CSP INC /MA/
Form 10-Q/A
February 12, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 10549

FORM 10-Q/A

Amendment number 1

(Mark One)

[X] Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended December 31, 2003

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: 0-10843

CSP Inc.

(Exact name of registrant as specified in its charter)

Massachusetts	04-2441294
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
43 Manning Road, Billerica, Massachusetts	01821-3901
(Address of principal executive offices)	(Zip Code)

(978) 663-7598
(Registrant's telephone number, including area code)

(Former name, former address, former fiscal year, if changed since last report)

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 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. [X] Yes [ ] No

The registrant is an accelerated filer (as defined by Rule 12b-2 of the Securities Exchange Act of 1934.

Yes [ ] No [X]

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding February 11, 2004
Common Stock, $.01 par value	3,555,286 shares

This amendment is being filed to correct Part II, Item 6, Exhibits and Form 8K . We are amending Part II, Item 6, Exhibits 31.1 and 31.2, to correct the Certifications pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

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CSP INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Amounts in thousands, except par value)

	December 31,	September 30,
	2003	2003
	2003	
	(Unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	$3,470	$3,129
Short-term investments	7,817	7,365
Accounts receivable, net	5,940	5,429
Inventories	2,507	2,034
Refundable income taxes	358	1,095
Deferred income taxes	603	291
Other current assets	927	1,189
Total current assets	21,622	20,532
Property, equipment and improvements, net	936	944
Other assets:		
Long-term investments	250	250
Goodwill, net	2,996	2,996
Cash surrender value life insurance	1,607	1,549

Other assets	125	154
Total other assets	4,978	4,949
Total assets	$27,536	$26,425
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued expenses	$6,185	$5,409
Deferred compensation and retirement plans	341	341
Income taxes payable	619	733
Total current liabilities	7,145	6,483
Deferred compensation and retirement plans	8,464	7,990
Other long-term liabilities	20	20
Total liabilities	15,629	14,493
Commitments and contingencies		
Shareholders' equity:		
Common stock, $.01 par; authorized, 7,500 shares; issued		
4,127 and 4,109 shares	41	41
Additional paid-in capital	11,345	11,303
Retained earnings	8,426	8,654
Accumulated other comprehensive loss	(5,046)	(5,207)
	14,766	14,791
Less treasury stock, at cost, 572 shares	(2,859)	(2,859)
Total shareholders' equity	11,907	11,932
Total liabilities and shareholders' equity	$27,536	$26,425

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See accompanying notes to consolidated financial statements.

CSP INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS
(Amounts in thousands, except for per share data)

	For the three months ended	
	December 31, 2003	December 31, 2002
Sales:		
Systems	$ 1,028	$ 633
Service and system integration	10,175	6,867
E-business software	294	338
Other software	303	341
Total sales	11,800	8,179
Cost of Sales:		
Systems	426	479
Service and systems integration	8,321	5,579
E-business software	82	127
Other software	74	78
Total cost of sales	8,903	6,263
Gross profit	2,897	1,916
Operating expenses:		
Engineering and development	766	882
Selling, general & administrative	2,347	1,703
Total operating expenses	3,113	2,585
Operating loss	(216)	(669)

Other income(expense):		
Foreign exchange gain	2	448
Other income	68	32
Total other income, net	70	480
Loss before income taxes	(146)	(189)
Provision for income taxes	82	206
Net loss	$(228)	$(395)
Net loss per share - basic and diluted	$(0.06)	$(0.11)
Weighted average shares outstanding - basic and diluted	3,555	3,532

See accompanying notes to consolidated financial statements

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CSP INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Amounts in thousands)

	For the three months ended	
	December 31, 2003	December 31, 2002
Cash flows from operating activities:		
Net loss	$(228)	$(395)

