CONVERSION SERVICES INTERNATIONAL INC
Form 10KSB
April 20, 2006

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

FORM 10-KSB

ý	**Annual report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934.** **For the fiscal year ending December 31, 2005**
	Or
o	**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 001-32623

CONVERSION SERVICES INTERNATIONAL, INC.
(Exact name of registrant as specified in its charter)

Delaware	**20-0101495**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification number)
100 Eagle Rock Avenue, East Hanover, NJ	**07936**
(Address of Principal Executive Offices)	(Zip Code)

973-560-9400
(Registrant’s Telephone Number, Including Area Code)

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

Title of Each Class	Name of Each Exchange On Which Registered
Common Stock, $.001 par value	American Stock Exchange

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

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

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 o NO ý

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. ý

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

---

State issuer's revenues for its most recent fiscal year: $27.6 million

The aggregate market value of the voting stock held by non-affiliates of the registrant was approximately $15,240,210 as of March 31, 2006 (based on the closing price for such stock as of March 31, 2006).

Indicate the number of shares outstanding of each of the issuer's classes of common stock:

Class	**Outstanding at March 31, 2006**
Common Stock, $.001 par value	49,997,834

INDEX

PART I		1
Item 1.	Business	1
Item 2.	Description of Property	35
Item 3.	Legal Proceedings	36
Item 4.	Submission of Matters to a Vote of Security Holders	36
PART II		37
Item 5.	Market for Common Equity and Related Stockholder Matters	37
Item 6.	Management's Discussion and Analysis or Plan of Operation	38
Item 7.	Financial Statements	61
Item 8.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	62
Item 8A.	Controls and Procedures	62
Item 8B.	Other Information	66
PART III		67
Item 9.	Directors, Executive Officers, Promoters and Control Persons; Compliance With Section 16(a) of the Exchange Act	67
Item 10.	Executive Compensation	72
Item 11.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	78
Item 12.	Certain Relationships and Related Transactions	79
Item 13.	Exhibits	80
Item 14.	Principal Accountant Fees and Services	87
	Signatures	131

PART I

ITEM 1. BUSINESS

References in this Form 10-KSB to the "Company," "CSI," "we," "our," and "us" refer to Conversion Services International, I and our consolidated subsidiaries. We are a technology firm providing professional services to the Global 2000 as well as mid-market clientele. Our core competency areas include strategic consulting, data warehousing, business intelligence and data management consulting. Our clients are primarily in the financial services, pharmaceutical, healthcare and telecommunications industries, although we do have clients in other industries. Our clients are primarily located in the northeastern United States. We enable organizations to leverage their corporate information assets by providing strategy, process, methodology, data warehousing, business intelligence, enterprise reporting and analytic solutions. Our organization delivers value to our clients, utilizing a combination of business acumen, technical proficiency, experience and a proven set of "best practices" methodologies to deliver cost effective services through time and material engagements (or on occasion fixed price engagements). CSI empowers clients to gain insight and intelligence from corporate data through our combination of business acumen, technical proficiency and proven methodology. We are committed to being a leader in data warehousing and business intelligence consulting, allowing us to be a valuable asset and trusted advisor to our customers.

We believe that our primary strengths that distinguish us from our competitors are our:

- role as a full life-cycle solution provider;
- ability to provide strategic guidance and ensure that business requirements are properly supported by technology;
- ability to provide solutions that integrate people, improve process and integrate technologies;
- extensive service offerings as it relates to data warehousing, business intelligence, strategy and data quality;
- our perspective regarding the accuracy of data and our data purification process;
- best practices methodology, process and procedures;
- experience in architecting, recommending and implementing large and complex data warehousing and business intelligence solutions;
- understanding of data management solutions; and
- ability to consolidate inefficient environments into robust, scalable, reliable and manageable enterprise solutions.

Our goal is to be the premier provider of data warehousing, business intelligence and related strategic consulting services for organizations seeking to leverage their corporate information. In support of this goal we intend to:

- enhance our brand and mindshare;
- continue growth both organically and via acquisition;
- increase our geographic coverage;
- expand our client relationships;
- introduce new and creative service offerings; and
- leverage our strategic alliances.

We are committed to being a leader in data warehousing and business intelligence consulting. As a data warehousing and business intelligence specialist, we approach business intelligence from a strategic perspective, providing integrated data warehousing and business intelligence strategy and technology implementation services to clients that are attempting to leverage their enterprise information. Our matrix of services includes strategy consulting, data warehousing and business intelligence architecture and implementation solutions, data quality solutions and data management solutions. We have developed a methodology which provides a framework for each stage of a client engagement, from helping the client conceive its strategy, to architecting, engineering and extending its information. We believe that our integrated methodology allows us to deliver reliable, robust, scalable, secure and extensible business intelligence solutions in rapid timeframes based on accurate information.

We are a Delaware corporation formerly named LCS Group, Inc. In January 2004, a privately-held company named Conversion Services International, Inc. ("Old CSI") merged with and into our wholly owned subsidiary, LCS Acquisition Corp. In connection with such transaction: (i) a 16-year old information technology business (formed in 1990) became our operating business, (ii) the former stockholders of Old CSI assumed control of our Board of Directors and were issued approximately 75.9% of the outstanding shares of our common stock at that time (due to subsequent events, that percentage of ownership has decreased), and (iii) we changed our name to "Conversion Services International, Inc." The acquisition was accounted for as a reverse acquisition. Please see Note 1 Accounting Policies of the Notes to Consolidated Financial Statements for further discussion on this transaction.

On September 21, 2005, our common stock began trading on the American Stock Exchange under the symbol "CVN".

Our offices are located at 100 Eagle Rock Avenue, East Hanover, New Jersey 07936, and our telephone number is (973) 560-9400.

Our Services

As a full service strategic consulting, business intelligence, data warehousing and data management firm, we offer services in the following solution categories:

Strategic Consulting: Involves planning and assessing both process and technology, performing gap analysis, making recommendations regarding technology and business process improvements to help our clients realize their business goals and maximize their investments in people and technology.

Business and Process Consulting

- Information, Process and Infrastructure (IPI) Diagrams (Claritypath) - A blueprinting process and service that facilitates and accelerates the strategic planning process.
- Change Management Consulting - Assist clients with implementing project management governance and best practices for large scale change initiatives, including consolidations, conversions, integration of new business processes and systems applications.
- Integration Management, Mergers and Acquisitions - Work with clients to implement best practices for mergers and acquisitions. Support all aspects of the integration process from initial assessment through implementation support.
- Acquisition Readiness - Work with clients to better prepare them for large scale acquisitions in the financial services domain. This includes building best practices, mapping and gapping and implementing a strategic roadmap to integrate multiple companies.
- Process Improvement (Lean, Six Sigma) - Provide a full array of products and services in support of Lean and Six Sigma, including training, process improvement, project management and implementation support.
- Regulatory Compliance (The Health Insurance Portability and Accountability Act of 1996, Basel II, Sarbanes-Oxley) - Work with clients to analyze, design and implement operational control, procedures and business intelligence that will align the organization to meet new regulatory requirements.
- Project Management (PMO) - Setting up an internal office at a client location, staffed with senior/certified project managers that act in accordance with the policies and procedures identified in CSI Best Practices for Project Management.
- Request For Proposal Creation and Responses - Gather user and technical requirements and develop Requests For Proposals (RFP) on behalf of our clients. Respond to client RFPs with detailed project plans, solutions and cost.

Technology Consulting

- Data Warehousing and Business Intelligence Strategic Planning - Helping clients develop a strategic roadmap to align with a data warehouse or business intelligence implementation. These engagements are focused on six strategic domains that have been identified and documented by CSI: Business Case, Program Formulation, Organizational Design, Program Methodologies, Architecture and Operations and Servicing.
- Business Technology Alignment - A strategic offering that consists of a series of interviews including both the business and technology constituents to collect information regarding user satisfaction, user requirements and expectations, as well as the technology groups understanding of needs and current and future deliverables. The result is a set of recommendations that will better align the user and technology groups and deliver more perceived value.
- Business Intelligence Strategy - Helping clients develop a roadmap to leverage a business intelligence platform throughout the enterprise aligning the client with best practices.
- BI/DW Software Selection - Evaluation, analysis and recommendation of appropriate software tools for deploying BI/DW solutions. Gather business and technical requirements and measure those requirements against the capabilities of available tools in the current marketplace. Software evaluated and recommended include reporting, ad-hoc query, analytics, extract, transform and load processes (ETL), data profiling, database and data modeling.

Business Intelligence: A category of applications and technologies for gathering, storing, analyzing and providing access to data to help enterprise users make better and quicker business decisions.

- Business Intelligence, Architecture and Implementation - Develop architecture plans and install all tools required to implement a business intelligence solution, including enterprise reporting, ad-hoc reporting, analytical views and data mining. Solutions are typically developed using tools such as Cognos, Business Objects, MicroStrategy, SAS and Crystal Reports.
- Business Intelligence Competency Center - Set up an internal office at a client location, staffed with a mix of senior business intelligence developers and business intelligence architects that will implement best practices, policies, procedures, standards and provide training and mentoring to further increase the use of the data warehouse and facilitate the business owners embracing of the business intelligence solution.
- Analytics and Dashboards - Identify and document dashboard requirements. These requirements are typically driven by Key Performance Indicators (KPIs) identified by upper management. Architect a supporting database structure to support the identified hierarchies, drill-downs and slice and dice requirements, implement a dashboard tool, provide training and education.
- Business Performance Management - Leveraging a new or existing business intelligence implementation to monitor and manage both business process and IT events through key performance indicators.
- Data Mining - Implementing data mining tools that extract implicit, previously unknown, and potentially useful information from data. These tools typically use statistical and visualization techniques to discover and present knowledge in a form which is easily comprehensible to humans. Business intelligence tools will answer questions based on information that has already been captured (history). Data mining tools will discover information and project information based on historic information.
- Proof of Concepts and Prototypes - Gather requirements, design and implement a small scale business intelligence implementation called a Proof of Concept. The Proof of Concept will validate the technology and/or business case, as well as “sell” the concept of business intelligence to management.
- Outsourcing - Development of new reports offsite/offshore and redeployment of reports in new technologies in support of technology consolidation.
- Training and Education - Provide formal classroom training for Business Objects software products. Provide training in data warehousing and business intelligence methodologies and best practices, as well as technology tool training, including business intelligence tools such as Cognos and MicroStrategy.

Data Warehousing: A consolidated view of high quality enterprise information, making it simpler and more efficient to analyze and report on that information.

- Data Warehousing and Data Mart Design, Development and Implementation - Design, development and implementation of custom data warehouse solutions. These solutions are based on our methodology and best practices.
- Proof of Concepts and Prototypes - Gather requirements, design and implement a small scale data warehouse that is called a Proof of Concept. The Proof of Concept will validate the technology and/or business case, as well as “sell” the concept of data warehousing to management.
- Extract, Transformation and Loading (ETL) - Design, development and implementation of data integration solutions with particular expertise and best practices for integrating ETL tools with other data warehouse tools.
- Enterprise Information Integration (EII) - Enterprise Information Integration tools are used to integrate information by providing a logical view of data without moving any data. This is particularly useful when bridging a business intelligence tool to multiple data marts or data warehouses.
- Outsourcing - Implementing and supporting a client data warehouse solution at a CSI location.

Data Management: Innovative solutions for managing data (information) throughout an enterprise.

- Enterprise Information Architecture - Leveraging our Information, Process and Infrastructure (IPI) Diagrams to create a “snapshot” of the current information flow and desired information flow throughout the enterprise.
- Metadata Management - Based on our Data Warehouse Framework, we will build a metadata repository that is integrated with all tools used in a data warehouse implementation and will be leveraged by the business intelligence environment.
- Data Quality Center of Excellence - Set up an internal office at a client location, staffed with a mix of senior data quality developers and data quality architects that will implement best practices, policies, procedures, standards and provide training and mentoring to further increase the level of data quality throughout the enterprise and increase the awareness and importance of data quality as it pertains to decision making.
- Data Quality/Cleansing/Profiling - Leveraging profiling as an automated data analysis process that significantly accelerates the data analysis process. Leveraging our best practices to identify data quality concerns and provide rules to cleanse and purify the information.

- Data Migrations and Conversions - Design, development and implementation of custom data migrations. These solutions are based on our methodology and best practices.
- Quality Assurance Testing (Verification, Validation, Certification) - We have developed a quality assurance process referred to as Verification, Validation, Certification (VVC) of information. This is a repeatable process that will insure that all data has been validated to be accurate, consistent and trustworthy.
- Application Development - Custom application development or integration to support data management or data warehouse initiatives. This may include modification of existing enterprise applications to capture additional information required in the warehouse or may be a standalone application developed to facilitate improved integration of existing information.
- Infrastructure Management and Support - An infrastructure must be in place to support any data warehouse or data management initiative. This may include servers, cables, disaster recovery or any process and procedure needed to support these types of initiatives.

The following illustrates the percentage of revenues provided by each category of services as a percentage of overall revenues:

Category of Services	Percentage of Revenues for the year ended December 31,	
	2005	2004
Strategic Consulting	40.6%	35.9%
Business Intelligence	22.4%	22.7%
Data Warehousing	22.8%	16.7%
Data Management	13.2%	23.4%
Software & Support	0.0%	1.0%
Other	1.0%	0.3%

Recent Acquisitions and Divestiture

We will also continue to pursue strategic acquisitions that strengthen our ability to compete and extend our ability to provide clients with a core comprehensive services offering.

In March 2004, we acquired DeLeeuw Associates, Inc. (“DeLeeuw Associates”), a management consulting firm in the information technology sector with core competency in delivering Change Management Consulting, including both Six Sigma and Lean domain expertise to enhance service delivery, with proven process methodologies resulting in time to market improvements within the financial services and banking industries. In connection with the DeLeeuw Associates acquisition, we: (i) paid Mr. Robert C. DeLeeuw, as the sole stockholder of DeLeeuw Associates, $1.9 million; and (ii) issued 5,333,334 shares of our common stock to Mr. DeLeeuw. Please see Note 1 of our Notes To Consolidated Financial Statements for further discussion on this transaction.

Integration of DeLeeuw's Change Management Consulting practices with CSI's Data Warehousing and Business Intelligence core competency "The Center for Data Warehousing" was completed in 2004. The Change Management, Six Sigma and Lean methodology have been introduced to our clients along with our innovative Information, Process and Infrastructure (IPI) Diagrams, which provide detailed blueprints of our client's information, business processes and infrastructure on a single highly detailed diagram. These diagrams can be utilized for risk management, compliance, validation, planning and budgeting requirements. The IPI diagram offering, launched in the first quarter of 2004, continues to receive favorable reaction from our clients. In addition, we expanded our Data Warehouse Assessment, Business Technology Alignment (BTA) and Quality Management Offering (QMO) related offerings in 2005, which will be the focus of our marketing and communications programs for 2006. A QMO offering is a combination of methodologies, best practices and automated techniques leveraged to establish and enforce standards and procedures as it relates to elevating the quality of executive information in an efficient and effective manner. We believe that these offerings will drive greater understanding and demand for both data warehousing and business intelligence implementations by delivering best practices methodologies, tools and techniques to reduce risk, time to market and total cost of ownership of these engagements. One component of our business strategy is to continue to enhance and expand our offerings which include best practices, process improvement, methodologies, advisory services and implementation expertise.

In May 2004, CSI acquired 49% of all issued and outstanding shares of common stock of Leading Edge Communications Corporation (LEC). The acquisition was completed through a Stock Purchase Agreement between CSI and the sole stockholder of LEC. In connection with the acquisition, CSI (i) repaid a bank loan on behalf of the seller in the amount of $35,000; (ii) repaid an LEC bank loan in the amount of $38,000; and (iii) satisfied an LEC obligation for $10,000 of prior compensation to an employee. LEC provides enterprise software and services solutions for technology infrastructure management. Previously, in November 2003, CSI executed an Independent Contractor Agreement with LEC, whereby CSI agreed to be a subcontractor for LEC, and to provide consultants as required to LEC. In return for these services, CSI receives a fee from LEC based on the hourly rates established for consultants subcontracted to LEC.

In June 2004, we acquired substantially all of the assets and assumed substantially all of the liabilities of Evoke Software Corporation ("Evoke"), which designed, developed, marketed and supported software programs for data analysis, data profiling and database migration applications and provides related support and consulting services. In connection with the Evoke acquisition, we: (i) issued 4,836,264 shares of our common stock to Evoke, 476,667 of which were deposited into an escrow account for a period of one year and were reduced based upon claims for indemnification that were made pursuant to the asset purchase agreement; (ii) issued 5% of the outstanding shares of our acquisition subsidiary to Evoke; (iii) issued 261,273 shares of our common stock to certain executives of Evoke as a severance payment and to certain employees as retention shares; (iv) paid approximately $0.5 million in deferred compensation to certain employees of Evoke; and (v) assumed substantially all of Evoke's liabilities. Evoke changed its name to WHRT I Corp. Before the merger, certain investors of Evoke invested $0.55 million in Evoke, which investment was converted into approximately 366,667 shares of our common stock upon effectuation of the merger. On February 2, 2006, we bought back WHRT I Corp.'s remaining holdings of our common stock, 3,892,355 shares, for $1,848,868.60, and such shares were placed back into the Company's treasury. An additional 253,027 shares of our common stock relating to the escrowed shares (see above) were placed into treasury as well. Please see Note 23 of our Notes to Consolidated Financial Statements for further discussion on this transaction.

In July 2005, the Company completed the sale of substantially all of the assets of its subsidiary Evoke Software Corporation and received an aggregate consideration of $645,000 cash, the assumption by Similarity Systems ("Similarity") and Similarity Vector Technologies, Ltd. ("SVT") of certain liabilities, shares of Similarity which were issuable by Similarity subject to the Company's satisfactory completion of certain post-closing obligations, and an earnout in an amount equal to 13% of certain Similarity revenues. The maximum earnout consideration to which the Company was entitled under this agreement was $1,400,000 and was to be received over a three year period. CSI changed the name of its "Evoke Software Corporation" subsidiary to "CSI Sub Corp II (DE)" in August 2005. On February 13, 2006, the Company received $2,050,000 from Informatica, SVT and Similarity Systems related to Informatica's acquisition of SVT and Similarity as final payment on all future consideration related to our agreement with SVT and Similarity.

In July 2005, we acquired McKnight Associates, Inc. ("McKnight Associates"). Since inception, McKnight Associates has focused on successfully designing, developing and implementing data warehousing and business intelligence solutions for its clients in numerous industries. In consideration of this merger agreement, the Company paid the following consideration to Mr. William McKnight, the sole stockholder of McKnight Associates: (i) $500,000 in cash, (ii) the commitment to pay an additional $250,000 in cash by June 2006 (the Company paid Mr. McKnight $125,000 in March 2006), (iii) the issuance of 909,091 shares of the Company's common stock, and (iv) the assumption of substantially all of the liabilities of McKnight Associates. Mr. McKnight joined the Company as Senior Vice President - Data Warehousing and is a well-known industry leader, frequently speaks at national trade shows and contributes to major data management trade publications.

In July 2005, we acquired Integrated Strategies, Inc. ("ISI"). With offices in New York City, ISI is a professional services firm with a solutions-oriented approach to complex business and technical challenges. Similar to our wholly owned subsidiary, DeLeeuw Associates, which is best known for its large-scale merger integration management and business process change programs for the financial services markets, ISI also counts many industry leaders in this sector among its customers. Because of this shared focus, the operations of ISI were folded into DeLeeuw Associates. In consideration of this merger agreement, the Company paid the following consideration to Adam Hock and Larry Hock, individual majority stockholders of ISI: (i) $2,050,000 in cash (reduced by certain amounts), (ii) the issuance of a promissory note in the amount of $177,937 (which was later reduced to $76,054), (iii) the issuance by the Company of a subordinated promissory note in the amount of $165,000, and (iv) the assumption of substantially all the liabilities of ISI. The agreement also provides for the commitment, subject to certain revenue and profit thresholds (as described in the agreement), to pay additional cash and issue shares of the Company common stock.

We believe that as new opportunities are created, Global 2000 companies will continue the trend of expanding the utilization of external consulting expertise to support corporate initiatives focused on maximizing Return On Investment (ROI), leveraging existing technology infrastructure through optimizations and best practices and will continue to leverage and derive value from corporate information assets such as data warehousing, business intelligence and analytics. We believe that we are positioned to expand our client base by delivering business value resulting from our 16 years of domain expertise, proven best practices, methodologies, processes and automation within data warehousing architecture and implementation. Our ability to apply Six Sigma and Lean core competency to client processes and implementation strategies further strengthens our competitive standing. CSI is well positioned to support the increasing industry emphasis on data quality and the use of automation to reduce the costs associated with data warehouse and business intelligence projects, data migrations and conversions, as well as packaged application implementations such as Enterprise Resource Planning (ERP), Customer Relationship Management (CRM) and Supply Chain Management (SCM) by leveraging the automation and validation gained by the use of data profiling technology.

Recent External Financings

Taurus

In May 2004, pursuant to the complete conversion of a $2.0 million unsecured convertible line of credit note issued in October 2003 at $1.80 per share, certain investors represented by Taurus Advisory Group, LLC (“Taurus”) received 1,111,111 shares of our common stock, plus interest paid in cash. Because we failed to perform a private investment in public equity transaction by September 1, 2004, the conversion price on the October 2003 note was adjusted to a fixed conversion price of $1.575 per share, and 158,730 additional shares of common stock were issued to Taurus. No additional proceeds were received by us. In addition, Taurus received a warrant to purchase 277,778 shares of our common stock, which has an exercise price of $1.575 per share. This warrant expires in June 2009. Further in May 2004, we raised an additional $2.0 million pursuant to a new five-year unsecured promissory note with Taurus. In June 2004, we replaced the May 2004 note by issuing a five-year $2.0 million unsecured convertible line of credit note with Taurus. The note accrues interest at an annual rate of 7%, and the conversion price of the shares of common stock issuable under the note is equal to $1.575 per share.

In July 2005, the Company obtained two $250,000 short term loans from certain investors represented by Taurus. Both notes bear interest at 8% per annum. The first note is dated July 6, 2005 and initially matured on September 6, 2005. The maturity date for this note has been extended to May 6, 2006. The second note is dated July 22, 2005 and originally matured on September 22, 2005. The maturity date for this note has been extended to April 22, 2006. These short term note holders have agreed to extend their maturity date on a month-to-month basis until the Company raises sufficient funds to repay the notes.

In December 2005, the Company obtained a $1,000,000 short term loan from certain investors represented by Taurus. This note bears interest at 8% per annum. The note is dated December 19, 2005 and initially matured on January 31, 2006. The maturity date for this note has been extended to June 1, 2006. In conjunction with this note, these investors received a warrant to purchase 277,777 shares of our common stock with an exercise price of $0.675 per share in December 2005, a warrant to purchase 277,777 shares of our common stock with an exercise price of $0.75 per share in February 2006 and a warrant to purchase 554,000 shares of our common stock with an exercise price of $1.30 per share in March 2006. These warrants expire in December 2008, January 2009 and February 2009, respectively. As of December 31, 2005, the Company had borrowed $500,000 under this note. The remaining $500,000 was borrowed by the Company in January 2006, and the entire $1,000,000 remains outstanding. These short term note holders have agreed to extend their maturity date on a month-to-month basis until the Company raises sufficient funds to repay the notes.

On February 2, 2006, the Company entered into a Securities Purchase Agreement with Taurus, pursuant to which the Company issued 19,000 shares of the Company's newly created Series A Convertible Preferred Stock, $.001 par value (the "Series A Preferred"). Each share of Series A Preferred has a stated value of $100.00. The Company utilized the proceeds ($1,900,000) to repurchase shares of its common stock from WHRT I Corp. (see above "Recent Acquisitions and Divestiture"). The Series A Preferred has a cumulative annual dividend equal to five percent (5%), which is payable semi-annually in cash or common stock, at the election of the Company, and is convertible into shares of the Company's common stock at any time at a price equal to $0.50 per share (subject to adjustments related to stock splits, reclassifications, combinations, dividends, change of control or the issuance of pari passu securities). In addition, the Series A Preferred has no voting rights, but has liquidation preferences and certain other privileges. All shares of Series A Preferred not previously converted shall be redeemed by the Company, in cash or common stock, at the election of Taurus, on February 1, 2011. Pursuant to the Securities Purchase Agreement, Taurus was also granted a warrant to purchase 1,900,000 shares of the Company's common stock exercisable at a price of $0.60 per share (subject to adjustments related to stock splits, reclassifications, combinations, dividends, change of control or the issuance of pari passu securities), exercisable for a period of five years.

See chart on page 58 in Liquidity and Capital Resources.

Laurus

In August 2004, we replaced our $3.0 million line of credit with North Fork Bank with a revolving line of credit with Laurus Master Fund, Ltd. ("Laurus"), whereby we had access to borrow up to $6.0 million based upon eligible accounts receivable. A portion of Laurus's revolving line of credit was used to pay off all outstanding borrowings from North Fork Bank. This revolving line, effectuated through a $2.0 million convertible minimum borrowing note and a $4.0 million revolving note, provided for advances at an advance rate of 90% against eligible accounts receivable, with an annual interest rate of prime rate (as reported in the Wall Street Journal) plus 1%, and matured in three years. We had no obligation to meet financial covenants under the $2.0 million convertible minimum borrowing note or the $4.0 million revolving note. This line of credit is secured by substantially all the corporate assets. Both the $2.0 million convertible minimum borrowing note and the $4.0 million revolving note provided for conversion at the option of the holder of the amounts outstanding into our common stock at a fixed conversion price of $2.10 per share.

Additionally, in exchange for a $5,000,000 secured convertible term note bearing interest at prime rate (as reported in the Wall Street Journal) plus 1%, Laurus had established a $5.0 million account to be used only for acquisition targets identified by us that were approved by Laurus in Laurus' sole discretion. We had no obligation to meet financial covenants under the $5.0 million secured convertible term note. This note was convertible into our common stock at a fixed conversion price of $2.10 per share. This note was to mature in three years. We issued Laurus a common stock purchase warrant that provided Laurus with the right to purchase 800,000 shares of our common stock. The exercise price for the first 400,000 shares acquired under the warrant is $4.35 per share, the exercise price for the next 200,000 shares acquired under the warrant is $4.65 per share, and the exercise price for the final 200,000 shares acquired under the warrant is $5.25 per share. The common stock purchase warrant expires on August 15, 2011. We paid $0.75 million in brokerage and transaction closing related costs. These costs were deducted from the $5.0 million restricted cash balance being provided to us by Laurus.

In May 2005, Laurus elected to convert $1,000,000 of debt underlying the minimum borrowing note into the Company's common stock. As a result of this conversion, the Company obtained $1,000,000 of additional borrowing capacity under its revolving line of credit and in return, issued 476,191 shares of Company common stock to Laurus.

