EIT Law, foreign invested enterprises (or FIEs), and Chinese domestic companies are subject to EIT at a uniform rate of 25%. On February 22, 2008, the Ministry of Finance and the State Administration of Taxation, or the SAT, promulgated the *Notice on Several Preferential Policies in Respect of Enterprise Income Tax* (or Notice No. 1 2008), reiterating the policy that a software enterprise newly established within China may, upon determination, be exempted from income taxes for its first two profit-making years and shall be subject to the income tax at half the standard rate for the next three years.

Qualification as a software enterprise is however subject to an annual assessment by the relevant government authorities in China. See Risk Factors - Risks Related to Doing Business in China - we may be classified as a resident enterprise for PRC enterprise income tax purposes, which could result in our global income becoming subject to 25% PRC enterprise income tax.

Under the PRC EIT Law and the Implementing Rules, dividends generated from the business of our PRC subsidiary and payable to us may be subject to a withholding tax rate of 10% if we are considered a non-resident enterprise incorporated outside of the PRC unless there is an applicable tax treaty with China that provides for a different withholding arrangement and we are deemed to be entitled to such favorable treatment. If we were to be classified as a resident enterprise for PRC enterprise income tax purposes, this would result in our global income becoming subject to 25% PRC enterprise income tax. The risk that we may be deemed to be a PRC resident enterprise under the PRC EIT Law is disclosed in Risk Factors Risks Related to Doing Business in China .

Foreign currency and foreign currency translation

Foreign currency may have a major impact on our financial results. The functional currency of the Company is the United States Dollars (USD). The functional currency of the Company s operating subsidiary, Surna HK, is the Hong Kong Dollar (HKD).The functional currency of the Surna HK s operating subsidiary in PRC, Flying Cloud, is the Renminbi (RMB), the PRC s currency. Monetary assets and liabilities denominated in currencies other than the functional currency are translated into the functional currency at rates of exchange prevailing at the balance sheet dates. Transactions denominated in currencies other than the functional currency are translated into the functional currency at the exchange rates prevailing at the dates of the transaction. Exchange gains or losses arising from foreign currency transactions are included in the determination of net income (loss) for the respective periods.

For financial reporting purposes, the consolidated financial statements of the Company are translated into the Company s reporting currency, United States Dollars (USD). Balance sheet accounts are translated using the closing exchange rate in effect at the balance sheet date and income and expense accounts are translated using the average exchange rate prevailing during the reporting period.

Adjustments resulting from the translation, if any, are included in accumulated other comprehensive income (loss) in stockholders equity.

Critical Accounting Policies

To aid in the understanding of our financial reporting, our most critical accounting policies are described in the notes accompanying our financial statements. These policies have the potential to have a more significant impact on our financial statements, either because of the significance of the financial statement item to which they relate, or because they require judgment and estimation due to the uncertainty involved in measuring, at a specific point in time, events which are continuous in nature.

Use of Estimates:

The preparation of consolidated financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and that affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates

Reclassifications:

Certain reclassifications have been made to amounts in prior periods to conform with the current period presentation. All reclassifications have been applied consistently to the periods presented.

Cash and Cash Equivalents:

All highly liquid investments with original maturities of three months or less at the date of purchase to be cash equivalents.

Property and Equipment:

Property and equipment are stated at cost. When retired or otherwise disposed, the related carrying value and accumulated depreciation are removed from the respective accounts and the net difference less any amount realized from disposition, is reflected in earnings. For financial statement purposes, property and equipment are recorded at cost and depreciated using the straight-line method over their estimated useful lives.

Revenue Recognition:

The Company provides software development services related to online games in current fiscal year. Based on ASC 985-605-25-3 Software Not Requiring Significant Production, Modification, or Customization , revenue is recognized when persuasive evidence of an arrangement exists, delivery of services has occurred, the service fee is fixed or determinable and the collectability is reasonably assured.

Accounts Receivable and Allowance for Doubtful Accounts:

Accounts receivable are recorded at invoiced amount and generally do not bear interest. An allowance for doubtful accounts is established, as necessary, based on past experience and other factors which, in management's judgment, deserve current recognition in estimating bad debts. Such factors include growth and composition of accounts receivable, the relationship of the allowance for doubtful accounts to accounts receivable and current economic conditions. The determination of the collectability of amounts due from customer accounts requires the Company to make judgments regarding future events and trends. Allowances for doubtful accounts are determined based on assessing the Company s portfolio on an individual customer and on an overall basis. This process consists of a review of historical collection experience, current aging status of the customer accounts, and the financial condition of Surna Inc s customers. Based on a review of these factors, the Company establishes or adjusts the allowance for specific customers and the accounts receivable portfolio as a whole. At December 31, 2012 and 2011, an allowance for doubtful accounts was not considered necessary as all accounts receivable were deemed collectible.

Concentration of Credit Risk:

Financial instruments that potentially subject Surna Inc. to concentration of credit risk consist of cash and accounts receivable. Under Section 343 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, for the two-year period of January 1, 2011 through December 31, 2012, cash balances in noninterest-bearing transaction accounts at all FDIC-insured depository institutions are provided temporary unlimited deposit insurance coverage. At December 31, 2012, cash balances in interest-bearing accounts are zero.

Sales to limited customers comprised 100% of Surna Inc. s revenues for the year ended December 31, 2012; there were a revenue of $938 and $335 for the year ended November 30, 2011 and one month ended December 31, 2011, respectively. At December 31, 2012 and December 31, 2011, Surna Inc. s accounts receivable from its primary customer was $0 and $1,273, respectively. The Company believes that, in the event that its primary customer is unable or unwilling to continue to purchase its products, there are alternative buyers for its production at comparable prices.

Foreign Currency Translation:

The Company translates the foreign currency financial statements into US Dollars using the year or reporting period end or average exchange rates in accordance with the requirements of Accounting Standards Codification subtopic 830-10, *Foreign Currency Matters* (ASC 830-10). Assets and liabilities of these subsidiaries were translated at exchange rates as of the balance sheet date. Revenues and expenses are translated at average rates in effect for the periods presented. The cumulative translation adjustment is included in the accumulated other comprehensive gain (loss) within shareholders equity (deficit). Foreign currency transaction gains and losses arising from exchange rate fluctuations on transactions denominated in a currency other than the functional currency are included in the unaudited condensed consolidated results of operations.

Functional Currency:

The functional currency of the Company is the United States Dollars (USD). The functional currency of the Company s operating subsidiary, Surna HK, is the Hong Kong Dollar (HKD). The functional currency of the Surna HK s operating subsidiary in PRC, Flying Cloud, is the Renminbi (RMB), the PRC s currency. Monetary assets and liabilities denominated in currencies other than the functional currency are translated into the functional currency at rates of exchange prevailing at the balance sheet dates. Transactions denominated in currencies other than the functional currency are translated into the functional currency at the exchange rates prevailing at the dates of the transaction. Exchange gains or losses arising from foreign currency transactions are included in the determination of net income (loss) for the respective periods.

For financial reporting purposes, the consolidated financial statements of the Company are translated into the Company s reporting currency, United States Dollars (USD). Balance sheet accounts are translated using the closing exchange rate in effect at the balance sheet date and income and expense accounts are translated using the average exchange rate prevailing during the reporting period.