Adjustments to reconcile net loss to net cash provided by		
(used in) operating activities:		
Depreciation and amortization	120	182
Non-cash changes in accounts receivable and inventory allowances	66	105
Deferred compensation and retirement plans	62	77
Refundable income taxes	761	--
Deferred income taxes	(278)	--
Cash surrender value life insurance	(58)	--
Other assets	28	(28)
Changes in current assets and liabilities:		
Increase in accounts receivable	(325)	(2,180)
Increase in inventories	(533)	(201)
Decrease (increase) in other current assets	303	(241)
Increase in accounts payable and accrued expenses	655	147
(Increase) Decrease in income taxes payable	(162)	467
Net cash provided by (used in) operating activities	411	(2,067)
Cash flows from investing activities:		
Purchases of available-for-sale securities	(100)	(107)
Purchases of held-to-maturity securities	(780)	(561)
Sales of available-for-sale securities	36	116
Maturities of held-to-maturity securities	392	1,504
Purchase of property, equipment and improvements	(112)	(57)
Net cash provided by (used in) investing activities	(564)	895

Cash flows from financing activities:		
Proceeds from issuance of shares under employee		
stock purchase plan	34	12
Proceeds from stock options	9	--
Net cash provided by financing activities	43	12
Effects of exchange rate on cash and cash equivalents	451	(320)
Net increase (decrease) in cash and cash equivalents	341	(1,480)
Cash and cash equivalents, beginning of period	3,129	3,835
Cash and cash equivalents, end of period	$3,470	$2,355
Supplementary cash flow information:		
Cash paid for income taxes, net	$156	$12
Cash paid for interest	$25	$74

See accompanying notes to consolidated financial statements.

CSP INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The accompanying financial statements have been prepared by the Company, without audit, and reflect all adjustments which, in the opinion of management, are necessary for a fair statement of the results of the interim periods presented. All adjustments were of a normal recurring nature. Certain information and footnote disclosures normally included in the annual financial statements, which are prepared in accordance with accounting principles generally accepted in the United States of America, have been condensed or omitted. Accordingly, the Company believes that although the disclosures are adequate to make the information presented not misleading, the financial statements should be read in conjunction with the footnotes contained in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2003.

1. Summary of Significant Accounting Policies

Earnings Per Share of Common Stock

Basic net income (loss) per common share is computed by dividing net income (loss) available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted net income (loss) per common share reflects the maximum dilution that would have resulted from the assumed exercise and share repurchase related to dilutive stock options and is computed by dividing net income (loss) by the weighted average number of common shares outstanding.

The reconciliation of the numerators and denominators of the basic and diluted net loss per share computations for the Company's reported net loss is as follows:

	For the three months ended	
	December 31, 2003	December 31, 2002
	(Amounts in thousands, except per share)	
Net loss	$(228)	$(395)
Weighted average number of shares outstanding - basic	3,555	3,532
Incremental shares from the assumed exercise of stock options	--	--
Weighted average number of shares outstanding - dilutive	3,555	3,532
Net loss per share - basic	$(0.06)	$(0.11)
Net loss per share - diluted	$(0.06)	$(0.11)

US GAAP requires all anti-dilutive securities, including stock options, to be excluded from the diluted earnings per share computation. For the three month periods ended December 31, 2003 and 2002, due to the Company's net loss, all of the outstanding options of 516,344 and 454,124, respectively, were excluded from the diluted loss per share calculation because their inclusion would have been anti-dilutive.

Stock Option Plans

SFAS 123, "Accounting for Stock-Based Compensation," amended by SFAS 148, "Accounting for Stock-Based Compensation - Transition and Disclosure" permits companies to measure compensation cost of stock-based awards based on their estimated fair value at the date of grant and recognize that amount over the related service period. As permitted by SFAS 148, the Company accounts for those plans under the recognition and measurement principles of APB Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. No stock-based employee compensation cost is reflected in net loss, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant.

