

INFINITE GROUP INC
Form 10-K
February 26, 2010

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

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2009

OR

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

For the transition period from to

Commission File Number 0-21816

INFINITE GROUP, INC.
(Exact name of registrant as specified in
its charter)

DELAWARE
(State or other jurisdiction
of incorporation or
organization)

52-1490422
(I.R.S. Employer
Identification No.)

60 Office Park Way
Pittsford, NY 14534
(Address of principal executive offices)

Registrant's telephone number, including area code (585) 385-0610

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:
Common Stock
Par value \$.001

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. T

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a small reporting company.

Large accelerated filer
Non-accelerated filer

Accelerated filer
Smaller reporting company

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

The aggregate market value of the common stock of the registrant held by non-affiliates of the registrant (based upon the closing price on the NASDAQ "Over the Counter Bulletin Board" of \$.29 on June 30, 2009) was approximately \$6,519,200.

As of February 26, 2010, 25,661,883 shares of the registrant's common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE
NONE

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FORWARD LOOKING STATEMENT INFORMATION

Certain statements made in this Annual Report on Form 10-K are “forward-looking statements” regarding the plans and objectives of management for future operations. Such statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. The forward-looking statements included herein are based on current expectations that involve numerous risks and uncertainties. Our plans and objectives are based, in part, on assumptions involving judgments with respect to, among other things, future economic, competitive and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond our control. Although we believe that our assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate and, therefore, there can be no assurance that the forward-looking statements included in this report will prove to be accurate. In light of the significant uncertainties inherent in the forward-looking statements included herein particularly in view of the current state of our operations, the inclusion of such information should not be

regarded as a statement by us or any other person that our objectives and plans will be achieved. Factors that could cause actual results to differ materially from those expressed or implied by such forward-looking statements include, but are not limited to, the factors set forth herein under the headings “Business,” “Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” We undertake no obligation to revise or update publicly any forward-looking statements for any reason.

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PART I

Item 1. Business

Business Overview

We are a provider of information technology (IT) services to federal, state and local governments and commercial clients. Our expertise includes managing leading edge operations and implementing complex programs in advanced server management, virtualization (server, desktop, application and storage), cloud computing, network services, information security, wireless technology, human capital services, enterprise architecture, and program and project management. We focus on aligning business processes with technology for delivery of solutions meeting our clients' exact needs and providing expert management services to the lifecycle of technology-based projects. We have a business development office with close proximity to the Washington, D.C. metropolitan area and operate in various locations in the United States and overseas. In December 2009, we opened an office in Colorado Springs, Colorado to serve as our new business development and client service office for the Rocky Mountain region. As of December 31, 2009, we had 93 full-time employees and five full time billable information technology independent contractors. Approximately 30% of our employees hold U.S. Government security clearances. During 2009, we became ISO 9001 certified. ISO or the International Organization for Standardization, is an international-standard-setting body composed of representatives from various national standards organizations which promulgates worldwide proprietary industrial and commercial standards.

We have several contract vehicles that enable us to deliver a broad range of our services and solutions to the federal and certain state governments. The quality and consistency of our services and IT expertise allow us to maintain long-term relationships with the U.S. Government and other major clients.

In 2009, we had sales of approximately \$11.4 million, a 14.7% increase over 2008 sales of approximately \$9.9 million. During 2009, we derived approximately 70% of our sales from one client, including sales under subcontracts for services to several different end clients. Approximately 82% of our total sales in 2009 were from U.S. Government contracts.

U.S. Government IT Market

The U.S. Government is the largest consumer of information technology services and solutions in the United States and we believe that its spending on information technology will continue to increase in the next several years. The growth is driven by the expansion of national defense and homeland security programs, the continued need for sophisticated intelligence gathering and information sharing, increased reliance on technology service providers, and the continuing impact of Office of Management and Budget mandates regarding IT spending. U.S. Government spending on information technology has consistently increased in each year since 1980.

