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MEDCOM USA INC  
Form 10KSB  
September 28, 2005

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-KSB

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED JUNE 30, 2005

OR  
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the transition period from N/A to N/A  
Commission File Number: 0-25474

MEDCOM USA, INCORPORATED  
(Name of small business issuer as specified in its charter)

DELAWARE  
State of Incorporation

65-0287558  
IRS Employer Identification No.

7975 NORTH HAYDEN ROAD, SUITE D-333, SCOTTSDALE, AZ 85258  
(Address of principal executive offices)

Registrant's telephone number, including Area Code: (480) 675-8865  
Securities registered pursuant to Section 12(b) of the Act: None  
Securities registered pursuant to Section 12(g) of the Act:

COMMON STOCK, \$.0001 PAR VALUE

Check whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

YES X NO  
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Check if disclosure of delinquent filers in response to Item 405 of Regulation S-B is not contained in this form, and no disclosure will be contained, to the best of the 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.

Registrant's revenues for the most recent fiscal year were \$ 2,747,269

The aggregate market value of the common stock held by non-affiliates computed based on the closing price of such stock on June 30, 2005, was approximately \$41,845,241

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### ITEM 1. DESCRIPTION OF BUSINESS.

Except for historical information contained herein, the following discussion contains forward-looking statements that involve risks and uncertainties. Such forward-looking statements include, but are not limited to, statements regarding future events and the Company's plans and expectations. Actual results could differ materially from those discussed herein. Factors that could cause or contribute to such differences include, but are not limited to, those discussed elsewhere in this Form 10-KSB or incorporated herein by reference, including those set forth in Management's Discussion and Analysis or Plan of Operation.

#### OVERVIEW

MedCom USA, Inc. (the "Company") a Delaware corporation was formed in August 1991 with the name Sims Communications, Inc. The Company's primary business was providing telecommunications services. In 1996 the Company introduced four programs to broaden the Company's product and service mix: (a) cellular telephone activation, (b) sale of prepaid calling cards, (c) sale of long distance telephone service and (d) rental of cellular telephones using an overnight courier service. With the exception of the sale of prepaid calling cards, these four programs were discontinued in December 1997. During the fiscal year of 1998, the Company diversified its operations and moved into the area of medical information processing.

The Company changed its name to MedCom USA, Inc. in October 1999. During the fiscal years of 1999 and continuing through 2003, the Company directed its efforts in medical information processing. As of June 30, 2005, the Company currently operates the MedCard System (MedCard) that is deployed through a point-of-sale terminal or personal computer offering electronic transaction processing, as well as insurance eligibility verification. The Company has aggressively focused on its primary operations in electronic data interchange and core business in electronic medical transaction processing.

#### MEDCARD SYSTEM

The Company provides innovative technology-based solutions for the healthcare industry that enable users to efficiently collect, use, analyze and disseminate data from payers, health care providers and patients. The MedCard System currently operates through a point-of-sale terminal or a personal computer. The point-of-sale terminals are purchased from Hypercom Corporation (Hypercom). The MedCard System also operates in a PC version and an on-line version. The Company is in the process of assessing the feasibility of offering a service bundled package that would have the capability of processing unlimited claims and eligibility verification for monthly service fees.

#### FINANCIAL SERVICES

The Company's credit card center and check services, provides the healthcare industry a combination of services designed to improve collection and approvals of credit/debit card payments along with the added benefit and convenience of personal check guarantee from financial institutions.

Flex-pay is an accounts receivable management program that allows a provider to swipe a patient's credit card and store the patient's signature in the terminals, and bill the patient's card at a later date when it is determined what services rendered were not covered by the patient's insurance. Also, an easy-pay option is offered which allows patient's the added benefit and convenience of a one-time payment option or a recurring installment payments that will be processed on a specified date determined by the provider and patient. These options insure providers that payments are timely processed with the features of electronic

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accounts receivable management. These services are all deployed thorough point-of-sale terminals or a personal computer. Using the MedCard system, medical providers are relieved of many of the problems associated with billings and account management, and results in lower administrative documentation and costs.

#### PATIENT ELIGIBILITY

The MedCard System is also an electronic processing system that consolidates insurance eligibility verification, processes medical claims, and monitors referrals. The MedCard System allows a patient's primary care physician to request approval from the patient's insurance carrier or managed care plan for a referral to a secondary physician or specialist. The secondary physician or specialist can use the MedCard system to verify referrals are approved by the patient's insurance carrier. The MedCard system's referral capabilities reduce documentation and administrative costs which results in increased productivity and greater patient information for the specialist, as well as a written record of the referral authorization.

The MedCard System can record and track encounters between patients and health care providers for performance evaluation and maintenance of records. After examining a patient the physician enters a patient's name, procedure code and diagnostic code at a nearby terminal. This information is then uploaded to MedCom's computer network, processed and transmitted back to the provider formatted in both summary and/or detailed reports, and as a result healthcare providers' reimbursements are accelerated and account receivables are reduced. The average time it takes the healthcare providers to collect payments from insurance carriers and plans decreases from an average of 89 days to 7-21 days. Health care providers will benefit from a 100% paperless claim processing system.

As of June 30, 2005 the MedCard system was able to retrieve on-line eligibility and authorization information from approximately 150 medical insurance companies and electronically process and submit billings for its healthcare providers to over 1,700 companies. These insurance providers include CIGNA, Prudential, Oxford Health Plan, United Health Plans, Blue Cross, Medicaid, Aetna, Blue Cross/Blue Shield, and Prudential.

#### PATENT

A new division is to be set up to market and sell licensing opportunities for the MedCom proprietary patented technology for Activating Phone card and Gift Card at retail. The patent covers the technology and process for taking a card with magnetic strip or other data capture mechanism and activating the card by downloading a determined monetary value onto the card for use at a later date for different types of transactions. This process can be utilized for prepaid phone cards, gift cards, and affinity cards. New View Technologies, which was acquired by MedCom USA, developed the patent and all patents were assigned.

#### COMPETITION

Competing health insurance claims processing and/or benefit verification systems include WebMD (HLTH), NDCHealth (NDC), and Per-se Technologies (PSTI). There are similar companies that compete with the Company with respect to its financial transaction processing services performed by the MedCard system. These companies compete with the Company directly or to some degree. Many of these competitors are better capitalized than the Company, and maintain a significant market share in their respective industries.

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### REGULATORY COMPLIANCE

With the passage of the Health Insurance Portability and Accountability Act (HIPAA) of 1996, the United States Congress has mandated the establishment of standards for the privacy of individually identifiable

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health information. Specifically, the regulation entitled, Standards for Privacy of Individually Identifiable Health Information ("the Privacy Rule") promulgated by the Department of Health and Human Services (HHS), provides for a comprehensive federal protection for the privacy of health information. The Rule applies only to health plans, health care clearinghouses, and certain health care providers, which must comply with the new requirements. The Company's core operating business is not subject to the Privacy Rule, which defines the Company as a "business associate". A business associate is an entity that provides certain functions, activities, or services for or to a covered entity. These covered entities typically obtain contractual assurances that the business associate will use the information only for the purposes for which they were contracted and not for independent use by the business.

### SERVICE AND PRODUCTS

The Company offers its healthcare providers, and health plan groups, a simple solution to expedite its Healthcare and financial transactions electronically through a processing terminal, and the Company maintains its website [www.MedCard.com](http://www.MedCard.com). The features of the terminals are as follows:

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The Company's credit card center and check services, provides the healthcare industry a combination of services designed to improve collection and approvals of credit/debit card payments along with the added benefit and convenience of personal check guarantee from financial institutions.

Flex-pay is an accounts receivable management program that allows a provider to swipe a patient's credit card and store the patient's signature in the terminals, and bill the patient's card at a later date when it is determined what services rendered were not covered by the patient's insurance. Also, an easy-pay option is offered which allows patient's the added benefit and convenience of a one-time payment option or a recurring installment payments that will be processed on a specified date determined by the provider and patient. These options insure providers that payments are timely processed with the features of electronic accounts receivable management. These services are all deployed thorough point-of-sale terminals or a personal computer. Using the MedCard system, medical providers are relieved of the problems associated with billings and account management, and results in lower administrative documentation and costs.

The MedCard System is also an electronic processing system that consolidates insurance eligibility verification, processes medical claims, and monitors referrals. The MedCard System allows a patient's primary care physician to request approval from the patient's insurance carrier or managed care plan for a referral to a secondary physician or specialist. The secondary physician or specialist can use the MedCard system to verify referrals are approved by the patient's insurance carrier. The MedCard system's referral capabilities reduce documentation and administrative costs which results in increased productivity and greater patient information for the specialist, as well as a written record of the referral authorization.

### LICENSING AGREEMENTS

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In May 2000 the license agreement with Dream Technologies, LLC was amended whereby the Company acquired direct ownership of the MedCard System including all software programs, intellectual property, and trade names and existing contracts. The amendment effectively terminated the original license agreement, except for the royalty provisions of the original license agreement.

Subsequently, on January 14, 2002, the Company changed the terms of the royalties included in the original agreement with Dream Technologies, and as a result past royalties were waived in good faith, for the exception of \$30,000, which was agreed and payable in equal monthly installments. In connection with the past royalties, Dream Technologies, LLC was issued a certificate representing one million unregistered shares of common stock with a par value of \$.001.

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The Company is required to pay royalties to Dream equal to twenty percent of the first \$1,000,000 of net monthly revenue and ten percent of net monthly revenue in excess of \$1,000,000. The term net revenues is defined as gross revenues received from the use of the MedCard software less (a) terminal lease costs (b) commissions payable to agents that place terminals with end users (c) network costs that include: i) claim fees payable to data vendors, ii) charges for verification of insurance coverage iii) similar telecommunications charges related to obtaining claims processing and/or benefits verification information; and (d) cost of the terminal and shipping/handling.

### SERVICE AGREEMENTS

During September 1998, the Company entered into a service agreement with WebMD/Envoy. This agreement encompasses the process of electronic data interchange and related services. The services provided are complimentary to the Company's core business, and accomplishes transaction processing services that allows healthcare providers and payers to process medical transactions quickly and accurately, and results in reduced administrative costs with the benefit of accelerated reimbursements to healthcare providers.

During January 2002, the Company has entered into a service agreement with MedUnite. This alliance will encompass the utilization of proprietary technologies and will enhance the existing network of healthcare constituents. Strategically both companies share the same vision of transforming the healthcare transactions systems affecting how healthcare providers, health plans, and other groups transacting business with one another by significantly reducing claim and payment processing time, and reducing healthcare administrative costs.

During February 2003, the Company has entered into a service agreement with HD Brous & Company. This agreement provides that HD Brous & Company acts as financial advisor and investment banking representative on the Company's behalf. Upon the execution of the contract the Company granted to HD Brous & Company warrants to purchase up to four hundred thousand shares of the Company's common stock at an exercise price of \$.50 per common share. The warrants will expire five years from the date of issuance.

During February 2004, the Company entered into a service agreement with CDS Capital. This agreement will enable eligible healthcare providers utilizing the Medcom terminals to finance their accounts receivables. Health care providers using the Medcom terminal to secure patient eligibility and process claims will now be able to receive regular payments for a large percentage of claims processed from the previous week. This financial management service will decrease the time and costs associated with accounts receivable collections.