New Accounting Pronouncements

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure". SFAS No. 148 amends SFAS No. 123, to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The transition guidance and annual disclosure provisions of SFAS No. 148 are effective for fiscal years ending after December 15, 2002. The interim disclosure provisions are effective for financial reports containing financial statements for interim periods beginning after December 15, 2002. As permitted under SFAS 148, the Company adopted the disclosure only provisions of that accounting standard in the fourth quarter of fiscal year 2003.

The Company accounts for stock based compensation using the intrinsic value method prescribed in ABP Opinion No. 25 whereby the stock options are granted at market price and therefore no compensation costs are recognized. The Company has elected to retain its current method of accounting as described above and has adopted disclosure requirements of FAS Nos. 123 and 148. If compensation expense for the Company's stock option plans had been determined based upon fair value at the grant dates for awards under those plans in accordance with FAS No. 123, the Company's pro forma net earnings, basic and diluted earnings per common share would have been as follows:

	Three months ended	
	December 31, 2003	December 31, 2002
	(Amounts in thousands except per share)	
Net loss	$(228)	$(395)
Deduct: Stock based employee		

Compensation expense determined		
under fair value based method for		
all awards, net of related tax effects	(36)	(37)
Pro forma net loss	$(264)	$(432)
Loss per share:		
Basic and diluted, as reported	$(0.06)	$(0.11)
Basic and diluted, pro forma	$(0.07)	$(0.12)
Weighted average shares outstanding - basic and diluted	3,555	3,532

In January 2003, the FASB issued SFAS 132(revised 2003), "Employers' Disclosures about Pensions and Other Postretirement Benefits" which retains all of the disclosures that are required by FASB 132 and includes several additional disclosures. It also amends APB Opinion 28 "Interim Financial Reporting" to require certain disclosures about pension and other postretirement benefit plans in interim financial statements. The provisions of SFAS 132(revised 2003) are effective for fiscal years ending after June 15, 2004. The interim disclosure provisions are effective for interim periods beginning December 15, 2003 (March 31, 2004 for a calendar year-end company). The Company has adopted the provisions of SFAS 132(revised 2003) in the first quarter of fiscal year 2004.

Reclassifications

Certain reclassifications were made to the 2003 financial statements to conform to the 2004 presentation.

2. Business acquired

On May 30, 2003 the Company acquired certain assets of Technisource Hardware, Inc., a subsidiary of privately held Technisource, Inc. Technisource Hardware is a reseller of software and hardware products for IT infrastructure requirements and provides professional services related to system integration. The total purchase price was $2,827,000 of which $2,701,000 was paid in cash plus $126,000 of transaction costs directly related to the acquisition. The transaction resulted in $2,779,000 in goodwill.

The acquisition was accounted for as a purchase. CSP Inc. consolidated results of operations include the operating result of the acquired company from the acquisition date. The acquired assets were recorded at their estimated fair market value at the acquisition date and the aggregate purchase price plus costs directly attributable to the completion of the acquisition have been allocated to the assets acquired.

The following unaudited pro forma financial information is not necessarily indicative of the Company's results of operations that would have occurred had the transaction taken place at the beginning of periods presented or future results of the combined companies.

	For the three months ended	
	December 31, 2003	December 31, 2002
	Actual	Pro Forma
	(Amounts in thousands except per share)	
Total revenue	$11,800	$10,425
Operating loss	$(216)	$(418)
Net loss	$(228)	$(252)
Loss per share	$(0.06)	$(0.07)

3. Inventories

Inventories consist of the following:

	December 31, 2003	September 30, 2003

	(Amounts in thousands)	
Raw materials	$1,361	$775
Work in process	348	119
Finished goods	798	1,140
Total	$2,507	$2,034

4. Stock repurchase

On October 9, 1986, the Board of Directors authorized the Company to repurchase up to 344,892 additional shares of the outstanding stock at market price. On September 28, 1995, the Board of Directors authorized the Company to repurchase up to 199,650 additional shares of the outstanding stock at market price. The timing of stock purchases are made at the discretion of management. On October 19, 1999, the Board of Directors authorized the Company to repurchase up to 200,000 additional shares of the outstanding stock at market price. The Company has repurchased 571,675 or 77% of the total shares authorized to be purchased as of December 31, 2003.