We expect that the U.S. Government's need for the types of IT services that we provide, such as IT modernization, program and project management, systems engineering, server and desktop virtualization projects and information security, will continue to grow in the foreseeable future, as a result of the high priority placed on the transformation and modernization of its IT programs. We believe that the U.S. Government is continuing to turn to the commercial IT industry to execute its support processes and functions.

Information Technology (IT) Services - Our Core Strengths

We strategically built our business to deliver a wide range of IT services and solutions that address challenges common to many U.S. Government agencies, state and local governments and commercial companies. We believe that our core strengths position us to respond to the long-term trends and changing demands of our market. Our key focus areas are:

IT Infrastructure Management. We manage one of the nation's largest wide area networks for a major establishment of the U.S. Government. We provide this support under a subcontract we entered into in 2004 with a large systems integrator, which subcontract has been renewed annually. Referred to as Advanced Server Management (ASM), our team of server experts supports approximately 3,000 servers and 250,000 client stations from facilities in Maryland and Colorado. Operating around the clock, we consistently exceed the requirements of our service level agreements.

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Systems Engineering. We provide critical systems engineering support to the ASM Program and on projects for the Department of Homeland Security (DHS). Our engineers design and build systems supporting a mix of business activities. We both manage and execute engineering projects supporting complex wide area networks and local area networks in Windows and UNIX environments, and we provided engineering support for a nationwide wireless operation. Our engineers follow proven methodologies to transition systems from concept to operations.

Server Virtualization. Virtualization is the process of presenting a logical grouping of computing resources so they can be accessed in ways that give benefits over the original configuration. A good example of virtualization is multiprocessing computer architectures. This is the practice of partitioning or splitting up one server to appear as multiple servers. Using virtualization software provided by third party vendors such as VMware, a client can run multiple operating systems on one physical machine and therefore a broader, richer set of business applications.

Beginning in 2006 and continuing throughout 2009, we executed phases of a nationwide physical to virtual server consolidation project for a major establishment of the U.S. Government. We have accomplished this by architecting, designing and migrating approximately 2,400 servers. We led the client's Advanced Computing Environment (ACE) virtual server project utilizing VMware's ESX 3.0.1 to virtualize everything from application and print servers to terminal servers and domain controllers. The migration was transparent to the end user – there was no server downtime and no lost data.

Since late 2007, we have provided consultant support to a Fortune 500 client in performing a global data center consolidation effort. In addition, we are working on the initial stage of a major server virtualization program for the Customs and Border Protection (CBP) Directorate of DHS. We began working with CBP in 2007 performing a wide array of services related to the architecture, testing, and implementation of virtualization services. Our staff created the architecture for the first CBP-approved virtualization system. We performed the architecture around, assisted in the testing of, and helped implement the most successful-to-date disaster recovery exercise. We architected the VMware Virtual Infrastructure 3 solution. Our staff has been key in the production of the certified documentation for the CBP virtualization projects. Additionally, we have continually provided key project management assistance to the CBP virtualization projects as well as for the Microsoft Windows engineering teams.

Cloud Computing. As part of our strategy of staying on the leading edge of the IT industry, we offer a comprehensive list of cloud computing-related services through our Cloud-CastSM Division. Cloud computing is defined as leveraging internet-based resources to deliver services and processing power. By utilizing cloud computing, organizations can respond dynamically to business demands, allaying the need to have extraneous systems on standby in anticipation of such peaks. Cloud computing can involve both on-premise clouds and off-premise clouds. On-premise clouds involve an organization designing and implementing a large processing and storage fabric within its own data center. Off-premise clouds involve using a third-party cloud service provider to host the needs of an organization. In both cases the underlying solution typically involves a virtualized infrastructure managed through intelligent automation. Our service offerings include cloud readiness assessments, cloud migration services and various platform-as-a-service solutions.

