

**U.S. SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-KSB**

(Mark One)

- Annual Report under Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the fiscal year ended December 31, 2005.
- Transition report under Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number 0-7441

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**SIERRA MONITOR CORPORATION**

(Name of small business issuer in its charter)

California	95-2481914
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1991 Tarob Court  
Milpitas, California 95035  
(Address of principal executive offices)

Issuer's telephone number, including area code: (408) 262-6611

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Securities registered under Section 12(b) of the Exchange Act: None.

Securities registered under Section 12(g) of the Exchange Act:  
Common Stock, par value \$0.001 per share  
(Title of class)

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Check whether the issuer is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act.

Check whether the issuer (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  No

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, 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-KSB or any amendment to this Form 10-KSB.

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

The Registrant's revenues for the fiscal year ended December 31, 2005 were \$8,816,414. The aggregate market value of the voting stock held by non-affiliates of the Registrant as of March 28, 2006 was approximately \$4,787,186 based upon the last reported sale price of \$0.85 per share on the Over The Counter Bulletin Board, which occurred on March 24, 2006. For purposes of this disclosure, Common Stock held by persons who hold more than 5% of the outstanding voting shares and Common Stock held by officers and directors of the Registrant have been excluded in that such persons may be deemed to be "affiliates" as that term is defined under the rules and regulations promulgated under the Securities Act of 1933. This determination is not necessarily conclusive.

The number of shares of the Registrant's Common Stock outstanding as of March 28, 2006 was 11,048,213.

DOCUMENTS INCORPORATED BY REFERENCE

Items 9, 10, 11, 12 and 14 of Part III of this Annual Report on Form 10-KSB incorporate information by reference from the Registrant's Information Statement for the Annual Shareholders' Meeting to be held on May 16, 2006.

Transitional Small Business Disclosure Format Yes \_\_\_\_; No X

**FORM 10-KSB**

**SIERRA MONITOR CORPORATION**

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## PART I

### Item 1. Description of Business.

Sierra Monitor Corporation, a California corporation ("SMC" or the "Company") was founded in 1978 to design and develop hazardous gas monitoring devices for the protection of personnel and facilities in industrial work places. The Company has also developed, and continues to develop, various industrial instruments used to monitor and control industrial environments and to enable communication between industrial devices, such as gas detection systems, building automation systems, programmable logic controllers and various analytical systems and sensing devices.

The Company continues to design, manufacture and market products which detect combustible and toxic gases for the protection of personnel and facilities. Gases which create a hazard to people and facilities can result from the manufacturing process or occur naturally in a wide variety of locations in the workplace, commercial areas and homes. The motivation for installation of gas detection devices is driven by industrial safety professionals guided by the United States Occupational Safety and Health Administration ("OSHA"), state and local governing bodies, insurance companies and various industry rule making bodies.

Gas monitoring instruments are usually categorized as fixed or portable applications. Fixed applications are permanently installed in a fixed location. Portable applications are those where a user carries or wears a gas monitor. Most manufacturers tend to specialize in only one of these categories because both manufacturing methods and channels of distribution are different. The Company participates primarily in the fixed installation market which characteristically requires higher levels of technical capability to develop and sell the products.

The Company markets gas detection products under the concept of "Gas Risk Management." Gas Risk Management products utilize features such as recorded event information, graphical displays on central computers, and web server displays to allow users to identify hazards and problems before they evolve into incidents which, at a minimum, could cause production delays and may force evacuation of personnel and potentially even damage and injury. By utilizing the Company's FieldServer devices described below, detection data can be presented on computers through a web server function for viewing over the Internet or by localized web browsers. In the three calendar years 2005, 2004 and 2003, revenue from gas detection products was approximately 60%, 60%, and 65% of the Company's sales, respectively.

In addition to gas detection devices, the Company supplies microprocessor-based environment control products to the telecommunications industry. The control products are used to monitor temperature, gas, smoke and other environmental and security conditions in remote structures such as DSL distribution nodes, fiber optic booster stations and cell-tower site buildings. Environment controllers integrate various functions which would otherwise require discrete controls and alarm handling. The demand for environment controllers is driven, primarily, by new construction of infrastructure for the telecommunications industries. The level of new construction of land line telecommunications infrastructure decreased in 2002 and has remained at depressed levels during 2004 and 2005. As a result, the Company has concentrated product development efforts on wireless industry applications by introducing a new cell site building control system in 2005. The new product, Intelesite, did not contribute significantly to revenue in 2005. Revenue from all products sold to the telecommunications industry was approximately 14% of the Company's sales in 2005 compared with 13% in 2004 and 14% in 2003.

The Company also manufactures industrial communications bridges. Many industrial instruments, such as gas detection systems, programmable logic controllers, various analytical systems, and building automation

systems, communicate in disparate, non-standard, protocols. The Company's communications bridges provide a means for transferring data between these devices using non-standard protocols bridged by a sophisticated data exchange software program. Data can be transmitted to other industrial applications over various wiring platforms including Ethernet. FieldServer Technologies, a wholly owned division of the Company, markets communication bridges under the product name "FieldServer." FieldServer sales are directed to the building automation and process automation industries. In 2005, the Company also introduced a line of original equipment manufacturer (OEM) modules, marketed under the product name ProtoCessors, which allow FieldServer Technologies to be embedded into instruments manufactured by other companies. In 2005, revenue from FieldServer products was approximately 26% of the Company's sales compared to approximately 27% in 2004 and 21% in 2003.

The Company maintains research and development programs to enhance existing products and to develop new products. The Company's research and development expenses, which include costs for sustaining engineering, were \$1,694,977 or 19% of sales, in 2005 compared to \$1,810,929, or 20% of sales, in 2004 and \$1,493,496, or 19% of sales, in 2003.

The Company's products are sold through a network of independent sales representatives supervised by regional managers. There are currently 26 authorized representative companies with a total of 28 sales offices in the United States. The majority of the Company's representatives have exclusive territories and the sales agreements with each representative restrict them from representing competing products. The Company's internal sales organization includes a Sales Manager, seven Regional Sales Managers, an outside salesperson and various inside support personnel. In addition to its primary factory and office facility in California and a technical support office located in Florida, the Company maintains separate regional sales offices in California, Illinois, Massachusetts, New Jersey, and Texas.

Products manufactured by the Company are marketed and sold primarily to oil and gas drilling and refining companies, chemical plants, waste-water treatment plants, telecommunications companies, parking garages, landfill rehabilitation projects and building automation projects. The Company considers itself to operate in one business segment. Substantially all of the revenues reported in Part II, Item 7 are attributable to sales to that single segment.

At December 31, 2005, the Company had 45 employees, of whom 8 were in research and development; 15 were in marketing, sales and service; 4 were in general administration; and 18 were in operations and manufacturing. At that date, 39 of the Company's employees were located in Milpitas, California, and the remaining employees were located in regional sales and technical support offices. None of the Company's employees are represented by a labor union. The Company believes that its relationship with its employees is satisfactory.

The demand for monitoring devices and other products manufactured by the Company is typically not seasonal and during 2005 and 2004 there were no customers to whom sales exceeded 10% of the Company's net sales. Factors within specific industries such as telecommunications, building automation or petrochemical processing could affect the Company's sales within that particular industry. The factors may include, but are not limited to, a general economic downturn, labor problems, rapid shifts in technology or introduction of competing products at lower prices.

The commercial order backlog for the Company's products at December 31, 2005 was approximately \$2,100,000 compared with approximately \$1,700,000 at December 31, 2004. The backlog includes orders for which the Company has not yet received engineering release from the customer. Since the Company generally ships many of its products within the same quarter that it receives a purchase order and engineering release

release from the customer for such products, the Company believes that its backlog at any particular time is generally not indicative of the level of future sales.

The Company's sales team includes a Regional Sales Manager with responsibility for sales development in Latin America. The Regional Sales Manager, based in Dallas, Texas, has responsibility for all direct sales and development of sales channels in the region. In addition, the Company has various agreements with representatives in foreign countries to promote the Company's products but no other formal international marketing program exists. In each of the two years ended December 31, 2005 and 2004, sales to international customers were 17% and 10%, respectively. The Company has no assets in any foreign countries.

The markets in which the Company participates are highly competitive and generally price sensitive. Most of the Company's competitors have far greater financial, marketing and manufacturing resources than the Company by virtue of their relationships with larger companies as divisions or subsidiaries. The principal competitive factors in the industry are reliability, ease of use, product support, and price. The Company's gas detection products compete with systems offered by Detector Electronics Corporation, Draeger Safety Inc., General Monitors Inc., Mine Safety Appliance Company, and Zellweger Ltd. The Company's other products tend to compete with alternate methods and technologies rather than direct equivalent products manufactured by other companies. For example, telephone companies may use discrete temperature, lighting and pump controls as an alternative to integrated control systems. Likewise, potential users of FieldServers may choose to write software programs as an alternative to using our packaged solution.

The Company purchases materials and components for use in manufacturing its products. The majority of the materials and components are standard items which can be purchased from multiple distributors, or fabricated by multiple custom fabrication vendors. Components which are generally purchased from sole sources are those which require a specific consistent quality such as gas sensors. Our principal suppliers of gas sensors are City Technology and E2V Technologies. We anticipate that the majority of components and materials used in products to be developed by us will be readily available. However, there is no assurance that the current availability of these materials will continue in the future, or if available, will be procurable at favorable prices.

