I2 TECHNOLOGIES INC
Form 10-K
July 21, 2003
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

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

For the fiscal year ended December 31, 2002

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 0-28030

i2 Technologies, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Delaware (State or other jurisdiction of incorporation or organization)	**75-2294945** (I.R.S. Employer Identification No.)
One i2 Place **11701 Luna Road** **Dallas, Texas** (Address of principal offices)	**75234** (Zip code)

Registrant s telephone number, including area code: **(469) 357-1000**

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

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, $0.00025 par value

Preferred Share Purchase Rights

(Title of Class)

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 x

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes x 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. ¨

As of June 30, 2003, the last business day of the registrant s most recently completed second fiscal quarter, the aggregate market value of the shares of Common Stock held by non-affiliates, based upon the closing price of the Common Stock as reported on the Pink Sheets, was approximately $295.4 million (affiliates being, for these purposes only, directors, executive officers and holders of more than 5% of the Registrant s Common Stock).

As of July 2, 2003, the Registrant had 432,853,021 outstanding shares of Common Stock.

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i2 TECHNOLOGIES, INC.

ANNUAL REPORT ON FORM 10-K

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ITEM 1. BUSINESS

The disclosures set forth in this report are qualified by the sections captioned Forward-Looking Statements and Factors That May Affect Future Results in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations, of this report, and other cautionary statements set forth elsewhere in this report.

References in this report to the terms optimal and optimization and words to that effect are not necessarily intended to connote the mathematically optimal solution, but may connote near-optimal solutions, which reflect practical considerations such as customer requirements as to response time, precision of the results and other commercial factors.

Recent Events

Chronology

In our quarterly report on Form 10-Q for the quarter ended September 30, 2002, we disclosed that we and certain members of our Board of Directors had received a series of communications from two of our former officers containing a variety of allegations generally related to: accounting and revenue recognition; inadequate financial controls; and gross negligence or potential fraud in connection with product and customer problems, acquisitions, public disclosure and other management decisions. Our Board of Directors directed its Audit Committee to investigate the initial allegations received from one of these former officers in the fall of 2001 promptly after they were received. The Audit Committee, which is comprised solely of independent directors, engaged independent legal and accounting advisors to assist with the investigation. The Audit Committee completed the investigation and reported its findings to our board of directors in the third quarter of 2002. Based on the results of the Audit Committee s investigation, our Board of Directors concluded that there were no adjustments necessary to our consolidated financial statements, that there were no indications of material deficiencies in our financial controls and that the facts did not support the allegations concerning gross negligence or potential fraud.

In the fall of 2002, the two former officers brought additional information to the attention of the Audit Committee in respect of their prior allegations regarding revenue recognition. A review of this additional information was performed and, as a result of that review, management concluded that the revenue recognition allegations remained unsubstantiated by the additional information. Management reviewed its findings with the Audit Committee which directed management to review its findings with the independent accounting advisors engaged by the Audit Committee to investigate the initial allegations. In January 2003, this investigation turned up information that persuaded management and the Audit Committee that material adjustments to our previously issued financial statements might be required and that our consolidated financial statements for the years ended December 31, 2001 and 2000 should be re-audited. On January 27, 2003, we announced that the Audit Committee had engaged Deloitte & Touche LLP, our external auditors, to re-audit those consolidated financial statements, which had previously been audited by Arthur Andersen LLP. Additionally, we announced that the Securities and Exchange Commission (SEC) had commenced an informal inquiry into these matters.

On March 31, 2003, we announced that due to the ongoing re-audits of our 2001 and 2000 consolidated financial statements and our additional decision to re-audit our consolidated financial statements for the year ended December 31, 1999, it would be necessary for us to delay our filing of this 2002 annual report on Form 10-K until early June 2003. We also announced that the re-audits would result in material adjustments to our previously-reported consolidated financial statements and that we had received notice from the SEC that it had issued a formal order of investigation in connection with matters relating to the restatement of our consolidated financial results.