In July 2005, the Company entered into amendments of the notes dated August 16, 2004 between the Company and Laurus. Pursuant to the amendment, the Company released $4,327,295 (the "Funds") to Laurus, which was being held in the Restricted Account (which was available to the Company for acquisitions) and issued an amended and restated convertible note in the principal amount of $749,000. In satisfaction of the balance of the accrued interest and any liquidated damages to which it was entitled pursuant the Registration Rights Agreement entered into in August 2004, the Company issued an option to purchase 333,334 shares of the Company's common stock at a purchase price of $0.015 per share. Laurus fully exercised this option to purchase Company stock on August 1, 2005. Laurus also agreed to extend the required filing date and effective date of the Registration Statement. For accounting purposes, the Company recorded this transaction as an early extinguishment of debt and recorded the remaining discount and liability on gain or loss on the early extinguishment of debt.

The Company also issued an amended and restated convertible secured revolving note in the principal amount of $4.5 million in favor of Laurus which amended the $4 million Revolving Note executed in August 2004. In connection with this note, the Company and Laurus entered into an Overadvance Letter Agreement, pursuant to which Laurus made a loan to the Company in excess of the amount available using the Company accounts receivable as collateral in the principal amount of $2.7 million. The Company utilized the $2.7 million which was advanced to it by Laurus to acquire McKnight Associates, Inc., Integrated Strategies, Inc. and ISI Consulting, LLC. Except as noted above, all terms of the August 2004 agreements continued to remain in effect.

On November 30, 2005, the Company (i) amended and restated the convertible term note in the principal amount of $749,000 by reducing the conversion rate of such note from $2.10 to $1.00, (ii) amended and restated the secured revolving convertible note by increasing the principal amount available from $4,500,000 to $5,500,000 and reducing the conversion rate from $2.10 to $1.00, and (iii) amended and restated the secured convertible minimum borrowing note in the principal amount of $2,000,000 by reducing the fixed conversion price from $2.10 to $0.65.

On February 1, 2006, the Company restructured its financing with Laurus again by entering into financing agreements with Laurus, pursuant to which it, among other things, (a) issued a secured non-convertible term note in the principal amount of $1,000,000 to Laurus (the “Term Note”), (b) issued a secured non-convertible revolving note in the principal amount of $10,000,000 to Laurus (the “Revolving Note”, collectively with the Term Note, the “Notes”), and (c) issued an option to purchase up to 3,080,000 shares of the Company's common stock to Laurus (the “Option”) at an exercise price of $.001 per share. The proceeds from the issuance of the Notes were used to refinance the Company’s outstanding obligations under the existing facility with Laurus (originally entered into in August 2004 and subsequently amended in July 2005) at a 5% premium. The Notes bear an annual interest rate of prime (as reported in the Wall Street Journal, which was 7.25% as of January 31, 2006) plus 1.0%, with a floor of 5.0%. Payments of interest will be made in equal monthly amounts until maturity of the Notes on December 31, 2007, at which time the 5% premium will also be due. In addition, payments of principal on the Term Note will be made in equal monthly amounts until maturity of the Notes on December 31, 2007.

In connection with the Notes, the Company and Laurus entered into an Overadvance Letter Agreement, pursuant to which Laurus exercised its discretion granted to it pursuant to the Security Agreement entered into in August 2004 to make a loan to the Company in excess of the “Formula Amount” (as defined therein). The Company also entered into a Stock Pledge Agreement and Security Agreement securing its obligations to Laurus, both prior to and including the Notes, as well as a Registration Rights Agreement pursuant to which the Company agreed to file a registration statement to register the shares of the Company’s common stock underlying the Option, as well as the shares of the Company’s common stock and the shares of the Company’s common stock underlying the warrants held by Laurus, within 90 days. As of the date of this filing, Laurus owns approximately 809,525 shares of the Company’s common stock, an option to purchase up to 3,080,000 shares of the Company's common stock at an exercise price of $.001 per share and warrants to purchase 400,000 shares of the Company’s common stock at $4.35 per share, 200,000 shares of the Company’s common stock at $4.65 per share and 200,000 shares of the Company’s common stock at $5.25 per share. Please see Risk Factors for more information related to certain events of default related to the Laurus transaction.

See chart on page 58 in Liquidity and Capital Resources.

Laidlaw/Sands

In September 2004, we issued to Sands Brothers Venture Capital LLC, Sands Brothers Venture Capital III LLC and Sands Brothers Venture Capital IV LLC (collectively, “Sands”) three subordinated secured convertible promissory notes equaling $1.0 million (the “Notes”), each with an annual interest rate of 8% expiring September 22, 2005. The Notes were secured by substantially all corporate assets, subordinate to Laurus. The Notes are convertible into shares of our common stock at the election of Sands at any time following the consummation of a convertible debt or equity financing with gross proceeds of $5.0 million or greater (a “Qualified Financing”). The conversion price of the shares of our common stock issuable upon conversion of the Notes shall be equal to a price per share of common stock equal to forty percent (40%) of the price of the securities issued pursuant to a Qualified Financing. Since no Qualified Financing had been consummated by September 8, 2005, Sands is entitled to elect to convert the Notes at a fixed conversion price of $2.10 per share. In the event that we issue stock or derivatives convertible into our stock for a price less than the aforementioned fixed conversion price, then the fixed conversion price is reset using a weighted average dilution calculation. We also issued Sands three common stock purchase warrants (the “Warrants”) providing Sands with the right to purchase 400,000 shares of our common stock. The exercise price of the shares of our common stock issuable upon exercise of the Warrants shall be equal to $2.10 or in the event of a Qualified Financing, a price per share of common stock equal to forty percent (40%) of the price of the securities issued pursuant to such Qualified Financing. The latest that the Warrants may expire is September 8, 2008.

On September 22, 2005, upon maturity of the September 2004 notes, the Company issued to Sands three amended subordinated secured convertible promissory notes equaling $1.08 million, each with an annual interest rate of 12% expiring on January 1, 2007. The Company also issued Sands three common stock purchase warrants (the "Additional Warrants") providing Sands with the right to purchase 400,000 shares of the Company's common stock. The exercise price of the shares of the Company's common stock issuable upon exercise of the Additional Warrants shall be equal to a price per share of common stock equal to one hundred twenty percent (120%) of the price of the securities issued pursuant to a Qualified Financing. If no Qualified Financing has been consummated by December 15, 2006, then Sands may elect to exercise the Additional Warrants at a fixed conversion price of $2.10 per share. The latest that the Warrants may expire is December 15, 2009.

Other

On November 8, 2004, we entered into a Stock Purchase Agreement (the "Agreement") with a private investor, CMKX-treme, Inc. Pursuant to the Agreement, CMKX-treme, Inc. agreed to purchase 833,333 shares of common stock for a purchase price of $1.75 million. Under the terms of the Agreement, CMKX-treme, Inc. initially purchased 238,095 shares of common stock for $0.5 million, and it was required to purchase the remaining 595,238 shares of Common Stock for $1.25 million by December 31, 2004. As of March 17, 2005, CMKX-treme, Inc. remitted final payment for the remaining 595,238 shares.

Clients

For 16 years, we have helped our clients develop strategies and implement technology solutions to help them leverage corporate information.

Our clients are primarily in the financial services, pharmaceutical, healthcare and telecommunications industries and are primarily located in the northeastern United States. During the year ended December 31, 2005, two of our clients, Leading Edge Communications Corporation, a related party, (13.4%) and Bank of America (27.2%), accounted collectively for approximately 40.6% of total revenues. During the year ended December 31, 2004, two of our clients, Leading Edge Communications Corporation, a related party, (16.1%) and Bank of America (16.7%), accounted collectively for approximately 32.8% of total revenues. As we continue to pursue and consummate acquisitions, our dependence on these customers should be less significant. We do not have long-term contracts with any of these customers. The loss of any of our largest customers could have a material adverse effect on our business. We have not had any collections problems with any of these customers to date.

Marketing

We currently market our services through our internal marketing group, our external public relations firm, and our sales force comprised of 14 employees. We also receive new business opportunities through referrals from current clients, strategic partners, independent industry analysts and industry associations. We are engaging in the following specific sales related programs and activities to expand our brand awareness and generate sales leads:

- *Advertising and Sponsorships*: Through advertising and sponsorship programs within the leading industry publications, we obtain new business leads and further increase our brand awareness. Throughout the year, we sponsor publications and newsletters published by DM Review, The Business Intelligence Network, The Data Warehousing Institute and iSix Sigma. Most of these sponsorships include web banner advertising and registration vehicles to promote CSI white papers and best practices research.

- *Web Site Promotion*: Our website (www.csiwhq.com) provides a comprehensive view of our service offerings and promotes our subject matter expertise via white papers, articles and industry presentations. We are currently promoting our website through internet search engine advertising, direct marketing and through reciprocity from partner sites.

- *Trade Show and Conference Participation*: Our participation in trade shows and conferences has further solidified our position in our industry. There are a number of trade shows and conferences within our target industry that provide significant exposure to prospective customers, business and trade media and industry analysts, as well as collaborative networking with technology partners. As with most trade show events, the higher the level of sponsorship, the greater exposure and benefits received, such as the location of our booth, banner and advertising space, and position on the conference agenda. We participated at the Shared Insights/DCI Data Warehousing and Business Intelligence Conference with a sponsorship, exhibit and keynote presentations (in San Diego in April 2005, Orlando in September 2005 and in Chicago in February 2006). We are a partner member of The Data Warehouse Institute (TDWI) and we sponsor and provide speakers for several of the conferences TDWI holds each year (in Baltimore in May 2005, in Orlando in October 2005 and upcoming in Chicago in May 2006).

- *Web Seminars:* Participation in web seminars provides exposure to new sales prospects and affords us the opportunity to demonstrate our subject matter expertise. We sponsor approximately three web seminars annually, in addition to participating as guest presenters at partner and vendor sponsored web seminars.

- *Thought Leadership:* We continually demonstrate our thought leadership by writing and promoting our white papers via our web site, the TDWI web site and through direct mail. Monthly articles by our consultants are published in DM Review, on The Business Intelligence Network Pharmaceutical Channel and the iSix Sigma financial services channel. We intend to continue and expand all our publishing activities, including blogs, by-line articles and expert web channels where our experts respond to end-user questions (searchCRM and searchDataManagement.com).

- *Sponsorships of Vendor Marketing Activities*: We expect that joint marketing activities with leading software vendors should also stimulate new business prospect generation. This participation also enhances the market perception of CSI as experts in individual product areas by co-sponsoring and participating in vendor marketing activities. We are invited to write white papers and articles for vendors such as Microsoft, Teradata and Dataflux. We sponsor and present at the Annual User Conferences for Business Objects and Teradata, as well as new product launch seminars with Business Objects and Cognos.

- *Vendor Relations*: We are continually identifying key vendor relationships. With the ability to leverage our 16 year history, we intend to continue to forge and maintain relationships with technical, service and industry vendors. We have solidified and continue to develop strategic relationships with technology vendors in the data warehousing and business intelligence arena. These relationships designate our status as a systems integration and/or reseller which authorizes us to provide consulting services and to resell select vendor software. We employ certified consultants in our vendor partner technology platforms. We maintain vendor independence by consistently evaluating the respective vendors' technologies in our lab located at our headquarters in East Hanover, New Jersey. We regularly attend vendor partnership events, including partner summits and user group meetings, in support of our partnership programs. We currently maintain relationships with the following:

Database Vendors:

IBM - We are an Indirect Passport Advantage Reseller Partner which enables us to resell IBM software products. We also employ consulting staff trained and certified in IBM technology.

Oracle - We are part of the Oracle Partner Program (OPP) as a Certified Solution Provider (CSP). We also employ certified Oracle professionals and our partnership allows us to utilize Oracle support channels for technical advisement.

15

Microsoft - We are a Microsoft Certified Solution Provider. We maintain the required number of Microsoft certified professionals to hold this designation.

Sybase - We have a Systems Integration Agreement and employ professionals trained in the vendor's technology.

Business Intelligence Vendors:

Busines Objects - We are a Systems Integration and Reseller Partner. We employ and maintain a staff of professionals that are certified in the vendor's technology. In addition, we are a Certified Onsite Education Partner, which allows us to directly market and provide a certified training partner, which enables us to provide onsite training classes in the respective vendor technology.

Cognos - We are a Systems Integration and Reseller Partner. We employ and maintain a staff of professionals that are certified in the vendor's technology.

MicroStrategy - We are a Systems Integration and Reseller Partner. We employ and maintain a staff of professionals that are certified in the vendor's technology.

Spotfire - We are a Systems Integration and Reseller Partner. We employ and maintain a staff of professionals that are certified in the vendor's technology.

Data Warehousing Vendors:

Informatica - We are a Systems Integration and Reseller Partner. We employ and maintain a staff of professionals that are certified in the vendor's technology.

Ascential Software - We are a Systems Integration and Reseller Partner. We employ and maintain a staff of professionals that are certified in the vendor's technology.

Computer Associates We are an affiliate partner. We employ and maintain a staff of professionals that are certified in the vendor's technology.

- *Expanded Direct Sales Activities*: We are continually updating and increasing our direct contact programs for lead generation, cross selling and up-selling. We conduct direct sales activities, such as e-mail and direct mail campaigns, telemarketing, networking and attending partnership functions to generate leads for direct sales opportunities. In addition, we have developed a number of best practices service offerings which encompass selection, deployment, implementation, maintenance and knowledge transfer. In some cases, these service offerings include methodologies and best practices for integrating several vendor technology platforms resulting in cross selling and up selling opportunities when applicable.

Protection Against Disclosure of Client Information

As our core business relates to the storage and use of client information, which is often confidential, we have implemented policies to prevent client information from being disclosed to unauthorized parties or used inappropriately. Our employee handbook, of which every employee receives and acknowledges, mandates that it is strictly prohibited for employees to disclose client information to third parties. Our handbook further mandates that disciplinary action be taken against those who violate such policy, including possible termination. Our outside consultants sign non-disclosure agreements prohibiting disclosure of client information to third parties, among other things, and we perform background checks on employees and outside consultants.

Intellectual Property

The trademarks "TECH SMART BUSINESS WISE", "QUALITY MANAGEMENT OFFICE", "QMO" and DQXPRESS have been registered with the United States Patent and Trademark Office ("USPTO"). Our trademark registration application for the mark DQROI is presently pending before the USPTO. We use non-disclosure agreements with our employees, independent contractors and clients to protect information which we believe are proprietary or constitute trade secrets.

Competition

To our knowledge, there are no publicly-traded competitors that focus solely on data warehousing and business intelligence consulting and strategy. However, we have several competitors in the general marketplace, including data warehouse and business intelligence practices within large international, national and regional consulting and implementation firms, as well as smaller boutique technology firms. Many of our competitors are large companies that have substantially greater market presence, longer operating histories, more significant client bases, and financial, technical, facilities, marketing, capital and other resources than we have. We believe that we compete with these firms on the basis of the quality of our services, industry reputation and price. We believe our competitors include firms such as:

- Accenture
- Cap Gemini Ernst & Young
- IBM Global Services
- Keane
- Bearing Point
- Answerthink

Employees

As of December 31, 2005, we had 37 outside consultants, 118 consultants on the payroll and 44 non-consultant employees. Outside consultants are not our employees, and as such, do not receive benefits or have taxes withheld. These consultants are members or employees of separate corporations, they are responsible for providing us with a current certificate of insurance and they are responsible for filing and payment of their own taxes. We maintain relationships with these consultants and their status is updated in a proprietary data base application that we have built. Consultants on the payroll are our employees, billable to clients, and they have taxes withheld similar to other employees.

None of our employees are represented by a labor union or subject to a collective bargaining agreement. We have never experienced a work stoppage and we believe that our relations with employees are good.

Available Information

We file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission (the "Commission"). You may read and copy any document we file with the Commission at the Commission's public reference rooms at 450 Fifth Street, N.W., Washington, D.C. 20549, 233 Broadway, New York, New York 10279, and Citicorp Center, 500 West Madison Street, Suite 1400, Chicago, Illinois 60661-2511. Please call the Commission at 1-800-SEC-0330 for further information on the public reference rooms. Our Commission filings are also available to the public from the Commission's Website at "http://www.sec.gov." We make available free of charge our annual, quarterly and current reports, proxy statements and other information upon request. To request such materials, please send a written request to Mitchell Peipert, our Chief Financial Officer, at our address as set forth above or at (973) 560-9400.

We maintain a Website at www.csiwhq.com (this is not a hyperlink, you must visit this website through an internet browser). Our Website and the information contained therein or connected thereto are not incorporated into this Annual Report on Form 10-KSB.

SPECIAL NOTE ON FORWARD LOOKING STATEMENTS

In addition to historical information, this Annual Report on Form 10-KSB contains forward looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those reflected in such forward-looking statements. Factors that might cause such a difference include, but are not limited to, those discussed in the sections entitled "Business", "Risk Factors", and "Management's Discussion and Analysis or Plan of Operation." Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management's opinions only as of the date thereof. We undertake no obligation to revise or publicly release the results of any revision of these forward-looking statements. Readers should carefully review the risk factors described in this Annual Report and in other documents that we file from time to time with the Securities and Exchange Commission.

In some cases, you can identify forward-looking statements by terminology such as "may," "will," "should," "expects," "plans," "anticipates," "believes," "estimates," "predicts," "potential," "proposed," "intended," or "continue" or the negative of these terms or other comparable terminology. You should read statements that contain these words carefully, because they discuss our expectations about our future operating results or our future financial condition or state other "forward-looking" information. There may be events in the future that we are not able to accurately predict or control. You should be aware that the occurrence of any of the events described in these risk factors and elsewhere in this Annual Report could substantially harm our business, results of operations and financial condition, and that upon the occurrence of any of these events, the trading price of our securities could decline. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, growth rates, levels of activity, performance or achievements.

Except as required by applicable law, including the securities laws of the United States, we do not intend to update any of the forward-looking statements to conform these statements to actual results. The following discussion should be read in conjunction with our financial statements and the related notes that appear elsewhere in this report.

We cannot give any guarantee that these plans, intentions or expectations will be achieved. All forward-looking statements involve risks and uncertainties, and actual results may differ materially from those discussed in the forward-looking statements as a result of various factors, including those factors described in the "Risk Factors" section of this Annual Report. Listed below and discussed elsewhere in this Annual Report are some important risks, uncertainties and contingencies that could cause our actual results, performances or achievements to be materially different from the forward-looking statements included in this Annual Report. These risks, uncertainties and contingencies include, but are not limited to, the following:

- *our ability to finance our operations on acceptable terms, either through the raising of capital, the incurrence of convertible or other indebtedness or through strategic financing partnerships;*
- *our ability to maintain the continued listing standards of the American Stock Exchange;*
- *our ability to retain members of our management team and our employees;*
- *our ability to retain existing clients or attract new clients;*
- *our ability to adapt to the rapid technological change constantly occurring in the areas in which we provide services*
- *our ability to offer pricing for services which is acceptable to clients;*
- *the competition that may arise in the future; and*
- *identifying suitable acquisition candidates and integrating new acquisitions.*

The foregoing does not represent an exhaustive list of risks. Please see "Risk Factors" below for additional risks which could adversely impact our business and financial performance. Moreover, new risks emerge from time to time and it is not possible for our management to predict all risks, nor can we assess the impact of all risks on our business or the extent to which any risk, or combination of risks, may cause actual results to differ from those contained in any forward-looking statements. All forward-looking statements included in this Report are based on information available to us on the date of this Report. Except to the extent required by applicable laws or rules, we undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise. All subsequent written and oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements contained throughout this Report.

RISK FACTORS

The following factors should be considered carefully in evaluating the Company and its business:

Risks Relating to Our Business

Because we depend on a small number of key clients, non-recurring revenue and contracts terminable on short notice, our business could be adversely affected if we fail to retain these clients and/or obtain new clients at a level sufficient to support our operations and/or broaden our client base.

During the year ended December 31, 2005, two of the Company’s clients, Leading Edge Communications Corporation (LEC), a related party, and Bank of America, accounted for approximately 13.4% and 27.2%, respectively, of total revenues. During the year ended December 31, 2004, two of our clients, LEC and Bank of America, accounted for approximately 16.1% and 16.7% of total revenues. Further, the majority of our current assets consist of accounts receivable, and as of December 31, 2005, one customer, LEC, accounted for 14% of our accounts receivable balance. With the recent acquisition of new businesses and our objective of acquiring more over the next year, we believe that our reliance on these clients will continue to decline in the future. The loss of any of our largest clients could have a material adverse effect on our business. In addition, our contracts provide that our services are terminable upon short notice, typically not more than 30 days. Non-renewal or termination of contracts with these or other clients without adequate replacements could have a material and adverse effect upon our business. In addition, a large portion of our revenues are derived from information technology consulting services that are generally non-recurring in nature. There can be no assurance that we will:

- obtain additional contracts for projects similar in scope to those previously obtained from our clients;
- be able to retain existing clients or attract new clients;
- provide services in a manner acceptable to clients;
- offer pricing for services which is acceptable to clients; or
- broaden our client base so that we will not remain largely dependent upon a limited number of clients that will continue to account for a substantial portion of our revenues.

Our internal controls and procedures have been materially deficient, and we are in the process of correcting internal control deficiencies.

In the first quarter of 2005, resulting from comments related to the Company’s Registration Statement on Form SB-2/A, the Company and its independent registered public accounting firm recognized that our internal controls had material weaknesses. In April 2005, we restated our results of operations for the Company's quarterly results for the quarters ended March 31, 2004, June 30, 2004 and September 30, 2004 related primarily to our purchase accounting for two acquisitions completed in 2004. In November 2005, resulting from discussions with the Staff of the SEC, we restated our results of operations for the Company's quarterly results for the quarters ended June 30, 2004, September 30, 2004 and March 31, 2005, and for the year ended December 31, 2004 primarily as a result of revised accounting treatment related to the our issuance of financial instruments in 2004 and to properly record the loss resulting from the fair value adjustment of the financial instruments. Finally, with this filing, resulting from discussions with the Staff of the SEC, we restated the manner in which we recorded and accounted for the beneficial conversion feature associated with convertible notes issued in 2004 in our results of operations for the Company's quarterly results for the quarters ended September 30, 2004, March 31, 2005, June 30, 2005 and September 30, 2005, and for the year ended December 31, 2004. As a result of this latest restatement, we were unable to file this Form 10-KSB in a timely fashion. Further restatements could cause us to miss our filing deadlines in the future, which could bring us out of compliance with the continued listing standards of the American Stock Exchange and/or cause us to default on certain of our financing arrangements, which would have a material adverse effect on our business.

If we cannot rectify these material weaknesses through remedial measures and improvements to our systems and procedures, management may encounter difficulties in timely assessing business performance and identifying incipient strategic and oversight issues. Management is currently focused on remedying internal control deficiencies, and this focus will require management from time to time to devote its attention away from other planning, oversight and performance functions.

We cannot provide assurances as to the timing of the completion of these efforts. We cannot be certain that the measures we take will ensure that we implement and maintain adequate internal controls in the future. Any failure to implement required new or improved controls, or difficulties encountered in their implementation, could harm our operating results or cause us to fail to meet our reporting obligations.

The Company may have liability in connection with its recent securities offerings.

We have completed various financings through the issuance of our common stock, as well as the issuance of notes and warrants convertible into our common stock, while a Registration Statement on Form SB-2 was on file with the SEC but had not yet been declared effective (those transactions were with certain investors of Taurus Advisory Group, LLC, Laurus Master Fund, Ltd. and three entities affiliated with Sands Brothers International Limited). We also issued our common stock in connection with the acquisition of substantially all the assets of Evoke Software Corporation during this time (we subsequently sold such assets in July 2005). Even though all stockholders, noteholders and warrantholders have been advised of their rights to rescind those financing transactions and they each have waived their rights to rescind those transactions, there is a remote possibility that each of those transactions could be reversed and the consideration received by us may have to be repaid. In such an event, our business could be adversely affected and we may have an obligation to fund such rescissions.

Certain client-related complications may materially adversely affect our business.

We may be subject to additional risks relating to our clients that could materially adversely affect our business, such as delays in clients paying their outstanding invoices, lengthy client review processes for awarding contracts, delay, termination, reduction or modification of contracts in the event of changes in client policies or as a result of budgetary constraints, and/or increased or unexpected costs resulting in losses under fixed-fee contracts, which factors could also adversely affect our business.

We have a history of losses and we could incur losses in the future.

During the fiscal years ended December 31, 2005 and December 31, 2004, we sustained operating losses and cannot be sure that we will operate profitably in the future. During the fiscal year ended December 31, 2005, we reported a net loss in the approximate amount of ($4.5 million). The Company recorded a ($6.1 million) loss from operating activities for the fiscal year ended December 31, 2005. During the fiscal year ended December 31, 2004, we sustained a net loss in the approximate amount of ($35.3 million). The Company recorded a ($17.0 million) loss from operating activities for the fiscal year ended December 31, 2004, of which $12.2 million of the loss resulted from impairment of goodwill and intangibles for the year ended December 31, 2004. If we do not become profitable, we could have difficulty obtaining funds to continue our operations. We have incurred net losses since our merger with LCS Group, Inc. We may continue to generate losses from the ongoing business prior to returning the Company to profitability.

We have a significant amount of debt, which, in the event of a default, could have material adverse consequences upon us.

Our total debt as of March 31, 2006 is approximately $15.0 million. The degree to which we are leveraged could have important consequences to us, including the following:

- A portion of our cash flow must be used to pay interest on our indebtedness, and therefore is not available for use in our business;
- Our indebtedness increases our vulnerability to changes in general economic and industry conditions;
- Our ability to obtain additional financing for working capital, capital expenditures, general corporate purposes or other purposes could be impaired;

- Our failure to comply with restrictions contained in the terms of our borrowings could lead to a default which could cause all or a significant portion of our debt to become immediately payable; and

- If we default, the loans will become due and we may not have the funds to repay the loans, and we could discontinue our business and investors could lose all their money.

In addition, certain terms of such loans require the prior consent of Laurus Master Fund, Ltd. on many corporate actions including, but not limited to, mergers and acquisitions—which is part of our ongoing business strategy**.**

If an event of default occurs under our notes with Laurus, it could seriously harm our operations.

On February 1, 2006, we issued two separate secured non-convertible term notes to Laurus in the amounts of up to $10 million and $1 million respectively. The note and related agreements contain several events of default which include:

- failure to pay interest, principal payments or other fees when due;
- failure to pay taxes when due unless such taxes are being contested in good faith;
- breach by us of any material covenant or term or condition of the notes or any agreements made in connection therewith;
- default on any indebtedness to which we or our subsidiaries are a party;
- breach by us of any material representation or warranty made in the notes or in any agreements made in connection therewith;
- attachment is made or levy upon collateral securing the Laurus debt which is valued at more than $150,000 and is not timely mitigated.
- any lien created under the notes and agreements is not valid and perfected having a first priority interest;
- assignment for the benefit of our creditors, or a receiver or trustee is appointed for us;
- bankruptcy or insolvency proceeding instituted by or against us and not dismissed within 30 days;
- the inability to pay debts as they become due or cease business operations;
- sale, assignment, transfer or conveyance of any assets except as permitted;
- a person or group becomes beneficial owner of 35% on fully diluted basis of the outstanding voting equity interest or the present directors cease to be the majority on the Board of Directors;
- indictment or threatened criminal indictment, or commencement of threatened commencement of any criminal or civil proceeding against the Company or any executive officer; and
- common stock suspension for five consecutive days or five days during any 10 consecutive days from a principal market, provided that we are unable to cure such suspension within 30 days or list our common stock on another principal market within 60 days.