5.

Accumulated Other Comprehensive Income

The components of Accumulated Other Comprehensive Income are as follows:

	Unrealized Gain(loss) on investments	Foreign Translation Adjustment	Accumulated Additional Pension Liability	Accumulated Other Comprehensive Income (Loss)
		(Amounts in thousands)		
Balance September 30, 2003	$12	$(1,641)	$(3,578)	$(5,207)
Change in period	30	131	--	161
Balance December 31, 2003	$42	$(1,510)	$(3,578)	$(5,046)
Balance September 30, 2002	$37	$(916)	$(3,310)	$(4,189)

Change in period	(36)	(245)	--	(281)
Balance December 31, 2002	$1	$(1,161)	$(3,310)	$(4,470)

6. Goodwill

On October 1, 2002, the Company adopted SFAS No. 142. SFAS No. 142 requires the Company to evaluate its existing goodwill that was acquired in prior purchase business combinations. Accordingly, the Company was required to reassess the useful lives and residual values of all identifiable intangible assets acquired in purchase business combinations, and make any necessary amortization period adjustments. In addition, to the extent an intangible is then determined to have an indefinite useful life, the Company was required to test the goodwill for impairment in accordance with the provisions of SFAS No. 142.

The changes in the carrying amount of goodwill for the three months ended December 31, 2003 and 2002 are as follows:

	Other Software	Service and System Integration	Total
		(Amounts in thousands)	
Balance as of September 30, 2003	$217	$2,779	$2,996
Goodwill amortization	--	---	--
Balance as of December 31, 2003	$217	$2,779	$2,996
Balance as of September 30, 2002	$582	$ --	$ 582
Goodwill amortization	--	--	--
Balance as of December 31, 2002	$582	$ --	$ 582

7. Deferred Compensation and Retirement Plans

The components of net period benefit cost related to the U.S. and international deferred compensation and retirement plans are as follow (Amounts in thousands)

Pension	Post Retirement

	Three months ended		Three months ended	
	December 31, 2003	December 31, 2002	December 31, 2003	December 31, 2002
Service cost	$38	$29	$2	$2
Interest cost	72	195	13	12
Expected return on plan assets	--	(67)	--	--
Amortization of:				
Prior service costs/(gains)	1	30	--	--
Net transition asset	--	(28)	--	--
Total cost	$111	$159	$15	$14

The Company does not anticipate that it will have to make any contributions for the fiscal year ended September 30, 2004 based upon the expected return on the plan assets.

8. Segment and Geographical Information

The following table presents certain operating segment information (Amounts in thousands):

	Systems	Service and System Integration	E-business Software	Other Software	Total
Quarter Ended 12/31/03					
Net Sales	$1,028	$10,175	$294	$303	$11,800
Income(loss) from operations	(134)	175	(144)	(113)	(216)
Identifiable assets	9,399	17,125	495	517	27,536
Capital expenditures	85	26	1	--	112
Depreciation and amortization	44	71	2	3	120
Quarter Ended 12/31/02					
Net Sales	$633	$6,867	$338	$341	$8,179
Income(loss) from operations	(646)	228	(173)	(78)	(669)
Identifiable assets	12,792	11,533	568	1,093	25,986
Capital expenditures	23	23	1	10	57
Depreciation and amortization	107	67	3	5	182

CSPI operates in four segments. The four segments are: I) systems, which include manufactured hardware products, II) systems integration and services, which includes maintenance and integration and sale of third-party hardware products and services, III) E-business software and IV) other software products that are developed by the Company.