On May 13, 2003, we provided additional relevant information during our user conference which was publicly broadcast via webcast. During that webcast we stated that our consolidated financial statements for the year ended December 31, 1999 would not be re-audited, as previously disclosed, but that any revenue transactions in 1999 that could affect the year 2000 would be analyzed. We further stated that we believed we

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would be able to file our 2002 annual report on Form 10-K in June 2003. The substance of the webcast was filed as an exhibit to our Current Report on Form 8-K filed on May 16, 2003. We subsequently announced, on June 30, 2003, that we would file our annual report on Form 10-K in July 2003.

During the course of the re-audits, we determined that the accounting with respect to certain transactions was required to be adjusted. As a result, we have restated our consolidated financial statements for the years ended December 31, 2001 and 2000, for the first three quarters of 2002 and for each of the quarters in 2001 and 2000. We have also adjusted the preliminary consolidated financial statement information for the quarter ended December 31, 2002, which we announced in a January 27, 2003 press release. This press release was filed as an exhibit to our Current Report on Form 8-K on January 30, 2003. Any adjustments for the quarter ended December 31, 2002 are as compared to our preliminary consolidated financial statement information for the quarter ended December 31, 2002 or, with respect to the year ended December 31, 2002, the aggregate of our previously issued quarterly results for the periods ended March 31, 2002, June 30, 2002 and September 30, 2002 and the announced quarterly results for the period ended December 31, 2002. We have also restated on an unaudited basis our consolidated financial statements for the years ended December 31, 1999 and 1998.

In addition to our consolidated financial statements for the year ended December 31, 2002, this annual report on Form 10-K includes our restated consolidated financial statements for the years ended December 31, 2001 and 2000, as well as our restated consolidated financial data for the years ended December 31, 1999 and 1998. We also include our restated unaudited consolidated statement of operations for the first three quarters of 2002 and for each of the quarters in 2001 and 2000. Our quarterly reports on Form 10-Q for 2003 will contain our restated consolidated financial statements for the corresponding quarters of 2002.

We have not amended our previously-filed annual reports on Form 10-K or quarterly reports on Form 10-Q for the periods affected by the restatements or adjustments. For this reason, the consolidated financial statements and related consolidated financial information contained in such previously-filed reports should no longer be relied upon.

Financial Statement Adjustments

As noted above, we have determined the need to adjust the accounting with respect to certain transactions. The revenue adjustments that have been made mostly result in revenue being deferred and recognized in subsequent periods, although in certain situations the adjustments result in revenue reversals. The adjustments include amounts deferred and reversed as a result of our application of the principles of contract accounting and amounts reversed as a result of the presence of concurrent transactions. The net effect of these revenue adjustments is to increase total revenue by $385.8 million in 2002 and to decrease total revenue by $137.6 million, $477.0 million and $130.9 million in 2001, 2000 and 1999, respectively. We have also made certain deferrals and reversals to our expenses in connection with these revenue adjustments and have made certain other adjustments to our expenses. The net effect of these expense adjustments is to increase expense by $45.8 million in 2002 and to decrease expense by $195.6 million, $34.6 million and $5.4 million in 2001, 2000 and 1999, respectively. As a result of these adjustments to our revenues and expenses, we are also making certain income tax-related adjustments which increase our tax expense by $235.2 million and $25.6 million in 2002 and 2001, respectively, and which decrease our tax expense by $166.9 million, $51.5 million and $5.2 million in 2000, 1999 and 1998, respectively.

The statement of operations impact of all of these adjustments discussed above is to decrease our net loss by $104.8 million and $32.4 million in 2002 and 2001, respectively, increase our net loss by $275.5 million in 2000, decrease our net income by $74.0 million in 1999 and increase our net income by $5.2 million in 1998. Any adjustments for the quarter ended December 31, 2002 are as compared to our preliminary consolidated financial statement information for the quarter ended December 31, 2002 or, with respect to the year ended December 31, 2002, the aggregate of our previously issued quarterly results for the periods ended March 31, 2002, June 30, 2002 and September 30, 2002 and the announced quarterly results for the period ended December 31, 2002.

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The following tables summarize the statement of operations impact of these adjustments on our net income/loss for the periods indicated.