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During June 2005, the Company entered into a service agreement with Tesia-PCI. This agreement to replace and service and support at a minimum of 1,500 POS terminals inclusive of eligibly, claims processing, credit card processing for Tesia's dental providers.

### PROCESSING TERMINAL LEASING AGREEMENTS

The Company has entered into leasing agreements with LADCO Financial Group for the purpose of leasing processing terminals. The Company has pledged in collateral in connection with the lease agreements one million restricted common shares of stock. These common stock shares would be surrendered upon the default of such leasing agreements. This pledge and granting of security interest was executed on January 3, 2002. The Company further provides direct leasing between LADCO and the provider and helps facilitate these transactions for the provider.

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The Company has arranged its terms with this credit facility as an equipment lessor whereby the Company sells terminals to the lessor when it has obtained a service contract with a provider. Under these agreements, the Company is leasing back the processing terminals from the lessor and in turn leases them to the purchaser for a period of 36-60 months however; the customer may terminate the agreement after 12 months. The Company is accounting for the transactions as sale-leasebacks. The leases with the customers are inclusive with the monthly service contracts and are effectively accounted for as operating leases. Gains on terminal sales under sale-leaseback transactions are deferred and are being amortized to income in proportion to amortization of the assets, generally over the term of the lease with the credit facility generally for a period of 36-60 months. At June 30, 2005, the remaining deferred equipment gain of \$2,716,526 is shown as "Deferred Revenues" in the Company's Balance Sheet.

### GROWTH STRATEGY

The Company's strategy is to become one of the dominant electronic transaction processing vendors in the Healthcare markets. MedCom USA will focus on providing health plan administrators, healthcare clearinghouses, and healthcare providers, financial as well as verification electronic transaction processing solutions. The Company's strategy to date has included large select markets for its products and services, however the Company will work with partners who will ensure national distribution of its products and services.

On March 23, 2005, MedCom USA, Inc. completed an agreement to become a direct credit card Independent Sales Organization (ISO) for National Processing Company (NPC) a wholly owned subsidiary of Bank of America for the processing of credit/debit card transactions.

This agreement allows MedCom USA, Inc. to bypass any intermediaries providing credit card processing and deal directly with the first level of the Merchant Bank's processors. This increases the profit margin for MedCom on these transactions substantially. This also allows MedCom more flexibility in engaging strategic distribution partnerships with major sales organizations, healthcare carriers, healthcare suppliers and other groups servicing the Medical and Dental industries by providing ability to compensate these organizations through residual sales income.

### ADDITIONAL INFORMATION

The Company files reports and other materials with the Securities and Exchange Commission. These documents may be inspected and copied at the Commission's Public Reference Room at 450 Fifth Street, N.W., Washington, D.C., 20549. You can obtain information on the operation of the Public Reference Room by calling

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the Commission at 1-800-SEC-0330. You can also get copies of documents that the Company files with the Commission through the Commission's Internet site at [www.sec.gov](http://www.sec.gov).

### ITEM 2. DESCRIPTION OF PROPERTY.

As of fiscal year end June 30, 2005, the Company maintains its corporate executive offices in Scottsdale, Arizona. The Company leases 1,317 square feet of office space for approximately \$32,000 annually. The Company entered into a five-year lease in May 2005 for the Scottsdale facility. The Company also maintains an office in Irvine, California, for executive office space for approximately \$2,900 a month. The Company also leases 5,906 square feet of office space in Islandia, New York, for approximately \$125,000 annually; the lease expires March 31, 2008.

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As of fiscal year end June 30, 2005, the Company had 38 employees of which approximately 37 are full-time equivalent employees.

### ITEM 3. LEGAL PROCEEDINGS

Subsequent to June 30, 2001, several former employees filed complaints against the Company alleging breach of employment agreements. The total known claims being sought by the former employees at June 30, 2001 was approximately \$175,000. The Company believes that it has settled all former employee claims in amounts aggregating to an amount approximating the accrued amount of \$104,000. A former officer has a claim remaining with the Company. The Company is attempting to settle this claim. At June 30, 2005, there was \$243,000 accrued relating to this matter.

The Company is also involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, except as discussed above, the ultimate disposition of these matters will not have a material adverse effect on the Company's financial position, results of operations, or liquidity.

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

The Company submitted no matters to a vote of its security holders during the fiscal year ended June 30, 2005.

## PART II

### ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

MedCom common stock is traded in the over-the-counter market, and quoted in the National Association of Securities Dealers Inter-dealer Quotation System ("Electronic Bulletin Board") and can be accessed on the Internet at [www.otcbb.com](http://www.otcbb.com) under the symbol "EMED."

At June 30, 2005, there were 57,664,432 shares of common stock of MedCom outstanding and there were approximately 551 shareholders of record of the Company's common stock.

The following table sets forth for the periods indicated the high and low bid quotations for MedCom's common stock. These quotations represent inter-dealer quotations, without adjustment for retail markup, markdown or commission and may

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not represent actual transactions.

| FISCAL 2005<br>-----             | HIGH BID<br>----- | LOW BID<br>----- |
|----------------------------------|-------------------|------------------|
| Quarter Ended June 30, 2005      | \$ 1.29           | \$ .75           |
| Quarter Ended March 31, 2005     | 1.75              | .75              |
| Quarter Ended December 31, 2004  | 2.49              | 1.54             |
| Quarter Ended September 30, 2004 | 2.50              | 2.10             |
| FISCAL 2004<br>-----             | HIGH BID<br>----- | LOW BID<br>----- |
| Quarter Ended June 30, 2004      | \$ 2.70           | \$ 2.60          |
| Quarter Ended March 31, 2004     | 2.85              | 2.65             |
| Quarter Ended December 31, 2003  | 0.69              | 0.65             |
| Quarter Ended September 30, 2003 | 0.78              | 0.66             |

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MedCom has never paid dividends on any of its common stock shares. MedCom does not anticipate paying dividends at any time in the foreseeable future and any profits will be reinvested in MedCom's business. MedCom's Transfer Agent and Registrar for the common stock is Corporate Stock Transfer located in Denver, Colorado.

#### SALE OF UNREGISTERED SECURITIES

DURING THE PERIOD ENDED JUNE 30, 2005 THE COMPANY ISSUED 6,695,093 SHARES OF ITS COMMON STOCK FOR \$2,727,289 IN A SUBSCRIPTION AGREEMENT FOR QUALIFIED INVESTORS. THE COMPANY ISSUED 276,000 SHARES OF ITS COMMON STOCK IN A SETTLEMENT OF LITIGATION WITH RYDER HOLDINGS. FURTHER THE COMPANY ISSUED TO THIRD PARTIES IN CASHLESS WARRANTS OF 289,195 SHARES OF ITS COMMON STOCK FOR NO CASH VALUE. THE COMPANY ISSUED 276,000 SHARES IN A SETTLEMENT OF AN OUTSTANDING LITIGATION WITH RYDER HOLDINGS. THE COMPANY ISSUED 85,000 IN THE SETTLEMENT OF AN OUTSTANDING ACCOUNT PAYABLE AND CONVERSION FROM DEBT TO EQUITY. LASTLY, THE COMPANY GRANTED STOCK FOR COMPENSATION OF SERVICES TO A THIRD PARTY.

#### STOCK SPLITS

Share data in this report have been adjusted to reflect the following stock splits relating to the Company's common stock: June 1995: 2-for-1 forward split, February 1996: 1-for-10 reverse split, February 1998: 1-for-4 reverse split, May 2001: 1-for-5 reverse split.

#### ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION.

Management's discussion and analysis contains statements that are forward-looking and involve risks and uncertainties. Several factors could cause actual results to differ materially from those described in such forward-looking statements. This includes the Company's ability to manage growth, involvement in litigation, competition in the health electronic



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transaction processing, ongoing contractual relationships, dependence upon key personnel, changes in customer demand for product and services, and the adoption of new, or changes in, accounting policies, practices and estimates and the application of such policies, practices, and estimates, and federal and state governmental regulation, specifically in the areas of electronic transaction processing in the health care industries.

The following financial data should be read in conjunction with the consolidated financial statements of MedCom USA and related notes and other financial information appearing elsewhere in this report.

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### Statement of Operations Data

|                              | Years Ended June 30, |                |
|------------------------------|----------------------|----------------|
|                              | 2005                 | 2004           |
| Revenues                     | \$ 2,747,269         | \$ 3,029,875   |
| Cost of Services             | \$ (440,155)         | \$ (458,656)   |
| Operating and Other Expenses | \$ (9,422,183)       | \$ (7,180,510) |
|                              | \$ (7,115,069)       | \$ (4,609,291) |

### Balance Sheet Data:

|                                | Years Ended June 30, |                |
|--------------------------------|----------------------|----------------|
|                                | 2005                 | 2004           |
| Current Assets                 | \$ 637,728           | \$ 2,850,032   |
| Total Assets                   | \$ 4,515,263         | \$ 7,466,668   |
| Current Liabilities            | \$ 4,388,644         | \$ 4,831,497   |
| Non Current Liabilities        | \$ 5,027,040         | \$ 4,668,982   |
| Total Liabilities              | \$ 9,415,684         | \$ 9,500,479   |
| Working Capital (Deficit)      | \$ (3,750,916)       | \$ (1,981,465) |
| Shareholders' Equity (Deficit) | \$ (4,900,421)       | \$ (2,033,811) |

The Company has declared no common stock dividends since its inception.

### FISCAL 2005 OPERATIONS

General. As of June 30, 2005, the Company currently utilizes the MedCard System that is deployed through a processing terminal, PC software, or online processing, and offers electronic transaction processing to the health care industries. MedCom USA continues to focus on its primary operations and core business in medical transaction processing.

YEAR ENDED JUNE 30, 2005

### RESULTS OF OPERATIONS

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FISCAL YEAR END JUNE 30, 2005, COMPARED TO FISCAL YEAR END JUNE 30, 2004

Revenues for Fiscal 2005 decreased to \$2,747,269 from \$3,029,875 during Fiscal 2005. This decrease in revenue is directly the result of changes in the Company's strategic direction in core operations. This included discontinuing declining or unprofitable business sectors and officer and management changes. The Company continues to aggressively pursue and devote its resources and focus its direction in electronic transaction processing. The Company's agreement with its credit facility in connection with the sale-leaseback transactions therewith, the Company must defer revenue gains on the sale of the terminals. Those gains are generally recognized over a period of 36-60 months.

Selling expenses for Fiscal 2005 decreased to \$304,522 from \$1,043,634 during Fiscal 2004. This decrease is primarily the result of marketing efforts and includes commissions paid to internal sales personnel to market the Company's products and services. Presently the company is increasing its sales team and will increase sales in various target states.

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General and administrative expenses for Fiscal 2005 increased to \$4,803,976 from \$3,488,632 during Fiscal 2004. This increase is attributed to the Company's hiring of additional employees as growth has occurred in the area of providing technical support for our products and services in relation to the increases in sales. The company is expanding its marketing services to include additional sales personnel and have incurred additional costs related to ramp up cost of training sales and marketing teams.