Desktop Virtualization. Desktop virtualization is the concept of separating a personal computer desktop environment from the physical machine through a client-server computing model. The resulting "virtualized" desktop is stored on a remote central server, instead of on the local storage of a remote client; thus, when users work from their remote desktop client, all of the programs, applications, processes and data used are kept and run centrally, allowing users to access their desktops on any capable device, such as a traditional personal computer, notebook computer, smartphone, or thin client.

Information Security. In January 2010, we launched our information security practice. Established to meet the data security needs of both commercial and government sector organizations, we plan to deliver a full range of IT security management services, emphasizing security processes and advanced technologies. The new practice group will offer

virtualization security, network perimeter security assessments, network access control architectures, vulnerability assessments, and Security Information Management (SIM) readiness assessments.

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Program Management. Our program managers are subject matter experts who are skilled in managing complex programs dealing with leading edge technologies. Our engagements span a broad range of tasks such as feasibility studies, concept and strategy planning, business process development and reengineering, and project execution. Our staff has a thorough understanding of the technical bases for management and therefore provides clients with expertise connecting technical delivery with sound project management using earned value management processes. We have provided program, portfolio and project management, risk management, master scheduling and acquisition management services to the DHS's Wireless Management Office.

Portfolio Management. We define, implement, and manage portfolios as an integral part of program management. We have proven experience in establishing portfolios as an effective strategy to assess the overall performance of a program through the projects that the program manages. Using performance measures that are defined for the program, the project portfolio can be better evaluated. In addition to overall program performance management, financial performance is supported through portfolio management by capturing planned and actual investments and their associated business cases. Through the use of industry standard software, such as ProSight, we ensure that the originator of the business case focuses on the accuracy and completeness of program and project information and that the program management office focuses on program management best practices.

Project Management. Managing technology-driven projects is a complex process requiring skilled personnel to deliver on the actual work, as well as requiring expert project managers who can plan and execute the work. We have a proven methodology for project management, which includes standards for Earned Value Management that can be applied to any project type. We have created web-based project management environments to integrate the entire process of delivery with project management standards to optimize performance. A portal provides a mechanism to engage the entire stakeholder community in the delivery process and enable team personnel to plan, perform, measure, and report on delivery. We developed a comprehensive project management system and have implemented earned value management-based project management standards for the DHS Wireless Management Office.

Enterprise Architecture. Our approach to developing architecture for our clients' IT needs begins with the business model. Business drives the need for solutions, and technology facilitates the solution. By understanding the business drivers, we establish the architectural framework to build or extend the computing environment with right sized technology solutions that maximize business processes while minimizing the costs and risks to the client. We developed and continue to support the implementation of business processes for a new operation of DHS where we have successfully integrated technology into the business layer of the existing architectural framework.

Software Development. We follow a systematic approach to developing software for specific client projects. Whether it is a full systems development lifecycle or portions of one, we approach our development tasks with process discipline to ensure tasks are defined, objectives established and progress measured. We developed a Human Resource PeopleSoft-based solution for the DHS to manage the entry and exit of personnel. We developed a software application called SmartForms and have converted standard paper forms to electronic forms to greatly enhance the simplicity and efficiency of processing personnel actions. We also created software to automate routine functions performed under a Network Services contract to enhance and speed-up productivity, as well as reduce the client's operating expenses.

During 2009, we derived approximately 82% of our sales from the U.S. Government including 42% of our sales from our ASM subcontract. We also have several subcontracts under which we provided IT services to various programs and divisions of DHS and other U.S. Government agencies.

Our Contract and Sales Vehicles

The acquisition of the following contract vehicles allows us additional opportunities to bid on new projects.

Federal Supply Schedule Contract. In 2003, we were awarded a Federal Supply Schedule Contract by the U.S. General Services Administration (GSA) for IT consulting services (Schedule 70). In 2008, our Schedule 70 Contract was extended for an additional five years through December 27, 2013. Having a Schedule 70 allows us to compete for and secure prime contracts with all executive agencies of the U.S. Government, as well as other national and international organizations. Our Schedule 70 contract encompasses 85 different labor categories for a three year term. During 2007, we had one prime contract under our Schedule 70 with sales of approximately \$756,000. Beginning in 2008, this contract was revised such that we are now a subcontractor to a major prime contractor for DHS for these same and additional services. We have used the Schedule 70 as a basis for pricing our current and proposed work. We intend to continue using our Schedule 70 to facilitate the sale of IT consulting services to the U.S. Government.