Restatement and Adjustment Impact on Net Income (Loss)

(in millions, except per share data)

	Quarter Ended March 31, 2002			Quarter Ended June 30, 2002			Quarter Ended September 30, 2002			Year Ended December 31, 2002
	(As Reported)	(Restated)	Difference	(As Reported)	(Restated)	Difference	(As Reported)	(Restated)	Difference	Difference*
Net Revenue adjustments	$ 168.4	$ 202.5	$ 34.1	$ 119.6	$ 162.5	$ 42.9	$ 114.6	$ 374.5	$ 259.9	$ 385.8
Expense adjustments, including operating expense and other income and expense	$ 222.7	$ 221.0	$ 1.7	$ 205.6	$ 205.7	$ (0.1)	$ 311.6	$ 338.3	$ (26.7)	$ (45.8)
Income tax adjustment	$ (19.6)	$ (6.3)	$ (13.3)	$ 671.4	$ 893.4	$ (222.0)	$ 2.1	$ 2.1	$ 0.0	$ (235.2)
Total effect on net income (loss) (increase) decrease	$ (34.8)	$ (12.2)	$ 22.6	$ (757.4)	$ (936.6)	$ (179.2)	$ (199.1)	$ 34.1	$ 233.2	$ 104.8
Effect on earnings per share										
Basic	$ (0.08)	$ (0.03)	$ 0.05	$ (1.77)	$ (2.18)	$ (0.41)	$ (0.46)	$ 0.08	$ 0.54	$ 0.24
Diluted	$ (0.08)	$ (0.03)	$ 0.05	$ (1.77)	$ (2.18)	$ (0.41)	$ (0.46)	$ 0.07	$ 0.53	$ 0.24

	Year Ended December 31, 2001			Year Ended December 31, 2000			Year Ended December 31, 1999			Year Ended December 31, 1998		
	(As Reported)	(Restated)	Difference	(As Reported)	(Restated)	Difference	(As Reported)	(Restated)	Difference	(As Reported)	(Restated)	Difference
Net Revenue adjustments	$ 1,012.9	$ 875.3	$ (137.6)	$ 1,149.5	$ 672.5	$ (477.0)	$ 583.0	$ 452.1	$ (130.9)	$ 371.2	$ 371.2	$ 0.0
Expense adjustments, including operating expense and other income and expense	$ 9,027.2	$ 8,831.6	$ 195.6	$ 2,865.8	$ 2,831.2	$ 34.6	$ 535.0	$ 529.6	$ 5.4	$ 348.7	$ 348.7	$ 0.0
Income tax adjustment	$ (263.0)	$ (237.4)	$ (25.6)	$ 35.7	$ (131.2)	$ 166.9	$ 24.6	$ (26.9)	$ 51.5	$ 17.3	$ 12.1	$ 5.2
Total effect on net income (loss) (increase) decrease	$ (7,751.3)	$ (7,718.9)	$ 32.4	$ (1,752.0)	$ (2,027.5)	$ (275.5)	$ 23.4	$ (50.6)	$ (74.0)	$ 5.2	$ 10.4	$ 5.2
Effect on earnings per share												
Basic	$ (18.68)	$ (18.61)	$ 0.07	$ (4.83)	$ (5.59)	$ (0.76)	$ 0.08	$ (0.15)	$ (0.23)	$ 0.02	$ 0.04	$ 0.02
Diluted	$ (18.68)	$ (18.61)	$ 0.07	$ (4.83)	$ (5.59)	$ (0.76)	$ 0.07	$ (0.15)	$ (0.22)	$ 0.02	$ 0.03	$ 0.01

* The differences for the year ended December 31, 2002, are a comparison of the aggregate of our previously issued quarterly results for the periods ended March 31, 2002, June 30, 2002 and September 30, 2002 and the announced quarterly results for the period ended December

31, 2002, and the restated consolidated financial results for the year ended December 31, 2002.

The following discussion provides additional information regarding these adjustments, including information with respect to the impact of these adjustments on our balance sheet.