Professional and consulting expenses for Fiscal 2005 increased to \$831,593 from \$745,348 during Fiscal 2004. The company incurred additional expenses due to the impairment writedown of goodwill of \$433,000 and legal settlement of \$276,000 and loss on the disposal of an asset of \$25,000. The Company impaired goodwill after assessing the value of the MedCard asset. MedCard has changed its software development and further modified the MedCard purchased to that the Company considered the complete impairment of goodwill. Interest expense for Fiscal 2005 increased to \$897,643 from \$877,921 for Fiscal 2004. This increase is a result of increased sales volume and sales-leaseback transactions with the Company's credit facility. Also, expenses were incurred and paid on notes the Company has outstanding.

### TRADE VENDOR OBLIGATIONS

The Company had in the past incurred obligations in many business segments that had been sold or divested several years ago. The Company has accruals of approximately \$586,606 since those business units were divested. These obligations were due to trade vendors and property management companies. Management believes that the statute of limitations for collecting on these obligations has expired. Subsequently, the Company has removed approximately \$870,000 of these obligations during the year ended June 30, 2004. The Company maintained approximately \$243,000 in accruals for these vendor obligations as of June 30, 2004. In June 2005, a settlement of one of the remaining obligations was settled. The accrual for this obligation of approximately \$140,000 was depleted and additional settlement expense of \$233,982 was recognized. The remaining accrual for these vendor obligations as of June 30, 2005 is approximately \$98,000. Although the Company believes that the possibility is remote, vendors associated with these written-off obligations may make a claim against the Company.

The loss for Fiscal 2005 was (\$7,115,069) from (\$4,609,291) for Fiscal 2004. Sales and marketing expenses along with interest expenses have increased for Fiscal 2004. The Company has incurred these marketing and sales expenses in

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relation to increased demand for the Company's products and services.

As of June 30, 2005, MedCom had a federal net operating loss carry forward of \$57,312,820 expiring 2007 to 2023. MedCom had a state net operating loss carry forward of \$29,603,000 expiring from 2005 to 2008. The company has incurred net operating loss in 1993 of \$197,688, 1994 of \$1,699,456, 1995 of \$2,428,673, 1996 of 3,685,557, 1997 of \$6,697,029, 1998 of \$6,467,303, 1999 of \$7,895,428, 2000 of \$12,879,733, 2001 of \$1,543,591, 2002 of \$1,029,889, 2003 of \$4,252,651, and 2004 of \$6,123,820. The net operating losses expire at the required period of 15 years from when they have been generated. The company does not expect to utilize the net operating loss and therefore had not made a provision for the assets.

### LIQUIDITY AND CAPITAL RESOURCES

The Company's operating requirements have been funded primarily on its capital sale- leaseback transactions, and sales of the Company's common stock. During the year ended June 30, 2005, the Company's net proceeds from the capital sales leaseback transactions was approximately \$1,692,904 and proceeds from the sale of common stock were approximately \$2,919,289. The Company believes that the cash flows from its monthly service and transaction fees are adequate to repay the capital sale-leaseback operations. The Company has reassessed its monthly service and transaction fees and reorganized customers that were slow pays that will increase the cash flow in the upcoming fiscal year.

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Cash used in operating activities for Fiscal 2005 was (\$4,700,884) compared to (\$5,088,511) for Fiscal 2004. The Company's focus on core operations will result in lower accounts receivable and inventory levels. The Company receives payments from a majority of its customers automatically through electronic fund transfers. Collection cycles are generally less than thirty days.

Cash provided by investing activities was \$1,307,044 for Fiscal 2005, compared to cash used in investing activities of (\$1,662,735) for Fiscal 2004. Streamlining operations and capital budget curtailment practices promoted a reduction in equipment purchases for the Company. The Company's cash provided by investing activities is due to the net advances from affiliates.

Cash provided by financing activities was \$3,317,426 in Fiscal 2005, compared to \$6,783,407 for Fiscal 2004. Financing activities primarily consisted of proceeds from the sale of the Company's common stock and proceeds from the sale-leaseback transactions during the fiscal period.

The Company has used funds advanced from an affiliated entity that is controlled by the Company's chairman and chief executive officer. As of June 30, 2005 the Company maintains an account receivable from this entity for the amount of \$368,197.

### OTHER CONSIDERATIONS

There are numerous factors that affect the business and the results of its operations. Sources of these factors include general economic and business conditions, federal and state regulation of business activities, the level of demand for product services, the level and intensity of competition in the healthcare electronic transaction processing industry, and the ability to develop new services based on new or evolving technology and the market's acceptance of those new services, the Company's ability to timely and effectively manage periodic product transitions, the services, customer and geographic sales mix of any particular period, and our ability to continue to improve our infrastructure including personnel and systems to keep pace with the

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Company's anticipated rapid growth.

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ITEM 7. FINANCIAL STATEMENTS

MEDCOM USA, INC.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board of Directors of  
MedCom USA, Inc.:

We have audited the accompanying consolidated balance sheet of MedCom USA, Inc. as of June 30, 2005 and the related statements of operations, stockholders' equity and cash flows for the each of the two years in the period then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Standards Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. 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 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 MedCom USA, Inc. as of June 30, 2005, and the results of its operations and cash flows for each of the two years

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in the period ended June 30, 2005, in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. The Company continues to incur significant operating losses. The Company has begun to generate revenue from its electronic transaction business but has continued to incur material obligations under sale-leaseback transactions. These factors raise substantial doubt about the Company's ability to continue as a going concern. Management's plans with regard to these matters are discussed in Note 1. The financial statements do not include any adjustments relating to the recoverability and classification of asset carrying amounts or the amount and classification of liabilities that might result should the Company be unable to continue as a going concern.

/s/ Epstein, Weber & Conover, PLC  
 Scottsdale, Arizona  
 September 28, 2005

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MEDCOM USA, INC.  
 CONSOLIDATED BALANCE SHEET  
 JUNE 30, 2005

|  |              |
|--|--------------|
| -----  |              |
| CURRENT ASSETS   |              |
| Cash   | \$ 10,207    |
| Accounts receivable, net of allowance of \$84,424                                | 272,185      |
| Subscription receivable  | 308,000      |
| Inventories  | -            |
| Prepaid expenses and other current assets  | 47,336       |
|  | -----        |
| Total current assets   | 637,728      |
| PROPERTY AND EQUIPMENT, net  | 474,097      |
| PROCESSING TERMINALS, net  | 3,325,782    |
| GOODWILL, net of accumulated amortization and impairment<br>reserve of \$758,998 | -            |
| OTHER ASSETS   | 77,656       |
|  | -----        |
| TOTAL ASSETS   | \$ 4,515,263 |
|  | =====        |
|  |              |
| LIABILITIES AND STOCKHOLDERS' EQUITY:  |              |
| CURRENT LIABILITIES:   |              |
| Accounts payable   | \$ 496,741   |
| Accrued expenses and other liabilities   | 343,873      |
| Bank Overdraft   | 252,535      |
| Reserve sales returns  | 31,304       |
| Deferred revenue   | 1,152,723    |
| Dividend payable   | 23,750       |
| Notes payable - current portion  | 201,313      |
| Capital lease obligations - current portion                                      | 1,886,405    |
|  | -----        |
| Total current liabilities  | 4,388,644    |
| NOTES PAYABLE - Affiliate  | 368,197      |

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|   |              |
|---|--------------|
| LONG TERM NOTE PAYABLE  | 164,865      |
| CAPITAL LEASE OBLIGATIONS - long-term portion   | 2,929,176    |
| DEFERRED REVENUE - long-term portion  | 1,564,803    |
|   | -----        |
| Total liabilities   | 9,415,684    |
|   | -----        |
| STOCKHOLDERS' DEFICIT:  |              |
| Convertible preferred stock, Series A \$.001par value, 52,900 shares designated, 4,250 issued and outstanding | 4            |
| Convertible preferred stock, Series D \$.01par value, 50,000 shares designated, 2,850 issued and outstanding  | 28           |
| Common stock, \$.0001 par value, 80,000,000 shares authorized, 57,664,432 issued, 57,477,445 outstanding      | 5,767        |
| Subscriptions receivable  | -            |
| Treasury Stock  | (37,397)     |
| Paid in capital   | 75,700,765   |
| Accumulated deficit   | (80,569,588) |
|   | -----        |
| Total stockholders' deficit   | (4,900,421)  |
|   | -----        |
| TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT   | \$ 4,515,263 |
|   | -----        |

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

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MEDCOM USA, INC.  
CONSOLIDATED STATEMENT OF OPERATIONS  
FOR THE YEAR ENDED JUNE 30, 2005 AND JUNE 30, 2004

|                                     | 2005        | 2004        |
|-------------------------------------|-------------|-------------|
|                                     | -----       | -----       |
| REVENUES:                           |             |             |
| Terminal sales                      | \$ 301,764  | \$ 636,075  |
| Service                             | 1,380,063   | 1,344,276   |
| Equipment lease income              | 1,065,442   | 1,049,524   |
|                                     | -----       | -----       |
|                                     | 2,747,269   | 3,029,875   |
| COST OF SALES AND SERVICE           | 440,155     | 458,656     |
|                                     | -----       | -----       |
| GROSS PROFIT                        | 2,307,114   | 2,571,219   |
|                                     | -----       | -----       |
| OPERATING EXPENSES:                 |             |             |
| General and administrative expenses | 4,803,976   | 3,488,632   |
| Sales and marketing expenses        | 304,522     | 1,043,634   |
| Royalties                           | 119,741     | 89,127      |
| Professional and consulting fees    | 831,593     | 745,348     |
| Depreciation and amortization       | 1,524,016   | 1,453,089   |
|                                     | -----       | -----       |
| Total operating expenses            | 7,583,848   | 6,819,830   |
|                                     | -----       | -----       |
| OPERATING LOSS                      | (5,276,734) | (4,248,611) |
|                                     | -----       | -----       |

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|   |                |                |
|---|----------------|----------------|
| OTHER (INCOME) AND EXPENSES                 |                |                |
| Interest expense                            | 897,643        | 887,921        |
| Goodwill Impairment                         | 436,423        | -              |
| Legal Settlement                            | 233,982        | -              |
| Loss on Disposal of Assets and Inventory    | 223,820        | -              |
| Other expenses                              | 46,467         | (527,241)      |
|   | -----          | -----          |
| Total other expense                         | 1,838,335      | 360,680        |
|   | -----          | -----          |
| LOSS BEFORE INCOME TAXES                    | (7,115,069)    | (4,609,291)    |
|   |                |                |
| INCOME TAX (BENEFIT) PROVISION              | -              | -              |
|   | -----          | -----          |
| NET LOSS                                    | \$ (7,115,069) | \$ (4,609,291) |
|   | =====          | =====          |
| NET LOSS PER SHARE:                         |                |                |
| Basic:                                      | \$ (0.13)      | \$ (0.11)      |
|   | =====          | =====          |
| Diluted:                                    | \$ (0.13)      | \$ (0.11)      |
|   | =====          | =====          |
| WEIGHTED AVERAGE COMMON SHARES OUTSTANDING: |                |                |
| Basic                                       | 54,015,797     | 41,167,477     |
|   | =====          | =====          |
| Diluted                                     | 54,015,797     | 41,167,477     |
|   | =====          | =====          |