#### **Selected Financial Data.**

The following table sets forth the selected financial data for each of the last five fiscal periods ended December 31, 2005 through 2000

	<b>Years Ended December 31,</b>				
	<b>2005</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>	<b>2001</b>
Net sales	\$ 8,816,414	\$ 9,125,536	\$ 7,868,199	\$ 8,440,518	\$ 9,953,011
Net income (loss)	\$ (230,679)	\$ (185,620)	\$ (173,603)	\$ (261,350)	\$ 381,018
Net income (loss) per share – basic and diluted	\$ (0.02)	\$ (0.02)	\$ (0.02)	\$ (0.02)	\$ 0.03
Total assets	\$ 4,392,202	\$ 4,448,318	\$ 4,230,797	\$ 4,461,849	\$ 4,971,370

#### **Certain Factors That May Affect Future Results.**

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Actual results could differ materially from those projected in the forward-looking statements as a result of the risk factors set forth below and elsewhere in this report. Forward-looking statements in this report include, among others, statements regarding (1) the impact of inflation on the Company's results of operations , (2) the sufficiency of cash and accounts

receivable, (3) the sufficiency of our reserves for uncollectible amounts, (4) competition and competitive pressures, (5) future sources of revenue, (6) growth, decline and seasonality of revenue; and (7) the Company's improved operating results in the first quarter of 2006. The Company's future operating results may be affected by a number of factors, including general economic conditions in both foreign and domestic markets, cyclical factors affecting the Company's industry, lack of growth in the Company's end-markets, and the Company's ability to develop, manufacture, and sell both new and existing products at a profitable yet competitive price.

The industry in which the Company competes is highly competitive and the Company expects such competition to continue in the future. Most of the Company's competitors are larger than the Company and have substantially greater financial, technical, marketing and manufacturing resources. While the Company has invested in new products, there can be no assurance that it can continue to introduce new products on a timely basis or that certain of its products will not be rendered non-competitive or obsolete by its competitors. The dramatic reduction in spending by the telecommunications industry since 2001 continues to have an adverse impact on our sales, in particular our environment controllers. Our ability to increase overall revenues is partially dependent upon increasing our sales of environment controllers in the telecommunications industry.

The company's operations are concentrated in a single building in Milpitas, California. The Company's operations could be interrupted by fire, earthquake, power loss, telecommunications failure and other events beyond our control. The Company does not have a detailed disaster recovery plan. In addition, the Company does not carry sufficient business interruption insurance to compensate the company for all losses that may occur and any losses or damages incurred by us could have a material adverse effect on our business and financial results.

#### **Cost of Compliance with Environmental Regulations.**

The Company has no costs associated with compliance with environmental regulations. However, there can be no assurance that the Company will not incur such costs in the future.

#### **Available Information.**

The Company files with the SEC annual reports on Form 10-KSB, quarterly reports on Form 10-QSB, current reports on Form 8-K and proxy and information statements and amendments to reports filed or furnished pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended. The public may read and copy these materials at the SEC's Public Reference Room at 450 Fifth Street, NW, Washington, D.C. 20549. The public may obtain information on the operation of the public reference room by calling the SEC at 1-800-SEC-0330. The SEC also maintains a website (<http://www.sec.gov>) that contains reports, proxy and information statements and other information regarding the Company and other companies that file materials with the SEC electronically. You may also obtain copies of reports filed with the SEC, free of charge, on our website at <http://www.sierramonitor.com>. The Company's headquarters are located at 1991 Tarob Court, Milpitas, CA 95035. The Company's phone number at that address is (408) 262-6611 and the Company's e-mail address is [sierra@sierramonitor.com](mailto:sierra@sierramonitor.com).

**Item 2. Description of Property.**

The Company's principal executive, administrative, manufacturing and engineering operations are located in a 15,000 square foot leased facility in Milpitas, California. This facility is occupied under a lease expiring March 31, 2009. Management considers that the current facilities are adequate for the present level of operations, are adequately covered by insurance and that additional office and factory space is available in the immediate vicinity. The Company also leases a warehouse in Milpitas, California, a small technical support office in Fort Myers, Florida and sales offices near Los Angeles, California; Chicago, Illinois; Boston, Massachusetts; Newark, New Jersey; Dallas, Texas and Houston, Texas.

**Item 3. Legal Proceedings.**

The Company may be involved from time to time in various claims, lawsuits, disputes with third parties, actions involving allegations of discrimination or breach of contract actions incidental in the normal course of the business operations. The Company is currently not involved in any such litigation or any pending legal proceedings that management believes could have a material adverse effect on the Company's financial position or results of operations.

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

The Company did not submit any matters to a vote of security holders during the fourth quarter of the fiscal year ended December 31, 2005.

## PART II

### Item 5. Market for Common Equity and Related Stockholder Matters

(a) The Company's common stock is quoted on the OTC Bulletin Board under the symbol "SRMC.OB." There is not an active market for the Company's stock and there is only infrequent trading in limited volume. The high and low closing sales price, as reported by the OTC Bulletin Board system, of the Company's common stock during each fiscal quarter for the Company's last two fiscal years were as follows:

<b>Common Stock Prices</b>		<b>High</b>		<b>Low</b>
Quarter ended December 31, 2005	\$	1.25	\$	0.65
Quarter ended September 30, 2005		1.20		0.65
Quarter ended June 30, 2005		1.25		0.95
Quarter ended March 31, 2005		1.10		0.56
Quarter ended December 31, 2004	\$	1.01	\$	0.52
Quarter ended September 30, 2004		0.63		0.63
Quarter ended June 30, 2004		0.80		0.45
Quarter ended March 31, 2004		0.75		0.45

These prices represent quotations among dealers without adjustments for retail markups, markdowns or commissions, and may not represent actual transactions.

(b) As of March 28, 2006 there were approximately 216 holders of record of the Company's common stock and the closing price of the Company's common stock was \$0.85. This figure does not include beneficial holders or common stock held in street name, as we cannot accurately estimate the number of these beneficial holders.

(c) The Company has never paid cash dividends on its common stock. The Company presently intends to retain any future earnings to finance operations and the further development of the Company's business and does not presently intend to disperse any cash dividends in the foreseeable future.

#### (d) Penny Stock

Unless and until the Company's shares qualify for inclusion in the NASDAQ system, the public trading, if any, of the Company's common stock will be on the OTC Bulletin Board. As a result, an investor may find it more difficult to dispose of, or to obtain accurate quotations as to the price of, the Company's common stock. The Company's common stock is subject to provisions of Section 15(g) and Rule 15g-9 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), commonly referred to as the "penny stock rule." Section 15(g) sets forth certain requirements for transactions in penny stocks, and Rule 15g-9(d) incorporates the definition of "penny stock" that is found in Rule 3a51-1 of the Exchange Act. The SEC generally defines "penny stock" to be any equity security that has a market price less than \$5.00 per share, subject to certain exceptions. If the Company's Common stock is deemed to be a penny stock, trading in the shares will be subject to additional sales practice requirements on broker-dealers who sell penny stock to persons other than established customers and accredited investors. "Accredited investors" are generally persons with assets in excess of \$1,000,000 or annual income exceeding \$200,000, or \$300,000 together with their spouse and certain entities with assets in excess of pre-determined amounts. For transactions covered by these rules, broker-dealers must make a special suitability determination for the purchase of such security and must have the purchaser's written consent to the transaction prior to the purchase. Additionally, for any transaction involving a penny stock, unless exempt, the rules require the delivery, prior to the first transaction,

of a risk disclosure document, prepared by the SEC, relating to the penny stock market. A broker-dealer also must disclose the commissions payable to both the broker-dealer and the registered representative, and current quotations for the securities. Finally, monthly statements must be sent disclosing recent price information for the penny stocks held in an account and information on the limited market in penny stocks. Consequently, these rules may restrict the ability of a broker-dealer to trade and/or maintain a market in the Company's common stock and may affect the ability of the Company's shareholders to sell their shares.

(e) Recent Sales of Unregistered Securities

None

With respect to the other information required by this item, the section entitled "Equity Compensation Plan Information" of the Company's Information Statement pursuant to Section 14(c) of the Securities Exchange Act of 1934 ("Information Statement") for the Company's Annual Meeting of Shareholders to be held on May 16, 2006 and to be filed with the SEC within 120 days of December 31, 2005 is incorporated by reference herein.

(f) Equity Compensation Plan Information

The following table sets forth certain information as of the end of the most recently completed fiscal year with respect to compensation plans (including individual compensation arrangements) under which equity securities of the registrant are authorized for issuance, aggregated as follows:

- i. All compensation plans previously approved by security holders; and
- ii. All compensation plans not previously approved by security holders.

	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders	1,195,500	\$0.76	388,875
Equity compensation plans not approved by security holders	110,000	\$0.65	-
Total	1,305,500	\$0.75	388,875

## **Item 6. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

### **Results of Operations.**

#### **Fiscal 2005 vs. Fiscal 2004**

For the year ended December 31, 2005, our net sales were \$8,816,414 compared to net sales of \$9,125,536 in the prior year ended December 31, 2004. Loss before interest expense and income taxes was \$347,766 in 2005 compared to loss before income taxes of \$287,976 in 2004. Net loss in 2005 was \$230,679, or \$0.02 per share, compared to net loss of \$185,620, or \$0.02 per share, in 2004. Our revenue decreased approximately 3% in 2005 compared with the prior year.

Our sales of gas detection products decreased approximately 4% in 2005 compared to 2004 primarily due to low sales of integrated systems based on our Sentry controller. The lower system sales were partially offset by sales of discrete gas detection sensor modules that are integrated into systems by third party integrators. New sensor module products we released in both 2004 and 2005 are flexible for either Sentry system applications or third party system integration. Sales of other gas detection products, including sales of products to the military, were slightly higher than the prior year.