Net Revenue Adjustments

Net Contract Revenue and Related Expense Adjustments

As a result of a comprehensive review of revenue recognition practices conducted by senior management simultaneously with the re-audits, which involved an extensive in-depth review and analysis of data and other information accumulated during the course of the re-audits from various sources within our company, we have changed the accounting for a number of transactions from revenue recognition under SOP 97-2, Software Revenue Recognition, to revenue recognition under SOP 81-1, Accounting for Certain Construction Type and Certain Production Type Contracts, referred to as contract accounting. This determination was made because we

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concluded that in some instances our services were essential to the functionality of certain software products we licensed and that contract accounting was therefore the appropriate accounting treatment for these transactions. We concluded that our services were essential to the functionality of certain software products we licensed for a variety of reasons, including (i) expansion of the use of such products into new industries and markets, (ii) communications with customers which established certain expectations inconsistent with the capabilities of products at the time of sale, (iii) significant performance and product-readiness issues related to certain products, and/or (iv) the requirement of significant customization, modifications or additions to products to meet the customers expectations or intended purposes.

Applying contract accounting to these transactions requires that the recognition of license, services and/or maintenance revenue for these transactions must be deferred and recognized in subsequent periods. The deferral and related revenue recognition is based on the applicability of either the percentage of completion method or the completed contract method of accounting. As discussed in more detail in *Note 1 Summary of Significant Accounting Policies* in the accompanying Notes to Consolidated Financial Statements, the percentage of completion method requires revenue to be recorded as the implementation is completed and the completed contract method requires revenue to be recorded only when we have satisfied all of our product and/or service delivery obligations to the customer.

We do not have fair value for our license revenue as a result of our varied discounting practices. Accordingly, under SOP 97-2 we have recognized revenue under the residual method as described in *Note 1 Summary of Significant Accounting Policies* in the accompanying Notes to Consolidated Financial Statements, which has prevented us from allocating license revenue among the individual products licensed to a customer. As a result, if a determination is made that our services are essential to the functionality of any single software product or group of products licensed to a customer as part of a larger bundle of our software products, then the license, services and/or maintenance revenue associated with the entire bundle must be accounted for in accordance with SOP 81-1. This is so even if the software product for which our services are essential has not been implemented by the customer. As a result of this treatment, in numerous situations we have deferred all license, maintenance and/or services revenue associated with transactions in which our customers have implemented many parts of a software bundle and have paid us in full.

In these situations, we have deferred license, services and/or maintenance revenue because the customer retains the license right to the non-implemented software product for which our services have been deemed to be essential. Once payment from the customer is received, these amounts remain on the balance sheet as deferred revenue until an event occurs to allow revenue to be recognized under SOP 81-1. There are a limited number of transactions that remain in deferred revenue at December 31, 2002 in which certain non-implemented software products for which services are essential are no longer being licensed by us. In these cases, we believe it is unlikely that the customer will implement these software products, although most are using other products and services from us. While we will attempt to resolve these situations with the customers involved in order to enable recognition of the deferred revenue in question, we cannot predict how successful we will be in doing so.

As a result of the use of contract accounting, our total revenues increased by $401.5 million in 2002 and decreased by $103.2 million, $406.4 million and $124.3 million in 2001, 2000 and 1999, respectively. We have also deferred certain contract costs associated with the use of contract accounting. As a result of these expense adjustments, our operating expense increased by $58.7 million in 2002 and decreased by $31.3 million, $34.1 million and $7.6 million in 2001, 2000 and 1999, respectively. As a further result of these adjustments as well as the revenue adjustments described below, deferred revenue increased by $210.0 million, $558.6 million, $383.1 million and $99.6 million at December 31, 2002, 2001, 2000 and 1999, respectively. Prepaid contract expense increased by $14.3 million, $72.9 million, $41.6 million and $7.6 million at December 31, 2002, 2001, 2000 and 1999, respectively. This deferred contract revenue and cost may be recognized in future periods only when and if we are able to arrange with our customers to terminate our residual service obligations, as described above.

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Revenue and Expense Reversals Contract Accounting

With respect to certain transactions that are now being accounted for under contract accounting rules, we were not paid all amounts due to us or we incurred transaction-related settlement expenses. In each of these cases we have reversed revenue equal to the amount of such payment shortfall and/or settlement expense. In the aggregate, we have reversed $83.2 million of revenue. These payment shortfalls and settlement expenses, formerly recorded as bad debt or customer litigation expenses, have also been reversed. These revenue reversal adjustments decreased revenue by $0.7 million, $20.9 million, $55.0 million and $6.6 million in 2002, 2001, 2000 and 1999, respectively. The expense reversal adjustments decreased operating expense by $14.5 million, $57.8 million, $8.3 million and $0.3 million in 2002, 2001, 2000 and 1999, respectively.