The exchange rates used to translate amounts in HKD and RMB into USD for the purposes of preparing the consolidated financial statements were as follows:

	December 31, 2012	December 31, 2011	November 30, 2011
Period-end HKD: USD exchange rate	$ 0.1290	$ 0.1287	$ 0.1287
Average Period HKD: USD exchange rate	$ 0.1289	$ 0.1284	$ 0.1284
Period-end RMB: USD exchange rate	$ 0.1587	$ 0.1571	Not applicable
Average Period RMB: USD exchange rate	$ 0.1587	$ 0.1545	Not applicable

Comprehensive Income (Loss):

The Company adopted Accounting Standards Codification subtopic 220-10, *Comprehensive Income* (ASC 220-10) which establishes standards for the reporting and displaying of comprehensive income (loss) and its components. Comprehensive income (loss) is defined as the change in stockholders equity (deficit) of a business during a period from transactions and other events and circumstances from non-owners sources. It includes all changes in stockholders equity (deficit) during a period except those resulting from investments by owners and distributions to owners. ASC 220-10 requires other comprehensive income (loss) to include foreign currency translation adjustments and unrealized gains and losses on available for sale securities.

Research and Development

The Company accounts for research and development cost in accordance with Accounting Standards Codification subtopic 730-10, Research and Development (ASC 730-10). ASC 730-10, requires research and development costs to be charged to expense as incurred. Accordingly, internal research and development costs are expensed as incurred. Third-party research and developments costs are expensed when the contracted work has been performed or as milestone results have been achieved. For the years ended December 31, 2012, one month ended December 31, 2011 and year ended November 30, 2011, we incurred approximately $47,600, $13,200 and $135,000 respectively for third party research and development expense which are included in the consolidated statements of operations.

Fair Value Measurements

The carrying value of financial instruments, including cash and cash equivalents, accrued liabilities, and accounts payable approximate fair value because of the short maturity of these instruments. The carrying amount of amounts due to related party approximates fair value primarily because all amounts due to related parties are due on demand and considered short term.

Basic and Diluted Net Loss per Common Share

Basic net loss per common share is computed by dividing net loss by the weighted-average number of common shares outstanding during the period. Diluted net loss per common share is determined using the weighted-average number of common shares outstanding during the period, adjusted for the dilutive effect of common stock equivalents. In periods when losses are reported, the weighted-average number of common shares outstanding excludes common stock equivalents, because their inclusion would be anti-dilutive.

Income Taxes

The Company accounts for income taxes using the asset and liability approach for financial accounting and reporting for income taxes and recognizes and measures deferred tax assets based upon the likelihood of realization of tax benefits in future years. Under the asset and liability approach, deferred taxes are provided for the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. A valuation allowance is provided for deferred tax assets if it is more likely than not these items will either expire before the Company is able to realize their benefits, or that future deductibility is uncertain.

Commitments and contingencies

In the normal course of business, the Company is subject to loss contingencies, such as legal proceedings and claims arising out of its business, that cover a wide range of matters, including, among others, government investigations, environment liability and tax matters. An accrual for a loss contingency is recognized when it is probable that an asset had been impaired or a liability had been incurred and the amount of loss can be reasonably estimated.

Recent Accounting Pronouncements:

There were various updates recently issued, most of which represented technical corrections to the accounting literature or application to specific industries and are not expected to a have a material impact on the Company s condensed consolidated financial position, results of operations or cash flows.

Going Concern

The consolidated financial statements have been prepared assuming that the Company will continue as a going concern. The Company currently has working capital deficit, no sources of recurring revenue and has generated cumulative net losses of $2,582,452 during the period from inception through December 31, 2012 and has a working capital deficit (current liabilities minus current assets) of $2,453,923 as of December 31, 2012. In the course of its development activities, the Company has sustained and continues to sustain losses. The Company cannot predict if and when the Company will generate profits. The Company expects to finance its operations primarily through debt or equity financing.

These conditions raise substantial doubt about the Company s ability to continue as a going concern. The Company s continuation as a going concern is dependent on its ability to meet its obligations, to obtain additional financing as may be required until such time as it can generate sources of recurring revenues and to ultimately attain profitability. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

The report of the Company s independent registered public accounting firm relating to the December 31, 2012 consolidated financial statements states that there is substantial doubt about the Company s ability to continue as a going concern.

Significant Concentrations, Risks and Uncertainties

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

Controls and Procedures

Under the supervision and with the participation of our management, including the Principal Executive Officer and Principal Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures as required by Exchange Act Rule 13a-15(b) as of the end of the period covered by this report. Based on that evaluation, the Principal Executive Officer and Principal Financial Officer have concluded that these disclosure controls and procedures are not effective because of the identification of a material weakness in our internal control over financial reporting which is identified below, which we view as an integral part of our disclosure controls and procedures.

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The Company lacks proper segregation of duties. We believe that the lack of proper segregation of duties is due to our limited resources.

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The Company does not have a comprehensive and formalized accounting and procedures manual.

ITEM 7A.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

We are a smaller reporting company as defined by Rule 12b-2 of the Exchange Act and are not required to provide the information under this item.

ITEM 8.

FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

SURNA INC.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors

Surna Inc.

Hong Kong, China

We have audited the accompanying consolidated balance sheets of Surna, Inc. and its subsidiaries (the Company), as of December 31, 2012 and 2011, and the related consolidated statements of operations, deficiency in stockholders equity and cash flows for the year ended December 31, 2012 and for the one month ended December 31, 2011. 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 have conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States of America). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 Surna, Inc. and its subsidiaries as of December 31, 2012 and 2011, and the consolidated results of its operations and its cash flows for the year ended December 31, 2012 and for the one month ended December 31, 2011, in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming the Company will continue as a going concern. As discussed in Note 2 to the accompanying consolidated financial statements, the Company has suffered recurring losses from operations and has an accumulated deficit as of December 31, 2012, which raises substantial doubt about its ability to continue as a going concern. Management's plans in regard to this matter are described in Note 2. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ RBSM LLP

New York, New York

April 15, 2013

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors

Surna Inc.

Hong Kong, China

We have audited the accompanying consolidated balance sheets of Surna Inc. and its subsidiaries (collectively, the Company) as of November 30, 2011 and the related consolidated statements of operations, cash flows and changes in stockholders deficit for the years then ended. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. 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 financial statements referred to above present fairly, in all material respects, the financial position of Surna Inc. and its subsidiaries, as of November 30, 2011 and the results of their operations and their 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 Surna Inc. will continue as a going concern. As discussed in Note 2 to the financial statements, the Company has suffered losses from operations which raise substantial doubt about its ability to continue as a going concern. Management s plans regarding those matters also are described in Note 2. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

<u>/s/ MALONEBAILEY, LLP</u>

www.malone-bailey.com

Houston, Texas

March 13, 2012

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Surna Inc.