Profit from operations is sales less cost of sales, engineering and development, selling, general and administrative expenses but is not affected by either non-operating charges/income or by income taxes. Non-operating charges/ income consists principally of gain on sale of property, impairment charge on investments, investment income and interest expense. In calculating profit from operations for individual operating segments, sales and administrative expenses incurred at the operating level for CSPI and Scanalytics are allocated to the Systems and Other Software segments, respectively. Sales and administrative expenses incurred at the operating level for MODCOMP are allocated to the E-business segment based upon employee headcount and the remaining balance is allocated to the Systems and service and system integration segments based upon sales revenue.

All intercompany transactions have been eliminated.

Identifiable assets include deferred income tax assets and other financial instruments managed by the Company. Capital expenditures common to more than one segment are allocated on a sales basis.

For the quarters ended December 31, 2003 and 2002, the Company had sales to one customer which accounted for approximately $3,216,000 (27%) and $1,262,000 (15%) to total sales, respectively. No other customers had sales in excess of 10% for the quarters ended December 31, 2003 and 2002.

Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

THIS QUARTERLY REPORT ON FORM 10-Q CONTAINS FORWARD-LOOKING STATEMENTS. SUCH STATEMENTS ARE GENERALLY IDENTIFIED BY THE USE OF FORWARD-LOOKING WORDS AND PHRASES, SUCH AS "INTENDED," "EXPECTS," "ANTICIPATES" AND "IS (OR ARE) EXPECTED (OR ANTICIPATED)." THESE FORWARD-LOOKING STATEMENTS INCLUDE BUT ARE NOT LIMITED TO THOSE IDENTIFIED BELOW ACTUAL RESULTS MAY DIFFER MATERIALLY FROM THOSE DISCUSSED IN SUCH FORWARD-LOOKING STATEMENTS, AND STOCKHOLDERS OF CSP INC. ("CSPI" OR THE "COMPANY") SHOULD CAREFULLY REVIEW THE CAUTIONARY STATEMENTS SET FORTH IN THIS FORM 10-Q, INCLUDING THOSE SET FORTH UNDER THE CAPTION "FACTORS THAT MAY AFFECT FUTURE RESULTS". CSPI DOES NOT UNDERTAKE TO UPDATE ANY OF SUCH FORWARD-LOOKING STATEMENTS.

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgements that affect the reported amounts of assets, liabilities, revenues and expenses. On an on-going basis, we evaluate our estimates, including those related to revenue recognition, uncollectible receivables, inventory valuation, goodwill impairment, income taxes, and deferred compensation and retirement plans. We base our estimates on historical performance and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements: revenue recognition; valuation allowances, specifically the allowance for doubtful accounts and deferred tax assets valuation allowance; inventory valuation and goodwill impairment.

Revenue recognition

Our revenues are primarily generated from the sale of e-business solutions and image processing software, network management and storage systems, integration services and high-performance cluster computer systems in accordance with generally accepted accounting principles in the United States of America and when all other revenue recognition criteria have been met. The Company enters into transactions to sell products (hardware and software), services and multiple element arrangements that may include any combination thereof. The Company evaluates revenue recognition for these transactions using the following basic criteria (collectively called the Revenue Recognition Criteria):

Evidence of an arrangement: Before revenue is recognized, the Company must have evidence of an agreement with the customer reflecting the terms and conditions to deliver products or services.

Delivery: For products, delivery is considered to occur when hardware or the media containing software products are shipped and title and risk of loss have been transferred or, in the case of electronic delivery of software, the customer is given access to the licensed software programs. For services, delivery is considered to occur when the contracted services are provided.

Fixed or determinable fee: The Company considers a fee to be fixed or determinable if the fee is not subject to refund or adjustment. If a portion of the arrangement fee is not fixed or determinable, the Company recognizes that amount as revenue when the amount becomes fixed or determinable.

Collection is deemed probable:

At the time of the transaction, the Company conducts a credit review of each customer involved in a significant transaction with the Company to determine the creditworthiness of the customer. Collection is deemed probable if management expects the customer to be able to pay amounts under the arrangement as those amounts become due. If management determines that collection is not probable, the Company recognizes revenue when collection becomes probable (upon cash collection).