Navy's SeaPort-Enhanced (SeaPort-e) Program. In June 2006, we were awarded a prime contract under the Department of the Navy's SeaPort-Enhanced (SeaPort-e) program. This contract allows us to compete for and perform service requirements solicited by various Navy commands, the Marine Corps, other organizations within the Department of Defense (DoD), non-DoD agencies, and certain joint agency organizations for work that is integrally related to the scope and mission of the contract. This work involves professional services in all phases of naval ship and weapon systems acquisition and life-cycle support, including research and development support, prototyping, technology analysis, acquisition logistics, project management support, modeling, test and evaluation trials, crisis and consequence management, and engineering support.

VMware Authorized Consultant (VAC). During 2007, we were approved as a VMware Authorized Consultant (VAC) by VMware, Inc. a subsidiary of EMC Corporation. VMware is recognized as the industry leader in virtualization technology. As a VAC, we are trained and certified to deliver consulting services and solutions leveraging VMware technology. We are also certified as a VMware Enterprise VIP Reseller authorized to resell VMware's full product line. We are actively working with a number of current and potential clients in that regard. These certifications are examples of our concerted effort to grow and expand our virtualization practice. Virtualization involves the creation, allocation, and management of "virtual machines," which entails the virtual representation of hardware by a software system. What this means is that traditional "physical servers," which typically run at only 5% to 15% of their capacity, can now be consolidated with the use of specialized software such as VMware to increase server utilization by a factor of ten to one or even greater. Reducing the number of physical machines required in a typical environment provides numerous and obvious benefits, including equipment cost savings, reduced operational maintenance costs, easier backup, improved availability, and better security. Due to the substantial energy savings resulting from reduced infrastructure, virtualization is also a "green" technology.

Microsoft Gold Certified Partner. In 2008, we attained Microsoft Gold Certified Partner status, the highest level of certification available from Microsoft Corporation. Gold Certified Partners have passed Microsoft's stringent requirements and have demonstrated the highest levels of knowledge, skill and technical ability, as well as the commitment to implement of Microsoft technologies. We have specifically been certified for Microsoft Competencies in the areas of advanced infrastructure solutions and unified communications. Created to help partner firms like Infinite Group differentiate their solution and service offerings, Microsoft competencies enable clients to secure a particular type of consulting solution, based on the firm's capabilities and expertise with specific Microsoft technologies. Each Microsoft competency has a unique set of requirements and benefits, formulated to accurately represent the specific skills and services that partners bring to the technology industry.

Dell Master Services and Authorized Reseller Agreements. In November 2009, we entered into master services relationship and authorized reseller agreements with Dell, Inc. Under the master services agreement with Dell's professional services organization, we can rapidly engage on consulting projects and deliver service in a streamlined and efficient manner. Our key areas of focus for our Dell partnership include virtualization services, as well as operational support for major Dell contracts in the federal and defense markets. In addition, our authorized reseller

status enables us to deliver Dell's world-class range of hardware and software solutions to our own end-user clients and those clients engaged under the Dell master services agreement.

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Hewlett Packard Supplier Based Consolidation Program (SBCP). In September 2009, we were accepted into the Hewlett Packard (HP) Supplier Based Consolidation Program (SBCP). Under SBCP, we are a member of a select group of suppliers that are eligible to be awarded tasks by HP nationwide. HP has many tools and resources to help us generate new sales streams, and improve our mutual profitability, while at the same time adding unique value for our joint customers. The program comprises practical tools and services that we hope will help us in the key areas of marketing and selling our solutions, optimizing the technology, and collaborating with other organizations within our industry. The Master Services Agreement covering the SCBP runs for five years.