If we default on the notes and the holder demands all payments due and payable, the cash required to pay such amounts would most likely come out of working capital, which may not be sufficient to repay the amounts due. The default payment shall be 115% of the outstanding principal amount of the note, plus accrued but unpaid interest, all other fees then remaining unpaid, and all other amounts payable thereunder. In addition, since we rely on our working capital for our day to day operations, such a default on the note could materially adversely affect our business, operating results or financial condition to such extent that we are forced to restructure, file for bankruptcy, sell assets or cease operations. Further, our obligations under the notes are secured by substantially all of our assets. Failure to fulfill our obligations under the notes and related agreements could lead to loss of these assets, which would be detrimental to our operations.

Our operating results are difficult to forecast.

We may increase our general and administrative expenses in the event that we increase our business and/or acquire other businesses, while our operating expenses for sales and marketing and costs of services for technical personnel to provide and support our services also increases. Additionally, although most of our clients are large, creditworthy entities, at any given point in time, we may have significant accounts receivable balances with clients that expose us to credit risks if such clients either delay or elect not to pay or are unable to pay such obligations. If we have an unexpected shortfall in revenues in relation to our expenses, or significant bad debt experience, our business could be materially and adversely affected.

Our profitability, if any, will suffer if we are not able to retain existing clients or attract new clients. A continuation of current pricing pressures could result in permanent changes in pricing policies and delivery capabilities.

Our gross profit margin is largely a function of the rates we are able to charge for our information technology services. Accordingly, if we are not able to maintain the pricing for our services or an appropriate utilization of our professionals without corresponding cost reductions, our margins will suffer. The rates we are able to charge for our services are affected by a number of factors, including:

- our clients’ perceptions of our ability to add value through our services;
- pricing policies of our competitors;
- our ability to accurately estimate, attain and sustain engagement revenues, margins and cash flows over increasingly longer contract periods;
- the use of globally sourced, lower-cost service delivery capabilities by our competitors and our clients; and
- general economic and political conditions.

Our gross margins are also a function of our ability to control our costs and improve our efficiency. If the continuation of current pricing pressures persists it could result in permanent changes in pricing policies and delivery capabilities and we must continuously improve our management of costs.

Unexpected costs or delays could make our contracts unprofitable.

In the future, we may have many types of contracts, including time-and-materials contracts, fixed-price contracts and contracts with features of both of these contract types. Any increased or unexpected costs or unanticipated delays in connection with the performance of these engagements, including delays caused by factors outside our control, could make these contracts less profitable or unprofitable, which would have an adverse effect on all of our margins and potential net income.

Our business could be adversely affected if we fail to adapt to emerging and evolving markets.

The markets for our services are changing rapidly and evolving and, therefore, the ultimate level of demand for our services is subject to substantial uncertainty. Most of our historic revenue was generated from providing information technology services only. During the last several years, we have focused our efforts on providing data warehousing services in particular since we believe that there is going to be an increased need in this area. Any significant decline in demand for programming, applications development, information technology or data warehousing consulting services could materially and adversely affect our business and prospects.

Our ability to achieve growth targets is dependent in part on maintaining existing clients and continually attracting and retaining new clients to replace those who have not renewed their contracts. Our ability to achieve market acceptance, including for data warehousing, will require substantial efforts and expenditures on our part to create awareness of our services.

If we should experience rapid growth, such growth could strain our managerial and operational resources, which could adversely affect our business.

Any rapid growth that we may experience would most likely place a significant strain on our managerial and operational resources. If we continue to acquire other companies, we will be required to manage multiple relationships with various clients, strategic partners and other third parties. Further growth (organic or by acquisition) or an increase in the number of strategic relationships may increase this strain on existing managerial and operational resources, inhibiting our ability to achieve the rapid execution necessary to implement our growth strategy without incurring additional corporate expenses.

Lack of detailed written contracts could impair our ability to collect fees, protect our intellectual property and protect ourselves from liability to others.

We try to protect ourselves by entering into detailed written contracts with our clients covering the terms and contingencies of the client engagement. In some cases, however, consistent with what we believe to be industry practice, work is performed for clients on the basis of a limited statement of work or verbal agreements before a detailed written contact can be finalized. To the extent that we fail to have detailed written contracts in place, our ability to collect fees, protect our intellectual property and protect ourselves from liability from others may be impaired.

Failure to achieve and maintain effective internal controls in accordance with Section 404 of the Sarbanes-Oxley Act could have a material adverse effect on our business and operating results. In addition, current and potential stockholders could lose confidence in our financial reporting, which could have a material adverse effect on our stock price.

Effective internal controls are necessary for us to provide reliable financial reports and effectively prevent fraud. If we cannot provide reliable financial reports or prevent fraud, our operating results could be harmed.

Commencing in July 2007, we will be required to document and test our internal control procedures in order to satisfy the requirements of Section 404 of the Sarbanes-Oxley Act, which requires annual management assessments of the effectiveness of our internal controls over financial reporting and a report by our independent registered public accounting firm addressing these assessments. During the course of our testing, we may identify deficiencies which we may not be able to remediate in time to meet the deadline imposed by the Sarbanes-Oxley Act for compliance with the requirements of Section 404. In addition, if we fail to maintain the adequacy of our internal controls, as such standards are modified, supplemented or amended from time to time, we may not be able to ensure that we can conclude on an ongoing basis that we have effective internal controls over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act. Failure to achieve and maintain an effective internal control environment could also cause investors to lose confidence in our reported financial information, which could have a material adverse effect on our stock price.

Compliance with changing regulation of corporate governance and public disclosure may result in additional expenses.

Changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, new SEC regulations and exchange rules (although not, as of the date of this Annual Report, applicable to us), are creating uncertainty for companies such as ours. These new or changed laws, regulations and standards are subject to varying interpretations in many cases due to their lack of specificity, and as a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies, which could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices. We are committed to maintaining high standards of corporate governance and public disclosure. As a result, our efforts to comply with evolving laws, regulations and standards have resulted in, and are likely to continue to result in, increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities. In particular, our efforts to comply with Section 404 of the Sarbanes-Oxley Act of 2002 and the related regulations regarding our required assessment of our internal controls over financial reporting and our independent registered public accounting firm's audit of that assessment will require the commitment of significant financial and managerial resources. Further, our board members, chief executive officer and chief financial officer could face an increased risk of personal liability in connection with the performance of their duties. As a result, we may have difficulty attracting and retaining qualified board members and executive officers, which could harm our business. If our efforts to comply with new or changed laws, regulations and standards differ from the activities intended by regulatory or governing bodies due to ambiguities related to practice, our reputation may be harmed.

We face intense competition and our failure to meet this competition could adversely affect our business.

Competition for our information technology consulting services, including data warehousing, is significant and we expect that this competition will continue to intensify due to the low barriers to entry. We may not have the financial resources, technical expertise, sales and marketing or support capabilities to adequately meet this competition. We compete against numerous large companies, including, among others, multi-national and other major consulting firms. These firms have substantially greater market presence, longer operating histories, more significant client bases and greater financial, technical, facilities, marketing, capital and other resources than we have. If we are unable to compete against such competitors, our business will be adversely affected.

Our competitors may respond more quickly than us to new or emerging technologies and changes in client requirements. Our competitors may also devote greater resources than we can to the development, promotion and sales of our services. If one or more of our competitors develops and implements methodologies that result in superior productivity and price reductions without adversely affecting their profit margins, our business could suffer. Competitors may also:

- engage in more extensive research and development;
- undertake more extensive marketing campaigns;
- adopt more aggressive pricing policies; and
- make more attractive offers to our existing and potential employees and strategic partners.

In addition, current and potential competitors have established or may establish cooperative relationships among themselves or with third parties that could be detrimental to our business.

New competitors, including large computer hardware, software, professional services and other technology companies, may enter our markets and rapidly acquire significant market share. As a result of increased competition and vertical and horizontal integration in the industry, we could encounter significant pricing pressures. These pricing pressures could result in substantially lower average selling prices for our services. We may not be able to offset the effects of any price reductions with an increase in the number of clients, higher revenue from consulting services, cost reductions or otherwise. In addition, professional services businesses are likely to encounter consolidation in the near future, which could result in decreased pricing and other competition.

If we fail to adapt to the rapid technological change constantly occurring in the areas in which we provide services, including data warehousing, our business could be adversely affected.

The market for information technology consulting services and data warehousing is rapidly evolving. Significant technological changes could render our existing services obsolete. We must adapt to this rapidly changing market by continually improving the responsiveness, functionality and features of our services to meet clients' needs. If we are unable to respond to technological advances and conform to emerging industry standards in a cost-effective and timely manner, our business could be materially and adversely affected.

We depend on our management. If we fail to retain key personnel, our business could be adversely affected.

There is intense competition for qualified personnel in the areas in which we operate. The loss of existing personnel or the failure to recruit additional qualified managerial, technical and sales personnel, as well as expenses in connection with hiring and retaining personnel, particularly in the emerging area of data warehousing, could adversely affect our business. We also depend upon the performance of our executive officers and key employees in particular, Messrs. Scott Newman, Glenn Peipert and Robert C. DeLeeuw. Although we have entered into employment agreements with Messrs. Newman, Peipert and DeLeeuw, the loss of any of these individuals could have a material adverse effect upon us. In addition, we have not obtained "key man" life insurance on the lives of Messrs. Newman, Peipert or DeLeeuw.

We will need to attract, train and retain more employees for management, engineering, programming, sales and marketing, and client service and support positions. As noted above, competition for qualified employees, particularly engineers, programmers and consultants, continues to be intense. Consequently, we may not be able to attract, train and retain the personnel we need to continue to offer solutions and services to current and future clients in a cost effective manner, if at all.

If we fail to raise capital that we may need to support and increase our operations, our business could be adversely affected.

Our future capital uses and requirements will depend on several factors, including:

- the extent to which our solutions and services gain market acceptance;
- the level of revenues from current and future solutions and services;
- the expansion of operations;
- the costs and timing of product and service developments and sales and marketing activities;
- the costs related to acquisitions of technology or businesses; and
- competitive developments.

We may require additional capital in order to continue to support and increase our sales and marketing efforts, continue to expand and enhance the solutions and services we are able to offer to current and future clients and fund potential acquisitions. This capital may not be available on terms acceptable to us, if at all. In addition, we may be required to spend greater-than-anticipated funds if unforeseen difficulties arise in the course of these or other aspects of our business. As a consequence, we will be required to raise additional capital through public or private equity or debt financings, collaborative relationships, bank facilities or other arrangements. We cannot assure you that such additional capital will be available on terms acceptable to us, if at all. Further, if we raise capital though an equity or debt financing at reduced exercise or conversion price, it could trigger certain anti-dilution provisions with other investors. Any additional equity financing is expected to be dilutive to our stockholders, and debt financing, if available, may involve restrictive covenants and increased interest costs. Our inability to obtain sufficient financing may require us to delay, scale back or eliminate some or all of our expansion programs or to limit the marketing of our services. This could have a material and adverse effect on our business.

We could have potential liability for intellectual property infringement, personal injury, property damage or breach of contract to our clients that could adversely affect our business.

Our services involve development and implementation of computer systems and computer software that are critical to the operations of our clients' businesses. If we fail or are unable to satisfy a client's expectations in the performance of our services, our business reputation could be harmed or we could be subject to a claim for substantial damages, regardless of our responsibility for such failure or inability. In addition, in the course of performing services, our personnel often gain access to technologies and content which include confidential or proprietary client information.

Although we have implemented policies to prevent such client information from being disclosed to unauthorized parties or used inappropriately, any such unauthorized disclosure or use could result in a claim for substantial damages. Our business could be adversely affected if one or more large claims are asserted against us that are uninsured, exceed available insurance coverage or result in changes to our insurance policies, including premium increases or the imposition of large deductible or co-insurance requirements. Although we maintain general liability insurance coverage, including coverage for errors and omissions, there can be no assurance that such coverage will continue to be available on reasonable terms or will be available in sufficient amounts to cover one or more large claims.

We do not intend to pay dividends on shares of our common stock in the foreseeable future.

We have never paid cash dividends on our common stock other than distributions resulting from our past tax status as a Subchapter S corporation. Our current Board of Directors does not anticipate that we will pay cash dividends in the foreseeable future. Instead, we intend to retain future earnings for reinvestment in our business and/or to fund future acquisitions. In addition, the security agreement with Laurus Master Fund, Ltd. requires that we obtain their consent prior to paying any dividends on our common stock.

Our management group owns or controls a significant number of the outstanding shares of our common stock and will continue to have significant ownership of our voting securities for the foreseeable future.

Scott Newman and Glenn Peipert, our principal stockholders and our executive officers and two of our directors, beneficially own approximately 39.2% and 18.7%, respectively, of our outstanding common stock. Robert C. DeLeeuw, our Senior Vice President and President of our wholly owned subsidiary, DeLeeuw Associates, LLC, owns approximately 10.7% of our outstanding common stock. As a result, these persons will have the ability, acting as a group, to effectively control our affairs and business, including the election of directors and subject to certain limitations, approval or preclusion of fundamental corporate transactions. This concentration of ownership of our common stock may:

- delay or prevent a change in the control;
- impede a merger, consolidation, takeover or other transaction involving us; or
- discourage a potential acquirer from making a tender offer or otherwise attempting to obtain control of us.

The authorization and issuance of “blank check” preferred stock could have an anti-takeover effect detrimental to the interests of our stockholders.

Our certificate of incorporation allows the Board of Directors to issue 20,000,000 shares of preferred stock with rights and preferences set by our board without further stockholder approval. The issuance of shares of this “blank check preferred” under particular circumstances could have an anti-takeover effect. For example, in the event of a hostile takeover attempt, it may be possible for management and the board to endeavor to impede the attempt by issuing shares of blank check preferred, thereby diluting or impairing the voting power of the other outstanding shares of common stock and increasing the potential costs to acquire control of us. Our Board of Directors has the right to issue blank check preferred without first offering them to holders of our common stock, as the holders of our common stock have no preemptive rights. To date, the Company has issued 19,000 shares of Series A Convertible Preferred Stock to Taurus Advisory Group, LLC.

Our services or solutions may infringe upon the intellectual property rights of others.

We cannot be sure that our services and solutions, or the solutions of others that we offer to our clients, do not infringe on the intellectual property rights of third parties, and we may have infringement claims asserted against us or against our clients. These claims may harm our reputation, cost us money and prevent us from offering some services or solutions. In some instances, the amount of these expenses may be greater than the revenues we receive from the client. Any claims or litigation in this area, whether we ultimately win or lose, could be time-consuming and costly, injure our reputation or require us to enter into royalty or licensing arrangements. We may not be able to enter into these royalty or licensing arrangements on acceptable terms. To the best of our knowledge, we have never infringed upon the intellectual property rights of another individual or entity.

We could be subject to systems failures that could adversely affect our business.

Our business depends on the efficient and uninterrupted operation of our computer and communications hardware systems and infrastructure. We currently maintain our computer systems in our facilities at our offices in New Jersey and elsewhere. We do not have complete redundancy in our systems and therefore any damage or destruction to our systems would significantly harm our business. Although we have taken precautions against systems failure, interruptions could result from natural disasters as well as power losses, telecommunications failures and similar events. Our systems are also subject to human error, security breaches, computer viruses, break-ins, "denial of service" attacks, sabotage, intentional acts of vandalism and tampering designed to disrupt our computer systems. We also lease telecommunications lines from local and regional carriers, whose service may be interrupted. Any damage or failure that interrupts or delays network operations could materially and adversely affect our business.

Our business could be adversely affected if we fail to adequately address security issues.

We have taken measures to protect the integrity of our technology infrastructure and the privacy of confidential information. Nonetheless, our technology infrastructure is potentially vulnerable to physical or electronic break-ins, viruses or similar problems. If a person or entity circumvents its security measures, they could jeopardize the security of confidential information stored on our systems, misappropriate proprietary information or cause interruptions in our operations. We may be required to make substantial additional investments and efforts to protect against or remedy security breaches. Security breaches that result in access to confidential information could damage our reputation and expose us to a risk of loss or liability.

Risks Relating To Acquisitions

We face intense competition for acquisition candidates, and we may have limited cash available for such acquisitions.

There is a high degree of competition among companies seeking to acquire interests in information technology service companies such as those we may target for acquisition. We are expected to continue to be an active participant in the business of seeking business relationships with, and acquisitions of interests in, such companies. A large number of established and well-financed entities, including venture capital firms, are active in acquiring interests in companies that we may find to be desirable acquisition candidates. Many of these investment-oriented entities have significantly greater financial resources, technical expertise and managerial capabilities than we do. Consequently, we may be at a competitive disadvantage in negotiating and executing possible investments in these entities as many competitors generally have easier access to capital, on which entrepreneur-founders of privately-held information technology service companies generally place greater emphasis than obtaining the management skills and networking services that we can provide. Even if we are able to compete with these venture capital entities, this competition may affect the terms and conditions of potential acquisitions and, as a result, we may pay more than expected for targeted acquisitions. If we cannot acquire interests in attractive companies on reasonable terms, our strategy to build our business through acquisitions may be inhibited.

We will encounter difficulties in identifying suitable acquisition candidates and integrating new acquisitions.

A key element of our expansion strategy is to grow through acquisitions. If we identify suitable candidates, we may not be able to make investments or acquisitions on commercially acceptable terms. Acquisitions may cause a disruption in our ongoing business, distract management, require other resources and make it difficult to maintain our standards, controls and procedures. We may not be able to retain key employees of the acquired companies or maintain good relations with their clients or suppliers. We may be required to incur additional debt and to issue equity securities, which may be dilutive to existing stockholders, to effect and/or fund acquisitions.

We cannot assure you that any acquisitions we make will enhance our business.

We cannot assure you that any completed acquisition will enhance our business. Since we anticipate that acquisitions could be made with both cash and our common stock, if we consummate one or more significant acquisitions, the potential impacts are:

- a substantial portion of our available cash could be used to consummate the acquisitions and/or we could incur or assume significant amounts of indebtedness;

- losses resulting from the on-going operations of these acquisitions could adversely affect our cash flow; and

- our stockholders could suffer significant dilution of their interest in our common stock.

Also, we are required to account for acquisitions under the purchase method, which would likely result in our recording significant amounts of goodwill. The inability of a subsidiary to sustain profitability may result in an impairment loss in the value of long-lived assets, principally goodwill and other tangible and intangible assets, which would adversely affect our financial statements. Additionally, we could choose to divest any acquisition that is not profitable.

Risks Relating To Our Common Stock

Our relationship with our majority stockholders presents potential conflicts of interest, which may result in decisions that favor them over our other stockholders.
Our principal beneficial owners, Scott Newman, Glenn Peipert and Robert C. DeLeeuw, provide management and financial assistance to us. When their personal investment interests diverge from our interests, they and their affiliates may exercise their influence in their own best interests. Some decisions concerning our operations or finances may present conflicts of interest between us and these stockholders and their affiliated entities.

The limited prior public market and trading market may cause possible volatility in our stock price.

There has only been a limited public market for our securities and there can be no assurance that an active trading market in our securities will be maintained. In addition, the overall market for securities in recent years has experienced extreme price and volume fluctuations that have particularly affected the market prices of many smaller companies. The trading price of our common stock is expected to be subject to significant fluctuations including, but not limited to, the following:

- quarterly variations in operating results and achievement of key business metrics;
- changes in earnings estimates by securities analysts, if any;
- any differences between reported results and securities analysts' published or unpublished expectations;
- announcements of new contracts or service offerings by us or our competitors;
- market reaction to any acquisitions, divestitures, joint ventures or strategic investments announced by us or our competitors;
- demand for our services and products;
- shares being sold pursuant to Rule 144 or upon exercise of warrants; and
- general economic or stock market conditions unrelated to our operating performance.

These fluctuations, as well as general economic and market conditions, may have a material or adverse effect on the market price of our common stock.

We may be de-listed from the AMEX if we do not meet continued listing requirements.

Our common stock commenced trading on the AMEX on September 21, 2005. The AMEX (Part 10, Section 1003) requires stockholders' equity (for continued listing) of at least $2.0 million if a listed company has sustained net losses in its five most recent fiscal years. As of December 31, 2005, our stockholders' equity was approximately $2.3 million. However, Section 1003 includes an exception to such requirement. Specifically, AMEX will not normally consider suspending a listed company if the company (i) has a total market capitalization of at least $50 million; or total assets and revenue of $50 million each in its last fiscal year, or in two of its last three fiscal years; and (ii) the Company has at least 1.1 million shares publicly held, a market value of publicly held shares of at least $15 million and 400 round lot stockholders. The Company currently meets such exception as well, however there can be no assurance that it will continue to do so, nor that AMEX will not consider the commencement of suspending or removing the Company's listing on the AMEX.

As a result of failing to file this Form 10-KSB in a timely fashion, the Company failed to meet the continued listing requirements of the American Stock Exchange from its due date on April 17, 2006 until the date of this filing. In the future, if we fail to timely file our required reports, we could be subject to delisting.

If our common stock is de-listed by the AMEX, trading of our common stock would thereafter likely be conducted on the OTC Bulletin Board. In such case, the market liquidity for our common stock would likely be negatively affected, which may make it more difficult for holders of our common stock to sell their securities in the open market and we could face difficulty raising capital necessary for our continued operations.

Additional authorized shares of our common stock and preferred stock available for issuance may adversely affect the market.

We are authorized to issue 85 million shares of our common stock. As of March 31, 2006, there were 49,997,834 shares of common stock issued and outstanding. However, the total number of shares of our common stock issued and outstanding does not include shares reserved in anticipation of the conversion of notes or the exercise of options or warrants. As of March 31, 2006, we had 1,784,127 shares of common stock underlying convertible notes, and we have reserved shares of our common stock for issuance in connection with the potential conversion thereof. As of March 31, 2006, we had outstanding stock options and warrants to purchase approximately 10,507,113 shares of our common stock, the exercise price of which range between $0.46 and $5.25 per share, and we have reserved shares of our common stock for issuance in connection with the potential exercise thereof. Of the reserved shares, a total of 6,666,667 shares are currently reserved for issuance in connection with our 2003 Incentive Plan, of which options to purchase approximately 5,619,781 shares have been issued under the plan as of March 31, 2006. A significant number of such options and warrants contain provisions for broker-assisted exercise. To the extent such options or warrants are exercised, the holders of our common stock will experience further dilution. In addition, in the event that any future financing should be in the form of, be convertible into or exchangeable for, equity securities, and upon the exercise of options and warrants, investors may experience additional dilution.

The exercise of the outstanding convertible securities will reduce the percentage of common stock held by our stockholders. Further, the terms on which we could obtain additional capital during the life of the convertible securities may be adversely affected, and it should be expected that the holders of the convertible securities would exercise them at a time when we would be able to obtain equity capital on terms more favorable than those provided for by such convertible securities. As a result, any issuance of additional shares of common stock may cause our current stockholders to suffer significant dilution which may adversely affect the market.

In addition to the above-referenced shares of common stock which may be issued without stockholder approval, we have 20 million shares of authorized preferred stock, the terms of which may be fixed by our Board of Directors. To date, the Company has issued 19,000 shares of Series A Convertible Preferred Stock to Taurus Advisory Group LLC. While we presently have no present plans to issue any more additional shares of preferred stock, our Board of Directors has the authority, without stockholder approval, to create and issue one or more series of such preferred stock and to determine the voting, dividend and other rights of holders of such preferred stock. The issuance of any of such series of preferred stock may have an adverse effect on the holders of common stock.

Shares eligible for future sale may adversely affect the market.

From time to time, certain of our stockholders may be eligible to sell all or some of their shares of common stock by means of ordinary brokerage transactions in the open market pursuant to Rule 144, promulgated under the Securities Act of 1933 (Securities Act), subject to certain limitations. In general, pursuant to Rule 144, a stockholder (or stockholders whose shares are aggregated) who has satisfied a one-year holding period may, under certain circumstances, sell within any three-month period a number of securities which does not exceed the greater of 1% of the then outstanding shares of common stock or the average weekly trading volume of the class during the four calendar weeks prior to such sale. Rule 144 also permits, under certain circumstances, the sale of securities, without any limitation, by our stockholders that are non-affiliates that have satisfied a two-year holding period. Any substantial sale of our common stock pursuant to Rule 144 or pursuant to any resale prospectus may have material adverse effect on the market price of our securities.

Director and officer liability is limited.

As permitted by Delaware law, our certificate of incorporation limits the liability of our directors for monetary damages for breach of a director's fiduciary duty except for liability in certain instances. As a result of our charter provision and Delaware law, stockholders may have limited rights to recover against directors for breach of fiduciary duty. In addition, our certificate of incorporation provides that we shall indemnify our directors and officers to the fullest extent permitted by law.

ITEM 2. DESCRIPTION OF PROPERTY

The Company's corporate headquarters are located at 100 Eagle Rock Avenue, East Hanover, New Jersey 07936, where it operates under an amended lease agreement expiring December 31, 2010. In addition to minimum rentals, the Company is liable for its proportionate share of real estate taxes and operating expenses, as defined. DeLeeuw Associates, LLC has an office at Suite 1460, Charlotte Plaza, 201 South College Street, Charlotte, North Carolina 28244. DeLeeuw leases this space which has a stated expiration date of December 31, 2010. The Company also leases office space at 11 Penn Plaza, New York, NY 10001. The current lease expiration date is March 31, 2007.

The Company is committed under several operating leases for automobiles that expire during 2007.

See Note 20 to the Notes to Consolidated Financial Statements.

ITEM 3. LEGAL PROCEEDINGS

On August 1, 2005, Sridhar Bhupatiraju and Scosys, Inc. commenced legal action against the Company in the Superior Court of New Jersey. The complaint alleges, among other things, the Company's failure to make certain payments pursuant to an asset purchase agreement with Scosys, Inc. and the Company's failure to make certain payments to Sridhar Bhupatiraju in accordance with his employment agreement with the Company. The plaintiffs are seeking unspecified compensatory damages, punitive damages, fees and other costs. On September 30, 2005, the Company filed its answer to complaint and third-party complaint against Scorpio Systems, alleging that Mr. Bhupatiraju embarked on a scheme to circumvent his contractual obligations under the asset purchase agreement, his non-compete agreement with the Company, and in violation of his duties of loyalty and fidelity to his employer (the Company) via Scorpio Systems, among other things Notwithstanding Mr. Bhupatiraju's contractual obligations, the Company alleges that he sold the assets of Scosys while at the same time operating and/or owning a competing business, Scorpio Systems. Management believes the suit against the Company to be without merit and intends to vigorously defend the Company against this action and pursue its countersuit.