The following policies are applicable to CSPI's major categories of revenue transactions:

Systems Revenue

Revenue is recognized when the Revenue Recognition Criteria are met. The Company's standard sales agreements do not include customer acceptance provisions. However, if there is a customer acceptance provision or there is uncertainty about customer acceptance, revenue is deferred until the Company has evidence of customer acceptance. Customers do not have the right of return.

Service and System Integration Revenue and E-business Revenue

Revenue is recognized when the Revenue Recognition Criteria are met. Specifically, maintenance contract revenue is recognized ratably over the contractual period; System integration revenue and E-business revenue is recognized as the services are rendered; time and material, and fixed price professional services contract revenue is recognized as the services are rendered, or upon completion of the professional services contract. Losses on fixed price professional services contracts are recognized in the period in which the loss becomes known. The Company's service agreements do not include customer acceptance provisions. However, if there is a customer acceptance provision, or if there is uncertainty about customer acceptance of services rendered, revenue is deferred until the Company has evidence of customer acceptance.

Third-party hardware and third-party software is recognized when the Revenue Recognition Criteria are met. The Company's standard sales agreements do not include customer acceptance provisions. However, if there is a customer acceptance provision or there is uncertainty about customer acceptance, revenue is deferred until the Company has evidence of customer acceptance. Customers do not have the right of return.

Other Software Revenue

CSPI sells its software offerings and recognizes its revenue as follows:

The Company recognizes revenue from the sale of software products in accordance with the AICPA Statement of Position ("SOP") 97-2, as amended by SOP 98-9. SOP 97-2 requires that revenue allocated to software products, specified upgrades and enhancements is recognized upon delivery of the related products, upgrades or enhancements. Revenue allocated by vendor specific objective evidence ("VSOE") to post contract customer support (maintenance) is recognized ratably over the term of the support, and revenue allocated by VSOE to service elements (training and consulting) is recognized as the services are performed. The residual method of revenue recognition is used for multi-element arrangements when the VSOE of the fair value does not exist for one of the delivered elements. Under the residual method, the arrangement fee is recognized as follows: (1) the total fair value of the undelivered elements, as indicated by VSOE, is deferred and subsequently recognized in accordance with the relevant sections of SOP 97-2 and (2) the difference between the total arrangement fee and the amount deferred for the undelivered elements is recognized as revenue related to the delivered elements.

The Company recognizes revenue from software licenses when persuasive evidence of an arrangement exists, delivery of the product has occurred, no significant Company obligations with regard to customization or implementation remain, the fee is fixed or determinable, and collectibility is probable when revenue recognition criteria of SOP 97-2 are met. If collectibility is not considered probable, revenue is recognized when cash is collected.

For software licenses sold separately without modification and training, revenue is recognized upon delivery.

Multiple Element Arrangements

In certain circumstance, the Company enters into revenue arrangements as a result of which the Company is obligated to deliver to its customers multiple products and/or services ("multiple elements"). In these transactions, the Company allocates the total revenue to be earned under the arrangement among the various elements based on their relative fair value; however, in the case of software transactions, the allocation is based on specific objective evidence of fair value. Specific objective evidence of fair value is the price charged when that element is sold separately. The Company recognizes revenue related to the delivered products or services only if: (1) the above Revenue Recognition Criteria are met; (2) any undelivered products or services are not essential to the functionality of the delivered products or services; (3) payment for the delivered products or services is not contingent upon delivery of the remaining products or services; (4) the Company has an enforceable claim to receive the amount due in the event it does not deliver the undelivered products or services; and (5) as discussed above, there is evidence of the fair value for each of the undelivered products or services. For example, in certain arrangements, installation services are considered essential to the functionality of the delivered product. Accordingly, revenue is not recognized in those arrangements until the installation is complete and all other revenue recognition criteria are met.

Valuation Allowances

The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. If the financial condition of its customers were to deteriorate, resulting in impairment of their ability to make payments, additional allowances may be required.