Consolidated Balance Sheets

	December 31, 2012	December 31, 2011	November 30, 2011
ASSETS			
Current Assets			
Cash	$ 1,197	$ 2,745	$ 3,411
Accounts receivable	-	1,273	938
Current assets of discontinued operations	-	3,307	3,195
Prepaid expenses	250	1,793	1,228
Total Current Assets	1,447	9,118	8,772
Equipment, net of accumulated depreciation	16,668	30,000	31,111
TOTAL ASSETS	$ 18,115	$ 39,118	$ 39,883
LIABILITIES AND STOCKHOLDERS DEFICIT			
CURRENT LIBILITIES			
Accrued liabilities	$ 83,509	$ 20,691	$ 24,924
Current liabilities of discontinued operations	-	24,200	22,194
Amounts due to related parties	2,371,861	1,664,117	1,573,651
Total Current Liabilities	2,455,370	1,709,008	1,620,769
TOTAL LIABILITIES	2,455,370	1,709,008	1,620,769
STOCKHOLDERS DEFICIT			
Preferred stock, $0.00001 par value; 150,000,000 shares authorized; 0 shares issued and outstanding	-	-	-
Common stock, $0.00001 par value;	994	994	994

350,000,000 shares authorized;						
99,375,000 issued and outstanding						
Paid in capital		148,507		148,507		148,507
Accumulated other comprehensive loss		(4,304)		(4,304)		(1,370)
Accumulated deficit		(2,582,452)		(1,815,087)		(1,729,017)
Total Stockholders' Deficit		(2,437,255)		(1,669,890)		(1,580,886)
TOTAL LIABILITIES AND STOCKHOLDERS DEFICIT	$	18,115	$	39,118	$	39,883

Please see accompanying notes to these financial statements

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Surna Inc.

Consolidated Statements of Operations and Comprehensive Loss

	For the year ended December 31, 2012	For the one month ended December 31, 2011	For the year ended November 30, 2011
Revenue	$ 310	$ 335	$ 938
Cost of revenue	-	-	-
Gross margin	310	335	938
Operating Expenses:			
Depreciation Expenses	13,332	1,111	8,889
Compensation expenses	-	-	769,231
Product development cost	47,619	13,256	135,424
General and administrative expenses	718,331	70,144	671,266
Total operating expenses	779,282	84,511	1,584,810
Operating loss	(778,972)	(84,176)	(1,583,872)
Other income (expenses):			
Loss on extinguishment of debt	-	-	(10,000)
Loss from continuing operations before provision for income taxes	(778,972)	(84,176)	(1,593,872)
Provision for income taxes	-	-	-
Loss from Continuing Operations	(778,972)	(84,176)	(1,593,872)
Income (loss) from Discontinued Operations	11,607	(1,894)	(21,775)
Net loss	(767,365)	(86,070)	(1,615,647)
Comprehensive loss:			
Foreign currency translation loss	-	(2,934)	(1,370)
Comprehensive Loss	$ (767,365)	$ (89,004)	$ (1,617,017)
Loss per common share from continuing operations - basic and diluted	($0.01)	($0.00)	($0.02)

Income (loss) per common share from discontinued operations - basic and diluted	$0.00	($0.00)	($0.00)
Net loss per common share - basic and diluted	($0.01)	($0.00)	($0.02)
Weighted average number of common shares outstanding, basic and diluted	99,375,000	99,375,000	99,264,315

Please see accompanying notes to these financial statements

Surna Inc.

Consolidated Statement of Changes in Stockholders Deficit

For the period from December 1, 2010 to December 31, 2012

	Common Stock Shares	Common Stock Amount	Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Total Stockholders Deficit
Balance at November 30, 2010	99,175,000	$ 992	$ 97,608	$ (113,370)	$ -	$ (14,770)
Stock issue for settlement of debt	200,000	2	49,998	-	-	50,000
Capital contribution	-	-	901	-	-	901
Foreign currency translation adjustment	-	-	-	-	(1,370)	(1,370)
Net loss for the year ended November 30, 2011	-	-	-	(1,615,647)	-	(1,615,647)
Balance at November 30, 2011	99,375,000	$ 994	$ 148,507	$ (1,729,017)	$ (1,370)	$ (1,580,886)
Foreign currency translation adjustment	-	-	-	-	(2,934)	(2,934)
Net loss for the one month ended December 31, 2011	-	-	-	(86,070)	-	(86,070)
Balance at December 31, 2011	99,375,000	994	148,507	(1,815,087)	(4,304)	(1,669,890)
Net loss for the year ended December 31, 2012				(767,365)		(767,365)
Balance at December 31, 2012	99,375,000	$ 994	$ 148,507	$ (2,582,452)	$ (4,304)	$ (2,437,255)

Please see accompanying notes to these financial statements

Surna Inc.

Consolidated Statements of Cash Flows

	For the year ended December 31, 2012	For the one month ended December 31, 2011	For the year ended November 30, 2011
CASH FLOWS FROM OPERATING ACTIVITIES			
Net loss	$ (767,365)	$ (86,070)	$ (1,615,647)
Income (loss) from discontinued operations	11,607	(1,894)	(21,775)
Loss from continuing operations	(778,972)	(84,176)	(1,593,872)
Adjustments to reconcile net loss to net cash used in provided by operating activities:			
Depreciation expense	13,332	1,111	8,889
Loss on extinguishment of debt	-	-	10,000
Changes in operating assets and liabilities:			
Accounts receivable	1,273	(335)	(938)
Prepaid expenses	1,543	(565)	1,983
Accounts payable	-	-	-
Accrued liabilities	62,818	(4,233)	24,873
Amount due to related parties	698,458	90,486	1,482,243
Cash (used in) provided by operating activities of continuing operations	(1,548)	2,288	(66,822)
Cash provided by (use in) operating activities of discontinued operations	-	(20)	(2,776)
Net cash (used in) provided by operating activities	(1,548)	2,268	(69,598)
CASH FLOWS FROM INVESTING ACTIVITIES			
Cash flow used in investing activities	-	-	-
CASH FLOWS FROM FINANCING ACTIVITIES			
Capital Contribution	-	-	901
Net cash provided by financing activities	-	-	901
Effect of exchange rate changes on cash	-	(2,934)	(1,370)
Net increase / (decrease) in cash	(1,548)	(666)	(70,067)
Cash, beginning of period	2,745	3,411	73,478
Cash, end of period	$ 1,197	$ 2,745	$ 3,411

Non- Cash Financing and Investing Transaction			
Stocks issue for settlement of debt	$ -	$ -	$ 40,000

Please see accompanying notes to these financial statements

Surna Inc.

Notes to Consolidated Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation

Surna Inc (the Company , we , our) was incorporated in Nevada, USA, on October 15, 2009.

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and the rules of the Securities and Exchange Commission. The consolidated financial statements include the Company s accounts and those of its wholly-owned subsidiaries. Upon consolidation, all significant intercompany accounts and transactions are eliminated.

On September 1, 2011, Surna Inc. acquired Surna Media, Inc. (Surna Media) for 20,000,000 common shares. The merger was accounted for as among entities under common control. Surna Media s predecessor entity Surna Hong Kong Limited (Surna HK) was formed June 14, 2010. Surna Media was formed October 29, 2010 by the same owners and Surna HK became a wholly-owned subsidiary. Flying Cloud Information Technology Co. Ltd.(Flying Cloud) was incorporated in China in April 2011 as a wholly-owned subsidiary of Surna HK. All Surna HK, Surna Media and Flying Cloud transactions are consolidated with those of Surna, Inc. beginning at the formation of Surna HK on June 14, 2010. Surna Networks, Inc. and Surna Network Limited are wholly-owned subsidiaries of Surna Inc. formed on July 19, 2011 and August 2, 2011, respectively. On March 27, 2012, Surna Inc sold Surna Networks, Inc. and Surna Networks Limited to Chan Kam Ming for a total sales price of US$1. Surna Inc assumed liabilities of Surna Networks, Inc. and Surna Networks Limited of US$9,286. All significant intercompany transactions are eliminated.