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

No matters were submitted to a vote of security holders during the fourth quarter of the fiscal year ended December 31, 2005.

PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

(a) ***Market Information***. Our common stock traded on the OTC Bulletin Board, except as indicated below, and/or the Pink Sheets LLC under the symbol “LCSI” from July 16, 2003 through February 2, 2004. From February 3, 2004 through September 20, 2005, our common stock traded on the OTC Bulletin Board under the symbol “CSII.” On September 21, 2005, our common stock began trading on the American Stock Exchange under the symbol “CVN.”

The following chart sets forth the high and low sales prices for each quarter from January 1, 2004 through September 20, 2005 and the closing high and low sales prices of the Company’s common stock as reported by the American Stock Exchange for each quarter from September 20, 2005 through March 31, 2006. All numbers give effect to a 1 for 15 reverse stock split effected on September 20, 2005.

	High	Low
2004 by Quarter		
January 1 - March 31	$ 3.75	$ 1.80
April 1 - June 30	$ 3.975	$ 1.65
July 1 - September 30	$ 4.65	$ 2.70
October 1 - December 31	$ 3.75	$ 2.40
2005 by Quarter		
January 1 - March 31	$ 3.825	$ 2.175
April 1 - June 30	$ 4.20	$ 1.67
July 1 - September 30	$ 2.33	$ 1.28
October 1 - December 31	$ 2.01	$ 0.40
2006 by Quarter		
January 1 - March 31	$ 1.49	$ 0.41

Our Common stock is listed on the American Stock Exchange. On March 31, 2006, the closing price for shares of our common stock, as reported by the American Stock Exchange, was $1.03.

No prediction can be made as to the effect, if any, that future sales of shares of our common stock or the availability of our common stock for future sale will have on the market price of our common stock prevailing from time-to-time. The additional registration of our common stock and the sale of substantial amounts of our common stock in the public market could adversely affect the prevailing market price of our common stock.

(b) ***Record Holders***. As of March 31, 2006, there were 475 registered holders of our common stock, including shares held in street name. As of March 31, 2006, there were 49,997,834 shares of common stock issued and outstanding.

(c) ***Dividends***. We have not paid dividends on our common stock in the past and do not anticipate doing so in the foreseeable future. We currently intend to retain future earnings, if any, to fund the development and growth of our business. In addition, the security agreement with Laurus Master Fund, Ltd. requires that we obtain their consent prior to paying any dividends on our common stock.

(d) ***Sales of Unregistered Securities***

During the period covered by this Annual Report, we did not issue any securities that were not registered under the Securities Act of 1933, as amended, except as previously included in a quarterly report on Form 10-QSB or a current report on Form 8-K.

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

Overview of our Business

Management's Discussion and Analysis contains statements that are forward-looking. These statements are based on current expectations and assumptions that are subject to risks and uncertainties. Actual results could differ materially because of factors discussed in "Risk Factors" and elsewhere in this report. The Company undertakes no duty to update any forward-looking statement to conform the statement to actual results or changes in the Company's expectations.

Conversion Services International, Inc. provides professional services to the Global 2000, as well as mid-market clientele relating to strategic consulting, data warehousing, business intelligence and data management and, through strategic partners, the sale of software which is used to survey and quantify the quality of data. The Company's services based clients are primarily in the financial services, pharmaceutical, healthcare and telecommunications industries, although it has clients in other industries as well. The Company's clients are primarily located in the northeastern United States. The Company is committed to being a leader in data warehousing and business intelligence consulting, enabling it to be a valuable asset and trusted advisor to its customers. See Item 1 - Business for a full description of our services and offerings.

The Company began operations in 1990. Its services were originally focused on e-business solutions and data warehousing. In the late 1990s, the Company strategically repositioned itself to capitalize on its data warehousing expertise in the fast growing business intelligence/data warehousing space. The Company became a public company via its merger with a wholly owned subsidiary of LCS Group, Inc., effective January 30, 2004.

The Company's core strategy includes capitalizing on the already established in-house business intelligence/data warehousing ("BI/DW") technical expertise and its seasoned sales force. This is expected to result in organic growth through the addition of new customers. In addition, this foundation will be leveraged as the Company pursues targeted strategic acquisitions.

The Company derives a majority of its revenue from professional services engagements. Its revenue depends on the Company's ability to generate new business, in addition to preserving present client engagements. The general domestic economic conditions in the industries the Company serves, the pace of technological change, and the business requirements and practices of its clients and potential clients directly affect this. When economic conditions decline, companies generally decrease their technology budgets and reduce the amount of spending on the type of information technology (IT) consulting the Company provides. The Company's revenue is also impacted by the rate per hour it is able to charge for its services and by the size and chargeability, or utilization rate, of its professional workforce. If the Company is unable to maintain its billing rates or sustain appropriate utilization rates for its professionals, its overall profitability may decline. The Company continues to see improvements in economic conditions, which have recently led to increased spending on consulting services in certain vertical markets, particularly in financial services. The Company's growing national presence and experienced, highly skilled workforce have enabled it to successfully differentiate its value and capabilities from those of its competitors, in effect, lessening the impact of current market pricing pressures.

The Company will continue to focus on a variety of growth initiatives in order to improve its market share and increase revenue. Moreover, as the Company endeavors to achieve top line growth, it will concentrate on improving margins and driving earnings to the bottom line. The Company will continue its best efforts to improve margins by limiting its use of outside consultants as employees provide higher levels of profitability. In addition, it will complement its service offerings with higher level management consulting opportunities, and continuously evaluating the size of its workforce in order to balance the Company's skill base with the market demand for services.

In addition to the conditions described above for growing the Company's current business, the Company will continue to grow through acquisitions. One of the Company's objectives is to make acquisitions of companies offering services complementary to the Company's lines of business. This is expected to accelerate the Company's business plan at lower costs than it would generate internally and also improve its competitive positioning and expand the Company's offerings in a larger geographic area. The service industry is very fragmented, with a handful of large international firms having data warehousing and/or business intelligence divisions, and hundreds of regional boutiques throughout the United States. These smaller firms do not have the financial wherewithal to scale their businesses or compete with the larger players. To that end, the service industry has experienced consolidation during the past 24 months and the Company has been a participant in this consolidation. The Company has been active in acquiring companies during the last two years:

° In March 2004, the Company acquired DeLeeuw Associates, a management consulting firm in the information technology sector with core competency in delivering Change Management Consulting, including both Six Sigma and Lean domain expertise to enhance service delivery, with proven process methodologies resulting in time to market improvements within the financial services and banking industries. Historically, the DeLeeuw Associates business was involved in the operational integration of mergers and acquisitions, and would prescribe the systems integration work necessary. DeLeeuw Associates has now begun to sell the expanded suite of services offered by the Company, from operational integration to systems integration.

° In May 2004, the Company acquired 49% of all issued and outstanding shares of common stock of Leading Edge Communications Corporation ("LEC"). LEC provides enterprise software and services solutions for technology infrastructure management.

° In June 2004, the Company acquired substantially all of the assets and assumed substantially all of the liabilities of Evoke Software Corporation, which designed, developed, marketed and supported software programs for data analysis, data profiling and database migration applications and provides related support and consulting services. In July 2005, the Company divested substantially all of the assets of Evoke Software Corporation. The market for software has changed, and the Company determined that data profiling should no longer be a standalone product and needed to be part of a suite of tools. This is evidenced by the subsequent acquisition of the Evoke software product by Similarity Systems in July 2005 and then Informatica in January 2006.

° In July 2005, the Company acquired McKnight Associates, Inc. Since inception, McKnight Associates has focused on successfully designing, developing and implementing data warehousing and business intelligence solutions for its clients in numerous industries. Mr. William McKnight, the founder of McKnight Associates who joined the Company as Senior Vice President - Data Warehousing, is a well-known industry leader, frequently speaks at national trade shows and contributes to major data management trade publications.

° In July 2005, the Company acquired Integrated Strategies, Inc. ("ISI"). With offices in New York City, ISI is a professional services firm with a solutions-oriented approach to complex business and technical challenges. Similar to our wholly owned subsidiary, DeLeeuw Associates, which is best known for its large-scale merger integration management and business process change programs for the financial services markets, ISI also counts many industry leaders in this sector among its customers. Because of this shared focus, the operations of ISI were essentially folded into DeLeeuw Associates.

The Company's most significant costs are personnel expenses, which consist of consultant fees, benefits and payroll-related expenses.

Results of Operations

The following table sets forth selected financial data for the periods indicated:

	Selected Statement of Operations Data for the Years Ended December 31,	
	2005	2004
Net Revenue	$ 27,269,909	$ 23,893,106
Gross Profit	7,097,506	5,046,129
Net loss from continuing operations	(3,386,378)	(22,697,298)
Loss from discontinued operations	(1,103,971)	(12,650,908)
Net loss	(4,490,349)	(35,348,206)
Basic loss per share		
From continuing operations	$ (0.06)	$ (0.49)
From discontinued operations	$ (0.02)	$ (0.27)
Net loss per share	$ (0.08)	$ (0.76)
Diluted loss per share:		
From continuing operations	$ (0.06)	$ (0.49)
From discontinued operations	$ (0.02)	$ (0.27)
Net loss per share	$ (0.08)	$ (0.76)

	Selected Statement of Financial Position Data for the Years Ended December 31,	
	2005	2004
Working capital	$ (6,959,936)	$ (13,923,181)
Total assets	18,478,469	28,868,029
Long-term debt	3,042,914	6,659,449
Related party debt	1,772,368	307,981
Total stockholders' equity	2,257,063	1,294,522

Years Ended December 31, 2005 and 2004

Revenues for the Company are categorized by strategic consulting, business intelligence, data warehousing and data management. They are reflected in the chart below as a percentage of overall revenues:

Category of Services	Percentage of Revenues for the year ended December 31,	
	2005	2004
Strategic Consulting	40.6%	35.9%
Business Intelligence	22.4%	22.7%
Data Warehousing	22.8%	16.7%
Data Management	13.2%	23.4%
Software & Support	0.0%	1.0%
Other	1.0%	0.3%

Strategic consulting revenues were 40.6% of total revenues for the year ended December 31, 2005, increasing by 4.7% as compared to 35.9% of total revenues for the comparable prior year period. During March 2004, the Company acquired DeLeeuw Associates, whose revenue base is entirely in the strategic consulting category of services. In July

2005, the Company acquired Integrated Strategies, Inc. (ISI), whose revenue base is also entirely in the strategic consulting category of services. DeLeeuw and ISI account for all of the Company's strategic consulting revenues. For the year ended December 31, 2005, DeLeeuw revenues were $9.3 million, as compared to $5.5 million year ended December 31, 2004, representing an increase of $3.8 million. The increase is mostly attributable to the increase in revenues at DeLeeuw's largest client, which represented a $3.5 million increase in billings for the year ended December 31, 2005 and the addition of a new client that produced $0.7 million in revenues for that period. ISI's revenues were $1.9 million for the year ended December 31, 2005.

41

The DeLeeuw Associates acquisition in 2004 and the ISI acquisition in 2005 increased the Company's revenue base and, as a result, the percentage of revenues contributed by each of the other services categories was impacted by the increased overall revenues in the strategic consulting category. The Company intends to continue to focus on increasing revenues in the strategic consulting, business intelligence and data warehousing lines of business during 2006 and is de-emphasizing the data management line of business since this category is less profitable to the Company than the other service categories.

Business intelligence service revenues were 22.4% of total revenues for the year ended December 31, 2005, decreasing by 0.3% as compared to 22.7% of total revenues for the comparable prior year period. On an absolute dollar basis, business intelligence revenues increased by $1.3 million for the year ended December 31, 2005 from $5.4 million for the year ended December 31, 2004 to $6.2 million for the year ended December 31, 2005. This increase is primarily attributable to an increase in average billing rates of 19.2% for the year ended December 31, 2005 versus the prior period, though it is partially offset by a 12.0% decrease in billable hours for this line of business. The increase in billing rates is attributable to the utilization of higher skilled consultants, while the decrease in billable hours is attributable to the reduction in the number of consultants utilized. The average number of consultants utilized for the year ended December 31, 2005 decreased by 10.9% as compared to the prior year.

Data warehousing revenues were 22.8% of total revenues for the year ended December 31, 2005, increasing by 6.1% as compared to 16.7% of total revenues for the comparable prior year period. On an absolute dollar basis, data warehousing revenues increased by $1.4 million for the year ended December 31, 2005, partially attributable to $0.5 million of revenues from McKnight Associates, from $4.9 million for the year ended December 31, 2004 to $6.3 million for the year ended December 31, 2005. This increase for the year ended December 31, 2005 is primarily attributable to a 48.7% increase in total hours billed in this line of business for the period versus the same period in the prior year, though it is partially offset by a 13.2% decrease in billable rates for this line of business. The increase in billable hours is attributable to an increase in number of consultants utilized, which includes contributions of McKnight Associates, whose business is concentrated in data warehousing. The decrease in billable rates is primarily attributable to a reduction of higher-skilled consultants utilized by the Company. The average number of consultants utilized for the year ended December 31, 2005 increased by 57.1% as compared to the prior year.

Data management revenues were $3.6 million, or 13.2% of total revenues, for the year ended December 31, 2005, decreasing by $1.8 million, or 10.2% as compared to $5.4 million, or 23.4% of total revenues, for the comparable prior year period. This category of services is less profitable to the Company than the other service categories and, as a result, is being de-emphasized and the Company's resources are being focused on the more profitable service categories.

Years ended December 31, 2005 and 2004

Revenue

The Company's revenues are primarily comprised of billings to clients for consulting hours worked on client projects. Revenues for the year ended December 31, 2005 were $27.6 million, an increase of $3.7 million, or 15.6%, as compared to revenues of $23.9 million for the year ended December 31, 2004.

Services

Services revenues for the year ended December 31, 2005 were $23.4 million, an increase of $3.6 million, or 18.4% of services revenues, as compared to services revenues of $19.8 million for the year ended December 31, 2004, respectively. DeLeeuw Associates contributed an additional $3.8 million of services revenue during the year ended December 31, 2005 as compared to the 10 month period subsequent to the acquisition of DeLeeuw Associates in the prior year. ISI contributed $1.9 million during the current year. Partially offsetting this increase is a reduction in revenues from services of $2.1 million relating to a decrease in the number of consultants in the ongoing CSI business. Exclusive of DeLeeuw Associates, billable hours declined by 25.7% due to a 19.0% reduction in the number of consultants on billing for the year ended December 31, 2005 compared to the same period for the prior year. This decline in the number of consultants on billing was attributable to the completion of certain client engagements, which resulted in unutilized consultant time for significant portions of the year ended December 31, 2005.

Related party services

Revenues from related parties for the year ended December 31, 2005 were $3.7 million, representing a decrease of $0.1 million, or 2.8% as compared to related party revenues of $3.8 million for the year ended December 31, 2004. The decrease for the year ended December 31, 2005 compared to the same period in the prior year, is primarily attributed to a 16.5% reduction in billable hours for the year ended December 31, 2005 versus the same period for the prior year. This is mostly offset by a 11.6% increase in billable rates. The decrease in billable hours is attributable to a reduction in the number of consultants required by our related party.

Cost of revenue

Cost of revenue primarily includes payroll and benefits costs for the Company's consultants. Cost of revenue was $20.5 million, or 74.3% of revenue, for the year ended December 31, 2005, compared to $18.8 million, or 78.9% of total revenue, for the year ended December 31, 2004, representing an increase of $1.7 million, or 8.9% as compared to the prior year. Cost of revenue for the year ended December 31, 2004 included a $1.4 million charge for stock based compensation. The cost of revenue would have been $17.4 million had this charge not occurred, or 73.0% of cost of revenue. The cost of revenue would have increased by 1.3% for the year ended December 31, 2005 compared to the year ended December 31, 2004.

Services

Cost of services was $17.3 million, or 74.0% of services revenue, for the year ended December 31, 2005, compared to $15.4 million, or 77.8% of services revenue, for the year ended December 31, 2004, representing an increase of $1.9 million, or 12.7%. DeLeeuw Associates generated a $2.4 million increase in cost of services, directly associated with its increase in revenues in this category, for the year ended December 31, 2005 as compared to the 10 month period subsequent to the acquisition of DeLeeuw Associates in the prior year. ISI and McKnight contributed a cost of services of $1.5 million and $0.4 million in 2005. Partially offsetting this increase was a reduction in cost of services of $0.5 million resulting from a 25.7% decrease in billable hours due to a 19.0% reduction in the number of consultants on billing and a 22.0% increase in the average pay rates for consultants. This shift reflects the higher skilled consultants employed in the categories of strategic consulting and data warehousing, whose revenues increase as a percentage of revenues as compared to the lower skilled consultants required in the shrinking category of data management.

Related party services

Cost of related party services was $3.2 million, or 86.2% of related party services revenue, for the year ended December 31, 2005, compared to $3.3 million, or 87.2% of related party services revenue, for the year ended December 31, 2004, respectively. The decreased cost as a percentage of related party services revenue is due to a 16.5% decrease in hours offset by an 18.2% increase in average pay rate. The decrease in billable hours is attributable to a reduction in the number of consultants utilized, while the increase in average pay reflects a reduction in the use of lower skilled consultants, resulting in an average higher pay rate.

Gross Profit

Gross profit was $7.1 million, or 25.7% of total revenue, for the year ended December 31, 2005, compared to $5.0 million, or 21.1% of total revenue, for the year ended December 31, 2004. Gross profit for the year ended December 31, 2004 included a $1.4 million charge for stock based compensation. The gross profit would have been 27.0% had this charge not occurred, in which case gross profit would have decreased by 1.3% for the year ended December 31, 2005 compared to the year ended December 31, 2004.

As a percentage of total gross profit for the years ended December 31, 2005 and 2004, respectively, services contributed 85.6% and 87.0% (89.8% if the charge for stock-based compensation had not occurred), respectively, related party services contributed 7.3% and 9.7% (7.6% if the charge for stock-based compensation had not occurred), respectively, and other, including software, support and maintenance contributed 7.1% and 3.3% (2.6% if the charge for stock-based compensation had not occurred), respectively,.

Services

Gross profit from services was $6.1 million, or 26.0% of services revenue, for the year ended December 31, 2005, an increase of $1.7 million as compared to $4.4 million, or 22.2% services revenue, for the year ended December 31, 2004, respectively. Gross profit from services for the year ended December 31, 2004 included a $1.4 million charge for stock based compensation. The gross profit from services would have been $5.8 million or 29.3% for the year ended December 31, 2004 had this charge not occurred, or an increase instead of $0.3 million from the year ended December 31, 2005 compared to the year ended December 31, 2004.

DeLeeuw Associates contributed a 34.1% gross profit for the year ended December 31, 2005 as compared to a 33.0% gross profit for the year ended December 31, 2004. Exclusive of DeLeeuw Associates, the Company contributed a 21.5% gross profit for the year ended December 31, 2005 as compared to a 25.1% gross profit for the year ended December 31, 2004 (had the aforementioned charge for stock based compensation not occurred).

Exclusive of DeLeeuw Associates, billable hours declined by 25.7% due to a 19.0% reduction in the number of consultants on billing for the year ended December 31, 2005 compared to the same period for the prior year. The decrease in billable hours, along with a 22% increase in average pay rate, accounted for the decrease in gross profit. The decrease in billable hours is attributable to a reduction in the number of consultants utilized, resulting from unutilized consultant time for significant portions of the year ended December 31, 2005. This cost had to be absorbed by the Company while the consultants were not utilized. The increase in average pay reflects a reduction in the use of lower skilled consultants, resulting in an average higher pay rate.

Related party services

Gross profit for related party services was $0.5 million, or 13.8% of related party services revenue, for the year ended December 31, 2005, compared to $0.5 million, or 12.8% of related party services revenue, for the year ended December 31, 2004, respectively. Gross profit was flat due to a 11.6% increase in billable rates, which was impacted by an 18.2% increase in average pay rate, as well as a 16.5% reduction in billable hours. The decrease in billable hours is attributable to a reduction in the number of consultants utilized, while the increase in average pay reflects a reduction in the use of lower skilled consultants, resulting in an average higher pay rate.

Selling and marketing

Selling and marketing expenses include payroll, employee benefits and other headcount-related costs associated with sales and marketing personnel and advertising, promotions, tradeshows, seminars and other programs. Selling and marketing expenses were $4.5 million, or 16.4% of revenue for the year ended December 31, 2005, compared to $3.2 million, or 13.4% of revenue for the year ended December 31, 2004, representing an increase of $1.3 million, or 5.5% of revenue, as compared to the prior year. $0.7 million of this increase relates to increased payroll expense, of which $0.4 million relates to the reclassification of a senior executive of the Company from general and administrative expense to sales and marketing expense and $0.3 million of the increase relates to increases in salaries and commissions. Additionally, $0.2 million of the increase relates to increased advertising, public relations and trade show expense during the year as the Company has continued to increase its visibility in the industry and the marketplace, $0.2 million relates to the acquisition of ISI in 2005, and the remaining $0.2 million primarily relates to increased professional fees, travel and subscriptions.

General and administrative

General and administrative costs include payroll, employee benefits and other headcount-related costs associated with the finance, legal, facilities, certain human resources and other administrative headcount, and legal and other professional and administrative fees. General and administrative costs were $6.4 million, or 23.2% of revenue for the year ended December 31, 2005 compared to $6.1 million, or 25.5% of revenue for the year ended December 31, 2004, representing an increase of $0.3 million, or 1.4% of revenues, as compared to the prior year. General and administrative expense increased by $0.4 million as a result of the ISI and McKnight Associates acquisitions that occurred during 2005. Additionally, the Company recorded charges of $0.5 million in 2005 due to issuances of stock at below market prices, professional fees and insurance expense increased by $0.2 million, and other expenses increased by $0.1 million. These increases were partially offset by a $0.2 million reduction in bad debt expense, a $0.3 million reduction in current year expense due to costs associated with the addition of certain employees of Software Forces and the LCS reverse merger in 2004, and $0.4 million reduction due to the reclassification of a senior executive of the Company.

Goodwill and intangibles impairment

Impairment of goodwill of $1.3 million for the year ended December 31, 2005 resulted from the Company's annual impairment review of the goodwill for the ISI and McKnight Associates acquisitions which occurred in 2005. Statement of Financial Accounting Standards No. 142 ("SFAS No. 142"), *"Goodwill and Other Intangible Assets"*, instructs the Company to test intangible assets for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. There were no specific events or changes in circumstances in either of the two acquired companies that would have required an interim impairment charge. The Company performed its annual impairment review as of December 31, 2005 and determined that a goodwill impairment charge of $0.8 million was required relating to the goodwill associated with the ISI acquisition and $0.5 million related to the goodwill associated with the McKnight Associates acquisition. The $12.2 million impairment charge for the year ended December 31, 2004 resulted from an $11.5 million impairment of the DeLeeuw Associates goodwill and a $0.7 million impairment of goodwill recorded for other Company assets.

Depreciation and amortization

Depreciation expense is recorded on the Company's property and equipment which is generally depreciated over a period between three to seven years. Amortization of leasehold improvements is taken over the shorter of the estimated useful life of the asset or the remaining term of the lease. The Company amortizes deferred financing costs utilizing the effective interest method over the term of the related debt instrument. Acquired software is amortized on a straight-line basis over an estimated useful life of three years. Acquired contracts are amortized over a period of time that approximates the estimated life of the contracts, based upon the estimated annual cash flows obtained from those contracts, generally five to six years. Depreciation and amortization expenses were $0.9 million for the year ended December 31, 2005 compared to $0.5 million for the year ended December 31, 2004, representing an increase of $0.4 million as compared to the prior year. $0.2 million of this increase relates to amortization of intangibles associated with the McKnight Associates acquisition which occurred in 2005. The remaining $0.2 million increase relates to the amortization of the deferred financing costs being amortized for a full year in 2005 as opposed to four months in 2004.

Interest Expense

The Company incurs interest expense on loans from financial institutions, from capital lease obligations related to the acquisition of equipment used in its business, and on outstanding convertible line of credit notes. Amortization of the discount on debt issued of $2.9 million and $0.9 million for the years ended December 31, 2005 and 2004, respectively, is also recorded as interest expense. In 2004, a $1.2 million charge for a beneficial conversion feature was also recorded as interest expense. Interest expense recorded was $4.2 million for the year ended December 31, 2005 compared to $5.0 million for the year ended December 31, 2004. This increase is primarily related to the Laurus, Sands and Taurus financing transactions described below in the Liquidity and Capital Resources section.

Other income (expense)

The Company recorded interest income of $69,000 and no other income for the year ended December 31, 2005, compared to interest income of $22,000 and other income of $7,300 for the year ended December 31, 2004. The Company recorded equity income in its investments in DeLeeuw International (Turkey) and Leading Edge Communications Corporation of approximately $5,000 for the year ended December 31, 2005 and $6,000 for the year ended December 31, 2004.

The Company adjusts the fair value of its financial instruments relating to its warrant and embedded derivative liabilities each quarter and records a gain or loss on the instruments. During the year ended December 31, 2005, the Company recorded a $8.4 million gain on the financial instruments and during the year ended December 31, 2004, the Company recorded a $0.6 million loss on the financial instruments. For accounting purposes, the Company recorded the renegotiation of the Laurus debt instruments in July 2005 and November 2005 as early extinguishments of debt and recorded the remaining discount and liability to gain or loss on the early extinguishments of debt. See Footnote 10 of the Notes to the Consolidated Financial Statements for further discussion.

Income Taxes

The Company evaluates the amount of deferred tax assets that are recorded against expected taxable income over its forecasting cycle which is currently two years. As a result of this evaluation, the Company has recorded a valuation allowance of $10.1 million and $8.0 million during the years ended December 31, 2005 and 2004, respectively. This allowance was recorded because, based on the weight of available information, it is more likely than not that some, or all, of the deferred tax asset may not be realized.

Years Ended December 31, 2004 and 2003

Revenue

Revenues for the Company are categorized by strategic consulting, business intelligence, data warehousing and data management. They are reflected in the chart below as a percentage of overall revenues:

Category of Services	Percentage of Revenues for the year ended December 31,	
	2004	2003
Strategic Consulting	35.9%	17.3%
Business Intelligence	22.7%	22.2%
Data Warehousing	16.7%	14.8%
Data Management	23.4%	45.7%
Software	1.0%	0.0%
Other	0.3%	0.0%

Strategic consulting revenues increased from 17.3% to 35.9% of total revenues for the years ended December 31, 2003 and 2004, respectively. This is primarily attributable to the $5.4 million, or 62.8% of strategic consulting revenues, derived from DeLeeuw Associates which was acquired by the Company in March 2004. After the acquisition of DeLeeuw Associates, the CSI core business flowed all strategic consulting work through DeLeeuw Associates. Excluding DeLeeuw Associates, strategic consulting revenues as a percent of total revenue for the year ended December 31, 2004 were 16.1%, a decrease of 1.2% from the 17.3% in the comparable prior year period. During 2004, the Company obtained new business and increased existing client business in this segment by 4.1% of total 2004 revenues, however, due to the acquisition of a new software business segment in 2004 which resulted in a larger revenue base attributable to a new business segment, the overall percentage of comparable year-to-year revenues (excluding the 2004 impact of the DeLeeuw Associates acquisition) declined.