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

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MEDCOM USA, INC.  
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY FOR THE  
FOR THE YEARS ENDED JUNE 30, 2005 AND 2004

|                                      | COMMON STOCK |          | PREFERRED STOCK           |        |                       |        |
|--------------------------------------|--------------|----------|---------------------------|--------|-----------------------|--------|
|                                      | SHARES       | AMOUNT   | PREFERRED A & B<br>SHARES | AMOUNT | PREFERRED C<br>SHARES | AMOUNT |
|                                      | -----        | -----    | -----                     | -----  | -----                 | -----  |
| BALANCE JULY 1, 2003                 | 36,979,865   | \$ 3,698 | 4,250                     | \$ 4   | -                     | \$ -   |
| Common stock issued for cash         | 7,144,973    | 714      |                           |        |                       |        |
| Common stock issued to settle claims | 298,866      | 30       |                           |        |                       |        |
| Common stock subscribed              | 1,000,000    | 100      |                           |        |                       |        |
| Conversion of affiliate note payable | 3,186,499    | 319      |                           |        |                       |        |
| Exercise of stock options            | 508,941      | 51       |                           |        |                       |        |
| Treasury shares taken in settlement  |              |          |                           |        |                       |        |

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|   |                   |                            |                        |               |       |       |
|---|-------------------|----------------------------|------------------------|---------------|-------|-------|
| Common stock granted as<br>consideration for services | 910,000           | 91                         |                        |               |       |       |
| Net loss  |                   |                            |                        |               |       |       |
| -----   |                   |                            |                        |               |       |       |
| BALANCE   |                   |                            |                        |               |       |       |
| JUNE 30, 2004   | 50,029,144        | \$ 5,003                   | 4,250                  | \$ 4          | -     | \$ -  |
|   | =====             | =====                      | =====                  | =====         | ===== | ===== |
|   | TREASURY<br>STOCK | SUBSCRIPTION<br>RECEIVABLE | ACCUMULATED<br>DEFICIT | TOTAL         |       |       |
|   | -----             | -----                      | -----                  | -----         |       |       |
| BALANCE JULY 1, 2003                                  | \$ -              | \$ -                       | \$(68,845,428)         | \$(5,563,510) |       |       |
| Common stock issued for cash                          |                   |                            |                        | 5,877,106     |       |       |
| Common stock issued to settle claims                  |                   |                            |                        | 657,505       |       |       |
| Common stock subscribed                               |                   | (500,000)                  |                        | -             |       |       |
| Conversion of affiliate note payable                  |                   |                            |                        | 776,992       |       |       |
| Exercise of stock options                             |                   |                            |                        | 296,984       |       |       |
| Treasury shares taken in settlement                   | (37,397)          |                            |                        | (37,397)      |       |       |
| Common stock granted as<br>consideration for services |                   |                            |                        | 567,800       |       |       |
| Net loss  |                   |                            | (4,609,291)            | (4,609,291)   |       |       |
| -----   |                   |                            |                        |               |       |       |
| BALANCE   |                   |                            |                        |               |       |       |
| JUNE 30, 2004   | \$ (37,397)       | \$ (500,000)               | \$(73,454,719)         | \$(2,033,811) |       |       |
|   | =====             | =====                      | =====                  | =====         |       |       |

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

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MEDCOM USA, INC.  
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY FOR THE  
FOR THE YEARS ENDED JUNE 30, 2005 AND 2004 (CONTINUED)

|                              |              |          |                 |        |                                |        |
|------------------------------|--------------|----------|-----------------|--------|--------------------------------|--------|
|                              | COMMON STOCK |          | PREFERRED A & B |        | PREFERRED STOCK<br>PREFERRED C |        |
|                              | SHARES       | AMOUNT   | SHARES          | AMOUNT | SHARES                         | AMOUNT |
|                              | -----        | -----    | -----           | -----  | -----                          | -----  |
| BALANCE JULY 1, 2004         | 50,029,144   | \$ 5,003 | 4,250           | \$ 4   | -                              | \$ -   |
| Common stock issued for cash | 5,925,093    | 593      |                 |        |                                |        |



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|   |             |              |                 |             |                |
|---|-------------|--------------|-----------------|-------------|----------------|
| Common stock issued to settle claims                                | 276,000     | 28           |                 |             |                |
| Common stock for payable conversions                                | 85,000      | 9            |                 |             |                |
| Exercise of cashless options  | 289,195     | 29           |                 |             |                |
| Common stock issued for cash<br>received subsequent to June 30 2005 | 770,000     | 77           |                 |             |                |
| Payment on 2004 subscription receivable                             |             |              |                 |             |                |
| Common stock granted as<br>consdieration for services               | 290,000     | 29           |                 |             |                |
| Net loss  |             |              |                 |             |                |
| <b>BALANCE</b>  |             |              |                 |             |                |
| JUNE 30, 2005   | 57,664,432  | \$ 5,767     | 4,250           | \$ 4        | - \$           |
|   | =====       | =====        | =====           | =====       | =====          |
|   |             |              |                 |             |                |
|   | TREASURY    | SUBSCRPTION  | ACCUMULATED     |             |                |
|   | STOCK       | RECEIVABLE   | DEFICIT         |             | TOTAL          |
|   | -----       | -----        | -----           |             | -----          |
| BALANCE JULY 1, 2004  | \$ (37,397) | \$ (500,000) | \$ (73,454,519) |             | \$ (1,496,214) |
| Common stock issued for cash  |             |              |                 |             | 2,419,289      |
| Common stock issued to settle claims                                |             |              |                 |             | 276,000        |
| Common stock for payable conversions                                |             |              |                 |             | 136,001        |
| Exercise of cashless options  |             |              |                 |             | 29             |
| Common stock issued for cash<br>received subsequent to June 30 2005 |             |              |                 |             | 308,000        |
| Payment on 2004 subscription receivable                             | 500,000     |              |                 | 0           |                |
| Common stock granted as<br>consdieration for services               |             |              |                 |             | 608,942        |
| Net loss  |             |              |                 | (7,115,069) | (7,115,069)    |
| <b>BALANCE</b>  |             |              |                 |             |                |
| JUNE 30, 2005   | \$ (37,397) | \$ -         | \$ (80,569,588) |             | \$ (4,863,024) |
|   | =====       | =====        | =====           |             | =====          |

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

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|  | 2005          | 2004          |
|--|---------------|---------------|
|  | -----         | -----         |
| CASH FLOWS FROM OPERATING ACTIVITIES:  |               |               |
| Net (loss)   | \$(7,115,069) | \$(4,609,291) |
| Adjustments to reconcile net income to net cash<br>(used in) operating activities: |               |               |
| Depreciation and amortization  | 1,524,016     | 1,453,088     |
| Issuance of stock as consideration for services                                    | 608,942       | 567,800       |
| Issuance of stock for settlement of claims   | 135,269       | 657,505       |
| Issuance of stock for conversion of payables                                       | 136,000       | -             |
| Gain on write-off of obligations   | -             | (870,110)     |
| Treasury stock taken in settlement of claims                                       | -             | (37,397)      |
| Allowance for sales returns  | -             | 40,270        |
| Loss on inventory/assets abandoned   | 223,820       | -             |
| Impairment of goodwill   | 436,423       | -             |
| Changes in assets and liabilities:   |               |               |
| Trade accounts receivable  | 11,118        | (93,690)      |
| Inventories  | 113,848       | (157,356)     |
| Prepaid and other current assets   | 41,887        | (86,096)      |
| Accounts payable   | 234,049       | (145,515)     |
| Accrued liabilities  | 14,235        | (758,195)     |
| Deferred revenue   | (1,065,422)   | (1,049,524)   |
|  | -----         | -----         |
| Net cash (used in) operating activities  | (4,700,884)   | (5,088,511)   |
|  | -----         | -----         |
| CASH FLOWS FROM INVESTING ACTIVITIES:  |               |               |
| Purchases of equipment   | (33,453)      | (34,351)      |
| Purchases of software upgrades   | (448,929)     | (208,155)     |
| Advances from/(to) affiliates  | 1,789,426     | (1,420,229)   |
|  | -----         | -----         |
| Net cash provided by (used in) investing activities                                | 1,307,044     | (1,662,735)   |
|  | -----         | -----         |
| CASH FLOWS FROM FINANCING ACTIVITIES:  |               |               |
| Principal repayments on capital leases   | (1,547,302)   | (1,200,996)   |
| Proceeds from sale of common stock   | 2,919,289     | 5,877,106     |
| Retirement of Stock  | -             | 296,984       |
| Bank overdraft usage   | 252,535       | -             |
| Proceeds from capital sale-leaseback transactions                                  | 1,692,904     | 1,810,313     |
|  | -----         | -----         |
| Net cash provided by financing activities  | 3,317,426     | 6,783,407     |
|  | -----         | -----         |
| (DECREASE) INCREASE IN CASH  | (76,414)      | 32,161        |
| CASH, BEGINNING OF YEAR  | 86,621        | 54,460        |
|  | -----         | -----         |
| CASH, END OF YEAR  | \$ 10,207     | \$ 86,621     |
|  | =====         | =====         |

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

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MEDCOM USA, INC.  
CONSOLIDATED STATEMENT OF CASH FLOWS, (CONTINUED)  
FOR THE YEAR ENDED JUNE 30, 2005 AND 2004  
-----

| SUPPLEMENTAL CASH FLOW INFORMATION: | 2005       | 2004       |
|-------------------------------------|------------|------------|
|                                     | -----      | -----      |
| Interest paid                       | \$ 850,004 | \$ 892,935 |
|                                     | =====      | =====      |
| Income taxes paid                   | \$ -0-     | \$ -0-     |
|                                     | =====      | =====      |

SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES:

|  |             |             |
|--|-------------|-------------|
| Terminals capitalized under sales/leaseback transactions                                 | \$1,692,904 | \$2,086,489 |
|  | =====       | =====       |
| Extinguishment of note payable obligations to affiliate by<br>conversion to common stock | \$ 0        | \$ 776,992  |
|  | =====       | =====       |
| Exercise of options through cashless transactions  | \$ 200,000  | \$ 121,166  |
|  | =====       | =====       |
| Terminals returned and placed back into inventory at net<br>Capitalized cost             | \$ 318,602  | \$ 920,060  |
|  | =====       | =====       |
| Terminals returned/leases assumed by Company   | \$ 8,966    | \$ 149,950  |
|  | =====       | =====       |

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

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MEDCOM USA, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEAR ENDED JUNE 30, 2005  
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1. ORGANIZATION AND BASIS OF PRESENTATION

MedCom USA, Inc. (the "Company"), formally Sims Communications, Inc., provides point-of-sale transaction terminals and personal computer based software to perform medical insurance eligibility verification, claims processing, and credit card/ATM charges and payments. The Company's customers are health care providers, primarily physicians' offices throughout the United States.