Qoo Games Limited was incorporated in Hong Kong on February 21, 2012. It was intended that this company operate as the publisher of mobile games, including for the iOS and Android operating systems, but to-date it has not commenced operations.

Use of Estimates:

The preparation of Consolidated financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and that affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates

Reclassifications:

Certain reclassifications have been made to amounts in prior periods to conform with the current period presentation. All reclassifications have been applied consistently to the periods presented.

Cash and Cash Equivalents:

All highly liquid investments with original maturities of three months or less at the date of purchase to be cash equivalents.

Property and Equipment:

Property and equipment are stated at cost. When retired or otherwise disposed, the related carrying value and accumulated depreciation are removed from the respective accounts and the net difference less any amount realized from disposition, is reflected in earnings. For financial statement purposes, property and equipment are recorded at cost and depreciated using the straight-line method over their estimated useful lives.

Revenue Recognition:

The Company provides software development services related to online games in current fiscal year. Based on ASC 985-605-25-3 Software Not Requiring Significant Production, Modification, or Customization , revenue is recognized when persuasive evidence of an arrangement exists, delivery of services has occurred, the service fee is fixed or determinable and the collectability is reasonably assured.

Accounts Receivable and Allowance for Doubtful Accounts:

Accounts receivable are recorded at invoiced amount and generally do not bear interest. An allowance for doubtful accounts is established, as necessary, based on past experience and other factors which, in management's judgment, deserve current recognition in estimating bad debts. Such factors include growth and composition of accounts receivable, the relationship of the allowance for doubtful accounts to accounts receivable and current economic conditions. The determination of the collectability of amounts due from customer accounts requires the Company to make judgments regarding future events and trends. Allowances for doubtful accounts are determined based on assessing the Company s portfolio on an individual customer and on an overall basis. This process consists of a review of historical collection experience, current aging status of the customer accounts, and the financial condition of Surna Inc s customers. Based on a review of these factors, the Company establishes or adjusts the allowance for specific customers and the accounts receivable portfolio as a whole. At December 31, 2012 and 2011, an allowance for doubtful accounts was not considered necessary as all accounts receivable were deemed collectible.

Concentration of Credit Risk:

Financial instruments that potentially subject Surna Inc. to concentration of credit risk consist of cash and accounts receivable. Under Section 343 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, for the two-year period of January 1, 2011 through December 31, 2012, cash balances in noninterest-bearing transaction accounts at all FDIC-insured depository institutions are provided temporary unlimited deposit insurance coverage. At December 31, 2012, cash balances in interest-bearing accounts are zero.

Sales to limited customers comprised 100% of Surna Inc. s revenues for the year ended December 31, 2012; there were a revenue of $938 and $335 for the year ended November 30, 2011 and one month ended December 31, 2011, respectively. At December 31, 2012 and December 31, 2011, Surna Inc. s accounts receivable from its primary customer was $0 and $1,273, respectively. The Company believes that, in the event that its primary customer is unable or unwilling to continue to purchase its products, there are alternative buyers for its production at comparable prices.

Foreign Currency Translation:

The Company translates the foreign currency financial statements into US Dollars using the year or reporting period end or average exchange rates in accordance with the requirements of Accounting Standards Codification subtopic 830-10, *Foreign Currency Matters* (ASC 830-10). Assets and liabilities of these subsidiaries were translated at exchange rates as of the balance sheet date. Revenues and expenses are translated at average rates in effect for the periods presented. The cumulative translation adjustment is included in the accumulated other comprehensive gain (loss) within shareholders deficit. Foreign currency transaction gains and losses arising from exchange rate fluctuations on transactions denominated in a currency other than the functional currency are included in the consolidated results of operations.

Functional Currency:

The functional currency of the Company is the United States Dollars (USD). The functional currency of the Company s operating subsidiary, Surna HK, is the Hong Kong Dollar (HKD). The functional currency of the Surna HK s operating subsidiary in PRC, Flying Cloud, is the Renminbi (RMB), the PRC s currency. Monetary assets and liabilities denominated in currencies other than the functional currency are translated into the functional currency at rates of exchange prevailing at the balance sheet dates. Transactions denominated in currencies other than the functional currency are translated into the functional currency at the exchange rates prevailing at the dates of the transaction. Exchange gains or losses arising from foreign currency transactions are included in the determination of net income (loss) for the respective periods.

For financial reporting purposes, the consolidated financial statements of the Company are translated into the Company s reporting currency, United States Dollars (USD). Balance sheet accounts are translated using the closing exchange rate in effect at the balance sheet date and income and expense accounts are translated using the average exchange rate prevailing during the reporting period.

The exchange rates used to translate amounts in HKD and RMB into USD for the purposes of preparing the consolidated financial statements were as follows:

	December 31, 2012	December 31, 2011	November 30, 2011
Period-end HKD: USD exchange rate	$ 0.1290	$ 0.1287	$ 0.1287
Average Period HKD: USD exchange rate	$ 0.1289	$ 0.1284	$ 0.1284
Period-end RMB: USD exchange rate	$ 0.1587	$ 0.1571	Not applicable
Average Period RMB: USD exchange rate	$ 0.1587	$ 0.1545	Not applicable

Comprehensive Income (Loss):

The Company adopted Accounting Standards Codification subtopic 220-10, *Comprehensive Income* (ASC 220-10) which establishes standards for the reporting and displaying of comprehensive income (loss) and its components. Comprehensive income (loss) is defined as the change in stockholders equity (deficit) of a business during a period from transactions and other events and circumstances from non-owners sources. It includes all changes in stockholders equity (deficit) during a period except those resulting from investments by owners and distributions to owners. ASC 220-10 requires other comprehensive income (loss) to include foreign currency translation adjustments and unrealized gains and losses on available for sale securities.

Research and Development:

The Company accounts for research and development cost in accordance with Accounting Standards Codification subtopic 730-10, Research and Development (ASC 730-10). ASC 730-10, requires research and development costs to be charged to expense as incurred. Accordingly, internal research and development costs are expensed as incurred. Third-party research and developments costs are expensed when the contracted work has been performed or as milestone results have been achieved.

For the years ended December 31, 2012, one month ended December 31, 2011 and year ended November 30, 2011, we incurred approximately $47,600, $13,200 and $135,000 respectively for third party research and development expense which are included in the consolidated statements of operations.

Fair Value Measurements:

The carrying value of financial instruments, including cash and cash equivalents, accrued liabilities, and accounts payable approximate fair value because of the short maturity of these instruments. The carrying amount of amounts due to related party approximates fair value primarily because all amounts due to related parties are due on demand and considered short term.

Basic and Diluted Net Loss per Common Share:

Basic net loss per common share is computed by dividing net loss by the weighted-average number of common shares outstanding during the period. Diluted net loss per common share is determined using the weighted-average number of common shares outstanding during the period, adjusted for the dilutive effect of common stock equivalents. In periods when losses are reported, the weighted-average number of common shares outstanding excludes common stock equivalents, because their inclusion would be anti-dilutive.