Business intelligence services revenues were 22.7% of total revenues for the year ended December 31, 2004, increasing by 0.5% of revenues as compared to 22.2% for the comparable prior year period. While the percentage of total revenues attributable to this category increased in 2004 as compared to the prior year, the increase is primarily due to the acquisition of DeLeeuw Associates, which substantially increased revenues in the strategic consulting line of business. On an absolute dollar basis, revenues in this category of $5.4 million for the year ended December 31, 2004 increased by $2.2 million, or 68.8%, from $3.2 million for the year ended December 31, 2003.

Data warehousing revenues represented 16.7% of total revenues for the year ended December 31, 2004, increasing by 1.9% of total revenues from 14.8% for the year ended December 31, 2003. While the percentage of total revenues attributable to this category remained constant in 2004 as compared to the prior year, this is primarily due to the acquisition of DeLeeuw Associates which substantially increased revenues in the strategic consulting line of business. On an absolute dollar basis, however, revenues in this category of $4.0 million for the year ended December 31, 2004 increased by $1.8 million, or 81.8%, from $2.2 million for the year ended December 31, 2003.

Data management revenues decreased as a percentage of total revenues by 22.4% of revenues, from 45.7% for the year ended December 31, 2003 to 23.4% for the year ended December 31, 2004. While the percentage of total revenues attributable to this category declined in 2004 as compared to the prior year, 15.4% of the decline is due to the acquisition of DeLeeuw Associates which substantially increased revenues in the strategic consulting line of business and 5.4% of the decline is due to a shift in the mix of the Company’s business from the data management line of business to the strategic consulting, business intelligence and data warehousing lines of business in 2004. In absolute dollars, 2004 revenues in the data management line of business of $5.7 million, decreased by $0.9 million, or 13.6%, from $6.6 million for the year ended December 31, 2003.

The Company’s revenues are primarily comprised of billings to clients for consulting hours worked on client projects. Revenues for the year ended December 31, 2004 were $23.9 million, an increase of $9.5 million, or 66.0%, over revenues of $14.4 million for the year ended December 31, 2003.

Services

Revenues from services for the year ended December 31, 2004 were $19.8 million, an increase of $5.8 million, or 41.4%, over revenues of $14.0 million for the year ended December 31, 2003. $5.5 million, or 27.3% of 2004 services revenues relates to revenues derived from DeLeeuw Associates which was acquired by the Company in March 2004. The remaining $0.4 million of increased 2004 revenue as compared to the prior year relates to an increase in the average billing rates coupled with a reduction in hours billed. The Company experienced a 15.9% increase in the average billing rate in 2004 as compared to the prior year, exclusive of the impact of the DeLeeuw Associates acquisition. This is a direct result of the increased revenues in the strategic consulting and business intelligence segments, both of which command higher billing rates than the other segments. Hours billed for time and material based work in 2004 were approximately 16.2% less than hours billed in 2003. This decline is partially due to resources that were utilized on a substantial fixed-price project that was undertaken by the Company during 2004. Additionally, the Company experienced some attrition in the consulting workforce coupled with increased nonbillable time due to gaps in the completion of ongoing assignments versus the start dates of new assignments.

Related party services

Revenues from related parties for the year ended December 31, 2004 were $3.8 million, an increase of $3.4 million over revenues of $0.4 million for the year ended December 31, 2003. The increase in 2004 results from a full year of invoicing to LEC during 2004, versus six weeks in the prior year, under the independent contractor agreement executed by the Company and LEC in November 2003. Additionally, the average billing rate increased by 7.6% in 2004 as compared to 2003 which is primarily due to the hiring of six higher level consultants for a project obtained by this related party.

Software

Software revenues are derived from the sale of third-party software to our clients as part of a consulting engagement. Revenues from software for the year ended December 31, 2004 were $0.2 million as compared to zero in the prior year.

Cost of revenue

Cost of revenue primarily includes payroll and benefits costs for the Company's consultants as well as the cost of software that is sold or licensed by the company. Cost of revenue was $18.8 million, or 78.9% of revenue for the year ended December 31, 2004, compared to $10.3 million, or 71.5% of revenue for the year ended December 31, 2003.

Services

Cost of services was $15.4 million, or 77.8% of services revenue for the year ended December 31, 2004, compared to $10.0 million, or 71.2% of services revenue for the year ended December 31, 2003. Cost of revenue for DeLeeuw Associates, which was acquired by the Company on March 4, 2004, for the period March 4, 2004 through December 31, 2004 was $3.7 million, or 18.6% of services revenues. Additionally, during 2004, the Company recorded a stock-based compensation charge of $1.4 million, or 7.0% of services revenues, to cost of services. Cost of services for the Company (excluding DeLeeuw Associates and the stock-based compensation charge) for the year ended December 31, 2004 were $10.3 million, an increase of $0.3 million, or 3.0%, as compared to $10.0 million for the year ended December 31, 2003. This increase is attributed to a 15.7% average increase in compensation cost, in 2004, for the Company's consulting force as compared to the prior year. This increase is primarily attributable to hiring highly skilled consultants in the strategic consulting, data warehousing and business intelligence lines of business.

Related party services

Cost of related party services was $3.3 million, or 87.2% of related party services revenue for the year ended December 31, 2004, compared to $0.3 million, or 82.5% of related party services revenue for the year ended December 31, 2003. The increase in 2004 results from a full year of costs related to the consultants which are providing services for this related party in 2004, versus six weeks of cost incurred in the prior year. Further, the increase in 2004 reflects the cost of six higher level consultants hired for specialized work during the year and annual increases for the consulting force.

Software

Cost of software was $0.1 million, or 72.6% of software revenue for the year ended December 31, 2004, compared to zero for the year ended December 31, 2003.

Gross Profit

Gross profit was $5.0 million, or 21.1% of revenue for the year ended December 31, 2004, compared to $4.1 million, or 28.5% of revenue for the year ended December 31, 2003.

As a percentage of total gross profit for the years ended December 31, 2004 and 2003, services contributed 87.0% and 98.4%, respectively, related party services contributed 9.7% and 1.6%, respectively, software contributed 3.3% and zero, respectively.

The gross profit percentage for the year ended December 31, 2004, was 33.2% and 17.5% for DeLeeuw Associates and ongoing operations of the Company, respectively. The Company's gross profit percentage for the year ended December 31, 2003 was 28.5%. There is no comparable prior year amount for DeLeeuw Associates as they were acquired by the Company in 2004.

Services

Gross profit from services was $4.4 million, for the year ended December 31, 2004, an increase of $0.4 million, or 10.0%, as compared to $4.0 million for the year ended December 31, 2003. As a percent of services revenues, gross profit of 22.2% for the year ended December 31, 2004 represented a decrease of 6.6% points as compared to 28.8% of services revenues for the year ended December 31, 2003. The Company recorded a $1.4 million stock-based compensation charge during 2004 which reduced gross profit by 7.0% of services revenues. Excluding this charge, the 2004 gross profit percentage would have been 29.3%, an increase of 0.5% as compared to the prior year. This increase is the result of the gross profit attributable to DeLeeuw Associates, which had a gross profit percentage of 33.2% for the ten months ended December 31, 2004.

Related party services

Gross profit for related party services was $0.5 million, or 12.8% of related party services revenue for the year ended December 31, 2004, compared to $64,000, or 17.5% of related party services revenue for the year ended December 31, 2003. The 4.7% point decline in the related party services gross profit percentage relates to increased consultant costs in 2004 as compared to the prior year without corresponding increases in the billing rates charged to the client.

Software

Gross profit resulting from software was $0.1 million, or 27.4% of software revenue for the year ended December 31, 2004, compared to zero for the year ended December 31, 2003.

Selling and marketing

Selling and marketing expenses include payroll, employee benefits and other headcount-related costs associated with sales and marketing personnel and advertising, promotions, tradeshows, seminars and other programs. Selling and marketing expenses were $3.2 million, or 13.4% of revenue for the year ended December 31, 2004, compared to $1.6 million, or 10.8% of revenue for the year ended December 31, 2003. $0.4 million of the increase in selling and marketing expenses during the year ended December 31, 2004 is attributed to the costs related to operating DeLeeuw Associates which was acquired during 2004. $0.7 million of the increase resulted from increased payroll and related costs associated with the increased headcount in the Company's existing sales force. The remaining $0.5 million is reflected in the addition of six additional employees and a Director of Marketing and Corporate Communications both through new hires and retaining existing employees of the acquired companies as part of our strategy to gain new clients and increase revenue.

General and administrative

General and administrative costs include payroll, employee benefits and other headcount-related costs associated with the finance, legal, facilities, certain human resources and other administrative headcount, and legal and other professional and administrative fees. General and administrative costs were $6.1 million, or 25.5% of revenue for the year ended December 31, 2004 compared to $2.7 million, or 18.8% of revenue for the year ended December 31, 2003. $1.2 million of the increase in general and administrative expenses during the year ended December 31, 2004 is attributed to the costs of operating DeLeeuw Associates subsequent to the acquisition during 2004. Additionally, $1.4 million is attributed to an increase in general and administrative payroll costs as the result of hiring a chief financial officer during the fourth quarter of 2003 and increasing the salaries of other Company officers to compensate them competitively with other public companies the size of the Company. $0.5 million represents an increase in development headcount by twelve employees during 2004, as compared to 2003, to support the increased size of the business and the increased compliance requirements inherent in becoming a public company. Professional fees related to legal and accounting increased by $0.3 million primarily due to work related to the Company's public filing requirements.

Goodwill impairment

Impairment of goodwill of $12.2 million for the year ended December 31, 2004 resulted primarily from the Company's annual impairment review for the DeLeeuw Associates acquisition which occurred in 2004. Statement of Financial Accounting Standards No. 142 ("SFAS No. 142"), *"Goodwill and Other Intangible Assets"*, instructs the Company to test intangible assets for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. There were no specific events or changes in circumstances in the acquired company that would have required an interim impairment charge. The Company performed its annual impairment review as of December 31, 2004 and determined that an impairment charge of $12.2 million was required consisting of $11.5 million related to the goodwill previously recorded for DeLeeuw Associates, and $0.7 million related to goodwill recorded for other assets. There were no goodwill impairment charges recorded during the year ended December 31, 2003.

Depreciation and amortization

Depreciation expense is recorded on the Company's property and equipment which is generally depreciated over a period between three to seven years. Amortization of leasehold improvements is taken over the shorter of the estimated useful life of the asset or the remaining term of the lease. The Company amortizes deferred financing costs utilizing the effective interest method over the term of the related debt instrument. Acquired software is amortized on a straight-line basis over an estimated useful life of three years. Acquired contracts are amortized over a period of time that approximates the estimated life of the contracts, based upon the estimated annual cash flows obtained from those contracts, generally five to six years. Depreciation and amortization expenses were $0.5 million for the year ended December 31, 2004 compared to $0.2 million for the year ended December 31, 2003. This increase in depreciation and amortization during the year ended December 31, 2004 is attributed to amortization of the acquired DeLeeuw Associates intangible assets and to depreciation on newly acquired assets.

Interest Expense

The Company incurs interest expense on loans from financial institutions, from capital lease obligations related to the acquisition of equipment used in its business, and on the outstanding convertible line of credit notes. Amortization of the discount on debt issued of $0.9 million is also recorded as interest expense. Interest expense recorded was $5.0 million for the year ended December 31, 2004 compared to $0.1 million for the year ended December 31, 2003. This increase is primarily related to the Laurus and Sands financing transactions described below in the Liquidity and Capital Resources section.

Other income (expense)

The Company recorded interest income of $22,000 and other income of approximately $7,300 for the year ended December 31, 2004, compared to interest income of $5,000 for the year ended December 31, 2003. The Company recorded equity income in its investment in DeLeeuw International (Turkey) of approximately $5,000 for the year ended December 31, 2004.

Income Taxes

The Company evaluates the amount of deferred tax assets that are recorded against expected taxable income over its forecasting cycle which is currently two years. As a result of this evaluation, the Company has recorded a valuation allowance of $9.0 million during the year ended December 31, 2004. This allowance was recorded because, based on the weight of available evidence, it is more likely than not that some, or all, of the deferred tax asset may not be realized.

No income tax expense or benefit was recorded in the prior year as the Company was an “S” Corporation through September 30, 2003. Pro forma income taxes for the prior year would have been an income tax benefit of $0.2 million using the effective tax rate of 40%.

LIQUIDITY AND CAPITAL RESOURCES

Cash totaled $0.2 million as of December 31, 2005 compared to $1.0 million as of December 31, 2004. The Company’s cash balance is primarily derived from customer remittances, bank borrowings and acquired cash and is used for general working capital needs.

The Company’s working capital deficit is ($7.0 million) as of December 31, 2005 compared to ($13.9 million)as of December 31, 2004. The Company’s working capital position has improved during the current year primarily due to gains resulting from the fair value adjustments to the financial instruments during the current year. However, the losses generated by the Company have resulted in the need for $2.0 million of additional borrowings against the Company’s line of credit, a $1.0 million loan on a short term note payable, $1.3 million raised through the sale of Company common stock, and an additional $1.4 million of loans to the Company by the Chief Executive Officer and the Chief Operating Officer of the Company.

Cash used in operating activities during the year ended December 31, 2005 was approximately $3.6 million, a decrease in cash used in operating activities of $0.8 million from the year ended December 31, 2004. Cash used in operating activities primarily relates to cash used as a result of operating losses of approximately $3.9 million and a decline in accounts payable of approximately $0.6 million relating to the sale of Evoke Software Corporation, which is partially offset by payables acquired related to the acquisitions of McKnight Associates and Integrated Strategies. Partially offsetting this cash decline is a approximately $1.0 million reduction in accounts receivable, also resulting from the sale of Evoke, partially offset by acquired receivables from the acquisitions of McKnight Associates and Integrated Strategies and the timing of collections from customers.

Cash used by investing activities was $2.5 million during the year ended December 31, 2005. This was due to payments of $2.2 million made primarily as acquisition payments for Integrated Strategies and $1.0 for McKnight Associates. This was offset by $0.6 million of cash received as part of the Evoke acquisition.

Cash provided by financing activities was $5.3 million during the year ended December 31, 2005. During 2005, $1.8 million was raised from stockholders, and $1.0 million was raised from the issuance of a short-term note payable, additional line of credit borrowings of $1.9 million and $1.2 million was raised from the sale of Company common stock. $0.7 million of principal payments on long-term debt and on capital lease obligations, of which $0.4 million of payments were made on stockholder loans, were made by the Company during this time period.

There are currently no material commitments for capital expenditures.

The Company also expects to incur costs, in 2006, of approximately $0.3 million in order to improve its internal controls surrounding financial reporting and disclosure and in ensuring compliance with Sarbanes-Oxley requirements.

As of December 31, 2005 and 2004, the Company had accounts receivable due from LEC of approximately $0.6 million and $0.8 million, respectively. There are no known collections problems with respect to LEC.

For the years ended December 31, 2005 and 2004, we invoiced LEC $3.7 million and $3.8 million, respectively, for the services of consultants subcontracted to LEC by us. The majority of its billing is derived from Fortune 100 clients. The collection process is slow as these clients require separate approval on their own internal systems, which extends the payment cycle. We feel confident in the collectibility of these accounts receivable as the majority of the revenues from LEC derive from Fortune 100 clients.

In 2004 and 2005, the Company experienced negative cash flow and operating losses, therefore it effectuated the following transactions to support the Company:

<u>Taurus</u>

In May 2004, pursuant to the complete conversion of a $2.0 million unsecured convertible line of credit note issued in October 2003 at $1.80 per share and a conversion price adjustment in September 2004 at $1.575, certain investors represented by Taurus Advisory Group, LLC (“Taurus”) received 1,269,841 shares of our common stock, plus interest paid in cash. The Taurus investors also received a warrant to purchase 277,778 shares of our common stock, which has an exercise price of $1.575 per share and expires in June 2009. Further in May 2004, we raised an additional $2.0 million pursuant to a new five-year unsecured promissory note with Taurus. In June 2004, we replaced the May 2004 note by issuing a five-year $2.0 million unsecured convertible line of credit note with Taurus. The note accrues interest at an annual rate of 7%, and the conversion price of the shares of common stock issuable under the note is equal to $1.575 per share.

In July 2005, the Company obtained two $250,000 short term loans from certain investors represented by Taurus. Both notes bear interest at 8% per annum. The first note is dated July 6, 2005 and initially matured on September 5, 2005. The maturity date for this note has been extended to May 6, 2006. The second note is dated July 22, 2005 and originally matured on September 22, 2005. The maturity date for this note has been extended to April 22, 2006. These short term note holders have agreed to extend their maturity date on a month-to-month basis until the Company raises sufficient funds to repay the notes.

In December 2005, the Company obtained a $1 million short term loan from certain investors represented by Taurus. This note bears interest at 8% per annum. The note is dated December 19, 2005 and initially matured on January 31, 2006. The maturity date for this note has been extended to June 1, 2006. In conjunction with this note, these investors received a warrant to purchase 277,777 shares of our common stock with an exercise price of $0.675 per share in December 2005, a warrant to purchase 277,777 shares of our common stock with an exercise price of $0.75 per share in February 2006 and a warrant to purchase 554,000 shares of our common stock with an exercise price of $1.30 per share in March 2006. These warrants expire in December 2008, January 2009 and February 2009, respectively. These short term note holders have agreed to extend their maturity date on a month-to-month basis until the Company raises sufficient funds to repay the notes.

On February 2, 2006, the Company entered into a Securities Purchase Agreement with Taurus, pursuant to which the Company issued 19,000 shares of the Company's newly created Series A Convertible Preferred Stock, $.001 par value (the "Series A Preferred"). Each share of Series A Preferred has a stated value of $100.00. The Company utilized the proceeds ($1.9 million) to repurchase shares of its common stock from WHRT I Corp. (see above). The Series A Preferred has a cumulative annual dividend equal to five percent (5%), which is payable semi-annually in cash or common stock, at the election of the Company, and is convertible into shares of the Company's common stock at any time at a price equal to $0.50 per share (subject to adjustments related to stock splits, reclassifications, combinations, dividends, change of control or the issuance of pari passu securities). In addition, the Series A Preferred has no voting rights, but has liquidation preferences and certain other privileges. All shares of Series A Preferred not previously converted shall be redeemed by the Company, in cash or common stock, at the election of Taurus, on February 1, 2011. Pursuant to the Securities Purchase Agreement, Taurus was also granted a warrant to purchase 1,900,000 shares of the Company's common stock exercisable at a price of $0.60 per share (subject to adjustments related to stock splits, reclassifications, combinations, dividends, change of control or the issuance of pari passu securities), exercisable for a period of five years.

Laurus

In August 2004, we replaced our $3.0 million line of credit with North Fork Bank with a revolving line of credit with Laurus Master Fund, Ltd. ("Laurus"), whereby we had access to borrow up to $6.0 million based upon eligible accounts receivable. We paid $0.75 million in brokerage and transaction closing related costs.

On February 1, 2006, the Company restructured its financing with Laurus by entering into financing agreements with Laurus which removed all conversion features in the originally issued notes, pursuant to which it, among other things, (a) issued a secured non-convertible term note in the principal amount of $1 million to Laurus (the "Term Note"), (b) issued a secured non-convertible revolving note in the principal amount of $10 million to Laurus (the "Revolving Note", collectively with the Term Note, the "Notes"), and (c) issued an option to purchase up to 3,080,000 shares of the Company's common stock to Laurus (the "Option") at an exercise price of $.001 per share. We had no obligation to meet financial covenants under the notes. The proceeds from the issuance of the Notes were used to refinance the Company's outstanding obligations under the existing facility with Laurus (originally entered into in August 2004 and subsequently amended in July 2005) at a 5% premium. The Notes bear an annual interest rate of prime (as reported in the Wall Street Journal, which was 7.25% as of January 31, 2006) plus 1.0%, with a floor of 5.0%. Payments and interest will be made in equal monthly amounts until maturity of the Notes on December 31, 2007, at which time the 5% premium will also be due. In addition, payments of principal on the Term Note will be made in equal monthly amounts until maturity of the Notes on December 31, 2007. A common stock purchase warrant issued to Laurus in August 2004 provides Laurus with the right to purchase 800,000 shares of our common stock. The exercise price for the first 400,000 shares acquired under the warrant is $4.35 per share, the exercise price for the next 200,000 shares acquired under the warrant is $4.65 per share, and the exercise price for the final 200,000 shares acquired under the warrant is $5.25 per share. The common stock purchase warrant expires on August 15, 2011.

In connection with the Notes, the Company and Laurus entered into an Overadvance Letter Agreement, pursuant to which Laurus exercised its discretion granted to it pursuant to the Security Agreement entered into in August 2004 to make a loan to the Company in excess of the "Formula Amount" (as defined therein). The Company also entered into a Stock Pledge Agreement and Security Agreement securing its obligations to Laurus, both prior to and including the Notes, as well as a Registration Rights Agreement pursuant to which the Company agreed to file a registration statement to register the shares of the Company's common stock underlying the Option, as well as the shares of the Company's common stock and the shares of the Company's common stock underlying the warrants held by Laurus, within 90 days. As of the date of this filing, Laurus owns approximately 809,525 shares of the Company's common stock, an option to purchase up to 3,080,000 shares of the Company's common stock at an exercise price of $.001 per share and the aforementioned warrant.

As a result of the issuance of warrants, the Company has recorded a discount on debt (valued at $2.2 million as of December 31, 2005) and a liability. The discount is being amortized over the remaining term of the debt instrument, and the liability is being adjusted to fair value using an option-pricing model. Additionally, the convertible notes contain an embedded derivative pertaining to the conversion feature in the notes, and the Company has recorded a discount and a liability to reflect this derivative.

Laidlaw/Sands

In September 2004, we issued to Sands Brothers Venture Capital LLC, Sands Brothers Venture Capital III LLC and Sands Brothers Venture Capital IV LLC (collectively, "Sands") three subordinated secured convertible promissory notes equaling $1.0 million (the "Notes"), each with an annual interest rate of 8% expiring September 22, 2005. The Notes were secured by substantially all corporate assets, subordinate to Laurus. The Notes are convertible into shares of our common stock at the election of Sands at any time following the consummation of a convertible debt or equity financing with gross proceeds of $5.0 million or greater (a "Qualified Financing"). The conversion price of the shares of our common stock issuable upon conversion of the Notes shall be equal to a price per share of common stock equal to forty percent (40%) of the price of the securities issued pursuant to a Qualified Financing. Since no Qualified Financing had been consummated by September 8, 2005, Sands is entitled to elect to convert the Notes at a fixed conversion price of $2.10 per share. In the event that we issue stock or derivatives convertible into our stock for a price less than the aforementioned fixed conversion price, then the fixed conversion price is reset using a weighted average dilution calculation. We also issued Sands three common stock purchase warrants (the "Warrants") providing Sands with the right to purchase 400,000 shares of our common stock. The exercise price of the shares of our common stock issuable upon exercise of the Warrants shall be equal to a price per share of common stock equal to forty percent (40%) of the price of the securities issued pursuant to a Qualified Financing. The latest that the Warrants may expire is September 8, 2008.

On September 22, 2005, upon maturity of the September 2004 notes, the Company issued to Sands three amended subordinated secured convertible promissory notes equaling $1.08 million, each with an annual interest rate of 12% expiring on January 1, 2007. The Company also issued Sands three common stock purchase warrants (the "Additional Warrants") providing Sands with the right to purchase 400,000 shares of the Company's common stock. The exercise price of the shares of the Company's common stock issuable upon exercise of the Additional Warrants shall be equal to a price per share of common stock equal to one hundred twenty percent (120%) of the price of the securities issued pursuant to a Qualified Financing. If no Qualified Financing has been consummated by December 15, 2006, then Sands may elect to exercise the Additional Warrants at a fixed conversion price of $2.10 per share. The latest that the Warrants may expire is December 15, 2009.

As of April 7, 2006, Mr. Scott Newman, President, Chief Executive Officer and Chairman, Mr. Glenn Peipert, Executive Vice President, Chief Operating Officer and Director, and Mr. Robert C. DeLeeuw, Senior Vice President, have agreed to personally support our cash requirements to enable us to fulfill our obligations through June 1, 2007, to the extent necessary, up to a maximum amount of $1.5 million, based upon their ability to sell their Company common stock. Mr. Newman guaranties up to approximately $0.9 million, Mr. Peipert guaranties up to approximately $0.4 million and Mr. DeLeeuw guaranties approximately $0.2 million. We believe that these written commitments provide us with the legal right to request and receive such advances from any of these officers. Any loan by Messrs. Newman, Peipert and DeLeeuw to the Company would bear interest at 8% per annum. As of December 31, 2005, Mr. Newman's outstanding loan balance to the Company was approximately $0.9 million, and Mr. Peipert's outstanding loan balance to the Company was approximately $0.9 million. The unsecured loans by Mr. Newman and Mr. Peipert each accrue interest at a simple rate of 8% per annum, and each has a term expiring on April 30, 2007. As of the date of this filing, the entire $1.5 million was still available pursuant to the guaranties outlined above.

The following is a summary of the debt instruments outstanding as of March 31, 2006

Lender	Type of facility	Outstanding as of March 31, 2006 (not including interest) (all numbers approximate)	Remaining Availability (if applicable)
Laurus Master Fund, Ltd.	Line of Credit	$5,752,000	$0
Laurus Master Fund, Ltd.	Term Note	$955,000	$0
Sands Brothers Venture Capital LLC	Convertible Promissory Note	$54,000	$0
Sands Brothers Venture Capital III LLC	Convertible Promissory Note	$918,000	$0
Sands Brothers Venture Capital IV LLC	Convertible Promissory Note	$108,000	$0
Taurus Advisory Group, LLC investors	Convertible Promissory Note	$3,500,000	$0
Taurus Advisory Group, LLC investors	Series A Convertible Preferred Stock	$1,900,000	$0
Scott Newman	Promissory Note	$ 863,000	$0
Glenn Peipert	Promissory Note	$ 909,000	$0
TOTAL		$14,959,000	$0

The Company has generated losses that exceeded expectations during 2004 and continued throughout 2005. To that extent, the Company has experienced continued negative cash flow which has created a liquidity issue for the Company. To address this issue, in addition to the various transactions above, in November 2004, the Company entered into a Stock Purchase Agreement (the "Agreement") with a private investor, CMKX-treme, Inc. Pursuant to the Agreement, CMKX-treme, Inc. agreed to purchase 833,333 shares of common stock for a purchase price of $1.75

million. Under the terms of the Agreement, CMKX-treme, Inc. initially purchased 238,095 shares of common stock for $0.5 million, and it was required to purchase the remaining 595,238 shares of common stock for $1.25 million by December 31, 2004. As of March 17, 2005, CMKX-treme, Inc. remitted final payment for the remaining 595,238 shares.