The accompanying financial statements represent the consolidated financial position and results of operations of the Company and includes the accounts and results of operations of the Company and its wholly owned subsidiaries. The accompanying financial statements include only the active entity of MedCom USA, Inc., The Company has several inactive subsidiaries.

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The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. The Company continues to incur material operating losses and has failed to generate positive cash flow from operations. The Company has a working capital deficit of \$3,750,916 at June 30, 2005. The Company has generated cash flow through sale-leaseback financing transactions to fund its operations. Management believes that the Company has begun to generate a level of volume in the sales and service contracts of its processing terminals that will allow the Company to meet operating cash flow requirements. The Company has recently changed some of its operations that may allow the Company to better manage cash flows.

The Company has begun to experience increased sales of its MedCard System and has generated cash through the use of sale-leaseback transactions connected to the sales of the terminals for the MedCard System. Management is attempting to attain a sustaining level of operating cash flow from the Company's MedCard operations. The Company has raised additional equity capital in the year ended June 30, 2005 and may attempt to raise additional capital to grow the MedCard operations and to fund inventory and receivable growth.

Cash reserves and working capital at June 30, 2005 were insufficient to fund currently due obligations. As discussed above, the Company is generating cash flow from sales activities and sale-leaseback transactions. Such cash flow is only recently provided some evidence that it is sufficient to cover current operating expenses. However, this level of cash flow does not permit the Company to retire many older debts or expand its operations. The Company believes that it needs additional cash, either from outside financing or expanded sales activities, in order to retire past due debts and significantly expand the Company's operations. If the Company is unable to produce sales as planned and/or raise additional investment capital to fully implement its business plan, it may jeopardize the ability of the Company to continue as a going concern.

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Cash includes all short-term highly liquid investments that are readily  
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convertible to known amounts of cash and have original maturities of three months or less. Net bank overdrafts are recorded as current liabilities.

Principles of Consolidation: The consolidated financial statements include  
-----  
the accounts of the Company and its wholly owned subsidiaries. All significant intercompany accounts and transactions are eliminated.

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Inventories consist primarily point-of sale ("POS") terminals and spare  
-----  
parts that are held for sale. Inventories are recorded at the lower of cost or market on a first-in, first-out basis. POS terminals that are returned by customers and are held for resale are recorded at the carrying value of the terminal, which is the capitalized cost of the underlying sale-leaseback transaction, net of accumulated amortization. During the year ended June 30, 2005, the Company determined that the POS terminals' hardware was in fact incidental to the providing of software and ongoing services and that substantially all of the terminals were ultimately part of the sale-leaseback transactions described in Note 8. The Company has recently made arrangements with its supplier of these terminals where the Company will no longer take title to terminals. Additionally, many of the Company's customers are now opting to use the service on an Internet based

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system rather than using the terminals. Because of these circumstances and the cost associated with tracking terminals out at customer facilities, the Company has determined that the terminal hardware has minimal value and has written off inventories at June 30, 2005 resulting in a charge of \$198,804 during the year ended June 30, 2005.

Property and Equipment and Terminals is stated at cost less accumulated

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depreciation. Depreciation is recorded on a straight-line basis over the estimated useful lives of the assets ranging from 3 to 5 years. Terminals are recorded at the capitalized cost of the underlying sale-leaseback transactions. Depreciation expense for the years ended June 30, 2005 and 2004 was \$1,524,016 and \$1,453,089, respectively.

Revenue Recognition - The Company's revenue is generated by the sale of POS

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terminals and transaction fees generated through those terminals. Revenue from the sale of POS terminals is recognized when delivered to the customer and installed. Customers also may rent terminals without purchasing them directly. Rental income is recorded monthly as customers utilize the terminals. Transactions fees are recognized upon completion of the transaction processing. Sales commissions are determined on the basis of the total contract value and are payable and expensed when the terminal is installed.

Gains are deferred on sale-leaseback transactions of terminals and are amortized in proportion to the amortization of the leased terminals, generally over the term of the related capital leases.

Customers may return terminals under certain terms outlined in the rental agreements. Generally, customer returns do not affect previously recognized revenue in that rental/service and transaction fee income is recognized as the customer utilizes the terminal. When a customer terminates service, the billing process ceases and the terminals are returned and placed into inventory.

Income Taxes - The Company provides for income taxes based on the

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provisions of Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes, which, among other things, requires that recognition of deferred income taxes be measured by the provisions of enacted tax laws in effect at the date of financial statements.

Financial Instruments - Financial instruments consist primarily of accounts

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receivable, and obligations under accounts payable, accrued expenses, capital lease obligations and notes payable. The carrying amounts of accounts receivable, accounts payable, accrued expenses and notes payable approximate fair value because of the short maturity of those instruments. The carrying value of the Company's capital lease arrangements approximates fair value because the instruments were valued at the retail cost of the equipment at the time the Company entered into the arrangements.

The Company has applied certain assumptions in estimating these fair values. The use of different assumptions or methodologies may have a material effect on the estimates of fair values.

Net Loss Per Share is calculated using the weighted average number of

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shares of common stock outstanding during the year. The Company has adopted the provisions of SFAS No. 128 Earnings Per Share.

Use of Estimates- The preparation of financial statements in conformity  
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with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Stock-Based Compensation - Statements of Financial Accounting Standards No.  
-----

123, Accounting for Stock-Based Compensation, ("SFAS 123") established accounting and disclosure requirements using a fair-value based method of accounting for stock-based employee compensation. In accordance with SFAS 123, the Company has elected to continue accounting for stock based compensation using the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees."

From time to time, the Company issues stock options to executives, key employees and members of the Board of Directors. Generally, when the Company grants stock options to employees, there is no intrinsic value of those options on the date of grant. Accordingly, no compensation cost has been recognized for stock options granted to employees. There were no options granted in the years ended June 30, 2005 and 2004. There was no additional vesting of options previously granted.

The Company accounts for stock awards issued to nonemployees in accordance with the provisions of SFAS 123 and Emerging Issues Task Force ("EITF") Issue No. 96-18 Accounting for Equity Instruments that are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling Goods or Services. Under SFAS 123 and EITF 96-18, stock awards to nonemployees are accounted for at their fair value as determined under Black-Scholes option pricing model.

Intangible Assets at June 30, 2005 consist of goodwill associated with the  
-----

Company's acquisition of MedCard for the difference between the purchase price of the acquired business and the fair value of the identifiable net assets. Medcard is the only remaining operating subsidiary. The Company adopted Statement of Financial Accounting Standard ("SFAS") No. 142, Goodwill and Other Intangible Assets, effective July 1, 2002. As a result, the Company discontinued amortization of goodwill, and instead annually evaluates the carrying value of goodwill for impairment, in accordance with the provisions of SFAS No. 142. The Company believes that there has been an impairment of the carrying value of goodwill of \$758,998 as of June 30, 2005.

Goodwill had been amortized over 5 years. Due to material continued operating losses, the Company determined that its carrying value of goodwill was impaired at June 30, 2005. On the basis of that determination a charge of \$436,423 was made in the year ended June 30, 2005 to write off the full remaining carrying value at June 30, 2005.

Research and Development costs are expensed as incurred.  
-----

Impairment of Long-Lived Assets is assessed by the Company for impairment

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whenever there is an indication that the carrying amount of the asset may not be recoverable. Recoverability of these assets is determined by comparing the forecasted undiscounted cash flows generated by those assets to the assets' net carrying value. The amount of impairment loss, if any, is measured as the difference between the net book value of the assets and the estimated fair value of the related assets.

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Recently Issued Accounting Pronouncements: In December 2002, the FASB

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issued SFAS No. 148, Accounting for Stock-Based Compensation - Transaction and Disclosure, which provides alternative methods of transition for a voluntary change to fair value based method of accounting for stock-based employee compensation as prescribed in SFAS 123, Accounting for Stock-Based Compensation. Additionally, SFAS No. 148 requires more prominent and more frequent disclosures in financial statements about the effects of stock-based compensation. The provisions of this statement are effective for fiscal years ending after December 15, 2002, with early application permitted in certain circumstances. The Company presently does not intend to adopt the fair value based method of accounting for its stock based compensation.

In June 2003 the FASB issued Statement No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity" SFAS No. 150 requires certain instruments, including mandatorily redeemable shares, to be classified as liabilities, not as part of shareholders' equity or redeemable equity. For instruments that are entered into or modified after May 31, 2003, SFAS No. 150 is effective immediately upon entering the transaction or modifying the terms. For other instruments covered by Statement 150 that were entered into before June 1, 2003, Statement 150 is effective for the first interim period beginning after June 15, 2003. The Company has evaluated the provisions of SFAS No. 150 and implementation of such was not material.

In November 2002, the FASB issued Interpretation No. 45 ("FIN 45"), Guarantor's Accounting and Disclosure Requirements for Guarantees, including Indirect Guarantees of Indebtedness of Others. FIN 45 requires a company, at the time it issues a guarantee, to recognize an initial liability for the fair value of obligations assumed under the guarantees and elaborates on existing disclosure requirements related to guarantees and warranties. The initial recognition requirements are effective for the Company during the third quarter ending March 31, 2003. The adoption of FIN 45 did not have an impact on the Company's financial position or results of operations.

In January 2003, the FASB issued FASB Interpretation No. 46 ("FIN 46"), Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51. FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after June 15, 2003. The adoption of FIN 46 did not have an impact on the Company's financial position or results of operations.

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In December 2004 the FASB issued a revised Statement 123 (SFAS 123R), "Accounting for Stock-Based Compensation" requiring public entities to measure the cost of employee services received in exchange for an award of equity instruments based on grant date fair value. The cost will be recognized over the period during which an employee is required to provide service in exchange for the award - usually the vesting period. The Company is evaluating the impact of this new pronouncement and does not expect the effect of implementation will have a significant impact on the Company's financial statements.

### 3. ACCOUNTS RECEIVABLE

The Company's accounts receivable at June 30, 2005 consisted of:

|                                       |            |
|---------------------------------------|------------|
| Medcard trade accounts receivable     | \$ 349,609 |
| Other                                 | 5,000      |
|                                       | -----      |
| Total                                 | 354,609    |
|                                       |            |
| Less: Allowance for doubtful accounts | ( 82,424)  |
|                                       | -----      |
|                                       | \$ 272,185 |
|                                       | =====      |

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The Company estimates uncollectible account balances and provides an allowance for such estimates. The allowance for doubtful accounts at June 30, 2005, consists of an estimate for potentially uncollectible accounts in the MedCard division.

### 4. GAIN ON WRITE-OFF OF OLD TRADE VENDOR OBLIGATIONS

The Company had incurred material unpaid obligations in many business segments that had been sold or abandoned several years ago. The Company has retained accruals of approximately \$586,606 since those business units were divested. The Company attempted to pay numerous of these obligations. Most of the obligations were due to trade vendors and landlords. Many of these creditors ceased collection efforts several years ago and the Company has not had communications with these creditors since then. Upon being advised by legal counsel, management believes that the statute of limitations for collecting on these obligations has expired. On that premise, the Company removed approximately \$870,000 of these obligations during the year ended June 30, 2004. The \$870,000 gain is included in other income in the accompanying statement of operations for the year ended June 30, 2004.