Income Taxes:

The Company accounts for income taxes using the asset and liability approach for financial accounting and reporting for income taxes and recognizes and measures deferred tax assets based upon the likelihood of realization of tax benefits in future years. Under the asset and liability approach, deferred taxes are provided for the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. A valuation allowance is provided for deferred tax assets if it is more likely than not these items will either expire before the Company is able to realize their benefits, or that future deductibility is uncertain.

Commitments and contingencies:

In the normal course of business, the Company is subject to loss contingencies, such as legal proceedings and claims arising out of its business, that cover a wide range of matters, including, among others, government investigations, environment liability and tax matters. An accrual for a loss contingency is recognized when it is probable that an asset had been impaired or a liability had been incurred and the amount of loss can be reasonably estimated.

Recent Accounting Pronouncements:

There were various updates recently issued, most of which represented technical corrections to the accounting literature or application to specific industries and are not expected to a have a material impact on the Company s condensed consolidated financial position, results of operations or cash flows.

NOTE 2 - GOING CONCERN

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. The Company currently has working capital deficit, no sources of recurring revenue and has generated cumulative net losses of $2,582,452 during the period from inception through December 31, 2012 and has a working capital deficit (current liabilities minus current assets) of $2,453,923 as of December 31, 2012.

In the course of its development activities, the Company has sustained and continues to sustain losses. The Company cannot predict if and when the Company will generate profits. The Company expects to finance its operations primarily through debt or equity financing.

These conditions raise substantial doubt about the Company s ability to continue as a going concern. The Company s continuation as a going concern is dependent on its ability to meet its obligations, to obtain additional financing as may be required until such time as it can generate sources of recurring revenues and to ultimately attain profitability. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

The report of the Company s independent registered public accounting firm relating to the December 31, 2012 consolidated financial statements states that there is substantial doubt about the Company s ability to continue as a going concern.

NOTE 3 - CHANGE IN FISCAL YEAR-END

On March 19, 2012, the Board of Directors approved a change to our fiscal year end from November 30 to December 31 of each year. With the change effective this 2012 fiscal year, which now ended December 31, 2012, there is a one fiscal month transition period covering the fiscal month of December 2011. Results for this transition period are reported in this Annual Report along with the results for the new fiscal year of January 1, 2012 through December 31, 2012. Notice of the Company s election of a change in fiscal year was made on Form 8-K, which was filed on March 20, 2012.

NOTE 4 - DISCONTINUED OPERATIONS

On March 27, 2012, Surna Inc. sold Surna Networks, Inc. and Surna Networks Limited (Surna Networks) to Chan Kam-Ming for a total sale price of US$1. Surna Inc. assumed liabilities of Surna Networks of US$9,286. Surna Networks, Inc. was incorporated on July 19, 2011 and Surna Networks Limited was incorporated on August 2, 2011.

The results of discontinued operations of Surna Networks for the one month ended December 31, 2011 and the year ended December 31, 2012 are summarized as below:

	Surna Networks, Inc. (USD)			Surna Networks Limited (USD)		
	Year Ended 12/31/2012	One Month Ended 12/31/2011	Year Ended 11/30/2011	Year Ended 12/31/2012	One Month Ended 12/31/2011	Year Ended 11/30/2011
Revenue	$ -	$ -	$ -	$ 44,433	$ 2,485	$ 18,988
Cost of Revenue	-	-	-	(31,323)	(1,898)	(21,116)

General& Administrative	-	-	-	(1,503)	(2,481)	(19,647)
Net (Loss) Income	$ -	$ -	$ -	$ 11,607	$ (1,894)	$ (21,775)

NOTE 5 - SIGNIFICANT CONCENTRATIONS, RISKS AND UNCERTAINTIES

The majority of the Company's operations are carried out in the PRC. Accordingly, the Company's business, financial condition and results of operations may be influenced by the political, economic and legal environments in the PRC, and by the general state of the PRC's economy.

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

NOTE 6 - ACQUISITION OF GAME UNDER DEVELOPMENT

On May 1, 2011, a set of software for an online game still under development and known as *Demon Immortal* was transferred from Kopere Limited to Surna HK. Kopere is majority-owned by Cherry Ping-Wai Lim. Therefore, Kopere is related to but not under majority common control with Surna HK. The transfer price of *Demon Immortal* was agreed at $769,231 (HKD 6 million), which is shown as an amount due to a related party and corresponding compensation expense.

NOTE 7 - COMMON STOCK

On May 18, 2011, authorized capital was also increased from 100,000,000 to 350,000,000 common shares and 100,000,000 to 150,000,000 preferred shares. Also on that date, the Company recorded a stock dividend of 4 new shares for each 1 share held. All share information in the Company s consolidated financial statements have been retroactively restated for the effect of the share splits.

NOTE 8 - RELATED PARTY TRANSACTIONS

As of December 31, 2012, 2011 and November 30, 2011 the Company had a balance due to related parties of $ 2,371,861, $1,664,117 and $1,573,651, respectively. This balance is from various advances from the Company s directors and which are non-interest bearing, unsecured and due on demand.

On April 20, 2011 the Company purchased computer equipment from Kopere Limited. Kopere is majority-owned by Cherry Ping-Wai Lim. The purchase price was agreed at $40,000. Later, 200,000 common shares were issued with a fair value of $50,000 and the $10,000 difference between the fair value of the common stock and the purchase price was recorded as loss on extinguishment of debt.

NOTE 9 - INCOME TAXES

The Company had deferred income tax assets as of December 31, 2012 and 2011 and November 30, 2011 as follows:

	December 31,	December 31,	November 30,

	2012	2011	2011
Deferred Tax Assets	$472,244	$336,235	$336,235
Less - Valuation Allowance	(472,244)	(336,235)	(336,235)
Total Net Deferred Tax Assets	$ -	$ -	$ -

The Company has approximately $ 2,255,997 in Net Operating Losses carried forward for income tax purposes in various jurisdictions which will expire, if not utilized, as follows:

	United States	Hong Kong	China	Total
Indefinite	$ -	$ 1,349,815	$ -	$ 1,349,815
2032	112,818			112,818
2031	90,740	-	-	90,740
2030	24,726	-	-	24,726
2029	1,500	-	-	1,500
2017	-	-	300,132	300,132
2016		-	376,266	376,266
	$ 229,784	$ 1,349,815	$ 676,398	$ 2,255,997

NOTE 10 - COMMITMENTS AND CONTINGENCIES

Settlement Payments

On March 7 2013, the Company entered into settlement agreement with a former employee for outstanding dues. In accordance with the terms of the agreement, the Company is obligated to make payments totaling HK$80,000 (US$10,257). An initial payment of HK$10,000 (US$1,282) was made on April 7, 2013 and monthly payments of HK$10,000 (US$1,282) are due through August 2013 and then HK$15,000 (US$1,923) is due for next two months. A final payment of HK$15,000 (US$1,923) will be due in October 2013. As of December 31, 2012, the Company has accrued of this settlement of HK$80,000 (US$10,257) under accrued liabilities on its balance sheet.