Mississippi Server Virtualization Contract. In September 2009, the State of Mississippi awarded us a three-year contract to provide server virtualization consulting services to all State agencies. Under the agreement, we will support the virtualization projects of each agency to move their servers to a virtualized environment at the State's new data center located in Jackson, Mississippi. The program started with Department of Human Services. We prepared a "total cost of ownership" analysis which estimated that virtualizing the department's 112 servers and migrating them to the central data center will save an estimated \$4 million over five years.

Navy Enterprise Maintenance Automated Information System (NEMAIS). We are a member of a team led by CACI International Inc. that was awarded a \$36 million task order by the U.S. Navy in October 2007 to support its Navy Enterprise Maintenance Automated Information System (NEMAIS) data center operations. The task order, awarded under the Seaport II Enhanced contract vehicle (Seaport-e), provides for one base year and three one-year options. The CACI team will perform the work at the Naval Sea Systems Command (NAVSEA) site in Norfolk, Virginia and the Puget Sound Naval Shipyard in Washington State. As a result of the award CACI was able to maintain the same level of support it has been providing to the Navy for the NEMAIS data center which in turn enhances CACI's and our core lines of business in engineering services, network services and business systems integration. In 2008, we began working with CACI on a portion of this project under the terms of our subcontract.

Competition

We compete mainly with other IT professional services firms operating in the federal, state and local government marketplace. We obtain much of our business on the basis of proposals submitted in response to requests from potential and current clients, who typically also receive proposals from other firms. Many of our proposed services are included with proposals of large prime contractors, where a specific area for our participation has been identified based on our expertise and experience. Certain large prime contractors are required to allocate a portion of their contract to small businesses and we are able to fill that role. We also face indirect competition from certain government agencies that perform services for themselves similar to those we market.

We have entered into subcontracts with systems integrators holding multi-year, multi-million dollar contracts with various agencies of the U.S. Government. In such cases, our competition is mainly with other IT services companies classified as small business entities by government standards. For prime contracts with the U.S. Government, we anticipate that our competition will range from small business set aside contractors to full and open competition with large firms such as Northrop Grumman Information Technologies, Science Applications International Corp., EDS Corp., Computer Sciences Corp., Unisys, IBM, Booz Allen Hamilton, SRA International, Inc., and Serco Services Inc.

Our competitors in general have substantially greater capital resources, research and development staffs, manufacturing capabilities, sales and marketing resources, facilities, and experience than we do.

Because of the diverse requirements of U.S. Government customers and the highly competitive nature of large procurements, corporations frequently form teams to pursue contract opportunities. The same companies listed as competitors will often team with us or subcontract to us in the pursuit of new business. We believe that the major competitive factors in our market are distinctive technical competencies, successful past contract performance, price

of services, reputation for quality and key management with domain expertise.

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Company Information Available on the Internet

We maintain a website at www.IGIus.com. Through a link to the Investor Relations section of our website, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), are available, free of charge, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission (SEC). The content of our website shall not be deemed part of this report.

Employees

As of December 31, 2009 we had 93 full-time employees, including 80 in information technology services, two in executive management, three in finance and administration, one in employee recruiting, and seven in marketing and sales. We also had five full-time billable information technology independent consultants and one full time administrative and business development consultant who worked for us. We are not subject to any collective bargaining agreements and we believe that our relations with our employees are good. We believe that we are currently staffed at an appropriate level to implement and carry out our business plan for the next 12 months.

Our ability to develop and market our services, and to establish and maintain a competitive position in our businesses will depend, in large part, upon our ability to attract and retain qualified technical, marketing and managerial personnel, of which there can be no assurance.

General Information

We were incorporated under the laws of the state of Delaware on October 14, 1986. On January 7, 1998, we changed our name from Infinite Machines Corp. to Infinite Group, Inc. Our principal corporate headquarters are located at 60 Office Park Way, Pittsford, NY 14534. Our business is exclusively in the field of IT services.