### 5. PROPERTY AND EQUIPMENT

Property and equipment consisted of the following at June 30, 2005:

|                   |            |
|-------------------|------------|
| Software          | \$ 936,479 |
| Software upgrades | 649,168    |



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|                               |             |
|-------------------------------|-------------|
| Office and computer equipment | 269,041     |
| Furnishings and fixtures      | 126,722     |
| Leasehold improvements        | 4,439       |
|                               | -----       |
| Total                         | 1,985,849   |
| Less accumulated depreciation | (1,511,752) |
|                               | -----       |
| Property and equipment, net   | \$ 474,097  |
|                               | =====       |

Software represents the cost of software acquired for the operation of the Company's MedCard System. The capitalized cost of the software is amortized on a straight-line basis over five years. Additional costs capitalized as software development during the years ended June 30, 2005 and 2004 were \$448,929 and \$208,155, respectively. These upgrades are amortized on a straight-line basis over three years.

### 6. TERMINALS

The Company capitalizes the value of the point of sale terminals that are sold under capital sale-leaseback transactions (Note 8). The terminals are purchased from third party vendors and are recorded as inventory at that time. The Company enters into sale and service agreements with its customers at which time the terminal is programmed with the Company's proprietary software and installed with the customer. Many of those terminals are the basis for the sale-leaseback transactions discussed in Note 8. The terminals are capitalized at the value determined by the lessor on the basis of the cash flow under the terms of the sale and service agreements with the customers.

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|                               |              |
|-------------------------------|--------------|
| Terminals                     | \$ 6,197,320 |
| Less accumulated amortization | (2,871,538)  |
|                               | -----        |
| Terminals, net                | \$ 3,325,782 |
|                               | =====        |

### 7. NOTES PAYABLE

Notes payable at June 30, 2005 comprise the following:

Convertible note payable to individual. The note bears interest at 8% per annum and is payable quarterly. The note is convertible to common stock at \$6.25 per share. The note had an original maturity date of February 1998 and is currently in default. \$ 25,000

Note payable to landlord. Collateralized by leasehold improvements. Original principal balance of \$95,000. Legal settlement negotiated July 2005 requires quarterly

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|  |                    |
|--|--------------------|
| payments beginning August 2005 through November 2007 (imputed interest at 8% per annum) plus the issuance of 150,000 shares of the Company's common stock. | 341,178<br>-----   |
|  | 366,178            |
| Less current portion   | 201,313<br>-----   |
|  | \$164,865<br>===== |

Maturities on long-term debt at June 30, 2005 are as follows:

|      |           |
|------|-----------|
| 2006 | \$201,313 |
| 2007 | 106,630   |
| 2008 | 58,235    |
|      | -----     |
|      | \$366,178 |
|      | =====     |

The convertible note payable is in default as of June 30, 2005. The note payable to a former landlord relates to a court ordered judgment against the Company for the past due note, unpaid rent and legal fees. The Company settled the terms of this obligation in the year ended June 30, 2005 by issuance of this note payable.

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### 8. CAPITAL LEASE OBLIGATIONS AND SALE-LEASEBACK TRANSACTIONS

The Company leases many of its MedCard terminals under capital lease agreements.

The Company has entered into an arrangement with a third party lessor whereby the Company sells its terminals that are placed with customers to the lessor. The lessor in turn leases back the terminals. These transactions are recorded as sale-leaseback transactions. The leases between the Company and the lessor are accounted for as capital leases. The Company generates revenue from the terminals through monthly service and rental fees and transaction fees. The value of the sale transaction between the Company and lessor is determined by Company's agreement with the customer relative to the number of terminals, length of the customer contract and monthly service fee due from the customer. The Company acquires terminals from its suppliers, programs the terminals with its software and sells the terminals to the lessor when it enters into an agreement with a customer for those specific terminals. Any gain on the sale transaction with the lessor is deferred and amortized proportionately with the capitalized asset. That period is generally three, four or five years, the typical length of the lease agreement. At June 30, 2005, the amount of deferred gain on sale-leaseback transactions was \$2,717,526.

Generally, the terms of repayment for the capital lease obligations approximates the monthly rental charged the customer by the Company. These leases are collateralized by the underlying equipment, contract with the customer and, in addition, 1,000,000 shares of the Company's common stock. The projected cash flow from the customer contract is generally greater than the payments required under the capital lease arrangement with the customer. There have been

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occurrences when customers terminate a contract and the terminals are returned to the Company. The Company will have the opportunity to resell that unit under a new contract. The Company may also obtain a new capital lease through a sale leaseback transaction with the lessor. Therefore, there may be more than a single capital lease obligation to repay although there is only a single customer contract. The Company believes that it generates sufficient cash flows from direct sales and service revenue to cover such variances in capital lease obligations to customer contracts.

The following presents future minimum lease payments under the capital leases by year and the present value of minimum lease payments as of June 30, 2005:

| Years ended June 30:                       | Terminals<br>-----    |
|--|-----------------------|
| 2006                                       | \$ 2,697,357          |
| 2007                                       | 1,952,386             |
| 2008                                       | 1,369,501             |
| 2009                                       | 435,459               |
| 2010                                       | 50,255                |
|  | -----                 |
| Total minimum lease payments               | 6,504,958             |
| Lees: amount representing interest         | (1,689,377)           |
|  | -----                 |
| Present value of minimum<br>lease payments | \$ 4,815,581<br>===== |

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The capitalized cost of terminals under capital leases for the year ended June 30, 2005 and 2004 was \$6,197,320 and \$5,884,507 respectively. The related accumulated amortization on these assets was \$2,871,538 and \$2,061,520 as of June 30, 2005 and 2004, respectively.

### 9. INCOME TAXES

The Company recognizes deferred income taxes for the differences between financial accounting and tax bases of assets and liabilities. Income taxes for the years ended June 30, consisted of the following:

|                                  | 2005<br>-----     | 2004<br>-----     |
|----------------------------------|-------------------|-------------------|
| Current tax (benefit) provision  | \$ (2,884,109)    | \$ (1,642,362)    |
| Deferred tax (benefit) provision | 2,884,109         | 1,642,362         |
|                                  | -----             | -----             |
| Total income tax provision       | \$ - 0 -<br>===== | \$ - 0 -<br>===== |

Net deferred tax assets of \$22,925,128 were fully offset by an equal valuation allowance at June 30, 2005. The deferred income tax assets relate primarily to net operating loss carryforwards and differences in book and tax bases of

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property and equipment, intangible assets and certain accruals. The net deferred income tax asset at June 30, 2005 is comprised of:

|   |    |              |
|---|----|--------------|
| Allowance for losses on accounts receivable | \$ | 34,000       |
| Deferred compensation                       |    | 79,000       |
| Contingency                                 |    | 160,000      |
| Deferred revenue                            |    | 1,089,000    |
| Property and equipment                      |    | 134,000      |
| Impairment of intangible assets             |    | 1,834,000    |
| Net operating loss carryforwards            |    | 22,065,000   |
|   |    | -----        |
| Deferred income tax asset                   |    | 25,394,000   |
| Less: valuation allowance                   |    | (25,394,000) |
|   |    | -----        |
| Total deferred income tax asset             |    | - 0 -        |
|   |    | -----        |
| Deferred income tax liability               |    | (- 0 -)      |
|   |    | -----        |
| Net deferred income tax asset               | \$ | - 0 -        |
|   |    | =====        |

Federal net operating loss carryforwards of \$51,189,000 expire from 2011 to 2023. State net operating loss carryforwards of \$29,603,000 expire from 2005 to 2008. During the year ended June 30, 2005, the Company reduced the deferred income tax asset related to net operating loss carryforwards by \$3,484,000 resulting from the expiration of such carryforwards. Due to the conditions discussed in Note 1, future utilization of the net operating losses is uncertain. The valuation allowance on the deferred income tax asset was decreased by \$1,648,702 in the year ended June 30, 2005, resulting primarily to the expiration of net operating loss carryforwards.

The differences between the statutory and effective tax rates is as follows for the years ended June 30:

|                              | 2005           |       | 2004           |       |
|------------------------------|----------------|-------|----------------|-------|
| Federal statutory rates      | \$ (2,419,000) | (34)% | \$ (1,563,141) | (34)% |
| State income taxes           | (427,000)      | (6)%  | (275,848)      | (6)%  |
| Valuation allowance for      |                |       |                |       |
| operating loss carryforwards | 2,841,000      | 40%   | 1,838,989      | 39%   |
| Other                        | 5,000          | -%    | 18,641         | 1%    |
|                              | -----          | ----- | -----          | ----- |
| Effective rate               | \$ ( - 0 -)    | 0%    | \$ ( - 0 -)    | 0%    |
|                              | =====          | ===== | =====          | ===== |

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### 10. OPERATING LEASES

The Company leases its office space under long-term operating leases expiring through 2008. Rent expense under these leases was \$213,616 and

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\$154,238 for the years ended June 30, 2005 and 2004, respectively.

Future minimum annual lease payments and sublease rentals under operating lease agreements for years ended June 30:

|      |           |
|------|-----------|
| 2006 | 164,432   |
| 2007 | 158,860   |
| 2008 | 170,980   |
| 2009 | 142,404   |
| 2010 | 7,148     |
|      | -----     |
|      | \$643,824 |
|      | =====     |

### 11. STOCKHOLDERS' EQUITY

During the year ended June 30, 2005, the Company issued 7,635,288 shares of its common stock. Of that amount, 42,184 shares of the Company's common stock were sold to an entity controlled by the Company's president and chairman. The balance of the shares were issued to third parties in a private placement of the Company's common stock, issued to settle obligations and as consideration for services. The shares were sold throughout the year ended June 30, 2005, ranging from \$0.50 per share at the beginning of the year to \$1.50 per share at the end of the year. Commissions of approximately \$426,000 are recorded as a charge in additional paid in capital as direct costs associated with the raising of equity capital. In conjunction with the offering of the common stock the Company issued and the investors received 1,332,199 warrants to purchase the Company's common stock. The warrants have exercise prices ranging from \$1.00 to \$4.50 per share and expire three years from date of issue.

The Company has issued shares of its common stock as consideration to consultants for services rendered. The value of those shares is determined based on the trading value of the stock at the dates on which the agreements were entered into for the services. During the year ended June 30, 2005, the Company granted to consultants, 290,000 shares of common stock valued in the aggregate at \$608,942. The value of these shares was expensed during the year.

The Company issued 276,000 shares of its common stock in the year ended June 30, 2005 to settle a legal dispute relating from operations that were discontinued in the 2001. The shares were at \$1.00 per share based on the trading price of the stock at the time of the settlement.

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During the year ended June 30, 2005, the Company issued 770,000 shares of its common stock under a notice of conversion of common stock warrants. Payment for the exercise of \$308,000 was not received until July 2005 and the amount has been recorded as a subscription receivable asset at June 30, 2005.