Sales of environment controller products, which are used by telecommunication companies, increased approximately 2% in 2005. The increase was the result of a small increase in the number of integrated systems shipped for underground equipment vaults. We are continuing efforts to promote our new "Intelesite" system specifically designed for environment control of above ground cell site buildings.

Sales of communications bridges, which are marketed under the brand name FieldServer Technologies, decreased approximately 5% in 2005 compared to 2004. Our FieldServer sales in 2004 included two large projects for building automation of university campuses. There were no similar projects shipped in 2005 but the remaining FieldServer sales increased approximately 7% compared to 2004.

Gross profit as a percent of sales was 60% in 2005, compared to gross profit of 61% in the prior year. Our gross margins vary by product mix and channel of distribution. Although our 2005 product mix was similar to the prior year, a larger percentage of sales were to international customers. International channel sales are generally discounted but do not require commission payments to sales representatives. The lower net invoice for international sales contributed to the lower gross margin for 2005 compared to 2004.

Research and development expenses, which include new product development and support for existing products, were \$1,694,977 or 19% of net sales, in the year ended December 31, 2005 compared to \$1,810,929 or 20% of net sales, in the year ended December 31, 2004. Several new product development programs, which required outside contract engineering, were undertaken during 2004 and completed early in 2005. The resulting lower contract engineering expenses in 2005 were partially offset by additional internal engineering costs for other new product development projects. In addition to continued gas detection product development we also continued work on our line of OEM modules marketed under the brand name ProtoCessor. ProtoCessors allow instrument designers to anticipate multiple communication requirements by integrating a ProtoCessor socket into printed circuit board designs.

Selling and marketing expenses were \$2,652,871 or 30% of net sales, in 2005, compared to \$2,769,870 also 30% of net sales, in the prior year. The lower selling expenses are primarily due to lower commissions paid to sales representatives as a result of a higher mix of international sales.

General and administrative expenses which include salaries and benefits, professional fees, and product and general liability insurance were \$1,275,894 or 14% of net sales, in 2005, compared to \$1,259,442 also 14% of net sales, in 2004. There were no significant changes in general and administrative expenses.

As a result of the loss from operations, a tax benefit of \$122,112 was recovered in 2005, compared to a tax benefit of \$102,356 in 2004. The Company has evaluated its accumulated tax benefit including the fact that the benefits are less than five years and the probability of future income tax to offset the benefit. Based on the evaluation of the probability of future taxable income, the Company has determined that no valuation allowance is currently required. The following comments include forward looking statements regarding the Company's ability to improve its operating results in the first quarter of 2006 which are subject to risks and uncertainties which would have an impact on the Company's valuation allowance. The financial results for the twelve month period ended December 31, 2005 reflect a continuation of losses the Company has experienced in each of the past four years. In determining whether a valuation allowance is currently required, the Company considered the net sales for the six month period ended December 2005 which were \$4,599,336, a ten percent improvement over sales of \$4,217,078 for the six month period ended June 30, 2005. As a result of the higher sales, improved margins and lower operating expenses, the income from operations for the six month period ended December 31, 2005 was \$126,638 compared to an operating loss of \$474,408 in the six month period ended June 30, 2005. In addition, the Company's backlog of orders at December 31, 2005 was approximately \$2,000,000 compared to the backlog of a year earlier of approximately \$1,200,000. Management anticipates that backlog releases for shipment and new business combined with the same level of manufacturing and operating expenses will result in continued improvement in operating results in the first quarter of 2006. The Company's ability to release backlog and improve operating results in the first quarter of 2006 is subject to a number of risks and uncertainties, including customer schedules on construction projects and availability of sufficient quantities of new products for which orders have been received.

### **Liquidity and Capital Resources.**

The Company's working capital at December 31, 2005 was \$2,709,484 compared to the working capital of \$2,989,704 at December 31, 2004. There were no significant equity or long term debt transactions in 2005.

Inventory on hand at December 31, 2005 was \$1,666,711, an increase of \$315,973 compared to the end of the prior year. During the fourth quarter of 2005 we completed development, and released for manufacturing, a new gas detection sensor module, a new FieldServer module and several ProtoCessor devices. ProtoCessor is a small module that enables Original Equipment Manufacturers (OEM) to integrate FieldServer capabilities into their product designs. Inventories were increased due to initial manufacture of the new items and also due to preparation of a large gas monitoring system that was not delivered prior to the year end.

At December 31, 2005 we had no long term liabilities.

We maintain a \$500,000 line of credit, secured by certain assets of the Company, with our commercial bank. The line of credit requires annual renewal and compliance with certain restrictive covenants including the requirement to maintain a quick ratio of 1.5:1.0 and a profitability test. At December 31, 2005 the Company was in compliance with the financial covenants and had a \$200,000 outstanding balance.

At December 31, 2005, our balance sheet reflected \$656,003 of cash and \$1,252,938 of net accounts receivable. At December 31, 2004 our total cash on hand was \$788,688 and our net accounts receivable was \$1,524,583.

The Company's management believes that its present resources, including cash and accounts receivable, are sufficient to fund its anticipated level of operations through at least January 1, 2007. There are no plans for significant capital equipment expenditures.

#### **Off Balance Sheet Arrangements.**

The Company does not currently have any off balance sheet arrangements.

#### **Inflation.**

Management believes that inflation will not have a material effect on the Company's results of operations.

#### **Critical Accounting Policies.**

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America requires management to make judgments, assumptions and estimates that affect the amounts reported in the Company's consolidated financial statements and the accompanying notes. The amounts of assets and liabilities reported on our balance sheet and the amounts of revenues and expenses reported for each of our fiscal periods are affected by estimates and assumptions, which are used for, but not limited to, the accounting for revenue recognition, accounts receivable, doubtful accounts and inventories. Actual results could differ from these estimates. The following critical accounting policies are significantly affected by judgments, assumptions and estimates used in the preparation of the financial statements:

##### Revenue Recognition

The Company recognizes revenues in accordance with Staff Accounting Bulletin ("SAB") No. 104, "Revenue Recognition," when all of the following conditions exist: a) persuasive evidence of an arrangement exists in the form of an accepted purchase order; b) delivery has occurred, based on shipping terms, or services have been rendered; c) the Company's price to the buyer is fixed or determinable, as documented on the accepted purchase order; and d) collectibility is reasonably assured. By product and service type, revenues are recognized when the following specific conditions are met:

##### Gas Detection and Environment Control Products

Gas Detection and Environment Control products are sold as off-the-shelf products with prices fixed at the time of order. Orders delivered to the Company by phone, fax, mail or email are considered valid purchase orders and once accepted by the Company are deemed to be the final understanding between us and our customer as to the specific nature and terms of the agreed-upon sale transaction. Products are shipped and are considered delivered when (a) for FOB factory orders they leave our shipping dock or (b) for FOB customer dock orders upon confirmation of delivery. The creditworthiness of customers is generally assessed prior to the Company accepting a customer's first order. Additionally, international customers and customers who have developed a history of payment problems are generally required to prepay or pay through a letter-of-credit.

##### Gas Detection and Environment Control Services

Gas Detection and Environment Control Services consist of field service orders (technical support) and training, which are provided separate from product orders. Orders are accepted in the same forms as discussed for Gas Detection and Environment Control Products above with hourly prices fixed at the time of order. Revenue recognition occurs only when the service activity is completed. Such services are provided to current and prior customers, and, as noted above, creditworthiness has generally already been assessed. In cases where the probability of receiving

receiving payment is low, a credit card number is collected for immediate processing.

#### FieldServer Products

FieldServer products are sold in the same manner as Gas Detection and Environment Control products (as discussed above) except that the products contain embedded software, which is integral to the operation of the device. The software embedded in FieldServer products includes two items: (a) A compiled program containing (i) the basic operating system for FieldServers, which is common to every unit, and (ii) the correct set of protocol drivers based on the customer order (see FieldServer Services below for more information); and (b) a configuration file that identifies and links each data point as identified by the customer. The Company does not deem the hardware, operating systems with protocol drivers and configuration files to be separate units of accounting, as defined in EITF 00-21, “*Revenue Arrangements with Multiple Deliverables*,” because the Company does not believe that they have value on a stand-alone basis. The hardware is useless without the software, and the software is only intended to be used in FieldServer hardware. Additionally, the software included in each sale is deemed to not require significant production, modification or customization, as described in Statement of Position (SOP) 97-02, “*Software Revenue Recognition*”, as amended, and therefore the Company recognize revenues upon the shipment or delivery of products (depending on shipping terms), as described in Gas Detection and Environment Control Products above.

#### FieldServer Services

FieldServer services consist of orders for custom development of protocol drivers. Generally customers place orders for FieldServer products concurrently with their order for protocol drivers. However, if custom development of the protocol driver is required, the product order is not processed until development of the protocol driver is complete. Orders are received in the same manner as described in *FieldServer Products* above, but due to the non-recurring engineering aspect of the customized driver development the Company is more likely to have a written evidence trail of a quotation and a hard copy order. The driver development involves further research after receipt of order, preparation of a scope document to be approved by the customer and then engineering time to write, test and release the driver program. When development of the driver is complete the customer is notified and can proceed with a FieldServer product (see FieldServer Products above). Revenues for driver development are billed and recognized upon shipment or delivery of the related product that includes the developed protocol drivers (as noted in FieldServer Products above). Collectibility is reasonably assured as described in FieldServer Products above.

#### Discounts and Allowances

Discounts are applied at time of order entry and sales are processed at net pricing. No allowances are offered to customers.