The Company records a valuation allowance to reduce the balance of deferred tax assets due to the lack of significant orders and the U.S. losses over the last three years. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which the associated temporary differences become deductible. The Company considers the scheduled reversals of deferred tax liabilities and projected taxable income in making this assessment. Based on the lack of taxable income in the U.S. over the last three years and lack of significant orders, the Company established a valuation allowance for the entire U.S. deferred tax asset. Based upon the level of historical taxable income and projections for the future taxable income over the period in which the deferred taxes will reverse or operating loss carryforwards expire, management believes it is more likely than not that the Company will not realize the benefits of these deductible differences.

In assessing the realizability of our deferred tax assets, the Company considers and relies upon projections of future income. The key assumptions in the projections include sales growth rates, including potential contract wins, and expected levels of operating expenditures in addition to factors discussed in the section "Factors That May Affect Future Performance". These assumptions are subject to variation based upon both internal and external factors, many of which are beyond the control of the Company. To the extent that actual experience deviates from the assumptions, the projections would be affected and hence the assessment of realizability of the Company's deferred tax asset may change. If the Company is awarded a significant contract, the Company's projections will be impacted and the Company may reverse the valuation allowance against the deferred tax asset.

Inventory Valuation

The recoverability of inventories is based upon the types and levels of inventories held, forecasted demand, pricing, competition and changes in technology. The Company writes down its inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those projected by management, additional inventory write-down may be required.

Goodwill

The Company adopted Statement of Financial Accounting Standard ("SFAS") No. 142 ("SFAS 142"), "Goodwill and Other Intangible Assets" on October 1, 2002. The Company completed the initial step of the required impairment test based on the comparison of the fair value of the reporting units with their respective carrying values as of October 1, 2002 and concluded that there was no impairment indicated as of October 1, 2002. This standard requires that goodwill no longer be amortized, and instead, be tested for impairment on an annual basis (or whenever events occur which may indicate possible impairment). This analysis requires management to make a series of critical assumptions to: (1) evaluate whether any impairment exists, and (2) measure the amount of the impairment. The Company's policy is to perform its annual impairment testing for all reporting units as of the fourth quarter of each fiscal year. The Company performs the impairment analysis at the operating segment level.

In testing for potential impairment of goodwill, SFAS 142 requires the Company to: (1) allocate goodwill to the various businesses to which the acquired goodwill relates; (2) estimate the fair value of those businesses to which goodwill relates; and (3) determine the carrying value (book value) of those businesses. This may require independent valuations. Only after this process is completed, is the amount of goodwill impairment determined.

The factors the Company considers important that could indicate impairment include significant under performance relative to prior operating results, change in projections, significant changes in the manner of the Company's use of the asset or the strategy for the Company's overall business, and significant negative industry or economic trend. In evaluating the impairment of goodwill, the Company considered a number of analyses such as discounted cash flow projections, enterprise value, and market capitalization value. The process of evaluating the potential impairment of goodwill is highly subjective and requires significant judgment at many points during the analysis. In estimating fair value of the businesses with goodwill for the purposes of the Company's annual or periodic analyses, management makes estimates and judgments about the future cash flows of these businesses. The Company's cash flow forecasts are based on assumptions that are consistent with the plans and estimates being used by the Company to manage the underlying businesses. In addition, management makes certain judgments about assets such as accounts receivable and inventory to the estimated balance sheet for those businesses. Management also considers the Company's market capitalization (adjusted for unallocated monetary assets such as cash, marketable debt securities and debt) on the date the analysis is performed. The key assumptions include sales growth and expected levels of operating expenditures that are subject to variation based on both internal and external factors. To the extent that actual experience deviates from the projections, the Company's assessment regarding impairment may change. Such a change could have a material adverse affect on the statement of operations.

As of December 31, 2003, the Company had $2,996,000 in Goodwill compared to $582,000 as of December 31, 2002.

Deferred Compensation and retirement plans