During the year ended June 30, 2004, the Company settled a claim with an investor. The investor had claimed that it was owed shares under the investment agreement due to substantial dilution and erosion of the stock price. The settlement required the Company to issue an additional 298,866 shares of the Company's common stock to the investor. The shares were

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valued at \$657,505 on the basis of the trading price on the date the settlement was entered into. In a separate settlement, 186,987 shares of the Company's stock was returned and placed in treasury. The treasury shares are recorded at \$0.20 per share, the trading price on the date the settlement was entered into. The 186,987 shares remain as treasury stock at June 30, 2005.

During the year ended June 30, 2004, the Company entered into an agreement with a third party to sell 1,000,000 shares to the third party at \$0.50 per share. The shares were issued but the funds have not yet been received. The transaction is reflected as a common stock subscription receivable of \$500,000 at June 30, 2005.

An entity controlled by the Company's president and chairman regularly advances funds to the Company to cover short-term cash flow deficiencies. During the year ended June 30, 2005, this affiliate converted advances of \$776,992 into 3,186,499 shares of the Company's common stock.

Common stock options for 508,941 shares were exercised during the year ended June 30, 2005. A total of 607,800 options were exercised. Of that amount, holders of 257,800 options performed a cashless exercise netting only 158,941 shares being issued in those exercises. The balance of 350,000 options were exercised for cash of \$296,984.

### Preferred Stock

The Company is authorized to issue up to 300,000 shares of \$.001 par value Preferred Stock. The Board of Directors has the authority to divide the Preferred Stock into series and, within the certain limitations, to set the relevant terms of such series created.

In April 1995, the Company established the Series A Preferred Stock and authorized the issuance of up to 50,000 shares. Each share of series A Preferred Stock is entitled to a dividend at the rate of \$1.60 per share when, and if declared by the Board of Directors. Dividends not declared are not cumulative. Additionally, each share of Series A Preferred Stock is convertible into .20 shares of the Company's Common Stock at any time after July 1, 1999. A total of 850 shares of common stock may be issued upon the conversion of the shares of Series A preferred stock outstanding as of June 30, 2000. Upon any liquidation or dissolution of the Company, each outstanding share of Series A Preferred Stock is entitled to distribution of \$20 per share prior to any distribution to the holders of the Company's common stock. As of June 30, 2000, the Company has 4,250 shares of Series A Preferred Stock issued and outstanding.

In April 2000, the Company established the Series D Preferred stock and authorized the issuance of up to 2,900 shares. The Company issued 494 shares related to a business acquisition of and 2,356 shares for the acquisition of related intellectual property.

Each share of Series D preferred stock is entitled to a dividend at the rate of \$0.04 per share and has a stated value of \$1,000 per share. Dividends on all Series D preferred stock begin to accrue and accumulate from the

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date of issuance. Additionally, each share of Series D preferred stock is convertible into 40.49 shares of common stock for a total of 576,923 shares at the option of the stockholders. Upon liquidation or dissolution of the Company, each outstanding share of Series D preferred stock is entitled to

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a distribution of the stated amount per share prior to any distribution to the shareholders of the Company's common stock. The Company can convert the Series D preferred stock into shares of common stock using the same conversion ratio at any time after April 15, 2001 so long as the bid price of the Company's common stock exceeds \$4.94 per share and the shares of common stock issuable upon the conversion of the Series D preferred stock are either covered by an effective registration statement or are eligible for sale pursuant to rule 144 of the Securities and Exchange Commission. Each share of Series D preferred stock is entitled to vote in all matters submitted to the Company's shareholders on an "as converted" basis.

The Company has not declared its dividend on the preferred stock for the years ended June 30, 2005 and 2004. At June 30, 2005, there was an accumulated undeclared and unpaid dividend on the Series D preferred stock of \$342,000. Total accrued, but unpaid dividends related to the Series D preferred stock was \$23,750 at June 30, 2005.

Common stock warrants issued in the year ended June 30, 2005 consist of the following:

| Number of<br>Warrants | Exercise<br>Price |
|-----------------------|-------------------|
| -----                 | -----             |
| 628,991               | \$ 4.00           |
| 678,400               | \$ 1.00           |
| 390,400               | \$ 2.75           |
| 94,400                | \$ 3.00           |
| 148,999               | \$ 4.00           |
| 20,000                | \$ 4.50           |
| -----                 |                   |
| 1,961,190             |                   |
| =====                 |                   |

### 12. COMMITMENTS AND CONTINGENCIES

#### Employment Agreements

The Company has entered into numerous employment agreements with officers and key employees. Generally, the employment agreements are for three-year periods and include, as potential additional compensation, incentive bonuses computed based upon Company's operations and other benefits, including such items as an automobile allowance, health and life insurance, vacation and sick pay benefits. In June 2000, the Company entered into employment agreements with several officers. These agreements were renegotiated in the year ended June 30, 2002. Total aggregate annual compensation under these agreements is \$208,000. These individuals may be entitled to receive incentive bonuses and other benefits including health insurance, disability coverage, vacation and sick pay. These individuals received options to purchase a total of 25,000 shares of the Company's common stock at \$3.00 per share with vesting on an annual basis over two years. The agreements terminated on June 19, 2003.

#### Royalty Agreement

In connection with the original licensing and subsequent acquisition of MedCard, the Company entered into a royalty agreement with the original Licensor. The royalty provisions of the license agreement remained in effect after the purchase. This agreement was amended in the year ended

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June 30, 2002. The Company will

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pay the Licensor 20% of the first \$1,000,000 of qualified monthly revenues, less direct costs, generated by the licensed software and 10% of net monthly revenue in excess of \$1,000,000.

### Consulting Agreements

The Company has entered into various consulting agreements with outside consultants. These agreements entitle the consultant to issuances of common stock and options as well as cash compensation in exchange for consulting services relating to such things as raising additional debt and equity capital, software development, sales development, investor and public relations and general strategic business consulting. However, certain of these agreements included additional compensation on the basis of performance. The Company has cancelled all of these agreements and wrote-off all of the associated prepaid expense balances at June 30, 2001. The Company does not believe that it has any further obligation under these agreements. However, there have been certain claims made. During the year ended June 30, 2003, the Company settled such claim resulting in the utilization of a \$98,000 accrual made as of June 30, 2002. This agreement included the return of 186,000 shares of the Company's common stock held by the consultant. These shares were returned as of June 30, 2003, and were recorded as treasury stock during the year ended June 30, 2004.

During February 2004, the Company has entered into a consulting agreement whereby the consultant will act as investor relations advisor on the Company's behalf. Upon the execution of the contract the Company granted the consultant fifty thousand shares of restricted stock and \$50,000.

During February 2003, the Company has entered into a service agreement with a consultant whereby the consultant will act as financial advisor and investment banking representative on the Company's behalf. Upon the execution of the contract the Company granted the consultant warrants to purchase up to 400,000 shares of the Company's common stock at an exercise price of \$0.50 per common share. The warrants expire five years from date of issuance.

### Litigation

Subsequent to June 30, 2001, several former employees filed complaints against the Company alleging unpaid payroll and breach of employment agreements. The total known claims being sought by the former employees at June 30, 2001 was approximately \$175,000. The Company has maintained an accrual amount of approximately \$140,000 as of June 30, 2004 for such claims. In June 2005, a settlement with a former officer was settled. The accrual for this obligation of approximately \$140,000 was depleted and additional settlement expense of \$233,982 was recognized.

Several landlords are seeking damages from the Company due to the Company defaulting on several lease agreements. Certain landlords have obtained legal judgments against the Company. The total amount of such claims was \$634,000. The Company and its legal counsel believed that ultimate settlement will result in a much lower payout. Subsequent to year-end, a settlement was reached with such landlord for \$341,178. The Company has recorded the settlement as a note payable at June 30, 2005 (see Note 7). Management believes possibility of further settlements is unlikely; therefore, as of June 30, 2005, no accrual for additional claims is recorded.



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The Company had obligated shares of the Company's common stock and warrants exercisable into common stock under numerous consulting and fund raising agreements. Some such agreements obligated shares in cases of the occurrence of substantial dilution or price drop in the trading value of the Company's common stock. Management believes that it has fulfilled all such obligations. The Company settled one such claim in the year ended June 30, 2005. Management believes that there is a possibility that additional claims may arise.

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The Company may be subject other unasserted claims associated with the abandonment of its operations. The Company is also involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, except as discussed above, the ultimate disposition of these matters will not have a material adverse effect on the Company's financial position, results of operations, or liquidity.

At June 30, 2005, there was approximately \$56,000 estimated and accrued for claims related to the litigation matters described above which were not settled as of the date of this report.

### Customer Contracts

Customers may arrange to have the purchase of the Company's point-of-sale terminals financed through the financial institution that provides the sale-leaseback financing to the Company. The Company has agreements with this financial institution to guarantee varying amounts associated with the financial institution's arrangements with the customers. Generally, the Company may be required to remit to the financial institution, one to six months of scheduled customer payments if the customer defaults on its financing arrangement with the financial institution. Subsequent to June 30, 2005, the Company entered into a new master contract with the financial institution that limits the recourse to the Company to the first payment under the customer's contract. The amount of such payment would not exceed \$100. The Company has not experienced material obligations to-date under the recourse agreements and believes that the new agreement substantially limits potential obligations in the future to an immaterial amount.

### 13. NET LOSS PER SHARE

Net loss per share is calculated using the weighted average number of shares of common stock outstanding during the year. Preferred stock dividends are subtracted from the net income to determine the amount available to common shareholders. Preferred stock convertible to 115,396 common shares and options and warrants exercisable into 3,207,224 shares of common stock were not considered in the calculation for diluted earnings per share for the year ended June 30, 2005 and 2004 respectively because the effect of their inclusion would be anti-dilutive.

The following presents the computation of basic and diluted loss per share from continuing operations:

|        | 2005   |       | 2004   |        |
|--------|--------|-------|--------|--------|
|        | -----  |       | -----  |        |
|        |        | Per   |        |        |
| (Loss) | Shares | Share | (Loss) | Shares |

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|                                       |                 |            |           |                |            |
|---------------------------------------|-----------------|------------|-----------|----------------|------------|
|                                       | -----           | -----      | -----     | -----          | -----      |
| Net (Loss)                            | \$ (7,115,069)  |            |           | \$ (4,609,291) |            |
| Preferred stock dividends             | (114,000)       |            |           | (114,000)      |            |
|                                       | -----           |            |           | -----          |            |
| Loss from continuing operations       | (7,229,069)     |            |           | (4,723,291)    |            |
| BASIC EARNINGS PER SHARE              |                 |            |           |                |            |
| Loss available to common stockholders | \$ (7,229,069)  | 54,015,797 | \$ (0.13) | \$ (4,723,291) | 41,167,477 |
| Effect of dilutive securities         |                 | N/A        |           | N/A            |            |
| DILUTED EARNINGS PER SHARE            | \$ ( 7,229,069) | 54,015,797 | \$ (0.13) | \$ (4,723,291) | 41,167,477 |

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14. RELATED PARTY TRANSACTIONS

The Company's president and chairman is a significant shareholder of the Company. This individual controls another entity that is also a significant shareholder of the Company.

During the year ended June 30, 2002, the Company moved its administrative offices into space occupied by this related entity that is a significant shareholder of the Company. The Company shares office space and management and administrative personnel with this related entity. Certain of the Company's personnel perform functions for the related entity but there was no allocation of personnel related expenses to the related entity in the years ended June 30, 2005 and 2004.