#### Accounts Receivable

Our domestic sales are generally made on an open account basis unless specific experience or knowledge of the customer’s potential inability or unwillingness to meet the payment terms dictate secured payments. Our international sales are generally made based on secure payments including cash wire advance payments and letters of credit. International sales are made on open account terms where sufficient historical experience justifies the credit risks involved. In many of our larger sales, the customers are frequently construction contractors who are in need of our start-up services to complete their work and obtain payment. Management’s ability to manage the credit terms and take advantage of the leverage of the need for our services is critical to the effective application of credit terms and minimization of accounts receivable losses.

We maintain an allowance for doubtful accounts which is analyzed on a periodic basis to insure that it is adequate to the best of management’s knowledge. We believe that we have demonstrated the ability to make

reasonable and reliable estimates of product returns and of allowances for doubtful accounts based on significant historical experience. Trends of sales returns, exchanges and warranty repairs are tracked as a management review item in the Company's ISO (International Organization for Standardization) quality program and data generated from that program forms a basis for the reserve management.

#### Inventories

Inventories are stated at the lower of cost or market, cost being determined on the first-in, first-out method. The Company uses an Enterprise Requirements Planning ("ERP") software system which provides data upon which management can rely to determine inventory trends and identify excesses. Write-down of slow moving and obsolete inventories are determined based on historical experience and current product demand. We evaluate the inventory for excess or obsolescence on a quarterly basis. The ultimate write-down is dependent upon management's ability to forecast demands accurately, manage product changes efficiently, and interpret the data provided by the ERP system.

The market cost of our inventory is equal to the realizable value which is based on management's forecast for sales of the Company's products in the ensuing years. The industry in which the Company operates is characterized by technological advancements and change. Should demand for the Company's products prove to be significantly less than anticipated, the ultimate realizable value of the Company's inventory could be substantially less than the amount shown on the accompanying balance sheet.

#### Determination of Applicability of Valuation Allowance

The Company determines the applicability of a valuation allowance against the accrued tax benefit by evaluating recent trends including sales levels, changes in backlog and fixed expenses. The Company also considers its plans for the current twelve month period regarding activities that would change the level of expenses relative to historical trends.

At December 31, 2005 the company determined that, based on the improvement in results of the second half of 2005 compared with the first half of 2005, including the profitability, improvement in backlog and plans for continued control of fixed expenses, no valuation allowance against the accrued tax benefit is required.

#### **Item 7. Financial Statements.**

Reference is made to the financial statements set forth in this Form 10-KSB report in Part IV, as indexed in Part III, Item 13, and by such reference such information is incorporated herein.

#### **Item 8. Changes In and Disagreements With Accountants on Accounting and Financial Disclosure.**

There have been no disagreements between Squar, Milner, Reehl, & Williamson, LLP and management of the type required to be reported under this Item 8 since the date of their engagement.

**Item 8a. Controls and Procedures.**

As of the end of the period covered by this report, management carried out an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures, pursuant to Exchange Act Rules 13a-15(e) and 15d-15(e) which includes inquiries made to certain other of our employees. Based upon that evaluation, the Principal Executive Officer and Principal Financial Officer concluded that, as of December 31, 2005 the Company's disclosure controls and procedures are effective. In addition there have been no significant changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) during the quarter ended December 31, 2005 that have materially affected or are reasonably likely to materially affect such internal controls.

**Item 8b. Other Information.**

There were no items required to be disclosed in an 8-K during the quarter ended December 31, 2005 that were not disclosed.

### PART III

#### Item 9. Directors, Executive Officers, Promoters and Control Persons; Compliance with Section 16(a) of the Exchange Act

The following table sets forth certain information with respect to the directors and executive officers of the Company as of December 31, 2005, based upon information furnished by such persons:

<u>Name</u>	<u>Principal Occupation or Employment</u>	<u>Age</u>	<u>Director or Officer Since</u>
Gordon R. Arnold	Director of the Company; President, Chief Executive Officer, Chief Financial Officer and Secretary	60	1984
Michael C. Farr	Vice President of Operations	48	1986
Edward K. Hague	Vice President of Engineering	44	1997
C. Richard Kramlich	Director of the Company	70	1980
Jay T. Last	Director of the Company	76	1977
Robert C. Marshall	Director of the Company	74	1998

All officers of the Company serve at the discretion of the Board of Directors.

Gordon R. Arnold joined Sierra Monitor Corporation, a California corporation (“Old Sierra”) in December 1979 as Operations Manager and Vice President. He became President in 1984 and Chief Executive Officer in 1985. In September 1989, Old Sierra merged into UMF Systems, Inc., a California corporation (“UMF”), and UMF changed its name to “Sierra Monitor Corporation.” Mr. Arnold has served as the Company’s President, Chief Executive Officer and Chief Financial Officer since the merger and as the Company’s Secretary since February 1993. Mr. Arnold was also a director of Old Sierra from 1984 until the merger with UMF.

Michael C. Farr joined Old Sierra in December 1983 as Operations Manager. He became Vice President, Operations in May 1986. Since the merger, Mr. Farr has served as Vice President, Operations of the Company.

Edward K. Hague joined the Company as Engineering Manager in July 1997. He became Vice President, Engineering in October 1997. Mr. Hague has consulted in the field of industrial communications for more than 10 years, initially consulting to Intellution, Inc., a leading process control software company, then to various companies, working on communication architecture design for IBM, Marin Municipal Water District, U.S. Postal Service, PG&E, Boeing and the U.S. Navy.

C. Richard Kramlich has been a Director of the Company since 1980. For more than the past five years, Mr. Kramlich has been a general partner of New Enterprise Associates, a venture capital firm. Mr. Kramlich’s present board memberships include Fabric7 Systems, Financial Engines, Force10 Networks, Foveon, Informative, Visual Edge Technology, Tabula, Nexthop Technologies, Xoom Corporation and Zhone Technologies. Mr. Kramlich received a Masters in Business Administration from the Harvard University Graduate School of Business and a Bachelor of Science in History from Northwestern University.

Jay T. Last has been a Director of the Company since 1980. Mr. Last, who was one of the founders of the first semiconductor manufacturing company, is a retired technologist and business investor. Mr. Last received a Ph.D. in Physics from Massachusetts Institute of Technology.

Robert C. Marshall has been a Director of the Company since 1998. Since 1997, Mr. Marshall has been the Managing General Partner of Selby Venture Partners, a venture capital firm. Mr. Marshall currently serves on the board of Bay Microsystems, Fabric7 Systems, OnSite Systems, QuickSilver Technology, and Triformix. Mr. Marshall received a Bachelors degree in Electrical Engineering from Heald Engineering and an MBA from Pepperdine University.

**Family Relationships.**

There are no family relationships between or among the directors, executive officers or persons nominated or charged by the Company to become directors or executive officers.

**Involvement in Legal Proceedings.**

To the Company's knowledge, during the past five years, none of the following occurred with respect to a present or former director or executive officer of the Company: (1) any bankruptcy petition filed by or against any business of which such person was a general partner or executive officer either at the time of the bankruptcy or within two years prior to that time; (2) any conviction in a criminal proceeding or being subject to a pending criminal proceeding (excluding traffic violations and other minor offenses); (3) being subject to any order, judgment or decree, not subsequently reversed, suspended or vacated, of any court of any competent jurisdiction, permanently or temporarily enjoining, barring, suspending or otherwise limiting his involvement in any type of business, securities or banking activities; and (4) being found by a court of competent jurisdiction (in a civil action), the SEC or the Commodities Futures Trading Commission to have violated a federal or state securities or commodities law, and the judgment has not been reversed, suspended or vacated.

With respect to the other information required by this item, the sections entitled "Election of Directors - Nominees" and "Section 16(a) Beneficial Ownership Reporting Compliance" of the Company's Information Statement pursuant to Section 14(c) of the Securities Exchange Act of 1934 ("Information Statement") for the Company's Annual Meeting of Shareholders to be held on May 16, 2006 and to be filed with the SEC within 120 days of December 31, 2005 are incorporated by reference herein.

**Item 10. Executive Compensation.**

The sections entitled "Compensation of Executive Officers" and "Compensation of Directors" in the Company's Information Statement are incorporated by reference herein.

**Item 11. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.**

The section entitled "Security Ownership of Certain Beneficial Owners and Management" in the Company's Information Statement is incorporated by reference herein.

**Item 12. Certain Relationships and Related Transactions.**

The section entitled "Certain Relationships and Related Transactions" in the Company's Information Statement is incorporated by reference herein.

**Item 13. Exhibits**

(a) Financial Statements. The following documents are filed as part of this report:

Balance Sheet at December 31, 2005

Statements of Operations for the years ended December 31, 2005 and 2004

Statements of Shareholders' Equity for the years ended December 31, 2005 and 2004

Statements of Cash Flows for the years ended December 31, 2005 and 2004

Notes to Financial Statements

(b) Exhibits.

<u>Exhibit Number</u>	<u>Description</u>
3.1 <sup>(1)</sup>	Articles of Incorporation of the Registrant.
3.2 <sup>(2)</sup>	Bylaws of the Registrant.
4.1 <sup>(3)</sup>	Specimen Common Stock Certificate of the Registrant.
10.1 <sup>(1)</sup>	1986 Stock Option Plan of Registrant as amended on December 1, 1987.
10.2 <sup>(4)</sup>	1996 Stock Plan of Registrant.
10.3 <sup>(5)</sup>	Assignment of Intellectual Property and Transfer of Rights.
10.4 <sup>(6)</sup>	Assignment of Intellectual Property, Transfer of Rights and Asset Purchase Agreement.
10.5 <sup>(7)</sup>	Standard Industrial Lease dated April 4, 2004, by and between Geomax and the Registrant.
23.1	Consent of Independent Registered Public Accounting Firm.
31.1	Rule 13a-14(e) Certification of Chief Executive Officer
31.2	Rule 13a-14(e) Certification of Chief Financial Officer
32.1	Section 1350 Certification of Chief Executive Officer and Chief Financial Officer

(1) Incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1989.