In 2004, the Company completed various financing transactions through the issuance of common stock, as well as the issuance of notes and warrants convertible into our common stock, while a registration statement was on file with the Securities and Exchange Commission but had not yet been declared effective. Those transactions were with the following entities:

· Taurus Advisory Group, LLC	$4.0 million
· Laurus Master Fund, Ltd.	$11.0 million
· Sands Brothers International Ltd.	
(3 affiliated entities)	$1.0 million

Even though all stockholders, noteholders and warrantholders have been advised of their rights to rescind those financing transactions and they each have waived their rights to rescind those transactions, there is a remote possibility that each of those transactions could be reversed. In such an event, the Company could be adversely affected and may have an obligation to fund such rescissions.

Although the Company has negative working capital at December 31, 2005 and March 31, 2006, and has incurred significant operating losses, the Company believes existing cash plus funds provided by operations, borrowing capacity under the line of credit and projected borrowing against, or the guarantees of the primary stockholders should be sufficient to fund operations through January 1, 2007. Nevertheless, the Company is presently exploring various financing alternatives, including debt or additional sales of equity securities in order to finance the core business of the Company and help provide adequate working capital for operations. There is no assurance that funds will be provided by operations or that such additional financing will be available, or if available, will be available on acceptable terms. Should the Company experience significant shortfalls in planned revenues, or experience unforeseen fixed expenses, the Company believes it has the ability to make additional reductions to variable expenses to extend its capital. Any decision or ability to obtain financing through debt or through equity investment will depend on various factors, including, among others, financial market conditions, strategic acquisition and investment opportunities, and developments in the Company's markets. The sale of additional equity securities or future conversion of any convertible debt would result in additional dilution to the Company's stockholders.

Off-balance sheet arrangements

The Company does not have any transactions, agreements or other contractual arrangements that constitute off-balance sheet arrangements.

Contractual Obligations

At December 31, 2005, the Company had certain contractual cash obligations and other commercial commitments, as set forth in the following table (amounts in table are noted in millions):

Contractual Obligations		Total		Less than 1 year		1-3 years		4-5 years
Long-term debt	$	3.9	$	0.5	$	1.4	$	2.0
Related Party Debt		1.8		-		1.8		-
Capital lease obligations		0.1		0.1		-		-
Operating leases		2.0		0.5		1.1		0.4
Employment agreements		3.9		3.9		-		-
Total	$	11.7		5.0	$	4.3	$	2.4

APPLICATION OF CRITICAL ACCOUNTING POLICIES

Revenue recognition

Our revenue recognition policy is significant because revenues are a key component of our results from operations. In addition, revenue recognition determines the timing of certain expenses, such as incentive compensation. We follow very specific and detailed guidelines in measuring revenue; however, certain judgments and estimates affect the application of the revenue policy. Revenue results are difficult to predict and any shortfall in revenues or delay in recognizing revenues could cause operating results to vary significantly from quarter to quarter and could result in future operating losses or reduced net income.

Services

Revenue from consulting and professional services is recognized at the time the services are performed on a project by project basis. For projects charged on a time and materials basis, revenue is recognized based on the number of hours worked by consultants at an agreed-upon rate per hour. For large services projects where costs to complete the contract could reasonably be estimated, the Company undertakes projects on a fixed-fee basis and recognizes revenues on the percentage of completion method of accounting based on the evaluation of actual costs incurred to date compared to total estimated costs. Revenues recognized in excess of billings are recorded as costs in excess of billings. Billings in excess of revenues recognized are recorded as deferred revenues until revenue recognition criteria are met. Reimbursements, including those relating to travel and other out-of-pocket expenses, are included in revenues, and an equivalent amount of reimbursable expenses are included in cost of services.

Business Combinations

We are required to allocate the purchase price of acquired companies to the tangible and intangible assets acquired and liabilities assumed based on their estimated fair values. Such a valuation requires us to make significant estimates and assumptions, especially with respect to intangible assets. Critical estimates in valuing certain intangible assets include, but are not limited to, future expected cash flows from customer contracts, customer lists, distribution agreements and acquired developed technologies, and estimating cash flows from projects when completed and discount rates. Our estimates of fair value are based upon assumptions believed to be reasonable, but which are inherently uncertain and unpredictable and, as a result, actual results may differ from estimates. These estimates may change as additional information becomes available regarding the assets acquired and liabilities assumed. Additionally, in accordance with "EITF 99-12," the Company values an acquisition based upon the market price of its common stock for a reasonable period before and after the date the terms of the acquisition are agreed to and announced.

Impairment of Goodwill, Intangible Assets and Other Long-Lived Assets

We evaluate our identifiable goodwill, intangible assets, and other long-lived assets for impairment on an annual basis and whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable based on expected undiscounted cash flows attributable to that asset. Future impairment evaluations could result in impairment charges, which would result in an expense in the period of impairment and a reduction in the carrying value of these assets.

Allowances for Doubtful Accounts

We make judgments regarding our ability to collect outstanding receivables and provide allowances for the portion of receivables when collection becomes doubtful. Provisions are made based upon a specific review of all significant outstanding invoices. For those invoices not specifically reviewed, provisions are provided at differing rates, based upon the age of the receivable. In determining these percentages, we analyze our historical collection experience and current economic trends. If the historical data we use to calculate the allowance provided for doubtful accounts does not reflect the future ability to collect outstanding receivables, additional provisions for doubtful accounts may be needed and our future results of operations could be materially affected. During 2005, $56,123 of uncollectible accounts receivable were written off of the accounts receivable against the allowance for doubtful accounts.

Discount on Debt

The Company has allocated the proceeds received from convertible debt instruments between the underlying debt instruments and the detachable warrants, and has recorded the conversion feature as a liability in accordance with SFAS No. 133. The conversion feature and certain other features that are considered embedded derivative instruments, such as a variable interest rate feature, a conversion reset provision and redemption option, have been recorded at their fair value within the terms of SFAS No. 133 as its fair value can be separated from the convertible note and its conversion is independent of the underlying note value. The conversion liability is marked to market each reporting period with the resulting gains or losses shown on the Statement of Operations. The Company has also recorded the resulting discount on debt related to the warrants and conversion feature and is amortizing the discount using the effective interest rate method over the life of the debt instruments. The discount is classified as a deferred financing cost.

Financial Instruments

The carrying value of the Company's financial instruments, including cash and cash equivalents, accounts receivable, note receivable, accounts payable and accrued liabilities approximate fair value because of the short maturities of those instruments. Based on borrowing rates currently available to the Company for loans with similar terms, the carrying value of convertible notes and notes payable are also approximate fair value.

We review the terms of convertible debt and equity instruments we issued to determine whether there are embedded derivative instruments, including the embedded conversion option, that are required to be bifurcated and accounted for separately as a derivative financial instrument. Generally, where the ability to physical or net-share settle the conversion option is deemed to be not within the control of the company, the embedded conversion option is required to be bifurcated and accounted for as a derivative financial instrument liability.

In connection with the sale of convertible debt and equity instruments, we may also issue freestanding options or warrants. Additionally, we may issue options or warrants to non-employees in connection with consulting or other services they provide. Although the terms of the options and warrants may not provide for net-cash settlement, in certain circumstances, physical or net-share settlement is deemed to not be within the control of the company and, accordingly, we are required to account for these freestanding options and warrants as derivative financial instrument liabilities, rather than as equity.

Derivative financial instruments are initially measured at their fair value. For derivative financial instruments that are accounted for as liabilities, the derivative instrument is initially recorded at its fair value and is then re-valued at each reporting date, with changes in the fair value reported as charges or credits to income. For option-based derivative financial instruments, we use the Black-Scholes option pricing model to value the derivative instruments.

In circumstances where the embedded conversion option in a convertible instrument is required to be bifurcated and there are also other embedded derivative instruments in the convertible instrument that are required to be bifurcated, the bifurcated derivative instruments are accounted for as a single, compound derivative instrument.

If freestanding options or warrants were issued and will be accounted for as derivative instrument liabilities (rather than as equity), the proceeds are first allocated to the fair value of those instruments. When the embedded derivative instrument is to be bifurcated and accounted for as a liability, the remaining proceeds received are then allocated to the fair value of the bifurcated derivative instrument. The remaining proceeds, if any, are then allocated to the convertible instrument itself, usually resulting in that instrument being recorded at a discount from its face amount. In circumstances where a freestanding derivative instrument is to be accounted for as an equity instrument, the proceeds are allocated between the convertible instrument and the derivative equity instrument, based on their relative fair values.

The discount from the face value of the convertible debt instrument resulting from the allocation of part of the proceeds to embedded derivative instruments and/or freestanding options or warrants is amortized over the life of the instrument through periodic charges to income, using the effective interest method.

The classification of derivative instruments, including whether such instruments should be recorded as liabilities or as equity, is re-assessed at the end of each reporting period. Derivative instrument liabilities are classified in the balance sheet as current or non-current based on whether or not net-cash settlement of the derivative instrument is expected within 12 months of the balance sheet date.

Equity investments

Prior to the Company’s acquisition of DeLeeuw in 2004, DeLeeuw had acquired a non-controlling interest in DeLeeuw International (a company formed under the laws of Turkey). The Company accounts for its share of the income (losses) of this investment under the equity method.

Stock-based Compensation

We issue stock options to our employees and provide our employees the right to purchase ordinary shares under employee stock purchase plans. We account for our stock-based compensation plans under the intrinsic value method

of accounting as defined by Accounting Principles Board Opinion No. 25, "*Accounting for Stock Issued to Employees*" ("APB 25") and related interpretations. For equity instruments under fixed plans, APB 25 does not require that any amount of expense to be recorded in the statement of income; however, SFAS No. 123, "*Accounting for Stock-Based Compensation*" does require disclosure of these amounts in a pro forma table to the financial statements. In determining this disclosure the value of an option is estimated using the Black Scholes option valuation model. This model requires the input of highly subjective assumptions and a change in our assumptions could materially affect the fair value estimate, and thus the total calculated costs associated with the grant of stock options or issuance of stock under employee stock purchase plans. In addition, in disclosing the fair-value cost of stock-based compensation, we estimate that we will be able to obtain a 40% tax benefit on these costs. There is the potential that this tax benefit will not be obtained to this extent or at all, which directly impacts the level of expenses associated with stock-based compensation. We expect our accounting policies, regarding stock-based compensation to be materially affected by our adoption of SFAS123R, which is described under "Recent Pronouncements." We have not yet determined what the impact of the adoption of SFAS123R will be on our compensation philosophy.

Deferred Income Taxes

Determining the consolidated provision for income tax expense, income tax liabilities and deferred tax assets and liabilities involves judgment. We record a valuation allowance to reduce our deferred tax assets to the amount of future tax benefit that is more likely than not to be realized. We have considered future taxable income and prudent and feasible tax planning strategies in determining the need for a valuation allowance. A valuation allowance is maintained by the Company due to the impact of the current years net operating loss (NOL). In the event that we determine that we would not be able to realize all or part of our net deferred tax assets, an adjustment to the deferred tax assets would be charged to net income in the period such determination is made. Likewise, if we later determine that it is more likely than not that the net deferred tax assets would be realized, then the previously provided valuation allowance would be reversed. Our current valuation allowance relates predominately to benefits derived from the utilization of our NOL's.

Recent Pronouncements

SFAS No. 123 (Revised 2004) ("SFAS No. 123R"), "Share-Based Payment," issued in December 2004, is a revision of FASB Statement 123, "Accounting for Stock-Based Compensation" and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees," and its related implementation guidance. The Statement focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. SFAS No. 123R requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award (with limited exceptions). That cost will be recognized over the period during which an employee is required to provide service in exchange for the award. On March 29, 2005, the SEC issued Staff Accounting Bulletin No. 107 ("SAB No. 107"), which provides the Staff's views regarding interactions between SFAS No. 123R and certain SEC rules and regulations and provides interpretations of the valuation of share-based payments for public companies.

SFAS No. 123(R) permits public companies to adopt its requirements using one of two methods:

(1) A "modified prospective" method in which compensation cost is recognized beginning with the effective date
(a) based on the requirements of SFAS No. 123(R) for all share-based payments granted after the effective date and
(b) based on the requirements of SFAS No. 123 for all awards granted to employees prior to the effective date of SFAS No. 123(R) that remain unvested on the effective date.

(2) A "modified retrospective" method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under SFAS No. 123 for purposes of pro forma disclosures either (a) all prior periods presented or (b) prior interim periods of the year of adoption.

This statement is effective for the beginning of the first annual reporting period that begins after June 15, 2005, therefore, we will adopt the standard in the first quarter of fiscal 2006 using the modified prospective method. As permitted by SFAS No. 123, we currently account for share-based payments to employees using the intrinsic value method prescribed in APB Opinion 25 and, as such, generally recognize no compensation cost for employee stock options. Although we have not completed our assessment, we believe the impact on our consolidated financial position or results or operations will not be material given the current number of outstanding stock options. The effect on our results of operations of expensing stock options using the Black-Scholes method is presented in the disclosure of pro forma net income and earnings per share in Note 2. SFAS No. 123(R) also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required under current literature. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption.

ITEM 7. FINANCIAL STATEMENTS.

The Financial Statements of the Company and the accompanying notes thereto, and the independent auditor's report required by this item are included as part of this Form 10-KSB and immediately follow the signatures page of this Form 10-KSB.

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

On June 1, 2004, Ehrenkrantz Sterling & Co., LLC (“Ehrenkrantz”) merged with the firm of Friedman Alpren & Green LLP. The new entity, Friedman LLP (“Friedman”), was retained by us, and our Board of Directors approved this decision on June 7, 2004. For the period since Ehrenkrantz's appointment through June 7, 2004, there have been no disagreements with Ehrenkrantz on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements if not resolved to the satisfaction of Ehrenkrantz would have caused them to make reference thereto in their report. In addition, for the period since Ehrenkrantz's appointment through June 7, 2004, we did not consult with Friedman regarding any matter that was the subject of a "disagreement" with Ehrenkrantz, as that term is defined in Item 304(a)(1)(iv) of Regulation S-K and the related instructions to Item 304 of Regulation S-K, or with regard to any "reportable event," as that term is defined in Item 304(a)(1)(v) of Regulation S-K, except as such consultations as may have been made with former employees of Ehrenkrantz who are now employees of Friedman.

ITEM 8A. CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures.

Under the supervision and with the participation of our management, including our chief executive officer and our chief financial officer, we have assessed the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Securities Exchange Act of 1934 Rule 13a-15(e) as of the end of the period covered by this report. Based on that assessment, our management has concluded that our internal control over financial reporting was not effective as of December 31, 2005 because of the material weaknesses identified and described below.

Control Activities:

1. The Company did not maintain effective controls over the accounting for embedded derivatives in certain financial instruments. Specifically the Company did not have controls designed and in place to ensure the completeness, accuracy and evaluation of embedded derivatives in its financing transactions with Laurus Master Fund, Ltd. and with three entities affiliated with Sands Brothers International Limited. The instruments included, among other things, convertible notes, freestanding warrant agreements and registration rights agreements. The warrant agreements are subject to registration rights agreements which require that the Company register the shares within a specified period of time and, in the event this is not done, provides for significant liquidated damages. In accordance with EITF 00-19 “Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company’s Own Stock,” the Company previously recorded a liability for these warrants. However, although the convertible notes are also subject to the registration rights agreements and are not “conventionally convertible,” the Company had not previously recorded a liability for the derivative associated with the conversion feature. Additionally, in July 2005, the Company renegotiated its financing with Laurus. As part of this transaction, the Company repaid $4.3 million to Laurus, issued an option to purchase Company stock at $0.015 per share and increased the availability under the revolving line of credit by $500,000. Since future cash flows under the new agreement with Laurus are more than 10% different than under the 2004 agreement with Laurus, it has been determined that this transaction should have been accounted for as an early extinguishment of debt as opposed to a modification of existing debt.

The deficiency resulted in a restatement of its financial statements for the three and nine months ended September 30, 2004, the year ended December 31, 2004, the three months ended March 31, 2005, the three and six months ended June 30, 2005 and the three and nine months ended September 30, 2005 as appropriate to properly account for the above transactions.

2. The Company did not maintain effective controls to ensure the completeness, accuracy and valuation over the accounting for business combinations, including the inability to prepare financial statements and footnotes in

accordance with SEC rules and regulations and with our 2004 acquisitions of DeLeeuw Associates, Inc. and Evoke Software Corporation. We misapplied generally accepted accounting principles whereby we did not value the acquisitions and record the resulting purchase accounting in accordance with SFAS 141 and EITF 99-12. As a result, we were required in April 2005 to restate our financial statements for the three months ended March 31, 2004, for the three and six months ended June 30, 2004 and for the three and nine months ended September 30, 2004. Management determined that the disclosure controls and procedures for these three quarters were not effective.

3. The Company did not maintain effective controls over the period end financial reporting process. Specifically, controls were not designed and in place to ensure that to the Company identified certain transactions, primarily contractual, and accounted for them in the proper periods. This does not relate to the subject matter of the material weaknesses described above, yet combined with the above-referenced material weaknesses, constitute in the aggregate a material weakness in our internal control over financial reporting.

4. The Company did not maintain effective controls over the accounting for income taxes to ensure amounts disclosed are accurately accounted for in accordance with GAAP. Specifically, the Company did not have controls designed and functioning to ensure that accounting personnel prepared the necessary disclosures required by FASB No. 109 "Accounting for Income Taxes."

Remediation of Material Weaknesses in Internal Control over Financial Reporting

In light of the need for these restatements and the material weaknesses described above, management began in the second quarter of our 2005 fiscal year, and continuing through the period covered by this report, to undertake a review of our disclosure, financial information and internal controls and procedures regarding these areas for future complex financing transactions and acquisitions. This review has included efforts by our management and directors, as well as the use of additional outside resources, as follows:

• Senior accounting personnel and our chief financial officer will continue to review any complex financing transaction in order to evaluate, document and approve its accounting treatment in accordance with EITF 00-19 and EITF 00-27;

• Senior accounting personnel and our chief financial officer will continue to review any future acquisition or divestiture in order to evaluate, document and approve its accounting treatment in accordance with SFAS 141 and EITF 99-12;

• We will augment, as necessary, such procedures by obtaining concurrence with independent outside accounting experts prior to finalizing financial reporting for such transactions; and

• We will incorporate the applicable parts of the action plan described below.

In conjunction with the measures outlined below, we believe these actions will strengthen our internal control over our review of complex financing transactions. We also believe these actions have sufficiently strengthened our internal control over our valuation and purchase accounting of acquisitions, and this material weakness should be resolved. Management does not anticipate any extra cost from this change over our review of complex financing transactions and in its valuation and purchase accounting of future acquisitions. Management established an action plan in the first quarter of 2005 that it believes will correct the aggregated material weaknesses described above. Our estimated costs related to the correction of these material weaknesses is approximately $0.25 million, most notably related to our conversion to the Great Plains accounting system during the third quarter of 2004. Other measures included in our action plan are as follows:

• Our Disclosure Committee, formed in the second quarter of 2005, consists of our chief executive officer, chief operating officer, senior vice president of sales, general counsel and controller, chaired by our chief financial officer. The Disclosure Committee is comprised of these key members of senior management who have knowledge of significant portions of our internal control system, as well as the business and competitive environment in which we operate. One of the key responsibilities of each Disclosure Committee member is to review quarterly reports, annual reports and registration statements to be filed with the SEC as each progress through the preparation process. Open lines of communication to financial reporting management exist for Disclosure Committee members to convey comments and suggestions;

• A process has been established whereby material agreements are reviewed by the legal and sales departments and an executive management member that includes determination of appropriate accounting and disclosure;

• Our accounting and legal departments are working closely and in conjunction to accurately account for period-end financial reporting and complex financing transactions;

• We are constantly assessing our existing environment and continue to make further changes, as appropriate, in our finance and accounting organization to create clearer segregation of responsibilities and supervision, and to increase the level of technical accounting expertise including the use of outside accounting experts;

• There has been closer monitoring of the preparation of our monthly and quarterly financial information. We have instituted regular quarterly meetings to review each department’s significant activities and respective disclosure controls and procedures;

• Department managers have been tasked with tracking relevant non-financial operating metrics and other pertinent operating information and communicating their findings to a member of the Disclosure Committee; and

• We have conducted quarterly reviews of the effectiveness of our disclosure controls and procedures, and we have enhanced our quarterly close process to include detailed analysis in support of the financial accounts, and improved supervision over the process.

We believe that we will satisfactorily address the control deficiencies and material weakness relating to these matters by the end of the third quarter of 2006, although there can be no assurance that we will do so.

Given the presence of material weaknesses in our internal control over financial reporting, there is a more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. Our financial reporting process includes extensive procedures we undertake in order to obtain assurance regarding the reliability of our published financial statements, notwithstanding the material weaknesses in internal control. We have expanded our year-end closing procedures. We have expanded our review of embedded derivative in our financial instruments. We have expanded our review of accounting for business combinations. All of the above mentioned procedures have been designed to help compensate for our material weaknesses in order to provide assurance that the financial statements are free of material inaccuracies or omissions of material fact. As a result, management, to the best of its knowledge, believes that (i) the report does not contain any untrue statements of a material fact or omits any material fact and (ii) the consolidated financial statements and other financial information included in this report for the year ended December 31, 2005 have been prepared in conformity with GAAP and fairly present in all material aspects our financial condition, results of operations and cash flows.

Management, including our chief executive officer and our chief financial officer, does not expect that our disclosure controls and internal controls will prevent all error or all fraud, even as the same are improved to address any deficiencies and/or weaknesses. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control.

Changes in internal control over financial reporting.

We are in the process of developing a comprehensive remediation plan to address our deficiencies and expect that this plan will extend into the third quarter of the 2006 fiscal year. The following list describes remedial actions that have been implemented since our last Annual Report:

• Senior accounting personnel and our chief financial officer continue to review any complex financing transaction in order to evaluate, document and approve its accounting treatment in accordance with EITF 00-19 and EITF 00-27;

• Senior accounting personnel and our chief financial officer continue to review any future acquisition or divestiture in order to evaluate, document and approve its accounting treatment in accordance with SFAS 141 and EITF 99-12;

• We have augmented, as necessary, such procedures by obtaining concurrence with independent outside accounting experts prior to finalizing financial reporting for such transactions;

• Our Disclosure Committee meets at the end of every quarter;

• Our accounting and legal departments continue to work more closely and in conjunction to accurately account for period-end financial reporting and complex financing transactions;

• There has been closer monitoring of the preparation of our monthly and quarterly financial information. We have instituted regular quarterly meetings to review each department's significant activities and respective disclosure controls and procedures; and

• Department managers have been tasked with tracking relevant non-financial operating metrics and other pertinent operating information and communicating their findings to a member of the Disclosure Committee.

ITEM 8B. OTHER INFORMATION

Not applicable.

PART III

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

The following table sets forth the names and ages of our current directors and executive officers, the principal offices and positions with us held by each person and the date such person became a director or executive officer. Our Board of Directors elects our executive officers annually. Each year the stockholders elect the members of our Board of Directors.

Our directors and executive officers are as follows:

Name	Year First Elected As an Officer Or Director	Age	Position(s) Held
Scott Newman	2004	46	President, Chief Executive Officer and Chairman
Glenn Peipert	2004	45	Executive Vice President, Chief Operating Officer and Director
Mitchell Peipert	2004	47	Vice President, Chief Financial Officer, Secretary and Treasurer
Robert C. DeLeeuw	2004	49	Senior Vice President and President of DeLeeuw Associates, LLC
William McKnight	2005	40	Senior Vice President - Data Warehousing
Lawrence K. Reisman*	2004	46	Director
Joseph Santiso**	2005	61	Director

*Chair of the Audit Committee, the Compensation Committee and the Nominating and Corporate Governance Committee.

** Member of the Audit Committee, the Compensation Committee and the Nominating and Corporate Governance Committee.

SCOTT NEWMAN has been our President, Chief Executive Officer and Chairman since January 2004. Mr. Newman founded the former Conversion Services International, Inc. in 1990 (before its merger with and into LCS Group, Inc.) and is our largest stockholder. He has over twenty years of experience providing technology solutions to major companies internationally. Mr. Newman has direct experience in strategic planning, analysis, design, testing and implementation of complex big-data solutions. He possesses a wide range of software and hardware architecture/discipline experience, including, client/server, data discovery, distributed systems, data warehousing, mainframe, scaleable solutions and e-business. Mr. Newman has been the architect and lead designer of several

commercial software products used by Chase, Citibank, Merrill Lynch and Jaguar Cars. Mr. Newman advises and reviews data warehousing and business intelligence strategy on behalf of our Global 2000 clients, including AT&T Capital, Jaguar Cars, Cytec and Chase. Mr. Newman is a member of the Young Presidents Organization, a leadership organization that promotes the exchange of ideas, pursuit of learning and sharing strategies to achieve personal and professional growth and success. Mr. Newman received his B.S. from Brooklyn College in 1980.

GLENN PEIPERT has been our Executive Vice President, Chief Operating Officer and Director since January 2004. Mr. Peipert held the same positions with the former Conversion Services International, Inc. since its inception in 1990 and is our second largest stockholder. Mr. Peipert has over two decades of experience consulting to major organizations about leveraging technology to enable strategic change. He has advised clients representing a broad cross-section of rapid growth industries worldwide. Mr. Peipert has hands on experience with the leading data warehousing products. His skills include architecture design, development and project management. He routinely participates in architecture reviews and recommendations for our Global 2000 clients. Mr. Peipert has managed major technology initiatives at Chase, Tiffany, Morgan Stanley, Cytec and the United States Tennis Association. He speaks nationally on applying data warehousing technologies to enhance business effectiveness and has authored multiple white papers regarding business intelligence. Mr. Peipert is a member of the Institute of Management Consultants, as well as TEC International, a leadership organization whose mission is to increase the effectiveness and enhance the lives of chief executives and those they influence. Mr. Peipert is the brother of Mitchell Peipert, our Vice President, Chief Financial Officer, Secretary and Treasurer. Mr. Peipert received his B.S. from Brooklyn College in 1982.

MITCHELL PEIPERT has been our Vice President, Chief Financial Officer, Secretary and Treasurer since January 2004. Mr. Peipert is a Certified Public Accountant who held the same positions with the former Conversion Services International, Inc. from January 2001 to September 2002. From September 2002 to December 2003, Mr. Peipert was Senior Sales Executive for NIA Group and President of E3 Management Advisors. From April 1992 until January 2001, Mr. Peipert served as Senior Vice President of Operations and Controller of TSR Wireless LLC, where he directed the accounting, operations and human resources functions. He also assisted the chief executive officer in strategic planning, capital raising and acquisitions. Prior to his employment by TSR, he held various managerial roles for Anchin, Block & Anchin, certified public accountants, Merrill Lynch and Grant Thornton. Mr. Peipert is the brother of Glenn Peipert, our Executive Vice President, Chief Operating Officer and Director. Mr. Peipert received his B.S. from Brooklyn College in 1980 and received his M.B.A. in Finance from Pace University in 1986.