Item 1A. Risk Factors

In addition to the other information provided in our reports, you should consider the following factors carefully in evaluating our business and us. Additional risks and uncertainties not presently known to us, which we currently deem immaterial or that are similar to those faced by other companies in our industry or business in general, such as competitive conditions, may also impair our business operations. If any of the following risks occur, our business, financial condition, or results of operations could be materially adversely affected.

Risks Related to our Industry

We depend on prime contracts or subcontracts with the U.S. Government for a substantial portion of our sales, and our business would be seriously harmed if the government ceased doing business with us or our prime contractors or significantly decreased the amount of business it does with us or our prime contractors.

We derived approximately 82% and 86% of our sales in 2009 and 2008, respectively, from U.S. Government contracts as either a prime contractor or a subcontractor. We expect that we will continue to derive a substantial portion of our sales for the foreseeable future from work performed under U.S. Government contracts, as we have in the past, and from new marketing efforts focused on state and local governments. If we or our prime contractors were suspended or prohibited from contracting with federal, state or local governments, or if our reputation or relationship with the federal, state or local governments were impaired, or if any of the foregoing otherwise ceased doing business with us or our prime contractors or significantly decreased the amount of business it does with us or our prime contractors, our business, prospects, financial condition and operating results would be materially adversely affected.

Our business could be adversely affected by changes in budgetary priorities of the U.S. Government.

Because we derive a significant portion of our sales from contracts with the U.S. Government, we believe that the success and development of our business will continue to depend on our successful participation in U.S. Government contract programs. Changes in U.S. Government budgetary priorities could directly affect our financial performance. A significant decline in government expenditures, a shift of expenditures away from programs which call for the types of services that we provide or a change in U.S. Government contracting policies, could cause U.S. Governmental agencies to reduce their expenditures under contracts, to exercise their right to terminate contracts at any time without penalty, not to exercise options to renew contracts or to delay or not enter into new contracts. Any of those actions could seriously harm our business, prospects, financial condition or operating results. Moreover, although our contracts with governmental agencies often contemplate that our services will be performed over a period of several years, Congress usually must approve funds for a given program each government fiscal year and may significantly reduce or eliminate funding for a program. Significant reductions in these appropriations by Congress could have a material adverse effect on our business. Additional factors that could have a serious adverse effect on our U.S. Government contracting business include:

- changes in U.S. Government programs or requirements;
- budgetary priorities limiting or delaying U.S. Government spending generally, or by specific departments or agencies in particular, and changes in fiscal policies or available funding, including potential governmental shutdowns;
- reductions in the U.S. Government's use of technology solutions firms;
- a decrease in the number of contracts reserved for small businesses, or small business set asides, which could result in our inability to compete directly for these prime contracts; and
- curtailment of the U.S. Government's use of IT or related professional services.

The Office of Management and Budget process for ensuring government agencies properly support capital planning initiatives, including information technology investments, could reduce or delay federal information technology spending and cause us to lose revenue.

The Office of Management and Budget, or OMB, supervises spending by federal agencies, including enforcement of the Government Performance Results Act. This Act requires, among other things, that federal agencies make an adequate business justification to support capital planning initiatives, including all information technology investments. The factors considered by the OMB include, among others, whether the proposed information technology investment is expected to achieve an appropriate return on investment, whether related processes are contemporaneously reviewed, whether inter-operability with existing systems and the capacity for these systems to share data across government has been considered, and whether existing off-the-shelf products are being utilized to the extent possible. If our clients do not adequately justify proposed information technology investments to the OMB, the OMB may refuse funding for their new or continuing information technology investments, and we may lose revenue as a result.

Our profitability will suffer if we are not able to maintain our pricing and utilization rates and control our costs.