(2) Incorporated by reference to the Company's Quarterly Report on Form 10-QSB (File No. 000-07441) filed with the SEC on August 14, 1998.

(3) Incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2003.

(4) Incorporated by reference to the Company's Registration Statement on Form S-8 (File No. 333-85376) filed with the SEC on April 2, 2004.

(5) Incorporated by reference to the Company's Quarterly Report on Form 10-QSB (File No. 000-07441) filed with the SEC on November 13, 1998.

(6) Incorporated by reference to the Company's Quarterly Report on Form 10-QSB (File No. 000-07441) filed with the SEC on May 14, 1999.

(7) Incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2004.

**Item 14. Principal Accountant Fees and Services**

The section entitled "Principal Accountant Fees and Services" in the Company's Information Statement is incorporated by reference herein.

## SIGNATURES

In accordance with Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has caused this report to be signed on its behalf by the undersigned, thereto duly authorized, on March 28, 2006.

### SIERRA MONITOR CORPORATION

(Registrant)

By /s/ Gordon R. Arnold

Gordon R. Arnold  
Chief Executive Officer

In accordance with the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Date</u>	<u>Title</u>	<u>Signature</u>
March 28, 2006	Chief Executive Officer, Chief Financial Officer and Director (Principal Executive, Financial and Accounting Officer)	By <u>/s/ Gordon R. Arnold</u> Gordon R. Arnold
March 28, 2006	Director	By <u>/s/ C. Richard Kramlich</u> C. Richard Kramlich
March 28, 2006	Director	By <u>/s/ Jay T. Last</u> Jay T. Last
March 28, 2006	Director	By <u>/s/ Robert C. Marshall</u> Robert C. Marshall

**PART IV**

**SIERRA MONITOR CORPORATION**

Financial Statements

December 31, 2005

# SIERRA MONITOR CORPORATION

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## **REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Shareholders  
Sierra Monitor Corporation

We have audited the accompanying balance sheet of Sierra Monitor Corporation (the "Company"), as of December 31, 2005, and the related statements of operations, shareholders' equity and cash flows for each of the two years in the period ended December 31, 2005. 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 the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Sierra Monitor Corporation as of December 31, 2005, and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2005 in conformity with accounting principles generally accepted in the United States of America.

**/s/ Squar, Milner, Reehl & Williamson, LLP**

Newport Beach, California  
February 17, 2006

# SIERRA MONITOR CORPORATION

## Balance Sheet

December 31, 2005

### Assets

#### Current assets:

Cash	\$	656,003
Trade receivables, less allowance for doubtful accounts of approximately \$53,000		1,252,938
Inventories, net		1,666,711
Prepaid expenses		84,676
Deferred income taxes		213,974
Total current assets		<u>3,874,302</u>

Property and equipment, net		150,809
Deferred income taxes		253,712
Other assets		<u>113,379</u>
Total assets	\$	<u><u>4,392,202</u></u>

### Liabilities and Shareholders' Equity

#### Current liabilities:

Accounts payable	\$	628,534
Accrued compensation expenses		257,643
Bank borrowings		200,000
Other current liabilities		78,641
Total current liabilities		<u>1,164,818</u>

#### Commitments and contingencies

#### Shareholders' equity:

Common stock, \$0.001 par value; 20,000,000 shares authorized; 11,048,213 shares issued and outstanding		11,048
Additional paid-in capital		3,231,545
Retained earnings		(15,209)
Total shareholders' equity		<u>3,227,384</u>

Total liabilities and shareholders' equity	\$	<u><u>4,392,202</u></u>
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See accompanying notes to financial statements.

**SIERRA MONITOR CORPORATION**  
 Statements of Operations  
 For the Years Ended December 31, 2005 and 2004

	<b>2005</b>	<b>2004</b>
Net sales	\$ 8,816,414	\$ 9,125,536
Cost of goods sold	3,540,438	3,573,271
Gross profit	5,275,976	5,552,265
Operating expenses:		
Research and development	1,694,977	1,810,929
Selling and marketing	2,652,871	2,769,870
General and administrative	1,275,894	1,259,442
	5,623,742	5,840,241
Loss from operations	(347,766)	(287,976)
Interest expense	5,025	-
Loss before provision for income tax benefit	(352,791)	(287,976)
Income tax benefit	(122,112)	(102,356)
Net loss	\$ (230,679)	\$ (185,620)
Basic and diluted net loss attributable to common		
shareholders per common share	\$ (0.02)	\$ (0.02)
Weighted-average number of shares used in per share computations:		
Basic and diluted	11,009,724	10,976,738

See accompanying notes to financial statements.

# SIERRA MONITOR CORPORATION

## Statements of Shareholders' Equity

For the Years Ended December 31, 2005 and 2004

	Common stock		Additional	Retained	Notes	Total
	Shares	Amount	paid-in capital		receivable from shareholders	
Balance as of						
December 31, 2003	10,971,546	10,972	3,151,189	401,090	–	3,563,251
Stock options exercised	10,000	10	2,190	–	–	2,200
Warrants compensation expense	–	–	30,800	–	–	30,800
Net loss	–	–	–	(185,620)	–	(185,620)
Balance as of						
December 31, 2004	10,981,546	\$ 10,982	\$ 3,184,179	\$ 215,470	\$ –	\$ 3,410,631
Stock options exercised	66,667	66	16,566	–	–	16,632
Warrants compensation expense	–	–	30,800	–	–	30,800
Net loss	–	–	–	(230,679)	–	(230,679)
Balance as of						
December 31, 2005	<u>11,048,213</u>	<u>\$ 11,048</u>	<u>\$ 3,231,545</u>	<u>\$ (15,209)</u>	<u>\$ –</u>	<u>\$ 3,227,384</u>

See accompanying notes to financial statements.

## SIERRA MONITOR CORPORATION

### Statements of Cash Flows

For the Years Ended December 31, 2005 and 2004

	2005	2004
Cash flows from operating activities:		
Net loss	\$ (230,679)	\$ (185,620)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	133,890	139,885
Amortization	14,722	22,184
Deferred income taxes	(124,588)	(107,218)
Provision for bad debt expense	34,823	(19,580)
Provision for inventory losses	(24,000)	79,894
Warrants compensation expense	30,800	30,800
Changes in operating assets and liabilities:		
Trade receivables	236,822	(326,351)
Inventories	(291,973)	(137,521)
Prepaid expenses	80,392	(46,139)
Income taxes receivable	-	79,254
Other assets	325	700
Accounts payable	41,896	241,560
Accrued compensation expenses	(84,255)	135,999
Other current liabilities	(30,510)	(7,418)
Net cash used in operating activities	(212,335)	(99,571)
Cash flows from investing activities:		
Purchases of property and equipment	(136,982)	(166,522)
Other asset additions	-	(2,500)
Net cash used in investing activities	(136,982)	(169,022)
Cash flows from financing activities:		
Bank borrowings	200,000	-
Proceeds from exercise of options	16,632	2,200
Net cash provided by financing activities	216,632	2,200
Net decrease in cash	(132,685)	(266,393)
Cash – beginning of year	788,688	1,055,081
Cash – end of year	\$ 656,003	\$ 788,688
Supplemental disclosure of cash flow information:		
Cash paid during the year for income taxes	\$ 3,292	\$ 3,585
Cash paid during the year for interest	\$ 5,025	-

See accompanying notes to financial statements.

# SIERRA MONITOR CORPORATION

Notes to Financial Statements

December 31, 2005 and 2004

## Note 1 - Summary of the Company and Significant Accounting Policies

### The Company

Sierra Monitor Corporation (the "Company") was incorporated in 1978. The Company designs, manufactures, and markets hazardous gas monitoring devices for industrial workplaces. The Company also designs and manufactures environment controllers for the telecommunications industry, as well as a line of software-based industrial communication bridge products known as FieldServers. The Company's headquarters are located in California. The Company's stock is quoted on the OTC Bulletin Board under the symbol "SRMC.OB."

### Concentrations

The Company currently maintains substantially all of its day to day operating cash with a major financial institution. At times cash balances may be in excess of the amounts insured by the Federal Deposit Insurance Corporation. Cash balances of approximately \$601,000 were in excess of such insured amounts at December 31, 2005.

The Company grants credit to customers within the United States of America and generally does not require collateral. The Company has international sales (see Note 9) that are generally prepaid or paid through a letter of credit. The Company's ability to collect receivables is affected by economic fluctuations in the geographic areas served by the Company. Reserves for uncollectible amounts are provided, based on past experience and a specific analysis of the accounts, which management believes are sufficient. Although management expects to collect amounts due, actual collections may differ from the estimated amounts.

No customer accounted for more than 10% of accounts receivable at December 31, 2005. No customers accounted for more than 10% of sales for either of the years ended December 31, 2005 and 2004.

### Risks and Uncertainties

The Company operates in a highly competitive industry that is subject to intense competition, government regulation and rapid technological change. The Company's operations are subject to significant risks and uncertainties including financial, operational, technological, regulatory and other business risks associated with such a company.

### Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates made by management are, among others, the allowance for bad debts on trade receivables, net realization of inventory, realizability of long-lived assets, the provision for warranty returns and deferred income tax asset valuation.

## **Accounts Receivable**

We maintain an allowance for doubtful accounts which is analyzed on a periodic basis to insure that it is adequate to the best of management's knowledge. We believe that we have demonstrated reliable estimates of product returns and of allowances for doubtful accounts based on significant historical experience. Trends of sales returns, exchanges and warranty repairs are tracked as a management review item in the Company's ISO (International Organization for Standardization) quality program and data generated from that program forms a basis for the reserve management.