ROBERT C. DELEEUW has been our Senior Vice President and the President of our wholly owned subsidiary, DeLeeuw Associates, LLC, since March 2004 and is our third largest stockholder. Mr. DeLeeuw founded DeLeeuw Associates, LLC, formerly known as DeLeeuw Associates, Inc., in 1991. Mr. DeLeeuw has over twenty-five years experience in banking and consulting. During this time, he has managed and supported some of the largest merger projects in the history of the financial services industry and has implemented numerous large-scale business and process change programs for his clients. He has been published in American Banker, Mortgage Banking Magazine, The Journal of Consumer Lending and Bank Technology News where he has also served as a member of the Editorial Advisory Board. Mr. DeLeeuw received his B.S. from Rider University in 1979 and received his M.S. in Management from Stevens Institute of Technology in 1986.

WILLIAM MCKNIGHT has been our Senior Vice President - Data Warehousing since July 2005. Mr. McKnight founded McKnight Associates, Inc. in 1998. Prior to forming his company, from 1992-1998, Mr. McKnight held various information technology management positions at Visa, and Anthem Blue Cross Blue Shield. From 1990-1992, Mr. McKnight was a consultant for Platinum Technology, and he was a developer of the DB2 product at IBM from 1987-1990. Mr. McKnight received his B.S. in Computer Science from Southern College in 1987 and received his M.B.A. from Santa Clara University in 1994.

LAWRENCE K. REISMAN has been a Director of our company since February 2004 and is the Chair of the Audit Committee, the Compensation Committee and the Nominating and the Corporate Governance Committee. Mr. Reisman is a Certified Public Accountant who has been the principal of his own firm, The Accounting Offices of L.K. Reisman, since 1986. Prior to forming his company, Mr. Reisman was a tax manager at Coopers & Lybrand and Peat Marwick Mitchell. He routinely provides accounting services to small and medium-sized companies, which services include auditing, review and compilation of financial statements, corporate, partnership and individual taxation, designing accounting systems and management consulting services. Mr. Reisman received his B.S. and M.B.A. in Finance from St. John’s University in 1981 and 1985, respectively.

JOSEPH SANTISO has been a Director of our company since May 2005 and was appointed by the Board to sit on the Board's Audit Committee, Nominating and Corporate Governance Committee and Compensation Committee in May 2005. Mr. Santiso founded and is President of The BCI Group, which consists of Breakthrough Concepts Inc., BCI Systems Inc. and BCI Knowledge Inc., since 1991. Prior to founding BCI, Mr. Santiso was the Chief Accounting Officer for Citibank Stock Transfer Services Division, a Financial Analyst in the Comptrollers Department of the Operational Services Division at Irving Trust and a Professor of Accounting at Jersey City State College. Mr. Santiso received his B.S. from Pace University in 1973 with a major in Accounting and Finance.

Directors do not receive compensation for their duties as directors.

Code of Conduct and Ethics

Our Board of Directors has adopted a Code of Conduct and Ethics which is applicable to all our directors, officers, employees, agents and representatives, including our principal executive officer and principal financial officer, principal accounting officer or controller, or other persons performing similar functions. We have made available on our website copies of our Code of Conduct and Ethics and charters for the committees of our Board and other information that may be of interest to investors.

Director Independence

The Board has reviewed each of the directors' relationships with the Company in conjunction with Section 121(A) of the listing standards of the American Stock Exchange ("AMEX") and has affirmatively determined that two of our directors, Lawrence K. Reisman and Joseph Santiso, are independent of management and free of any relationship that would interfere with the independent judgment as members of the Audit Committee. The Company is in the process of interviewing independent director candidates so the Board of Directors will have a majority of independent directors.

Committees of the Board of Directors

The Board of Directors has established three standing committees: (1) the Audit Committee, (2) the Compensation Committee and (3) the Nominating and Corporate Governance Committee. Each committee operates under a charter that has been approved by the Board. Copies of the Audit Committee, Compensation Committee and Nominating and Corporate Governance Committee's' charters are posted on the Company's website. Mr. Reisman and Mr. Santiso are the members of each of such committees. Mr. Reisman serves as the Chair of each of such committees.

Audit Committee

The Audit Committee was formed in April 2005. The Audit Committee has met once since its formation and each member of the Audit Committee was present at such meeting, and acted by unanimous written consent four times. The Audit Committee is responsible for matters relating to financial reporting, internal controls, risk management and compliance. These responsibilities include appointing, overseeing, evaluating and approving the fees of our independent auditors, reviewing financial information which is included in our Annual Report on Form 10-KSB/A, discussions with management and the independent auditors the results of the annual audit and our quarterly financial statements, reviewing with management our system of internal controls and financial reporting process and monitoring our compliance program and system.

The Audit Committee operates pursuant to a written charter, which sets forth the functions and responsibilities of this committee. A copy of the charter can be viewed on our website. All members of this committee are independent directors under the SEC rules. The Board of Directors has determined that Lawrence K. Reisman, the committee's chairman, meets the SEC criteria of an "audit committee financial expert", as defined in Item 401(e) of Regulation S-B.

Compensation Committee

The Compensation Committee was formed in May 2005 and did not meet during fiscal 2005. The Compensation Committee is responsible for matters relating to the development, attraction and retention of the Company's management and for matters relating to the Company's compensation and benefit programs. As part of its responsibilities, this committee evaluates the performance and determines the compensation of the Company's Chief Executive Officer and approves the compensation of our senior officers.

The Compensation Committee operates under a written charter that sets forth the functions and responsibilities of this committee. A copy of the charter can be viewed on our website.

Pursuant to its charter, the Compensation Committee must be comprised of at least two (2) Directors who, in the opinion of the Board of Directors, must meet the definition of "independent director" within the rules and regulations of the SEC. The Board of Directors has determined that all members of this committee are independent directors under the SEC rules.

Nominating and Corporate Governance Committee

The Nominating and Corporate Governance Committee is responsible for providing oversight on a broad range of issues regarding our corporate governance practices and policies and the composition and operation of the Board of Directors. These responsibilities include reviewing potential candidates for membership on the Board and recommending to the Board nominees for election as directors of the Company. The Nominating and Corporate Governance Committee was formed in May 2005 and did not meet during fiscal 2005. A complete description of the Nominating and Corporate Governance Committee's responsibilities is set forth in the Nominating and Corporate Governance written charter. A copy of the charter is available to stockholders on the Company's website. All members of the Nominating and Corporate Governance Committee are independent directors as defined by the rules and regulations of the SEC. The Nominating and Corporate Governance Committee will consider director nominees recommended by stockholders. There are no minimum qualifications for consideration for nomination to be a director of the Company. The nominating committee will assess all director nominees using the same criteria. Nominations made by stockholders must be made by written notice received by the Secretary of the Company within 30 days of the date on which notice of a meeting for the election of directors is first given to stockholders. The Nominating and Corporate Governance Committee and the Board of Directors carefully considers nominees regardless of whether they are nominated by stockholders, the Nominating and Corporate Governance Committee or existing board-members.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires our officers, directors and persons who beneficially own more than 10% of a registered class of our equity securities ("ten percent stockholders") to file reports of ownership and changes in ownership with the Securities and Exchange Commission. Officers, directors and ten percent stockholders are charged by the SEC regulations to furnish us with copies of all Section 16(a) forms they file.

Based solely upon a review of Forms 3, 4 and 5 and amendments thereto furnished to us during the past fiscal year, and, if applicable, written representations that Form 5 was not required, we believe that all Section 16(a) filing requirements applicable to our officers, directors and ten percent stockholders were fulfilled.

ITEM 10. EXECUTIVE COMPENSATION.

The following table sets forth, for the fiscal years indicated, all compensation awarded to, paid to or earned by the following type of executive officers for the fiscal years ended December 31, 2005, 2004 and 2003: (i) individuals who served as, or acted in the capacity of, our principal executive officer for the fiscal year ended December 31, 2005; and (ii) our other most highly compensated executive officer, who together with the principal executive officer are our most highly compensated officers whose salary and bonus exceeded $100,000 with respect to the fiscal year ended December 31, 2005 and who were employed at the end of fiscal year 2005.

SUMMARY COMPENSATION TABLE*

					Long Term Compensation			
		Annual Compensation(1)			Awards		Payouts	
Name and Principal Position	**Year**	**Salary ($)**	**Bonus ($)**	**Other Annual Compensation ($)**	**Restricted Stock Award(s) ($)**	**Securities Underlying Options/SARs (#)**	**LTIP Payouts ($)**	**All Other Compensation ($)**
Scott Newman	2005	500,000	—	—	—	—	—	39,809 (2)
President, Chief	2004	500,000	—	—	—	—	—	38,054 (2)
Executive Officer and Chairman	2003	244,452	—	—	—	—	—	206,686 (3)
Glenn Peipert	2005	375,000	—	—	—	250,000	—	40,779 (2)
Executive Vice	2004	375,000	—	—	—	—	—	38,054 (2)
President, Chief Operating Officer and Director	2003	223,016	—	—	—	—	—	171,309 (4)
Mitchell Peipert,	2005	209,375	—	—	—	150,000	—	24,129 (2)
Vice President,	2004	190,000	—	—	—	300,000	—	14,413 (2)
Chief Financial Officer, Treasurer and Secretary	2003	10,000	—	—	—	—	—	1,133 (2)
Robert C.	2005	350,000	—	56,695 (5)	—	250,000	—	17,736 (2)
DeLeeuw, Senior Vice President	2004	329,400	—	—	—	—	—	592 (6)
William McKnight, Senior Vice President -Data Warehousing	2005	125,047	—	—	—		—	10,494 (2)

* Salary reflects total compensation paid to these executives (both before and after the merger described in Item 1).

(1) The annual amount of perquisites and other personal benefits, if any, did not exceed the lesser of $50,000 or 10% of the total annual salary reported for each named executive officer and has therefore been omitted, unless otherwise stated above.

(2) Amounts shown reflect payments related to medical, dental and life insurance and car payments.

72

(3) Amounts shown reflect distributions resulting from the operating entity's past tax status as a Subchapter S corporation of $153,738 in 2003, as well as $66,262 in 2003 of expenses, which include auto, travel and equipment purchases paid for by the Company.

(4) Amounts shown reflect distributions resulting from the operating entity's past tax status as a Subchapter S corporation of $101,988 in 2003, as well as $63,645 in 2003 of expenses, which include auto, travel and equipment purchases paid for by the Company.

(5) Incentive compensation received based on profibility of business units under Mr. DeLeeuw's control.

(6) Amounts shown reflect payment related to life insurance.

Option/SAR Grants During Fiscal 2005

Name	Number of securities underlying options/SARs granted (#) (1)	Percent of total options/SARs granted to employees in fiscal year	Exercise or base price ($/Sh)	Expiration Date
Glenn Peipert	250,000 (2)	9.3%	$0.83	November 15, 2010
Robert C. DeLeeuw	250,000 (2)	9.3%	$0.83	November 15, 2010
Mitchell Peipert	100,000 (3)	3.7%	$0.83	November 15, 2015

(1) All options were granted under the Company's 2003 Incentive Plan. All of the above options were granted on November 16, 2005.

(2) One-third of such options vest upon the one year month anniversary of the grant date, one-third vest on the two year anniversary of the grant date, and one-third vest on the three year anniversary of the grant date.

(3) One-third of such options vest upon the six month anniversary of the grant date, one-third vest on the eighteen month anniversary of the grant date, and one-third vest on the thirty month anniversary of the grant date.

AGGREGATE OPTIONS EXERCISEABLE IN LAST FISCAL YEAR AND FISCAL YEAR END OPTION VALUES

	Number of Securities Underlying Unexercised Options at December 31, 2005 (1)		Value of Unexercised In-the-Money Options at December 31, 2005 (1)	
Name and Principal Position	Exercisable	Unexercisable	Exercisable	Unexercisable
Glenn Peipert, Executive Vice President, Chief Operating Officer and Director	0	250,000	$0	$0
Robert C. DeLeeuw, Senior Vice President	0	250,000	$0	$0
Mitchell Peipert Vice President , Chief Financial Officer, Secretary and Treasurer	100,000	350,000	$0	$0

(1) As of December 30, 2005 the market value of a share of common stock was $0.53. No shares were exercised by executive officers or directors in fiscal year ended December 31, 2005.

2003 Incentive Plan

General

The 2003 Incentive Plan was approved at a special meeting of our stockholders on January 23, 2004. The Plan authorizes us to issue 6,666,667 shares of common stock for issuance upon exercise of options, and such shares have been reserved. It also authorizes the issuance of stock appreciation rights, referred to herein as SARs. The Plan authorizes us to grant:

- incentive stock options to purchase shares of our common stock,
- non-qualified stock options to purchase shares of common stock, and
- SARs and shares of restricted common stock.

The Plan may be amended, terminated or modified by our Board of Directors or our Stock Option Committee at any time, subject to stockholder approval as required by law, rule or regulation. No such termination, modification or amendment may affect the rights of an optionee under an outstanding option or the grantee of an award.

Objectives

The objective of the Plan is to provide incentives to our officers, other key employees, consultants, professionals and non-employee directors to achieve financial results aimed at increasing stockholder value and attracting talented individuals to CSI. Persons eligible to be granted incentive stock options under the Plan will be those employees, consultants, professionals and non-employee directors whose performance, in the judgment of the Stock Option Committee of our Board of Directors, can have a significant effect on our success.

Oversight

The Stock Option Committee, consisting of our independent directors Lawrence K. Reisman (chairman) and Joseph Santiso, administers the Plan by making determinations regarding the persons to whom options should be granted and the amount, terms, conditions and restrictions of the awards. The Board or the Stock Option Committee also has the authority to interpret the provisions of the Plan and to establish and amend rules for its administration subject to the Plan's limitations.

Types of grants

The Plan allows us to grant incentive stock options, non-qualified stock options, shares of restricted stock, SARs in connections with options and independent SARs. The Plan does not specify what portion of the awards may be in the form of any of the foregoing. Incentive stock options awarded to our employees are qualified stock options under the Internal Revenue Code.

Eligibility

Under the Plan, we may grant incentive stock options only to our officers and employees, and we may grant non-qualified options to officers and employees, as well as our directors, independent contractors and agents.

Statutory Conditions on Stock Options

Exercise Price. To the extent that Options designated as incentive stock options become exercisable by an optionee for the first time during any calendar year for common stock having a fair market value greater than One Hundred Thousand Dollars ($100,000), the portions of such options which exceed such amount shall be treated as nonqualified stock options. Incentive stock options granted to any person who owns, immediately after the grant, stock possessing more than 10% of the combined voting power of all classes of our stock, or of any parent or subsidiary of ours, must have an exercise price at least equal to 110% of the fair market value of common stock on the date of grant and the term of the option may not be longer than five years.

Expiration Date. Any option granted under the Plan will expire at the time fixed by the Board or the Stock Option Committee, which cannot be more than ten (10) years after the date it is granted or, in the case of any person who owns more than 10% of the combined voting power of all classes of our stock or of any parent or subsidiary corporation, not more than five years after the date of grant.

Exerciseability. The Board or its committee may also specify when all or part of an option becomes exercisable, but in the absence of such specification, the option will ordinarily be exercisable in whole or part at any time during its term. However, the Board or its committee may accelerate the exerciseability of any option at its discretion.

Assignability. Options granted under the Plan are not assignable, except by the laws of descent and distribution or as may be otherwise provided by the Board or its committee.

Payment Upon Exercise Of Options

Payment of the exercise price for any option may be in cash or by broker assisted exercise.

Stock Appreciation Rights

A Stock Appreciation Right is the right to benefit from appreciation in the value of common stock. A SAR holder, on exercise of the SAR, is entitled to receive from us in cash or common stock an amount equal to the excess of: (a) the fair market value of common stock covered by the exercised portion of the SAR, as of the date of such exercise, over (b) the fair market value of common stock covered by the exercised portion of the SAR as of the date on which the SAR was granted.

The Board or the Stock Option Committee may grant SARs in connection with all or any part of an option granted under the Plan, either concurrently with the grant of the option or at any time thereafter, and may also grant SARs independently of options.

Tax Consequences

An employee or director will not recognize income on the awarding of incentive stock options and nonstatutory options under the Plan.

An optionee will recognize ordinary income as the result of the exercise of a nonstatutory stock option in the amount of the excess of the fair market value of the stock on the day of exercise over the option exercise price.

An employee will not recognize income on the exercise of an incentive stock option, unless the option exercise price is paid with stock acquired on the exercise of an incentive stock option and the following holding period for such stock has not been satisfied. The employee will recognize long-term capital gain or loss on a sale of the shares acquired on exercise, provided the shares acquired are not sold or otherwise disposed of before the earlier of:

(i) two years from the date of award of the option, or

(ii) one year from the date of exercise.

If the shares are not held for the required period of time, the employee will recognize ordinary income to the extent the fair market value of the stock at the time the option is exercised exceeds the option price, but limited to the gain recognized on sale. The balance of any such gain will be a short-term capital gain. Exercise of an option with previously owned stock is not a taxable disposition of such stock. An employee generally must include in alternative minimum taxable income the amount by which the price such employee paid for an incentive stock option is exceeded by the option's fair market value at the time his or her rights to the stock are freely transferable or are not subject to a substantial risk of forfeiture.

As of December 31, 2005, options to purchase a total of 4,883,114 shares of common stock were outstanding at exercise prices ranging from $0.825 to $3.45 per share. Generally, one-third of the options granted vest on the first anniversary, one-third of the options granted vest on the second anniversary and one-third of the options granted vest on the third anniversary. All options expire on the ten year anniversary of their grant date.

All options described above have been issued pursuant to the 2003 Incentive Plan described above.

Employment Agreements

Scott Newman, our President and Chief Executive Officer, agreed to a five-year employment agreement dated as of March 26, 2004. The agreement provides for an annual salary to Mr. Newman of $500,000 and an annual bonus to be awarded by our Compensation Committee. No bonus was awarded in 2005. The agreement also provides for health, life and disability insurance, as well as a monthly car allowance. In the event that Mr. Newman’s employment is terminated other than with good cause, he will receive a lump sum payment of 2.99 times his base salary.

Glenn Peipert, Executive Vice President and Chief Operating Officer, agreed to a five-year employment agreement dated as of March 26, 2004. The agreement provides for an annual salary to Mr. Peipert of $375,000 and an annual bonus to be awarded by our Compensation Committee. No bonus was awarded in 2005. The agreement also provides for health, life and disability insurance, as well as a monthly car allowance. In the event that Mr. Peipert’s employment is terminated other than with good cause, he will receive a lump sum payment of 2.99 times his base salary.

Mitchell Peipert, Vice President, Chief Financial Officer, Treasurer and Secretary, agreed to a three-year employment agreement dated as of March 26, 2004. The agreement provides for an annual salary to Mr. Peipert of $200,000 and an annual bonus to be awarded by our Compensation Committee. No bonus was awarded in 2005. In August 2005, Mr. Peipert received an increase to his annual salary to $225,000. The agreement also provides for health, life and disability insurance, as well as a monthly car allowance. In the event that Mr. Peipert’s employment is terminated other than with good cause, he will receive a lump sum payment of 2.99 times his base salary.

Robert C. DeLeeuw, Senior Vice President and President of our wholly owned subsidiary, DeLeeuw Associates, LLC, agreed to a three-year employment agreement dated as of February 27, 2004. The agreement provides for an annual salary to Mr. DeLeeuw of $350,000 and an annual bonus to be awarded by our Compensation Committee. No bonus was awarded in 2005. The agreement also provides for health, life and disability insurance. In the event that Mr. DeLeeuw’s employment is terminated other than with good cause, he will receive a lump sum payment of the longer of (1) one year's base salary or (2) the period from the date of termination through the expiration date.

William McKnight, Senior Vice President - Data Warehousing, agreed to a three-year employment agreement dated as of July 22, 2005. The agreement provides for an annual salary to Mr. McKnight of $250,000 and an annual bonus to be awarded by our Compensation Committee. No bonus was awarded in 2005. The agreement also provides for health, life and disability insurance. In the event that Mr. McKnight’s employment is terminated other than with good cause, he will receive a lump sum payment of the longer of (1) one year's base salary or (2) the period from the date of termination through the expiration date.

ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The following table sets forth certain information regarding the beneficial ownership of our common stock, our only class of outstanding voting securities as of March 31, 2006, based on 49,997,834 aggregate shares of common stock outstanding as of such date, by: (i) each person who is known by us to own beneficially more than 5% of our outstanding common stock with the address of each such person, (ii) each of our present directors and officers, and (iii) all officers and directors as a group:

Name and Address of Beneficial Owner(1)(2)	Amount of Common Stock Beneficially Owned	Percentage of Outstanding Common Stock Beneficially Owned
Scott Newman(3)	19,613,056	39.2%
Glenn Peipert(4)	9,346,032	18.7%
Mitchell Peipert(5)	250,000	*
Robert C. DeLeeuw(6)	5,333,334	10.7%
William McKnight(7)	909,091	1.8%
Lawrence K. Reisman(8)	20,000	*
Joseph Santiso(9)	0	
All directors and officers as a group (7 persons)	35,471,513	70.6%

* Represents less than 1% of the issued and outstanding Common Stock.

(1) Each stockholder, director and executive officer has sole voting power and sole dispositive power with respect to all shares beneficially owned by him, unless otherwise indicated.

(2) All addresses are c/o Conversion Services International, Inc., 100 Eagle Rock Avenue, East Hanover, New Jersey 07936.

(3) Mr. Newman is the Company's President, Chief Executive Officer and Chairman of the Board.

(4) Mr. Glenn Peipert is the Company's Executive Vice President, Chief Operating Officer and Director. Does not include an option to purchase 250,000 shares of common stock granted on November 16, 2005 and expiring on November 16, 2010 at an exercise price of $.83 per share, which vest as follows: (i) 83,333 on November 16, 2006; (ii) 83,333 on November 16, 2007; (iii) 83,334 on November 16, 2008.

(5) Mr. Mitchell Peipert is the Company's Vice President, Chief Financial Officer, Secretary and Treasurer. Consists of an option to purchase 300,000 shares of common stock granted on March 29, 2004 at an exercise price of $2.475 per share, 200,000 of which have vested and 100,000 of which shall vest on March 29, 2007. The option grant expires on March 28, 2014. Consists of an option to purchase 150,000 shares of common stock granted on November 16, 2005 at an exercise price of $.83 per share, 50,000 of which have vested, 50,000 of which vest on May 16, 2007 and 50,000 of which vest on May 16, 2008.

(6) Mr. DeLeeuw is the Company's Senior Vice President and the President of the Company's wholly owned subsidiary, DeLeeuw Associates, LLC. Does not include an option to purchase 250,000 shares of common stock granted on November 16, 2005 and expiring on November 16, 2010 at an exercise price of $.83 per share, which vest as follows: (i) 83,333 on November 16, 2006; (ii) 83,333 on November 16, 2007; (iii) 83,334 on November 16, 2008. Does not include an option to purchase 1,000,000 shares of common stock granted on January 9, 2006 and expiring on January 9, 2011 at an exercise price of $.46 per share, which vest as follows: (i) 333,333 on January 9, 2007; (ii) 333,333 on January 9, 2008; (iii) 333,334 on January 9, 2009.

(7) Mr. McKnight is the Company's Senior Vice President - Data Warehousing.

(8) Mr. Reisman is a Director. Consists of an option to purchase 20,000 shares of common stock granted on May 28, 2004 at an exercise price of $3.00 per share, 10,000 of which have vested and 10,000 of which vest on May 28, 2006. Does not include an option to purchase 10,000 shares of common stock granted on May 28, 2004 at an exercise price of $3.00 per share, which vest on May 28, 2007. The option grant expires on May 27, 2014. Does not include an portion to purchase 20,000 shares of common stock granted on November 16, 2005 at an exercise price of $.83 which vest as follows: (i) 6,666 on November 16, 2006; (ii) 6,667 on November 16, 2007; (iii) 6,667 on November 16, 2008

(9) Mr. Santiso is a Director. Does not include an option to purchase 10,000 shares of common stock granted on November 16, 2005 at an exercise price of $0.83 per share, which vest as follows: (i) 3,333 on November 16, 2006; (ii) 3,333 on November 16, 2007; (iii) 3,334 on November 16, 2008.

Equity Compensation Plan Disclosure

The following table sets forth certain information as of December 31, 2005 regarding securities:

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans
Equity Compensation Plans Approved by Security Holders	4,883,114	$ 1.43	1,783,553
Equity Compensation Plans Not Approved by Security Holders	-	-	-
Total	4,883,114	$ 1.43	1,783,553

ITEM 12. CERTAIN RELATIONSHIPS AND RELATED PARTY TRANSACTIONS

On November 8, 2004, Mr. Scott Newman entered into a stock purchase agreement with a private investor, CMKX-treme, Inc. Pursuant to the agreement, CMKX-treme, Inc. agreed to purchase 188,889 shares of common stock for a purchase price of $250,000. As of April 10, 2006, the shares have not been issued to CMKX-treme, Inc. because it has not yet remitted payment for the shares.

On November 8, 2004, Mr. Glenn Peipert entered into a stock purchase agreement with a private investor, CMKX-treme, Inc. Pursuant to the agreement, CMKX-treme, Inc. agreed to purchase 377,778 shares of common stock for a purchase price of $500,000. As of June 9, 2005, CMKX-treme, Inc. remitted final payment for the shares.

On November 10, 2004, the Company and Dr. Michael Mitchell, the former President, Chief Executive Officer and sole director of LCS, executed a one-year consulting agreement whereby Dr. Mitchell would perform certain consulting services on behalf of the Company. Dr. Mitchell will receive an aggregate amount of $0.25 million as compensation for services provided to the Company. During 2005, an aggregate amount of $175,000 was paid to Mr. Mitchell for services provided under this consulting agreement.

As of November 16, 2004, Mr. Newman and Mr. Peipert repaid in full to the Company loans in the aggregate of approximately $0.2 million, including accrued interest. These loans bore interest at 3% per annum and were due and payable by December 31, 2005.

As of April 7, 2006, Mr. Scott Newman, President, Chief Executive Officer and Chairman, Mr. Glenn Peipert, Executive Vice President, Chief Operating Officer and Director, and Mr. Robert C. DeLeeuw, Senior Vice President, have agreed to personally support our cash requirements to enable us to fulfill our obligations through June 1, 2007, to the extent necessary, up to a maximum amount of $1.5 million, based upon their ability to sell their Company common stock. Mr. Newman guaranties up to approximately $0.9 million, Mr. Peipert guaranties up to approximately $0.4 million and Mr. DeLeeuw guaranties approximately $0.2 million. We believe that these written commitments provide us with the legal right to request and receive such advances from any of these officers. Any loan by Messrs. Newman, Peipert and DeLeeuw to the Company would bear interest at 8% per annum. As of December 31, 2005, Mr. Newman’s outstanding loan balance to the Company was $0.9 million, and Mr. Peipert’s outstanding loan balance to the Company was $0.9 million. The unsecured loans by Mr. Newman and Mr. Peipert each accrue interest at a simple rate of 8% per annum, and each has a term expiring on April 30, 2007. As of the date of this filing, the entire $1.5 million was still available pursuant to the guaranties outlined above.