Revenue and Expense Reversals Concurrent Transactions

We have also identified four transactions which were concluded at or about the same time as other arrangements with the same customers and with respect to which we have been unable to determine that we had paid or received fair value for the products or services involved. See *Note 1 Summary of Significant Accounting Policies* in the accompanying Notes to Consolidated Financial Statements for a discussion regarding our accounting policy for concurrent transactions.

The principal transaction was our license of software to International Business Machines Corporation (IBM) in the first quarter of 2000. See *Note 3 Business Combinations* in the accompanying Notes to Consolidated Financial Statements. The concurrent arrangements with IBM included (i) our license of certain software from IBM, (ii) our purchase of certain software from IBM, (iii) the issuance of common stock to IBM, (iv) the amendment of a marketing agreement between us and IBM, and (v) the entry into a patent cross-license agreement between us and IBM (which included a related release and covenant not to sue).

The original accounting treatment, applied in accordance with the advice of our former auditor, was based on recording two separate transactions: (i) a license of software to IBM and (ii) an issuance of common stock to IBM in consideration for a purchase of certain business assets, a license of certain software and the entry into a patent cross-license agreement. This accounting treatment resulted in the recognition of license revenue on a subscription basis over a four-year recognition period, $38.5 million of which had been recognized at December 31, 2002. We have determined that our license of software to IBM and the concurrent arrangements with IBM should be accounted for as a single transaction. As a result, the fixed license revenue of $60 million from IBM associated with this transaction has been recorded as an offset against the value of the assets received from IBM. The cumulative statement of operations impact through December 31, 2002 was a $38.5 million reversal of license revenue and a $62.7 million reversal of expense. The balance sheet impact at December 31, 2002 was an increase to intangibles and goodwill of $2.6 million and a decrease in deferred revenue of $18.5 million.

The cumulative amount of the revenue reversals as a result of the IBM transaction and the other three transactions involving substantially concurrent arrangements was $44.1 million as of December 31, 2002. The year-by-year impact of these revenue reversals is to decrease revenue by $15.0 million, $13.5 million and $15.6 million for 2002, 2001 and 2000, respectively. The year-by-year impact of the associated expense reversals is to increase expense by $1.6 million in 2002, decrease expense by $79.8 million in 2001 and increase expense by $10.0 million in 2000. The balance sheet impact of these reversals was a decrease in deferred revenue of $18.5 million, $33.2 million, and $37.0 million at December 31, 2002, 2001 and 2000, respectively.

Other Expense Adjustments

We have also identified several accrued expense items for which we have made adjustments to the amount of the liability, the timing of recording the liability or the timing of releasing the liability. These adjustments related to our accrued compensation and related expenses, including the accruals related to vacation, employee health plans and potential bonus payouts. Finally, the original accounting treatment with respect to certain business combinations, applied in accordance with the advice of our former auditor, has been modified. As a result, we are adjusting the allocation of purchase price on certain acquisitions and the related amortization of intangibles and goodwill. The net effect of the expense adjustments associated with these various kinds of

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adjustments is to increase operating expenses by $0.2 million in 2002, to decrease operating expenses by $26.6 million and $2.2 million in 2001 and 2000, respectively, and to increase operating expenses by $2.2 million in 1999. These adjustments also decreased our accrued liabilities by $20.0 million, $23.0 million and $13.4 million at December 31, 2002, 2001 and 2000, respectively, and increased our accrued liabilities by $0.3 million, at December 31, 1999.

Income Tax Adjustments

As a result of these adjustments to our revenues and expenses, we are also making certain income tax-related adjustments. For 2002, our income tax expense increased by $235.2 million. For 2001, we decreased our previously recorded tax benefit by $25.6 million. For 2000, 1999 and 1998, our income tax expense decreased by $166.9 million, $51.5 million and $5.2 million, respectively. Despite these adjustments, there was no impact to our previously announced balance sheet at December 31, 2002 due to the fact that, in the second quarter of 2002, we recorded a full valuation allowance on our deferred tax asset which reduced the value to zero. Our deferred tax assets increased by $230.8 million, $225.1 million, $58.1 million and $5.2 million at December 31, 2001, 2000, 1999 and 1998, respectively.