## **Inventories**

Inventories are stated at the lower of cost (first-in, first-out) or market. Cost is determined on a standard cost basis that approximates the first-in, first-out method. Market is determined by comparison with recent sales or net realizable value (see Note 2).

Such net realizable value is based on management's forecasts for sales of the Company's products or services in the ensuing years. The industry in which the Company operates is characterized by technological advancement, change and certain regulations. Should the demand for the Company's products prove to be significantly less than anticipated, the ultimate realizable value of the Company's inventories could be substantially less than amounts shown in the accompanying balance sheet. Management maintains a reserve for obsolescence sufficient to cover slow-moving and obsolete inventory.

## **Property and Equipment**

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is provided on the straight-line method over the estimated useful lives of the respective assets, generally two to five years. Leasehold improvements are amortized using the straight-line method over the shorter of the lease term or the estimated useful life of the related asset. Betterments, renewals, and extraordinary repairs that extend the lives of the assets are capitalized; other repairs and maintenance charges are expensed as incurred. The cost and related accumulated depreciation applicable to assets sold or retired are removed from the accounts, and the gain or loss on disposition is recognized in current operations.

## **Research and Development**

Research and development is primarily comprised of engineering salaries, new product development costs, software development and maintenance costs and certain other general costs, such as depreciation on engineering equipment. Research and development costs are expenses as incurred. All software development and maintenance costs are expensed as incurred.

## **Long-Lived Assets**

Statement of Financial Accounting Standards ("SFAS") No. 144, "*Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of*" addresses financial accounting and reporting for the impairment or disposal of long-lived assets. SFAS 144 requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. If the cost basis of a long-lived asset is greater than the projected future undiscounted net cash flows from such asset (excluding interest), an impairment loss is recognized. Impairment losses are calculated as the difference between the cost basis of an asset and its estimated fair value. SFAS 144 also requires companies to separately report discontinued operations and extends that reporting to a component of an entity that either has been disposed of (by sale, abandonment, or in a distribution to shareholders) or is classified as held for sale. Assets to be

disposed are reported at the lower of the carrying amount or fair value less costs to sell. The provisions of this statement for assets held for sale or other disposal are generally required to be applied prospectively after the adoption date to newly initiated commitments to plan, as defined, by management. At December 31, 2005, management has determined that there were no indicators requiring review for impairment and therefore no adjustments have been made to the carrying values of long-lived assets. There can be no assurance, however, that market conditions will not change or demand for the Company's products or services will continue which could result in impairment of long-lived assets in the future.

## **Revenue Recognition**

The Company recognizes revenues in accordance with Staff Accounting Bulletin ("SAB") No. 104, "*Revenue Recognition*," when all of the following conditions exist: a) persuasive evidence of an arrangement exists in the form of an accepted purchase order; b) delivery has occurred, based on shipping terms, or services have been rendered; c) the Company's price to the buyer is fixed or determinable, as documented on the accepted purchase order; and d) collectibility is reasonably assured. By product and service type, revenues are recognized when the following specific conditions are met:

### *Gas Detection and Environment Control Products*

Gas Detection and Environment Control products are sold as off-the-shelf products with prices fixed at the time of order. Orders delivered to the Company by phone, fax, mail or email are considered valid purchase orders and once accepted by the Company are deemed to be the final understanding between us and our customer as to the specific nature and terms of the agreed-upon sale transaction. Products are shipped and are considered delivered when (a) for FOB factory orders they leave our shipping dock or (b) for FOB customer dock orders upon confirmation of delivery. The creditworthiness of customers is generally assessed prior to the Company accepting a customer's first order. Additionally, international customers and customers who have developed a history of payment problems are generally required to prepay or pay through a letter-of-credit.

### *Gas Detection and Environment Control Services*

Gas Detection and Environment Control Services consist of field service orders (technical support) and training, which are provided separate from product orders. Orders are accepted in the same forms as discussed for Gas Detection and Environment Control Products above with hourly prices fixed at the time of order. Revenue recognition occurs only when the service activity is completed. Such services are provided to current and prior customers, and, as noted above, creditworthiness has generally already been assessed. In cases where the probability of receiving payment is low, a credit card number is collected for immediate processing.

### *FieldServer Products*

FieldServer products are sold in the same manner as Gas Detection and Environment Control products (as discussed above) except that the products contain embedded software, which is integral to the operation of the device. The software embedded in FieldServer products includes two items: (a) a compiled program containing (i) the basic operating system for FieldServers, which is common to every unit, and (ii) the correct set of protocol drivers based on the customer order (see FieldServer Services below for more information); and (b) a configuration file that identifies and links each data point as identified by the customer. The Company does not deem the hardware, operating systems with protocol drivers and configuration files to be separate units of accounting, as defined in EITF 00-21, "*Revenue Arrangements with Multiple Deliverables*," because the Company does not believe that they have value on a stand-alone basis. The hardware is useless without the software, and the software is only intended to be used in FieldServer hardware. Additionally, the software included in each sale is deemed to not require significant production, modification or customization, as described in Statement of Position (SOP) 97-02, "*Software Revenue Recognition*", as amended, and therefore the

the Company recognizes revenues upon the shipment or delivery of products (depending on shipping terms), as described in Gas Detection and Environment Control Products above.

#### FieldServer Services

FieldServer services consist of orders for custom development of protocol drivers. Generally customers place orders for FieldServer products concurrently with their order for protocol drivers. However if custom development of the protocol driver is required, the product order is not processed until development of the protocol driver is complete. Orders are received in the same manner as described in *FieldServer Products* above, but due to the non-recurring engineering aspect of the customized driver development the Company is more likely to have a written evidence trail of a quotation and a hard copy order. The driver development involves further research after receipt of order, preparation of a scope document to be approved by the customer and then engineering time to write, test and release the driver program. When development of the driver is complete the customer is notified and can proceed with a FieldServer product (see FieldServer Products above). Revenues for driver development are billed and recognized upon shipment or delivery of the related product that includes the developed protocol drivers (as noted in FieldServer Products above). Collectibility is reasonably assured as described in FieldServer Products above.

#### Discounts and Allowances

Discounts are applied at time of order entry and sales are processed at net pricing. No allowances are offered to customers.

### **Employee Stock-Based Compensation**

The Company accounts for stock-based compensation issued to employees using the intrinsic value method as prescribed by Accounting Principles Board Opinion No. 25 ("APB 25"), *"Accounting for Stock issued to Employees."* Under the intrinsic value based method, compensation expense is calculated as the excess, if any, of the fair value of the stock at the grant date or other measurement date over the amount an employee must pay to acquire the stock. Compensation expense, if any, is recognized over the applicable service period, which is usually the vesting period.

SFAS 123, *"Accounting for Stock-Based Compensation,"* as amended by SFAS 148, *"Accounting for Stock-Based Compensation - Transition and Disclosure, an amendment of FASB Statement No. 123,"* changed the method of accounting for employee stock-based compensation plans to the fair value method. For stock options and warrants, fair value is determined using an option pricing model that takes into account the stock price at the grant date, the exercise price, the expected life of the option or warrant, stock volatility, and the annual rate of quarterly dividends. Compensation expense, if any, is recognized over the applicable service period, which is usually the vesting period.

The adoption of the accounting methodology of SFAS 123 is optional and the Company has elected to continue accounting for stock-based compensation issued to employees using APB 25; however, pro forma disclosures, as if the Company adopted the cost recognition requirement under SFAS 123, are required to be presented (see below). SFAS 123 was amended in December 2004 by SFAS 123-R and accounting treatment under APB 25 will no longer be available after December 31, 2005 (see Significant Recent Accounting Pronouncements below).

At December 31, 2005, the Company has one stock-based employee compensation plan, which is described more fully in Note 6. The company accounts for those plans under the recognition and measurement principles of APB 25, and related Interpretations. No stock-based employee compensation cost is reflected in net loss, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net loss and loss per share if the Company had applied the fair value recognition provisions of SFAS 123 to stock-based employee compensation.

	<u>2005</u>	<u>2004</u>
Net loss:		
As reported	\$ (230,679)	\$ (185,620)
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards	\$ (155,066)	\$ (164,501)
Pro forma	<u>\$ (385,745)</u>	<u>\$ (350,121)</u>
Basic and diluted net loss per common share:		
As reported	\$ (0.02)	\$ (0.02)
Pro forma	\$ (0.03)	\$ (0.03)

## Warranty

The Company provides a warranty on all electronics sold for a period of two years after the date of shipment. Warranty issues are usually resolved with repair or replacement of the product. Trends of sales returns, exchanges and warranty repairs are tracked as a management review item in the Company's ISO (International Organization for Standardization) quality program and data generated from that program forms a basis for the reserve that management records in our financial statements. Estimated future warranty obligations related to certain products and services are provided by charges to operations in the period in which the related revenue is recognized. At December 31, 2005, warranty reserve approximated \$40,000, which is recorded under other current liabilities on the balance sheet.

## Advertising

The Company expenses the cost of advertising when incurred as selling and marketing expense in the accompanying statements of operations. Advertising expenses were approximately \$120,000 and \$94,000 for the years ended December 31, 2005 and 2004, respectively.

## Shipping and Handling Costs

Shipping and handling costs are included in cost of goods sold in the accompanying statements of operations in accordance with Emerging Issues Task Force ("EITF") No. 00-10, *"Accounting for Shipping and Handling Fees and Costs."*

## Income Taxes

Income taxes are accounted for using the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is established when management estimates that future taxable income will not fully utilize deferred tax assets.