Service agreement

During March, 2012, the Company entered into an agent agreement with Jurun Information Technology (Shanghai) Co. Ltd. (Jurun), and Jurun entered into a technical service agreement with Kunlun Wanwei Information Technology Company Ltd (Kunlun). Under the agreements, the Company provided the license of the online game to Jurun and on the same date the license was transferred from Jurun to Kunlun for a period of five years. The Company will receive upfront fees of RMB 1 million (US$158,730) payable in the following installments: 1) 30% after the first closed-beta testing; 2) 50% after the second closed-beta testing and 3) 20% after the first open-beta testing. In addition, the Company will receive 20% of game-related revenue from Kunlun during the agreement term. All amounts due from Kunlun will be transferred to Jurun and Jurun will return 100% of the fees back to the Company.

Therefore, the Company recognized the RMB 1 million (US$158,730) fee as revenue during the year 2012 in accordance with ASC 985-605-25-3 Software Not Requiring Significant Production, Modification, or Customization. As of the date the Company was unable to collect the revenue amounts and therefore, as of balance sheet date, the Company had reversed the whole revenue.

Litigation

The Company is subject to certain legal proceedings and claims, which arise in the ordinary course of its business. Although occasional adverse decisions or settlements may occur, the Company believes that the final disposition of such matters should not have a material adverse effect on its financial position, results of operations or liquidity. There was no outstanding litigation as of December 31, 2012.

ITEM 9.

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

Previous independent registered public accounting firm

On November 10, 2012, we notified our existing independent registered public accounting firm, MaloneBailey, LLP (MaloneBailey) that we had engaged RBSM LLP (RBSM) to become our new independent registered public accounting firm, effective with the interim period ended September 30, 2012. The change in independent registered public accounting firm was ratified and approved by the Company s Board of Directors. This change constituted a dismissal of the former independent registered public accounting firm, MaloneBailey.

MaloneBailey s reports on the Company s consolidated financial statements as of and for the two fiscal years ended November 30, 2011 and 2010 did not contain an adverse opinion or disclaimer of opinion, nor were they qualified or modified as to uncertainty, audit scope, or accounting principle, except that the reports of MaloneBailey on the Company s consolidated financial statements for the two fiscal years ended November 30, 2011 and 2010 contained an explanatory paragraph which noted that there was substantial doubt about the Company s ability to continue as a going concern.

During the fiscal year ended November 30, 2011, and the subsequent interim period through November 10, 2012, there were no disagreements between the Company and MaloneBailey on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements, if not resolved to MaloneBailey s satisfaction, would have caused them to make reference to the subject matter of the disagreement in connection with their report on the consolidated financial statements of the Company for such year.

During the fiscal year ended November 30, 2011, and during the subsequent interim period through November 10, 2012, there were no reportable events, as defined in Item 304(a)(1)(v) of Regulation S-K.

New independent registered public accounting firm

On November 10, 2012 (the Engagement Date), the Company engaged RBSM LLP (RBSM) as its independent registered public accounting firm for the Company s fiscal year ended December 31, 2012 and for the transition period of one month ended December 31, 2011. The engagement of RBSM as the Company s independent registered public accounting firm was approved by the Company s Board of Directors.

Our financial statements for the period from 1 December, 2011 to December 31, 2012, included in this report, have been audited by RBSM as set forth in this annual report.

ITEM 9A.

CONTROLS AND PROCEDURES.

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures, as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the Exchange Act), that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. We conducted an evaluation (the Evaluation), under the supervision and with the participation of our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), of the effectiveness of the design and operation of our disclosure controls and procedures (Disclosure Controls) as of the end of the period covered by this report pursuant to Rule 13a-15 of the Exchange Act. Based on this Evaluation, our CEO and CFO concluded that our Disclosure Controls were not effective because of the identification of a material weakness in our internal control over financial reporting which is identified below, which we view as an integral part of our disclosure controls and procedures.

The material weakness relates to the monitoring and review of work performed by our limited accounting staff in the preparation of financial statements, footnotes and financial data provided to our independent registered public accounting firm in connection with the annual audit. More specifically, the material weakness in our internal control over financial reporting is due to the fact that:

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The Company lacks proper segregation of duties. We believe that the lack of proper segregation of duties is due to our limited resources.

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The Company does not have a comprehensive and formalized accounting and procedures manual.

Limitations on the Effectiveness of Controls

Our management, including our CEO and CFO, does not expect that our Disclosure Controls and internal controls will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management or board override of the control.

The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

CEO and CFO Certifications

Appearing immediately following the Signatures section of this report there are Certifications of the CEO and the CFO. The Certifications are required in accordance with Section 302 of the Sarbanes-Oxley Act of 2002 (the Section 302 Certifications). This Item of this report, which you are currently reading is the information concerning the

Evaluation referred to in the Section 302 Certifications and this information should be read in conjunction with the Section 302 Certifications for a more complete understanding of the topics presented.

Management s Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). The Company s internal control over financial reporting is a process designed to provide reasonable assurance to our management and board of directors regarding the reliability of financial reporting and the preparation of the financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

Our internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal controls over financial reporting may not prevent or detect misstatements. All internal control systems, no matter how well designed, have inherent limitations, including the possibility of human error and the circumvention of overriding controls. Accordingly, even effective internal control over financial reporting can provide only reasonable assurance with respect to financial statement preparation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2012. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Based on our assessment, as of December 31, 2012, the Company s internal control over financial reporting were ineffective.

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The Company lacks proper segregation of duties. We believe that the lack of proper segregation of duties is due to our limited resources.

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The Company does not have a comprehensive and formalized accounting and procedures manual.

This annual report does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting. Management s report was not subject to attestation by our registered public accounting firm pursuant to rules of the Securities and Exchange Commission that permit us to provide only management s report in this annual report.

Changes in Internal Controls

There were no changes in our internal control over financial reporting during the one month ended December 31, 2011 and the year ended December 31, 2012 that have affected, or are reasonably likely to affect, our internal control over financial reporting.

ITEM 9B.

OTHER INFORMATION.

None.

PART III

ITEM 10.

DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.

Officers and Directors

Our directors will serve until their successor is elected and qualified. Our officers are elected by the board of directors to a term of one (1) year and serves until his or his successor is duly elected and qualified, or until he or she is removed from office. The board of directors has no nominating, auditing or compensation committees.

The names, addresses, ages and positions of our present officers and directors are set forth below:

Name and Address	Age	Position(s)
Cherry Ping-Wai Lim 16F, North Point Terrace North Point, Hong Kong	47	Chief Executive Officer (Principal executive officer), President, and a member of the Board of Directors
Richard Clarke 1524 Prince s Building 10 Chater Road, Central, Hong Kong	39	Chairman, Secretary, and a member of the Board of Directors
Man-Chor Poon S3-414 Block B, Goldway Industrial Centre, 2 Wing Kin Road, Kwai Tsing, Hong Kong	32	Chief Financial Officer (Principal financial and accounting Officer), Treasurer

The people named above are expected to hold their offices/positions until the next annual meeting of our stockholders.