Net Income / Stockholders Equity

The statement of operations impact of the adjustments described above is to decrease our net loss by $104.8 million and $32.4 million in 2002 and 2001, respectively, increase our net loss by $275.5 million in 2000, decrease our net income by $74.0 million in 1999 and increase our net income by $5.2 million in 1998. The balance sheet impact of these adjustments is to decrease our stockholders equity by $204.7 million, $310.4 million, $328.2 million and $65.4 million at December 31, 2002, 2001, 2000 and 1999, respectively, and increase our stockholders equity by $6.7 million in 1998.

Our restated consolidated financial statements for the years ended December 31, 2001 and 2000 are included elsewhere in this annual report on Form 10-K. See *Note 2 Restatement* in the accompanying Notes to Consolidated Financial Statements for additional information on the effect of these adjustments on our previously-reported consolidated statement of operations for the years ended December 31, 2001 and 2000 and our previously-reported consolidated balance sheet at December 31, 2001. See Selected Consolidated Financial Data for additional information on the effect of these adjustments on our previously-reported unaudited consolidated statements of operations for the first three quarters of 2002 and for each of the quarters in 2001 and 2000.

Cumulative Restatement and Adjustment Impact

In sum, the cumulative impact of the revenue adjustments is to reduce revenue by $359.7 million, which is comprised of $127.3 million of revenue that has been reversed and $232.4 million of revenue that has been deferred and may be recognized in the future. The cumulative impact to net loss of the revenue and expense adjustments is to increase our net loss by $207.1 million. To the extent that revenue that has been deferred is subsequently recognized, it will reduce the impact of the adjustments to net income. The following table summarizes the cumulative statement of operations impact of these adjustments on our net income/loss for the periods indicated.

Cumulative Restatement and Adjustment Impact on Net Income (Loss)

(in millions)

		For the Years Ended December 31, 2002, 2001, 2000, 1999 and 1998**
Cumulative net revenue deferrals	$	(232.4)
Cumulative net revenue reversals	$	(127.3)
Total cumulative and revenue adjustments	$	(359.7)
Cumulative expense adjustments, including operating expense and other income and expense	$	189.8
Cumulative income tax adjustments	$	(37.2)
Cumulative total increase in net loss	$	(207.1)

** The cumulative impact represents the sum of the Difference columns set forth above for the years ended December 31, 2002, 2001, 2000, 1999 and 1998.

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Securities and Exchange Commission and Internal Investigations

As previously disclosed, our Board of Directors had directed our Audit Committee to conduct an internal investigation of certain allegations made during the fall of 2001 by a former officer relating to revenue recognition and financial reporting, among other things. In November 2002, we reported to the SEC and in our third quarter Form 10-Q the results of that investigation, as well as certain new, related allegations (discussed above) made during the fall of 2002 by the former officer and another former officer. Thereafter, the staff of the SEC opened an informal inquiry into these allegations and other matters relating to our financial reporting. On or about March 26, 2003, we were advised that the SEC had issued a formal order of investigation to determine whether there have been violations of the federal securities laws by us and/or others involved with us in connection with matters relating to the restatement of our consolidated financial statements.

In response to the allegations received in the fall of 2002, our Audit Committee asked its independent legal and accounting advisors to conduct a further investigation into the actions of our officers and employees in connection with the circumstances necessitating the restatement of our consolidated financial statements. Based on the results of this investigation, taking all relevant factors into consideration and exercising its business judgment, the Audit Committee has advised the Board of Directors that it has no present intention to recommend the replacement of any members of senior management. Nevertheless, in light of the nature and extent of the restatement, the Audit Committee directed management to review the company s internal systems, controls and procedures, a process management had already commenced, and to develop and implement a remedial plan to ensure that the circumstances causing the need to restate our financial statements do not occur again. In response to this request, management has completed a review of the company s revenue recognition practices that focused on:

- our revenue recognition policies and procedures, including related product release management and price list practices;

- the adequacy of the training we have and will provide regarding these policies and procedures, including specifically programs designed to educate our sales, services and development employees;