Our profit margin, and therefore our profitability, is largely a function of the rates we charge for our IT Services and the utilization rate, or chargeability, of our employees. Accordingly, if we are not able to maintain the rates we charge for our services or an appropriate utilization rate for our employees, we will not be able to sustain our profit margin and our profitability will suffer. The rates we charge for our IT Services are affected by a number of factors, including:

- our clients' perception of our ability to add value through our services;
- competition;

- introduction of new services or products by us or our competitors;
- pricing policies of our competitors; and
- general economic conditions.

Our utilization rates are also affected by a number of factors, including:

- seasonal trends, primarily as a result of holidays, vacations, and slowdowns by our clients, which may have a more significant effect in the fourth quarter;
 - our ability to transition employees from completed engagements to new engagements;
- our ability to forecast demand for our services and thereby maintain an appropriately balanced and sized workforce; and
 - our ability to manage employee turnover.

We have implemented cost-management programs to manage our costs, including personnel costs, support and other overhead costs. Some of our costs, like office rents, are fixed in the short term, which limits our ability to reduce costs in periods of declining sales. Our current and future cost-management initiatives may not be sufficient to maintain our margins as our level of sales varies.

If we fail to meet our contractual obligations to our clients, our ability to compete for future work and our financial condition may be adversely affected.

If we fail to meet our contractual obligations, we could be subject to legal liability, which could adversely affect our business, operating results and financial condition. The provisions we typically include in our contracts which are designed to limit our exposure to legal claims relating to our services may not protect us or may not be enforceable under some circumstances or under the laws of some jurisdictions. It is possible, because of the nature of our business, that we may be exposed to legal claims in the future. We have errors and omissions insurance with coverage limits of \$5,000,000 and a deductible payable by us of \$100,000. The policy limits may not be adequate to provide protection against all potential liabilities. As a consulting firm, we depend to a large extent on our relationships with our clients and our reputation for high-quality services to retain and attract clients and employees. As a result, claims made against us may damage our reputation, which in turn, could impact our ability to compete for new business.

Unfavorable government audits could require us to refund payments we have received, to forego anticipated sales and could subject us to penalties and sanctions.

The government agencies we work for generally have the authority to audit and review our contracts with them and/or our subcontracts with prime contractors. As part of that process, the government agency reviews our performance on the contract, our pricing practices, our cost structure and our compliance with applicable laws, regulations and standards. If the audit agency determines that we have improperly received payment or reimbursement, we would be required to refund any such amount. If a government audit uncovers improper or illegal activities by us, we may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeitures of profits, suspension of payments, fines and suspension or disqualification from doing business with the government. Any such unfavorable determination could adversely impact our ability to bid for new work which would have a negative impact on our business.

The IT services industry is highly competitive, and we may not be able to compete effectively.

We operate in a highly competitive industry that includes a large number of participants. We believe that we currently compete principally with other IT professional services firms, technology vendors and the internal information systems groups of our clients. Many of the companies that provide services in our markets have significantly greater financial, technical and marketing resources than we do. Our marketplace is experiencing rapid changes in its

competitive landscape. Some of our competitors have sought access to public and private capital and others have merged or consolidated with better-capitalized partners. These changes may create more or larger and better-capitalized competitors with enhanced abilities to compete for market share generally and our clients specifically, in some cases, through significant economic incentives to clients to secure contracts. These competitors may also be better able to compete for skilled professionals by offering them large compensation incentives. In addition, one or more of our competitors may develop and implement methodologies that result in superior productivity and price reductions without adversely affecting the competitors' profit margins. In addition, there are relatively few barriers to entry into our markets and we have faced, and expect to continue to face, competition from new entrants into our markets. As a result, we may be unable to continue to compete successfully with our existing or any new competitors.

The failure by Congress to approve budgets on a timely basis for the U.S. Government agencies we support could delay procurement of our services and solutions and cause us to lose future revenues.

On an annual basis, Congress must approve budgets that govern spending by the U.S. Government agencies that we support. In years when Congress is not able to complete its budget process before the end of the U.S. Government's fiscal year on September 30, Congres