## Earnings Per Share

Under SFAS 128, “*Earnings Per Share*,” basic loss per common share is computed by dividing loss available to common shareholders by the weighted-average number of common shares assumed to be outstanding during the period of computation. Diluted loss per share is computed similar to basic loss per share except that the denominator is increased to include the number of additional common shares that would have been outstanding, using the treasury stock method, if the potential common shares had been issued and if the additional common shares were dilutive.

The following is a reconciliation of the shares used in the computation of basic and diluted loss per share for the years ended December 31, 2005 and 2004, respectively:

	<u>2005</u>	<u>2004</u>
Basic loss per share – weighted-average number of shares of common stock outstanding	11,009,724	10,976,738
Effect of dilutive stock options and warrants	—	—
Diluted loss per share – dilutive potential common shares	<u>11,009,724</u>	<u>10,976,738</u>

For purposes of calculating diluted loss per share, there were no adjustments to net loss.

The Company reported net losses for the years ended December 31, 2005 and 2004. As a result, options to purchase 1,195,500 and 1,556,500 shares of common stock (see Note 6) as well as warrants to purchase 110,000 shares of common stock in 2004 have been excluded from the calculation of diluted net loss per share, because those shares would be antidilutive.

## Comprehensive Income (Loss)

SFAS 130, “*Reporting Comprehensive Income*,” established standards for reporting and display of comprehensive income and its components in a full set of general-purpose financial statements. For the years ended December 31, 2005 and 2004, the Company had no items of comprehensive income.

## Segments of Business

SFAS 131, “*Disclosures about Segments of an Enterprise and Related Information*,” changed the way public companies report information about segments of their business in their quarterly and annual reports issued to stockholders. It also requires entity-wide disclosures about the products and services an entity provides, the material countries in which it holds assets and reports revenues and its major customers. The Company currently operates in one segment, as disclosed in the accompanying consolidated statements of operations, however, the Chief Executive Officer (“CEO”) reviews financial information on an entity level (see Note 9).

## Fair Value of Financial Instruments

SFAS 107, “*Disclosures About Fair Value of Financial Instruments*,” requires disclosure of fair value information about financial instruments when it is practicable to estimate that value. The carrying amounts of the Company's cash, trade receivables, accounts payables, accrued liabilities, and bank borrowings approximate their estimated fair values due to the short-term maturities of those financial instruments.

## Goodwill and Intangible Assets

SFAS 142, *"Goodwill and Other Intangible Assets,"* addresses how intangible assets that are acquired individually or with a group of other assets should be accounted for in the financial statements upon their acquisition and after they have been initially recognized in the financial statements. SFAS 142 requires that goodwill and intangible assets that have indefinite useful lives not be amortized but rather be tested at least annually for impairment, and intangible assets that have finite useful lives (see Note 4) be amortized over their useful lives. The Company has no goodwill or indefinite-life intangible assets not subject to amortization.

## Significant Recent Accounting Pronouncements

In January 2003, the FASB issued FASB Interpretation ("FIN") No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB 51." The primary objectives of FIN 46 are to provide guidance on the identification of entities for which control is achieved through means other than voting rights (variable interest entities, or "VIEs") and how to determine when and which business enterprise should consolidate the VIE. This new model for consolidation applies to an entity for which either: (1) the equity investors do not have a controlling financial interest; or (2) the equity investment at risk is insufficient to finance that entity's activities without receiving additional subordinated financial support from other parties. In addition, FIN 46 requires that both the primary beneficiary and all other enterprises with a significant variable interest in a VIE make additional disclosures. As amended in December 2004, the effective dates of FIN 46 for public entities that are small business issuers, as defined ("SBIs"), are as follows: (a) For interests in special-purpose entities ("SPEs"): periods ended after December 15, 2004; and (b) For all other VIEs: periods ended after December 15, 2004. The December 2003 amendment of FIN 46 also includes transition provisions that govern how an SBI which previously adopted the pronouncement (as it was originally issued) must account for consolidated VIEs. Management has concluded that the Company does not have any VIE's and does not believe FIN 46 will have any significant effect on the Company's future financial statements.

In November 2004, the FASB issued SFAS 151, "Inventory Costs - an amendment of ARB No. 43, Chapter 4," which clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material. In Chapter 4 of ARB 43, paragraph 5 previously stated that "...under some circumstances, items such as idle facility expense, excessive spoilage, double freight, and re-handling costs may be so abnormal as to require treatment as current period charges..." SFAS 151 requires that such items be recognized as current-period charges, regardless of whether they meet the criterion of so abnormal (an undefined term). This pronouncement also requires that allocation of fixed production overhead to the costs of conversion be based on the normal capacity of the production facilities. SFAS 151 is effective for inventory costs incurred in years beginning after June 15, 2005. Management does not believe this pronouncement will have a significant impact on its future financial statements.

In December 2004, the FASB issued SFAS 123-R, "Share-Based Payment," which requires that the compensation cost relating to share-based payment transactions (including the cost of all employee stock options) be recognized in the financial statements. That cost will be measured based on the estimated fair value of the equity or liability instruments issued. SFAS 123-R covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. SFAS 123-R replaces SFAS 123, "Accounting for Stock-Based Compensation," and supersedes Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees." As originally issued, SFAS 123 established as preferable a fair-value-based method of accounting for share-based payment transactions with employees. However, that pronouncement permitted entities to continue applying the intrinsic-value model of APB Opinion 25, provided that the financial statements disclosed the pro

forma net income or loss based on the preferable fair-value method. Small Business Issuers are required to apply SFAS 123-R in the first interim or annual reporting period that begins after December 15, 2005. Thus, the Company's financial statements will reflect an expense for (a) all share-based compensation arrangements granted after December 31, 2005 and for any such arrangements that are modified, cancelled, or repurchased after that date, and (b) the portion of previous share-based awards for which the requisite service has not been rendered as of that date, based on the grant-date estimated fair value. Management has not determined the future effect of this pronouncement on its future financial statements.

The FASB issued SFAS 153, "Exchanges of Nonmonetary Assets, an amendment of APB Opinion 29, Accounting for Nonmonetary Transactions." The amendments made by SFAS 153 are based on the principle that exchanges of nonmonetary assets should be measured using the estimated fair value of the assets exchanged. SFAS 153 eliminates the narrow exception for nonmonetary exchanges of similar productive assets, and replaces it with a broader exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has "commercial substance" if the future cash flows of the entity are expected to change significantly as a result of the transaction. This pronouncement is effective for nonmonetary exchanges in fiscal periods beginning after June 15, 2005. Management does not believe that this pronouncement will have a significant effect on its future financial statements.

Other recent accounting pronouncements issued by the FASB (including its Emerging Issues Task Force), the AICPA, and the SEC did not or are not believed by management to have a material impact on the Company's present or future consolidated financial statements.

## Note 2 – Inventories

A summary of inventories as of December 31, 2005 follows:

Raw materials	\$ 662,392
Work in process	873,668
Finished goods	259,975
Obsolescence reserve	<u>(129,325)</u>
	<u>\$ 1,666,711</u>

## Note 3 - Property and Equipment

A summary of property and equipment as of December 31, 2005 follows:

Machinery and equipment	\$ 437,779
Furniture, fixtures, and leasehold improvements	<u>786,778</u>
	1,224,557
Less accumulated depreciation and amortization	<u>(1,073,748)</u>
	<u>\$ 150,809</u>

## Note 4 - Other Assets

As of December 31, 2005, other assets consist principally of lease deposits and certain specifically identifiable intangible assets and technology rights. As of December 31, 2005, the remaining balances of intangible assets were \$66,580 net of accumulated amortization of \$159,246. Certain fully amortized intangible assets with an original cost of \$13,682 were retired during the year-ended December 31, 2005. Future amortization of intangible assets is not estimated to be material.

## Note 5 – Related Party Transactions

There are no related party transactions.

### Note 6 - Employee Stock Compensation Plan

During 1996, the Company's 1986 Stock Option Plan expired. Subsequently, the shareholders adopted the 1996 Stock Plan. The Company has reserved 1,600,000 shares of common stock for issuance under the 1996 Stock Plan. Options are granted under the 1996 Stock Plan at the fair market value of the Company's common stock at the grant date, vest ratably over 4 years, and expire 10 years from the grant date.

As of December 31, 2005, there were 388,875 shares available for grant under the Company's 1996 Stock Plan. A summary of stock option transactions for the two years ended December 31, 2005 follows:

	<u>Options</u>	<u>Range of prices</u>	<u>Weighted-average exercise price</u>
Balance as of January 1, 2004	1,452,500	0.22 – 1.50	0.78
Granted	150,000	0.60 – 0.63	0.62
Exercised	(10,000)	0.22	0.22
Canceled	<u>(36,000)</u>	0.22 – 1.48	0.47
Balance as of December 31, 2004	1,556,500	0.22 – 1.50	0.77
Granted	69,000	1.10	1.10
Exercised	(66,667)	0.22 – 0.56	0.25
Canceled	<u>(363,333)</u>	0.22 – 1.50	0.92
Balance as of December 31, 2005	<u>1,195,500</u>	0.23 – 1.48	0.76

The following table summarizes information about the Company's stock options outstanding under the plan as of December 31, 2005:

<u>Exercise prices</u>	<u>Options outstanding</u>			<u>Options exercisable</u>	
	<u>Number outstanding</u>	<u>Weighted-average remaining contractual life (years)</u>	<u>Weighted-average exercise price</u>	<u>Number exercisable</u>	<u>Weighted-average exercise price</u>
\$ 0.23 – 1.48	1,126,500	5.0	\$ 0.73	989,000	\$ 78.00
1.10	<u>69,000</u>	9.9	1.10	—	0.00
	<u>1,195,500</u>	5.3	0.76	<u>989,000</u>	0.78

The weighted average grant date fair values of options granted during the years ended December 31, 2005 and 2004 were \$1.10 and \$0.59 per share, respectively. Such fair values were estimated using the Black-Scholes stock option pricing model and the following weighted average assumptions:

	<u>2005</u>	<u>2004</u>
Expected life	8 years	8 years

Estimated volatility	81%	186%
Risk-free interest rate	4.5%	4.6%
Dividends	None	None

#### Note 7- Warrants

The Company has warrants outstanding to acquire 110,000 shares of common stock at \$0.65 per share. The warrants vest over five years. As of December 31, 2005, 33,000 of the 110,000 warrants had vested and are exercisable. The warrants expire on December 31, 2014. No warrants were granted during the year ended December 31, 2005.