Background of officers and directors

Cherry Ping-Wai Lim

Ping-Wai Lim, also known as Cherry Lim, has been a member of our Board of Directors, since January 10, 2010. Mr. Clarke and Ms. Lim own 75.62% of the outstanding shares of our common stock. As such, they unilaterally decided that Ms. Lim was going to be a director. Their decisions did not in any manner relate to Ms. Lim s s previous employments. Ms. Lim s previous experience, qualifications, attributes or skills were not considered when Mr. Clarke and Ms. Lim appointed Ms. Lim as one of our directors. Ms. Lim is currently a partner with Lim Clarke & Co, a Hong Kong based private equity and venture capital group. Since January 2010, she has been Chief Executive Officer and a Director of FTG Media Group, a private cross-media digital entertainment corporation headquartered in Hong Kong; and was Executive Director (from July 2009) and Chief Executive Officer (from December 2009) of Heyspace International, a precursor business to FTG Media. From May 2008 until February 2009 she served as Vice President and Chief Operating Officer of Advanced ID Corp., a Radio-frequency identification (RFID) technology company whose common stock is traded on the Bulletin Board operated by the Financial Industry Regulatory Authority (FINRA) under the symbol AIDO. Prior to this, from March 2005 until May 2008, she was CEO of Tsing-Tech Innovations, a Hong Kong based venture capital incubation and industrialization fund. From June 30, 2008 to February 24, 2009, Ms. Lim was a Director of EcoloCap Solutions Inc., which at the time was engaged in the business of providing services and products related to the reduction of greenhouse gases and whose common stock traded on the Bulletin Board under the symbol ECOS. From January 10, 2003 to January 13, 2006 Ms. Lim was a Director of Manaris Corporation (formerly C-Chip Technologies Corporation) and whose stock traded on the Bulletin Board under the symbol MANS.

Richard Clarke

Since our inception on October 15, 2009, Richard Clarke has served as our President, Principal Executive Officer, Secretary, and a member of the Board of Directors. Mr. Clarke and Ms. Lim own 75.62% of the outstanding shares of our common stock. As such, they unilaterally decided that Mr. Clarke was going to be an officer and director. Their decisions did not in any manner relate to Mr. Clarke s previous employments. Mr. Clarke s previous experience, qualifications, attributes or skills were not considered when Mr. Clarke and Ms. Lim appointed Mr. Clarke as one of our officers and directors. Since August 2006, he has been a partner with Lim Clarke & Co, a Hong Kong based private equity and venture capital group. Prior to this, from January 2003, he was a Senior Manager with 7bridge Capital Partners, which is now part of Lim Clarke & Co.

Man-Chor Poon

Man-Chor Poon has been our Chief Financial Officer since September 4, 2012. Ms. Poon was selected for the foregoing positions as a result of her qualifications in accountancy and experience in financial management and business operations in the People s Republic of China. Ms. Poon holds a Bachelor of Business Administration from Lingnan University in Hong Kong and is a Member of the Hong Kong Institute of Certified Public Accountants.

Conflicts of Interest

The only conflict that we foresee is that our officers and directors will devote time to projects that do not involve us. There are no conflicts of interest with Lim Clarke & Co.

Audit Committee Financial Expert

We do not have an audit committee financial expert. We do not have an audit committee financial expert because we believe the cost related to retaining a financial expert at this time is prohibitive. Further, because we are only beginning our commercial operations, at the present time, we believe the services of a financial expert are not warranted.

Audit Committee and Charter

We have a separately-designated audit committee of the board, but this consists of the two serving board members and audit committee functions are therefore performed by our full board of directors. All our directors also hold positions as our officers, and none are deemed independent. Our board, serving as the audit committee, is responsible for: (1) selection and oversight of our independent accountant; (2) establishing procedures for the receipt, retention and treatment of complaints regarding accounting, internal controls and auditing matters; (3) establishing procedures for the confidential, anonymous submission by our employees of concerns regarding accounting and auditing matters; (4) engaging outside advisors; and, (5) funding for the outside auditory and any outside advisors engagement by the audit committee. A copy of the audit committee charter is available on our website at governance.surna.com.

Code of Ethics

We have adopted a corporate code of ethics. We believe our code of ethics is reasonably designed to: deter wrongdoing and promote honest and ethical conduct; provide full, fair, accurate, timely and understandable disclosure in public reports; comply with applicable laws; ensure prompt internal reporting of code violations; and provide accountability for adherence to the code. A copy of the code of ethics is available on our website at governance.surna.com.

Disclosure Committee and Charter

We have a disclosure committee and disclosure committee charter. Our disclosure committee is comprised of all of our officers and directors. The purpose of the committee is to provide assistance to the Chief Executive Officer and the Chief Financial Officer in fulfilling their responsibilities regarding the identification and disclosure of material information about us and the accuracy, completeness and timeliness of our financial reports. A copy of the disclosure committee charter is available on our website at governance.surna.com.

Section 16(a) of the Securities Exchange Act of 1934

As of the date of this report, we are not subject to section 16(a) of the Securities Exchange Act of 1934.

ITEM 11.

EXECUTIVE COMPENSATION.

The following table sets forth the compensation paid by us for the last two fiscal years ending December 31, 2012 for each of our officers. This information includes the dollar value of base salaries, bonus awards and number of stock options granted, and certain other compensation, if any. The compensation discussed addresses all compensation awarded to, earned by, or paid or named executive officers.

Executive Officer Compensation Table

Name and Principal Position (a)	**Year** (b)	**Salary** (US$) (c)	**Bonus** (US$) (d)	**Stock Awards** (US$) (e)	**Option Awards** (US$) (f)	**Non-equity Incentive Plan Compensation** (US$) (g)	**Non-qualified Deferred Compensation earnings** (US$) (h)	**All other compensation** (US$) (i)	**Total** (US$) (j)

Richard Clarke, Chairman	2012	120,000	0	0	0	0	0	0	120,000
	2011	120,000	0	0	0	0	0	0	120,000
Cherry Lim President and CEO	2012	120,000	0	0	0	0	0	0	120,000
	2011	120,000	0	0	0	0	0	0	120,000
Man-Chor Poon CFO	2012	2,564	0	0	0	0	0	0	2,564
	2011	0	0	0	0	0	0	0	0

The compensation discussed herein addresses all compensation awarded to, earned by, or paid to our named executive officers. There are no other stock option plans, retirement, pension, or profit sharing plans for the benefit of our officers and directors other than as described herein.

Compensation of Directors

The members of our board of directors are not compensated for their services as Directors. The board has not implemented a plan to award options to any Directors and there are no contractual arrangements with any member of the board of Directors or any Director s service contracts. Accordingly, from inception on October 15, 2009 to our year end on December 31, 2012, we have not paid any compensation to Mr. Clarke or Ms. Lim as a director.

Long-Term Incentive Plan Awards

We do not have any long-term incentive plans.

Indemnification

Under our Articles of Incorporation and Bylaws of the corporation, we may indemnify an officer or director who is made a party to any proceeding, including a lawsuit, because of his position, if he acted in good faith and in a manner he reasonably believed to be in our best interest. We may advance expenses incurred in defending a proceeding. To the extent that the officer or director is successful on the merits in a proceeding as to which he is to be indemnified, we must indemnify him against all expenses incurred, including attorney s fees. With respect to a derivative action, indemnity may be made only for expenses actually and reasonably incurred in defending the proceeding, and if the officer or director is judged liable, only by a court order. The indemnification is intended to be to the fullest extent permitted by the laws of the State of Nevada.