The Company frequently receives advances and advances funds to an entity controlled by the Company's president and which is a significant shareholder of the Company. During the year ended June 30, 2004, the Company converted advances of \$776,992 into 3,186,499 shares of the Company's common stock and advanced funds of \$1,420,229 to this entity. During the year ended June 30, 2005, repayments were made on these advances and additional funds were contributed. The balance due to this affiliate at June 30, 2005 was \$368,197. The advances are generally short term in nature with an interest rate of 3%.

The Company paid management fees of \$450,000 to an entity owned by the Company's president during each of the years ended June 30, 2005 and 2004.

During the year ended June 30, 2005, an affiliate controlled by the Company's president and chairman assumed obligations of the Company totaling \$276,000 in exchange for 276,000 shares of the Company's common stock.

15. CONCENTRATIONS

Financial instruments that potentially subject the Company to concentrations of credit risk are primarily trade accounts receivable. The trade accounts receivable are due primarily from small business customers in numerous geographical locations throughout the United States.

The Company estimates and provides an allowance for uncollectible accounts

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receivable.

The Company has raised cash through sale-leaseback transactions. All of these transactions have been conducted through two lessors. During the years ended June 30, 2005 and 2004, the Company received \$1,692,904 and \$1,810,313 respectively, under sale-leaseback transactions from these entities.

### 16. STOCK BASED COMPENSATION

The Company issues stock options from time to time to executives, key employees and members of the Board of Directors. The Company has adopted the disclosure-only provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation," and continues to account for stock based compensation using the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees". Accordingly, no compensation cost has been recognized for the stock options granted to employees.

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There were no options granted in the year ended June 30, 2005 and 2004 and all options previously granted have been fully vested and therefore there is no pro forma effect for the year ended June 30, 2005. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model.

In February 2003, 400,000 warrants to acquire the Company's common stock at \$0.50 per share were issued as consideration for consulting services to be rendered. The fair value of these warrants of \$150,600 was expensed in that year.

The Company grants options under several stock option plans. The Company's Incentive Stock Option Plans, Non-Qualified Stock Option Plans and Stock Bonus Plans are collectively referred to as the "Plans". The following sets forth certain information as of June 30, 2005 concerning the stock options and stock bonuses granted by the Company pursuant to the Plans. Each option represents the right to purchase one share of the Company's Common Stock.

|   | TOTAL SHARES RESERVED<br>UNDER THE PLAN | REMAINING OPTIONS<br>UNDER THE PLAN |
|---|---|-------------------------------------|
| 1998 Incentive Stock Option Plan        | 1,500,000                               | 400,167                             |
| 2000 Incentive Stock Option Plan        | 1,000,000                               | 925,150                             |
| 2000 Non-Qualified Stock<br>Option Plan | 2,000,000                               | 1,820,575                           |
| 1999 Stock Bonus Plan                   | 900,000                                 | 833,250                             |
| 2000 Stock Bonus Plan                   | 500,000                                 | 500,000                             |

The options under these plans generally expire five years from date of

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grant. The summary of activity for the Company's stock options and warrants is presented below:

|  | 2005       | Weighted<br>Average<br>Exercise<br>Price | 2004        | Weighted<br>Average<br>Exercise<br>Price |
|--|------------|--|-------------|--|
|  |            |  |             |  |
| Options/warrants outstanding at                                |            |  |             |  |
| Beginning of year  | 1,875,024  | \$ 12.59                                 | 3,877,281   | \$ 9.49                                  |
| Granted  | 628,991    | \$ 3.25                                  | - 0 -       |  |
| Exercised  | - 0 -      |  | (607,800)   | \$ 0.69                                  |
| Terminated/Expired   | (542,825)  | \$ 5.35                                  | (1,394,457) | \$ 5.35                                  |
| Options outstanding at end of year                             | 1,961,190  | \$ 12.59                                 | 1,875,024   | \$ 12.59                                 |
| Options exercisable at end of year                             | 1,961,190  | \$ 12.59                                 | 1,875,024   | \$ 12.59                                 |
| Options available for grant at end                             |            |  |             |  |
| of year  | 1,961,190  |  | 5,873,599   |  |
| Price per share of options outstanding                         | \$ 0.47 to |  | \$ 0.47 to  |  |
|  | \$ 40.00   |  | \$ 40.00    |  |
| <br>   |            |  |             |  |
| Weighted average remaining contractual lives                   | 0years     |  | 1.84years   |  |
| <br>   |            |  |             |  |
| Weighted Average fair value of options granted during the year | N/A        |  | \$ 0.3765   |  |

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Range of exercise prices of options outstanding at June 30, 2005:

| Exercise Price      | Number Outstanding | Weighted Average Exercise Price | Number Exercisable | Weighted Average Exercise Price |
|---------------------|--------------------|---------------------------------|--------------------|---------------------------------|
|                     |                    |                                 |                    |                                 |
| \$0.47-\$1.50       | 178,125            | \$ 0.49                         | 178,125            | \$ 0.49                         |
| \$1.51-\$3.00       | 638,086            | \$ 2.52                         | 638,086            | \$ 2.52                         |
| \$3.01-\$4.50       | -0-                | N/A                             | -0-                | N/A                             |
| \$4.51-\$6.00       | 189,804            | \$ 5.00                         | 189,804            | \$ 5.00                         |
| \$6.01-\$10.00      | 20,000             | \$ 6.25                         | 20,000             | \$ 6.25                         |
| \$10.01-15.00       | 65,000             | \$ 15.00                        | 65,000             | \$ 15.00                        |
| \$15.01 and greater | 870,175            | \$ 24.71                        | 870,175            | \$ 24.71                        |

All warrants issued in the year ended June 30, 2005 were issued as part of equity units that included common stock sold in private placement transactions.

### 17. EMPLOYEE BENEFIT PLAN

The Company maintains a 401(k) profit sharing plan for its employees. Each United States based full-time employee is eligible to participate in that plan on the first day of the calendar quarter after completing ninety days of employment with the Company. A participating employee can contribute up to fifteen percent (15%) of their annual compensation, up to a maximum of

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the federally mandated limit. The Company matches 50% of the contributions on the first six percent (6%) of the employee's contribution up to a maximum of three percent (3%). Employees are fully vested on their own contributions and vest in the Company's contributions twenty percent (20%) per year over five years. The Plan was frozen subsequent to June 30, 2001 and there were no contributions for the years ended June 30, 2005 and 2003.

### 18. BUSINESS SEGMENTS

The Company previously had three reportable segments: intelligent vending machines, healthcare management software development and medical transaction processing. During the year ended June 30, 2001, the Company determined it would divest or abandon all business segments other than the medical transaction processing segment. Therefore, going forward, the Company will have only one reportable segment. At June 30, 2005 the Company operates only in the medical transaction-processing segment with substantially all revenue generated in the United States.

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The medical transaction-processing segment includes revenue from the MedCard System, including the sale of terminals, processing fees and billing service revenue and the licensing, sales and services related to the Company's One Medical Services Network.

For the years ended June 30, 2005 and 2004, there were no material concentrations of revenue to specific customers. However, all gains related to sale-leaseback transactions are associated with one lessor but relate to numerous customer contracts.

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

Not applicable.

### PART III

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

#### DIRECTOR AND EXECUTIVE OFFICER

Mr. William P. Williams as of August 2001 accepted the position of Chief Executive Officer and sole Director of the Company. Information representing Mr. Williams, is set forth below:

|                     |    |  |
|---------------------|----|--|
| William P. Williams | 51 | Chairman, President, Chief Executive Officer |
|---------------------|----|--|

The chief executive officer and sole director of the Company will hold office until additional members or officers are duly elected and qualified. The background and principal occupations of the sole officer and director of the Company is as follows:

William P. Williams has been the Chairman, Chief Executive Officer, of Medcom USA since August 2001. He is also currently Chief Executive Officer and Chairman of the Board for American Nortel Communications, Inc., a publicly traded company located in Scottsdale, Arizona, which is in the business of

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long-distance telephone service domestically, as well as internationally. From 1983 to 1995, he was President and Chairman of the Board of Shelton Financial, Inc., a financial factoring firm headquartered in San Antonio, Texas. Mr. Williams has a Bachelor of Arts, and a Master of Business Administration in Finance from Baylor University.

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

The Company is aware that all filings of Form 4 and 5 required of Section 16(a) of the Exchange Act of Directors, Officers or holders of 10% of the Company's shares have not been timely and the Company has instituted procedures to ensure compliance in the future.

### ITEM 10. EXECUTIVE COMPENSATION

General. Mr. William P. Williams serves as the Company's sole-director and chief executive officer. Pursuant to a Management Services Agreement executed and approved by the Company Mr. Williams was compensated

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approximately \$450,000 for management fees, and other sources or forms of compensation was not paid or collected for Fiscal year ended 2004.

### ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT.

As of June 30, 2005 information with respect to the only persons owning beneficially 5% or more of the outstanding common stock and the number of and percentage of the outstanding shares owned is represented below:

| Name and Address<br>-----  | Shares Owned (1)<br>----- | Common Stock<br>----- |
|--|---------------------------|-----------------------|
| American Nortel Communications<br>7975 North Hayden Road #D-333<br>Scottsdale, Arizona 85258 | 19,024,347                | 39.13%                |
| William P. Williams<br>7975 North Hayden Road #D-333<br>Scottsdale, Arizona 85258            | 5,083,397                 | 10.46 %               |

(1) Excludes any shares issuable upon the exercise of any warrants or options or upon the conversion of other convertible securities.

### ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.

The Company frequently advances funds to an affiliated entity, which is also a significant shareholder of the Company. During the year ended June 30, 2005, the Company advanced funds of \$1,420,229 to this entity.

### ITEM 13. EXHIBITS AND REPORTS.

3.1 Articles of Incorporation (2)

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- 3.2 Amendments to Articles of Incorporation - Fourth Article (2)
- 3.3 Amendment to Articles of Incorporation - Name Change (2)
- 10.18 Amendment to License Agreement - Dream Technologies, LLC (1)

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(1). Incorporated by reference to the same exhibit filed with Amendment No. 5 to the Company's Registration Statement on Form S-3 (Commission File No. 333-71179)

(2). Incorporated by reference to the same exhibit filed with the Company's Annual Report on Form 10-KSB for the year ending June 30, 2001.

REPORTS ON FORM 8-K

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Not applicable.

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ITEM 14. CONTROLS AND PROCEDURES.

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

The Company maintains controls and procedures designed to ensure that information required to be disclosed in this report is recorded, processed, accumulated, and reported to its management, including the chief executive officer to allow timely decisions regarding the required disclosures. Within the 90 days prior to the filing date of this report, MedCom's management, with the participation of its chief executive officer and corporate accounting, performed an evaluation of the effectiveness of the design and operation of these disclosure controls and procedures. This officer and management have concluded that such disclosure controls and procedures are effective at ensuring that required information is disclosed in the Company's reports.

CHANGES IN INTERNAL CONTROLS

There were no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the evaluation date.

ITEM 15. SIGNATURES.

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

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