#### Note 8 - Commitments

##### Leases

The Company leases its facilities under non-cancelable operating lease agreements that expire at various dates through 2009. Certain leases require the payment of property taxes, utilities and insurance, and provide options to extend the lease term.

As of December 31, 2005, future minimum lease payments are as follows:

<b><u>Year ending</u></b> <b><u>December 31,</u></b>	
2006	339,000
2007	336,000
2008	320,000
2009	105,000
2010	-
	<u>\$ 1,100,000</u>

Rent expense was approximately \$369,000 and \$363,000 in 2005 and 2004, respectively.

##### Legal

The Company may be involved from time to time in various claims, lawsuits, disputes with third parties, actions involving allegations or discrimination or breach of contracts actions incidental to the normal course of operations. The Company is currently not involved in any such litigation that management believes could have a material adverse effect on its financial position or results of operations.

#### Note 9 – Line-of-Credit

As of December 31, 2005, the Company has a \$500,000 line of credit, secured by certain assets of the Company, that bears interest at the Bank's prime rate (7.0% at December 31, 2005) plus 0.5%. The line of credit requires annual renewal and compliance with certain restrictive covenants including the requirement to maintain a quick ratio of 1.5:1.0 and a quarterly profitability test. At December 31, 2005 the Company was in compliance with the financial covenants and had a \$200,000 outstanding balance.

## Note 10 - Income Taxes

The components of income tax (benefit) expense consist of the following:

	<u>2005</u>	<u>2004</u>
Current:		
Federal	\$ -	\$ -
State	2,650	4,863
Total current	<u>2,650</u>	<u>4,863</u>
Deferred:		
Federal	(112,888)	(62,447)
State	(11,874)	(44,772)
Total deferred	<u>(124,762)</u>	<u>(107,219)</u>
	<u>\$ (122,112)</u>	<u>\$ (102,356)</u>

At December 31, 2005, the Company has federal net operating loss carryforwards of approximately \$400,000 and state tax net operating loss carryforwards of approximately \$600,000. In addition, the Company has approximately \$18,000 in federal business credit carryforwards and \$30,000 in state business credit carryforwards. The carryforwards begin to expire in 2012.

The tax effects of temporary differences that gave rise to significant portions of deferred tax assets and liabilities at December 31, 2005 are as follows:

	<u>2005</u>
Accruals and Reserves	\$ 217,052
State Taxes	(3,077)
NOL and Credit Carryforwards	200,396
Property, Plant and Equipment	53,316
Total deferred tax assets	<u>467,687</u>
Valuation Allowance	—
Net Deferred Tax Assets	<u>\$ 467,687</u>

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which temporary differences become deductible or includable in taxable income. Management considers projected future taxable income and tax planning strategies in making this assessment. Based upon the level of historical income and projections for future taxable income over the periods to which the deferred tax assets are applicable, management believes it is more likely than not the Company will realize the benefits of these deductible differences and, therefore, no valuation allowance is deemed necessary at December 31, 2005.

The provision (benefit) for income tax differs from the amounts computed by applying the statutory federal income tax rate of 34% as follows:

	<u>2005</u>	<u>2004</u>
Computed tax (benefit) expense	\$ (119,950)	\$ (97,911)
Nondeductible items and other	3,985	12,357
State taxes, net of federal benefit	<u>(6,147)</u>	<u>(16,802)</u>
		\$
Total Income Tax (Benefit) Expense	<u><u>\$ (122,112)</u></u>	<u><u>\$ (102,356)</u></u>

### Note 11 - Segment Reporting

The Company's chief operating decision-maker is considered to be the Company's chief executive officer (CEO). The CEO reviews financial information presented on an entity level basis for purposes of making operating decisions and assessing financial performance. The entity-level financial information is identical to the information presented in the accompanying statements of operations. Therefore, the Company has determined that it operates in a single operating segment: industrial gas detection and monitoring devices.

In addition, the CEO reviews the following information on revenues by product category:

	<u>2005</u>	<u>2004</u>
Gas detection devices	\$ 5,282,000	\$ 5,428,000
Environmental controllers	1,210,000	1,172,000
FieldServers	<u>2,324,000</u>	<u>2,525,000</u>
	<u><u>\$ 8,816,000</u></u>	<u><u>\$ 9,125,000</u></u>

The Company sells its products to companies located primarily in the United States. In the years ended December 31, 2005 and 2004, sales to international customers were 17% and 10%, respectively.

## Exhibits.

<u>Exhibit Number</u>	<u>Description</u>
3.1 <sup>(1)</sup>	Articles of Incorporation of the Registrant.
3.2 <sup>(2)</sup>	Bylaws of the Registrant.
4.1 <sup>(3)</sup>	Specimen Common Stock Certificate of the Registrant.
10.1 <sup>(1)</sup>	1986 Stock Option Plan of Registrant as amended on December 1, 1987.
10.2 <sup>(4)</sup>	1996 Stock Plan of Registrant.
10.3 <sup>(5)</sup>	Assignment of Intellectual Property and Transfer of Rights.
10.4 <sup>(6)</sup>	Assignment of Intellectual Property, Transfer of Rights and Asset Purchase Agreement.
10.5	Standard Industrial Lease dated April 4, 2003, by and between Geomax and the Registrant.
23.1	Consents of Registered Public Accounting Firm.
31.1	Rule 13a-14(e) Certification of Chief Executive Officer
31.2	Rule 13a-14(e) Certification of Chief Financial Officer
32.1	Section 1350 Certification of Chief Executive Officer and Chief Financial Officer
(1)	Incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1989.
(2)	Incorporated by reference to the Company's Quarterly Report on Form 10-QSB (File No. 000-07441) filed with the SEC on August 14, 1998.
(3)	Incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2003.
(4)	Incorporated by reference to the Company's Registration Statement on Form S-8 (File No. 333-85376) filed with the SEC on April 2, 2004.
(5)	Incorporated by reference to the Company's Quarterly Report on Form 10-QSB (File No. 000-07441) filed with the SEC on November 13, 1998.
(6)	Incorporated by reference to the Company's Quarterly Report on Form 10-QSB (File No. 000-07441) filed with the SEC on May 14, 1999.

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Shareholders  
Sierra Monitor Corporation:

We consent to the incorporation by reference in the registration statement (No. 333-18241) on Form S-8 of Sierra Monitor Corporation of our report dated February 17, 2006, relating to the balance sheet of Sierra Monitor Corporation as of December 31, 2005, and the related statements of operations, shareholders' equity and cash flows for each of the two years in the period ended December 31, 2005, which report appears in the December 31, 2005, annual report on Form 10-KSB of Sierra Monitor Corporation.

**/s/ Squar, Milner, Reehl & Williamson, LLP**

Newport Beach, California  
March 29, 2006

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER**

I, Gordon R. Arnold, the Chief Executive Officer of Sierra Monitor Corporation certify that:

1. I have reviewed this annual report on Form 10-KSB of Sierra Monitor Corporation (the “registrant”);
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:
  - a) Designed such disclosure controls and procedures or caused such disclosure controls and procedures to be designed under our supervision to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report was being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted account principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any changes in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonable likely to materially affect, the registrant’s internal control over financial reporting; and
5. The registrant’s other certifying officer(s) and I have disclosed, based on my most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonable likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 28, 2006

By:           /s/ Gordon R. Arnold            
Gordon R. Arnold  
Chief Executive Officer

**CERTIFICATION OF CHIEF FINANCIAL OFFICER**

I, Gordon R. Arnold, the Chief Financial Officer of Sierra Monitor Corporation, certify that:

1. I have reviewed this annual report on Form 10-KSB of Sierra Monitor Corporation (the “registrant”);
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:
  - a. Designed such disclosure controls and procedures or caused such disclosure controls and procedures to be designed under our supervision to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report was being prepared;
  - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted account principles;
  - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. Disclosed in this report any changes in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonable likely to materially affect, the registrant’s internal control over financial reporting; and
5. The registrant’s other certifying officer(s) and I have disclosed, based on my most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonable likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 28, 2006

By:           /s/ Gordon R. Arnold            
 Gordon R. Arnold  
 Chief Financial Officer

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2003**

I, Gordon R. Arnold, certify, Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the annual report of Sierra Monitor Corporation on Form 10-KSB for the year ended December 31, 2005 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that the information contained in such annual report on Form 10-KSB fairly presents in all material respects the financial condition and results of operations of Sierra Monitor Corporation.

Date: March 28, 2006

By: /s/ Gordon R. Arnold

Gordon R. Arnold  
Chief Executive Officer and  
Chief Financial Officer

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Sierra Monitor Corporation and will be retained by Sierra Monitor Corporation and furnished to the Securities and Exchange Commission or its staff upon request.