Regarding indemnification for liabilities arising under the Securities Act of 1933, which may be permitted to directors or officers under Nevada law, we are informed that, in the opinion of the Securities and Exchange Commission, indemnification is against public policy, as expressed in the Act and is, therefore, unenforceable.

ITEM 12.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.

The following table sets forth, as of the date of this report, the total number of shares owned beneficially by our sole director, officer and key employee, individually and as a group, and the present owner of 5% or more of our total outstanding shares. The stockholder listed below has direct ownership of his/her shares and possess voting and dispositive power with respect to the shares.

Name and Address of Beneficial Owner	Number of shares	Percentage ownership
Cherry Ping-Wai Lim [1] [2] 16F, North Point Terrace North Point, Hong Kong	78,700,000	79.20 %
Richard Clarke [1] 1524 Prince s Building 10 Chater Road, Central, Hong Kong	78,500,000	79%
All officers and directors as a group (2 individuals)	**75,200,000**	**75.67 %**

[1] Title to 75,000,000 shares of common stock is held in the name of Lim Clarke & Co Limited, which is co-owned by Mr. Clarke and Ms. Lim.

[2] 200,000 shares of common stock is held by Ms. Lim.

There are no outstanding options or warrants to purchase, or securities convertible into, our common stock.

There are 59 holders of record for our common stock.

ITEM 13.

CERTAIN RELATIONSHIPS, RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE.

On October 16, 2009, we issued a total of 75,000,000 shares of restricted common stock to 7bridge Capital Management Limited for $15,000. 7bridge Capital Management is indirectly owned and controlled by Cherry Ping-Wai Lim, our principal executive officer and a director and Richard Clarke, a director.

On June 20, 2011 we issued 200,000 shares of restricted common stock with an aggregate value of US$50,000 to Cherry Ping-Wai Lim, our principal executive officer and a director, when we completed the purchase of assets from Kopere Limited, a Hong Kong company owned and controlled by Ms. Lim.

On September 1, 2011 we issued 10,500,000 shares of restricted common stock to Lim Clarke & Co Limited under a share exchange agreement. Lim Clarke is owned and controlled by Cherry Ping-Wai Lim, our principal executive officer and a director, and by Richard Clarke, a director.

The copyright for the PRC of online products, including online games, that are developed by Flying Cloud is held in trust by a domestic PRC company, Jurun Information Technology (Shanghai) Co. Ltd. (Jurun). Jurun is incorporated in Pudong, Shanghai and its equity interest is owned by two PRC citizens, who hold the company in-trust for a BVI company, Evident Games Limited (Evident), through a series of contractual arrangements that make Jurun a Variable Interest Entity (VIE) of Evident. Evident is in turn 52% owned and controlled by Lim Clarke. Jurun owns the entire equity interest of another PRC company, Shenzhen Tengyu Network Technology Co. Ltd. (Tengyu), which holds the licenses necessary to publish online products in the PRC.

The development of the *Hamsterland* children s online game and social network was contracted to Flying Cloud by Shuren Limited, a BVI corporation which is owned and controlled by Lim Clarke, and which holds a license to utilize the hamster cartoon characters for online games, mobile games and social networks.

Development of the online game *Serica* and technical support was contracted by Flying Cloud to YouQu Interactive (Beijing) Technology Co. Ltd., a company controlled by Yeah YE, a former consultant to Flying Cloud. This contract had a total value that approximates US$ 123,000 plus the rights to a 20% share in revenue from the game.

ITEM 14.

PRINCIPAL ACCOUNTANT FEES AND SERVICES.

(1)

Audit Fees

The aggregate fees billed for each of the last two fiscal years for professional services rendered by the principal accountant for our audit of annual financial statements and review of financial statements included in our Form 10-Qs or services that are normally provided by the accountant in connection with statutory and regulatory filings or engagements for those fiscal years was:

Year		Amount	
2012	$	9,000	RBSM
2012	$	8,000	MaloneBailey

2011	$	27,200	MaloneBailey

(2)

Audit-Related Fees

The aggregate fees billed in each of the last two fiscal years for assurance and related services by the principal accountants that are reasonably related to the performance of the audit or review of our financial statements and are not reported in the preceding paragraph:

Year		Amount	
2012	$	-	RBSM
2011	$	-	MaloneBailey

(3)

Tax Fees

The aggregate fees billed in each of the last two fiscal years for professional services rendered by the principal accountant for tax compliance, tax advice, and tax planning was:

Year		**Amount**	
2012	$	-	RBSM
2011	$	-	MaloneBailey

(4)

All Other Fees

The aggregate fees billed in each of the last two fiscal years for the products and services provided by the principal accountant, other than the services reported in paragraphs (1), (2), and (3) was:

Year		**Amount**	
2012	$	0	RBSM
2011	$	0	MaloneBailey

(5)

Our audit committee s pre-approval policies and procedures described in paragraph (c)(7)(i) of Rule 2-01 of Regulation S-X were that the audit committee pre-approve all accounting related activities prior to the performance of any services by any accountant or auditor.

(6)

The percentage of hours expended on the principal accountant s engagement to audit our financial statements for the most recent fiscal year that were attributed to work performed by persons other than the principal accountant s full time, permanent employees was zero.

PART IV

ITEM 15.

EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.

Incorporated by reference to the Exhibit index attached hereto.

SIGNATURES

Pursuant to the requirements of the Securities Act of 1933, the registrant certifies that it has reasonable grounds to believe that it meets all of the requirements for filing of this Form 10-K and has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on this 16th day of April, 2013.

SURNA INC.

(the Registrant)

BY: /s/ Cherry Lim
Cherry Ping-Wai Lim
Chief Executive Officer, Principal Executive Officer, and a member of the Board of Directors

BY: /s/ Poon Man Chor
Man-Chor Poon
Chief Financial Officer (Principal Financial and Accounting Officer) and Treasurer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following person on behalf of the Registrant and in the capacities.

Signature	Title	Date
/s/ Cherry Lim Cherry Ping-Wai Lim	Chief Executive Officer, Principal Executive Officer, and a member of the Board of Directors	April 16, 2013
/s/ Richard Clarke Richard Clarke	Secretary and a member of the Board of Directors	April 16, 2013
/s/ Poon Man Chor Man-Chor Poon	Chief Financial Officer (Principal Financial and Accounting Officer) and Treasurer	April 16, 2013

EXHIBIT INDEX

Exhibit	Document Description	Incorporated by reference Form	Date	Number	Filed herein
3.1	Articles of Incorporation	S-1	1/28/10	3.1	
3.2	Bylaws	S-1	1/28/10	3.2	
3.3	Amended Articles of Incorporation	8K	6/16/11	3.3	
4.1	Specimen Stock Certificate	S-1	1/28/10	4.1	
10.1	Asset purchase agreement with Kopere Limited	8-K	4/28/11	10.1	
10.2	Debt conversion agreement with Kopere Limited	8-K	6/23/11	10.1	
10.3	Share exchange agreement for Surna Media Inc.	8-K	11/8/11	10.1	
10.4	Technical Services Agreement with Jurun Information Technology (Shanghai) Co. Ltd.	10-Q	5/21/12	10.4	
21.1	List of Subsidiaries				X
31.1	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.				X
31.2	Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.				X
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.				X
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.				X