Other than those described above, during the last two fiscal years, we have no material transactions which involved or are planned to involve a direct or indirect interest of a director, executive officer, greater than 5% stockholder or any family of such parties.

ITEM 13. EXHIBITS

2.1 Agreement and Plan of Reorganization, dated August 21, 2003, among the Company, LCS Acquisition Corp., Conversion Services International, Inc. and certain affiliated stockholders of Conversion Services International, Inc. (filed as Appendix A on Schedule 14A on January 5, 2004).

2.2 First Amendment to Agreement and Plan of Reorganization, dated November 28, 2003, among the Company, LCS Acquisition Corp., Conversion Services International, Inc. and certain affiliated stockholders of Conversion Services International, Inc. (filed as Appendix A on Schedule 14A on January 5, 2004).

2.4 Acquisition Agreement, dated February 27, 2004, among the Company, DeLeeuw Associates, Inc. and Robert C. DeLeeuw (filed as Exhibit 2.1 on Form 8-K on March 16, 2004).

2.5 Plan and Agreement of Merger and Reorganization, dated February 27, 2004, among the Company, DeLeeuw Associates, Inc. and DeLeeuw Conversion LLC filed as Exhibit 2.1 on Form 8-K on March 16, 2004).

2.6 Asset Purchase Agreement, dated May 26, 2004, among the Registrant, Evoke Asset Purchase Corp. and Evoke Software Corporation (filed as Exhibit 2.1 on Form 8-K on July 13, 2004).

2.7 Asset Purchase Agreement, dated July 18, 2005 by and among the registrant, Similarity Vector Technologies (Sivtech) Limited (d/b/a Similarity Systems), Similarity Systems Inc. and Evoke Software Corporation (filed as Exhibit 2.1 on Form 8-K on September 27, 2004).

2.8 Agreement and Plan of Merger, dated July 22, 2005 among the Registrant., McKnight Associates, Inc., McKnight Associates, Inc. and William McKnight (filed as Exhibit 2 on Form 8-K on July 28, 2005).

2.9 Agreement and Plan of Merger, dated July 29, 2005 by and among the Registrant, ISI Merger Corp., Integrated Strategies, Inc., ISI Consulting LLC, Adam Hock and Larry Hock (filed as Exhibit 2 on Form 8-K on August 3, 2005).

3.1 Certificate of Incorporation, as amended (filed as Exhibit 3.1 on Form 10-SB on December 9, 1999).

3.2 Certificate of Amendment to the Company's Certificate of incorporation, dated January 27, 2004, amending, among other things, the authorized shares of common and preferred stock (filed as Exhibit 3.1 on Form 8-K on February 17, 2004).

3.3 Certificate of Amendment to the Company's Certificate of Incorporation, dated January 30, 2004, changing the name of the Company from LCS Group, Inc. to Conversion Services International, Inc. (filed as Exhibit 3.2 on Form 8-K on February 17, 2004).

3.4 Certificate of Merger, dated January 30, 2004, relating to the merger of LCS Acquisition Corp. and Conversion Services International, Inc. (filed as Exhibit 2.3 on Form 8-K on February 17, 2004).

3.5 Amended and Restated Bylaws (filed as Exhibit 3.3 on Form 8-K on February 17, 2004).

3.6 Certificate of Merger (Delaware) of McKnight Associates, Inc. (filed as Exhibit 3.1 on Form 8-K on July 28, 2005).

3.7 Articles of Merger (Texas) of McKnight Associates, Inc. (filed as Exhibit 3.1 on Form 8-K on July 28, 2005).

3.8 Certificate of Merger of Integrated Strategies, Inc. and ISI Consulting, LLC with and into ISI Merger Corp. (filed as Exhibit 3.1 on Form 8-K on August 3, 2005).

4.1 Common Stock Purchase Warrant, dated August 16, 2004, in favor of Laurus Master Fund, Ltd. (filed as Exhibit 4.7 on Form 10-QSB on August 23, 2004).

4.2 Secured Convertible Minimum Borrowing Note, dated August 16, 2004 (filed as Exhibit 4.4 on Form 10-QSB on August 23, 2004).

4.3 Secured Revolving Note, dated August 16, 2004 (filed as Exhibit 4.5 on Form 10-QSB on August 23, 2004).

4.4 Secured Convertible Term Note, dated August 16, 2004 (filed as Exhibit 4.6 on Form 10-QSB on August 23, 2004).

4.5 Senior Subordinated Secured Convertible Promissory Note, dated September 22, 2004, in favor of Sands Brothers Venture Capital LLC (filed as Exhibit 10.1 on Form 8-K on September 27, 2004).

4.6 Senior Subordinated Secured Convertible Promissory Note, dated September 22, 2004, in favor of Sands Brothers Venture Capital III LLC (filed as Exhibit 10.2 on Form 8-K on September 27, 2004).

4.7 Senior Subordinated Secured Convertible Promissory Note, dated September 22, 2004, in favor of Sands Brothers Venture Capital IV LLC (filed as Exhibit 10.3 on Form 8-K on September 27, 2004).

4.8 Common Stock Purchase Warrant, dated September 22, 2004, in favor of Sands Brothers Venture Capital LLC (filed as Exhibit 4.1 on Form 8-K on September 27, 2004).

4.9 Common Stock Purchase Warrant, dated September 22, 2004, in favor of Sands Brothers Venture Capital III LLC (filed as Exhibit 4.2 on Form 8-K on September 27, 2004).

4.10 Common Stock Purchase Warrant, dated September 22, 2004, in favor of Sands Brothers Venture Capital IV LLC (filed as Exhibit 4.3 on Form 8-K on September 27, 2004).

4.11 Promissory Note, dated July 29, 2005, in favor of Adam Hock and Larry Hock (filed as Exhibit 10.1 on Form 8-K on August 3, 2005)

4.12 Subordinated Promissory Note, dated July 29, 2005, in favor of Adam Hock and Larry Hock (filed as Exhibit 10.2 on Form 8-K on August 3, 2005)

4.13 Option to purchase shares of common stock, dated July 28, 2005, (filed as Exhibit 4.1 on Form 8-K on August 3, 2005).

4.14 Amended and Restated Revolving Note, dated August 16, 2004, in favor of Laurus Master Fund, Ltd. (filed as Exhibit 10.1 on Form 8-K on August 3, 2005).

4.15 Amended and Restated Secured Convertible Term Note, dated August 16, 2004, in favor of Laurus Master Fund, Ltd. (filed as Exhibit 10.2 on Form 8-K on August 3, 2005).

4.16 Amended and Restated Secured Revolving Note, dated August 16, 2004, as amended and restated on July 28, 2005 in favor of Laurus Master Fund, Ltd (filed as Exhibit 10.1 on Form 8-K on December 6, 2005).

4.17 Amended and Restated Secured Convertible Term Note, dated August 16, 2004, as amended and restated on July 28, 2005 in favor of Laurus Master Fund, Ltd (filed as Exhibit 10.2 on Form 8-K on December 6, 2005).

4.18 Amended and Restated Secured Convertible Minimum Borrowing Note, dated August 16, 2004, as amended and restated on July 28, 2005 in favor of Laurus Master Fund, Ltd (filed as Exhibit 10.3 on Form 8-K on December 6, 2005).

4.19 Option to purchase shares of common stock, dated February 1, 2006 (filed as Exhibit 4.1 on Form 8-K on February 7, 2006).

4.20 Secured Non-Convertible Revolving Note, dated February 1, 2006, in favor of Laurus Master Fund, Ltd (filed as Exhibit 10.1 on Form 8-K on February 7, 2006).

4.21 Certificate of Designations of Preferences, Rights and Limitations of Series A Convertible Preferred Stock of the Registrant (filed as Exhibit 4.1 on Form 8-K on February 8, 2006).

4.22 Common Stock Purchase Warrant, dated February 2, 2006 (filed as Exhibit 10.3 on Form 8-K on February 8, 2006).

10.1 Employment Agreement among the Company and Scott Newman, dated March 26, 2004 (filed as Exhibit 10.1 on Form 8-K/A on April 1, 2004).

10.2 Employment Agreement among the Company and Glenn Peipert, dated March 26, 2004 (filed as Exhibit 10.2 on Form 8-K/A on April 1, 2004).

10.3 Employment Agreement among the Company and Mitchell Peipert, dated March 26, 2004 (filed as Exhibit 10.3 on Form 8-K/A on April 1, 2004).

10.4 Employment Agreement among the Company and Robert DeLeeuw, dated March 26, 2004 (filed as Exhibit 10.4 on Form SB-2/A on September 30, 2004).

10.5 2003 Incentive Plan (filed as Exhibit 4.1 to Form S-8 filed on November 11, 2005).

10.6 Security Agreement, dated August 16, 2004, among the Registrant, DeLeeuw Associates, LLC, CSI Sub Corp. (DE), Evoke Software Corporation and Laurus Master Fund, Ltd. (filed as Exhibit 4.1 on Form 10-QSB on August 23, 2004).

10.7 Stock Pledge Agreement, dated August 16, 2004, among the Registrant and Laurus Master Fund, Ltd. (filed as Exhibit 4.8 on Form 10-QSB on August 23, 2004).

10.8 Securities Purchase Agreement, dated August 16, 2004, among the Registrant and Laurus Master Fund, Ltd. (filed as Exhibit 4.2 on Form 10-QSB on August 23, 2004).

10.9 Registration Rights Agreement, dated August 16, 2004, among the Registrant and Laurus Master Fund, Ltd. (filed as Exhibit 4.3 on Form 10-QSB on August 23, 2004).

10.10 Security Agreement, dated September 22, 2004, among the Registrant, Sands Brothers Venture Capital LLC, Sands Brothers Venture Capital III LLC and Sands Brothers Venture Capital IV LLC (filed as Exhibit 10.4 on Form 8-K on September 27, 2004).

10.11 Subordination Agreement, dated September 22, 2004, among the Registrant, Sands Brothers Venture Capital LLC, Sands Brothers Venture Capital III LLC, Sands Brothers Venture Capital IV LLC and Laurus Master Fund, Ltd. (filed as Exhibit 10.5 on Form 8-K on September 27, 2004).

10.12 Registration Rights Agreement, dated September 22, 2004, among the Company, Sands Brothers Venture Capital LLC, Sands Brothers Venture Capital III LLC and Sands Brothers Venture Capital IV LLC (filed as Exhibit 4.4 on Form 8-K on September 27, 2004).

10.13 Consulting Agreement with Morgan Stanley & Co., Incorporated (filed as Exhibit 10.18 on Form SB-2/A on January 19, 2005).

10.14 Consulting Agreement with Cellco Partnership (now known as Verizon Wireless) (filed as Exhibit 10.19 on Form SB-2/A on January 19, 2005).

10.15 Restricted Account Agreement by and among the Registrant, North Fork Bank and Laurus Master Fund, Ltd. (filed as Exhibit 10.11 on Form 10-KSB/A on July 26, 2005).

10.16 Employment Agreement dated July 22, 2005 by and between the Registrant and William McKnight (filed as Exhibit 10.1 on Form 8-K on July 28, 2005).

10.17 Omnibus Amendment, dated July 28, 2005 (filed as Exhibit 10.3 on Form 8-K on August 3, 2005).

10.18 Joinder, dated July 28, 2005 (filed as Exhibit 10.4 on Form 8-K on August 3, 2005).

10.19 Reaffirmation and Ratification Agreement, dated July 28, 2005 (filed as Exhibit 10.5 on Form 8-K on August 3, 2005).

10.20 Overadvance Letter, dated July 28, 2005 (filed as Exhibit 10.6 on Form 8-K on August 3, 2005).

10.21 Omnibus Amendment, dated November 30, 2005 (filed as Exhibit 10.4 on Form 8-K on December 6, 2005).

10.22 Reaffirmation and Ratification Agreement, dated November 30, 2005 (filed as Exhibit 10.5 on Form 8-K on December 6, 2005).

10.23 Security Agreement dated February 1, 2006 by and among Laurus Master Fund, Ltd., the Registrant, DeLeeuw Associates, LLC, CSI Sub Corp. (DE), Integrated Strategies, Inc., CSI Sub Corp. II (DE), and McKnight Associates, Inc. (filed as Exhibit 10.3 on Form 8-K on February 7, 2006).

10.24 Stock Pledge Agreement, dated February 1, 2006 (filed as Exhibit 10.4 on Form 8-K on February 7, 2006).

10.25 Overadvance Side Letter dated February 1, 2006 (filed as Exhibit 10.5 on Form 8-K on February 7, 2006).

10.26 Stock Purchase Agreement dated February 2, 2006 by and between the Registrant and Taurus Advisory Group, LLC (filed as Exhibit 10.1 on Form 8-K on February 8, 2006).

10.27 Registration Rights Agreement dated February 2, 2006 by and between the Registrant and Taurus Advisory Group, LLC (filed as Exhibit 10.1 on Form 8-K on February 8, 2006).

14.1 Code of Conduct and Ethics (filed as Exhibit 14 on Form SB-2, filed on November 24, 2004).

21* Subsidiaries of the Company.

23.1* Consent of Friedman LLP, Independent Registered Public Accounting Firm.

31.1* Certification of the Company's Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934.

31.2* Certification of the Company's Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934.

32.1* Certification of the Company's Chief Executive Officer pursuant to Rule 13a-14(b)/15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350.

32.2* Certification of the Company's Chief Financial Officer pursuant to Rule 13a-14(b)/15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350.

---

* filed herewith

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.

The following table sets forth fees billed to us by our independent registered public accounting firms during the fiscal years ended December 31, 2005 and December 31, 2004 for: (i) services rendered for the audit of our annual financial statements and the review of our quarterly financial statements; (ii) services by our independent registered public accounting firms that are reasonably related to the performance of the audit or review of our financial statements and that are not reported as Audit Fees; (iii) services rendered in connection with tax compliance, tax advice and tax planning; and (iv) all other fees for services rendered.

	December 31, 2005	December 31, 2004
Audit Fees	$ 319,748	$ 281,975
Audit Related Fees	$ 8,700	$ 212,480
Tax Fees	$ 78,850	$ 36,799
All Other Fees	$ -	$ -
	$ 407,298	$ 531,254

Audit Committee Policies

The board of directors is solely responsible for the approval in advance of all audit and permitted non-audit services to be provided by the independent auditors (including the fees and other terms thereof), subject to the de minimus exceptions for non-audit services provided by Section 10A(i)(1)(B) of the Exchange Act, which services are subsequently approved by the board of directors prior to the completion of the audit. None of the fees listed above are for services rendered pursuant to such de minimus exceptions.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Conversion Services International, Inc. and Subsidiaries
East Hanover, New Jersey

We have audited the accompanying consolidated balance sheets of Conversion Services International, Inc. and Subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of operations, stockholders' equity, and cash flows for the two years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Conversion Services International, Inc. and Subsidiaries as of December 31, 2005, and the consolidated results of its operations and its cash flows for the two years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Notes 1 and 22 to the consolidated financial statements, the Company has restated its consolidated financial statements for the year ended December 31, 2004.

/s/ Friedman LLP

East Hanover, New Jersey
April 20, 2006

CONVERSION SERVICES INTERNATIONAL, INC.
AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
DECEMBER 31,

		2005		2004 (as Restated, see Notes 1 and 22)
ASSETS				
CURRENT ASSETS				
Cash	$	176,073	$	1,028,146
Restricted cash		-		83,375
Accounts receivable, net of allowance for doubtful accounts of $489,070 and $209,582 in 2005 and 2004, respectively		3,194,375		4,349,229
Accounts receivable from related parties; (Note 21)		569,908		781,100
Prepaid expenses		142,432		309,459
TOTAL CURRENT ASSETS		4,082,788		6,551,309
PROPERTY AND EQUIPMENT, at cost, net; (Note 6)		417,469		587,575
OTHER ASSETS				
Restricted cash		-		4,269,377
Goodwill		7,239,566		4,690,972
Intangible assets, net of accumulated amortization of $740,350 and $911,142 in 2005 and 2004, respectively; (Note 7)		1,862,964		3,627,096
Deferred financing costs, net of accumulated amortization of $467,604 and $126,767 in 2005 and 2004, respectively; (Note 8)		425,705		766,542
Discount on debt issued, net of accumulated amortization of $678,917 and $941,212 in 2005 and 2004, respectively; (Note 9)		4,177,428		8,217,278
Equity investments		149,117		144,460
Other assets		123,432		13,420
		13,978,212		21,729,145
Total Assets	$	18,478,469	$	28,868,029
LIABILITIES AND STOCKHOLDERS' EQUITY				
CURRENT LIABILITIES				
Line of credit; (Note 10)	$	4,713,312	$	3,733,403
Current portion of long-term debt		495,122		120,834
Accounts payable and accrued expenses		2,519,446		3,777,940
Short term note payable; (Note 11)		1,063,990		1,000,000
Deferred revenue		41,121		1,327,222
Financial instruments; (Note 12)		2,209,733		10,515,091
TOTAL CURRENT LIABILITIES		11,042,724		20,474,490
		3,042,914		6,659,449

LONG-TERM DEBT, net of current portion, (Note 13)				
RELATED PARTY NOTE PAYABLE; (Note 21)		1,772,368		307,981
DEFERRED TAXES		363,400		-
Total Liabilities		16,221,406		27,441,920
MINORITY INTEREST		-		131,587
COMMITMENTS AND CONTINGENCIES; (Note 20)		-		-
STOCKHOLDERS' EQUITY				
Common stock, $0.001 par value, 85,000,000 shares authorized;				
54,093,916 and 51,472,140 issued and outstanding in 2005 and 2004, respectively		54,094		51,472
Additional paid in capital		42,264,407		36,814,064
Accumulated deficit		(40,061,438)		(35,576,312)
Accumulated other comprehensive income		-		5,298
Total Stockholders' Equity		2,257,063		1,294,522
Total Liabilities and Stockholders' Equity	$	18,478,469	$	28,868,029

See Notes to Consolidated Financial Statements.

89

CONVERSION SERVICES INTERNATIONAL, INC.
AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31,

	2005	2004 (as Restated, see Notes 1 and 22)
REVENUE:		
Services	$ 23,392,464	$ 19,755,370
Related party services	3,731,198	3,837,065
Software	123,198	184,882
Support and maintenance	225,133	42,979
Other	157,916	72,810
	27,629,909	23,893,106
COST OF REVENUE:		
Services (inclusive of stock-based compensation of zero and $1.4 million at December 31, 2005 and 2004, respectively)	17,316,494	15,367,477
Related party services	3,215,909	3,345,318
Software	-	134,182
Support and maintenance	-	-
Other	-	-
	20,532,403	18,846,977
GROSS PROFIT	7,097,506	5,046,129
OPERATING EXPENSES		
Selling and marketing	4,521,054	3,210,790
General and administrative (inclusive of stock-based compensation of $0.5 million and $0.1 million at December 31, 2005 and 2004, respectively)	6,418,245	6,086,017
Goodwill and intangibles impairment	1,321,543	12,247,234
Depreciation and amortization	911,772	468,235
	13,172,614	22,012,276
LOSS FROM OPERATIONS	(6,075,108)	(16,966,147)
OTHER INCOME (EXPENSE)		
Equity in earnings from investments	4,657	5,684
Financial instruments	8,424,493	(551,241)
Loss on early extinguishment of debt	(1,607,763)	-
Other income	-	7,300
Interest income	69,166	22,355
Interest expense	(4,201,823)	(5,024,449)
	2,688,730	(5,540,351)
LOSS BEFORE INCOME TAXES AND DISCONTINUED OPERATIONS	(3,386,378)	(22,506,498)
INCOME TAXES	-	190,800
NET LOSS FROM CONTINUING OPERATIONS	(3,386,378)	(22,697,298)

DISCONTINUED OPERATIONS (Note 4):				
Gain on disposal of discontinued operations	$	49,148	$	-
Loss from discontinued operations		(1,153,119)		(12,650,908)
		(1,103,971)		(12,650,908)
NET LOSS	$	(4,490,349)	$	(35,348,206)
Basic net loss per share from continuing operations	$	(0.06)	$	(0.49)
Basic net loss per share from discontinued operations	$	(0.02)	$	(0.27)
Basic net loss per share	$	(0.08)	$	(0.76)
Diluted net loss per share from continuing operations	$	(0.06)	$	(0.49)
Diluted net loss per share from discontinued operations	$	(0.02)	$	(0.27)
Diluted net loss per share	$	(0.08)	$	(0.76)
Weighted average shares used to compute net loss per share:				
Basic		52,919,340		46,548,065
Diluted		52,919,340		46,548,065

See Notes to Consolidated Financial Statements.

90

CONVERSION SERVICES INTERNATIONAL, INC.
AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

	Common Shares	Capital Stock	Additional Paid-in Capital	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income	Total Stockholders' Equity	Comprehensive Loss
Balance, December 31, 2003	66,667	$ 67	$ 1,447,183	$ (228,106)	$ -	$ 1,219,144	
Net loss	-	-	-	(35,348,206)		(35,348,206)	(35,348,206)
Foreign currency translation	-	-	-	-	5,298	5,298	5,298
Effect of Conversion Services International recapitalization	(66,667)	(67)	67	-	-	-	
Relative fair value of warrants issued	-	-	500,000	-	-	500,000	
Issuance of Common Stock in connection with the reverse merger into LCS Golf.	39,533,333	39,533	(39,533)	-	-	-	
Issuance of Common Stock in connection with the acquisition of DeLeeuw Associates, Inc.	5,333,333	5,333	15,834,667	-	-	15,840,000	
Issuance of Common Stock in connection with the conversion of debt into Company stock.	1,269,841	1,270	1,998,730	-	-	2,000,000	
Issuance of Common Stock in connection with the acquisition of Evoke Software Corporation.	5,097,537	5,098	12,379,000	-	-	12,384,098	
Issuance of Common Stock in connection with a stock purchase	238,095	238	499,762	-	-	500,000	

agreement.							
Compensation expense for stock and stock option grants	-	-	1,479,902	-	-	1,479,902	
Discount on debt issued	-	-	1,500,000	-	-	1,500,000	
Unsecured convertible line of credit beneficial conversion feature	-	-	1,214,286	-	-	1,214,286	
Total comprehensive loss	-	-	-	-	-	-	(35,342,908)
Balance, December 31, 2004, as restated (See Notes 1 and 22)	51,472,139	$ 51,472	$ 36,814,064	$ (35,576,312)	$ 5,298	$ 1,294,522	
Net loss	-	-	-	(4,490,349)	-	(4,490,349)	(4,490,349)
Foreign currency translation	-	-	-	-	(75)	(75)	(75)
Sale of Evoke Software Corp.	-	-	-	5,223	(5,223)	-	
Issuance of Common Stock in connection with a stock purchase agreement.	595,238	595	1,249,405	-	-	1,250,000	
Issuance of Common Stock in connection with a conversion of debt to equity.	476,190	476	999,524	-	-	1,000,000	
Issuance of Common Stock in connection with a legal settlement.	21,368	21	80,107	-	-	80,128	
Issuance of Common Stock in connection with the Evoke Software Corp. acquisition.	286,204	287	429,019	-	-	429,306	
Issuance of Common Stock in connection with the acquisition of McKnight Associates	909,091	909	1,771,818	-	-	1,772,727	
Issuance of Common Stock in connection with a	333,334	334	776,333	-	-	776,667	

stock option exercise.							
Issuance of fractional shares resulting from the 1:15 reverse stock split.	352	-	-	-	-	-	
Compensation expense for stock and stock option grants.	-	-	33,026	-	-	33,026	
Relative fair value of warrants issued.	-	-	111,111	-	-	111,111	
Total comprehensive loss	-	-	-	-	-	-	(4,490,424)
Balance, December 31, 2005	54,093,916	$ 54,094	$ 42,264,407	$ (40,061,438)	$ -	$ 2,257,063	

See Notes to Consolidated Financial Statements.

91

CONVERSION SERVICES INTERNATIONAL, INC.
AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31,

		2005		2004 (as Restated, see Notes 1 and 22)
CASH FLOWS FROM OPERATING ACTIVITIES:				
Net loss	$	(4,490,349)	$	(35,348,205)
Net loss from discontinued operations		(1,103,971)	$	(12,650,908)
Net loss from continuing operations	$	(3,386,378)	$	(22,697,297)
Adjustments to reconcile net loss from continuing operations to net cash used in operating activities:				
Depreciation and amortization of leasehold improvements		137,798		132,890
Amortizaton of intangible assets		433,137		217,503
Amortization of discount on debt		2,873,617		941,212
Amortization of relative fair value of warrants issued		110,105		60,652
Amortization of deferred financing costs		340,837		134,402
Excess of derivative value over notional amount of debt		449,275		2,305,360
Beneficial conversion feature associated with convertible debt instruments		-		1,214,286
Deferred taxes		-		190,800
Goodwill impairment		1,321,543		12,247,235
Stock and stock option based compensation		542,460		1,479,902
(Gain) loss on change in fair value of financial instruments		(8,424,493)		551,240
Loss on early extinguishment of debt		1,607,763		-
Allowance for doubtful accounts		92,862		91,823
Write-off deferred loan costs		-		45,213
Loss on disposal of equipment		-		88,190
Income from equity investments		(4,657)		(5,684)
Changes in operating assets and liabilities:				
(Increase) decrease in accounts receivable		1,042,245		(1,040,154)
(Increase) decrease in accounts receivable from related parties		211,192		(388,100)
(Increase) decrease in prepaid expenses		69,419		(95,574)
(Increase) decrease in other assets		(108,375)		14,721
Increase (decrease) in accounts payable and accrued expenses		(550,502)		1,639,815
Increase (decrease) in deferred revenue		(75,546)		116,667
Net cash used in operating activities of continuing operations		(3,317,698)		(2,754,898)

Net cash used in operating activities of discontinued operations		(302,260)		(1,692,381)
Net cash used in operating activities		(3,619,958)		(4,447,279)
CASH FLOWS FROM INVESTING ACTIVITIES:				
Acquisition of property and equipment		(31,498)		(143,582)
Investment in DeLeeuw Associates, net of cash acquired		-		(2,010,266)
Investment in Evoke Software Corp., net of cash acquired		-		334,073
Investment in McKnight Associates, Inc., net of cash acquired		(946,412)		
Investment in Integrated Strategies, Inc., net of cash acquired		(2,175,820)		
Equity investment in Leading Edge Communications Corp.		-		(83,000)
Net cash used in investing activities of continuing operations		(3,153,730)		(1,902,775)
Net cash used in investing activities of discontinued operations		-		(4,251)
Net proceeds from the sale of discontinued operations		644,958		-
Net cash used in investing activities		(2,508,772)		(1,907,026)
CASH FLOWS FROM FINANCING ACTIVITIES:				
Net advances under line of credit		1,838,307		1,950,704
Principal payment on short-term notes		(76,054)		
Issuance of short-term note payable		1,000,000		1,000,000
Issuance of long-term note payable		-		4,730,623
Issuance of long-term note payable to stockholders		1,767,914		307,981
Deferred loan costs		-		(893,309)
Principal payments on long-term debt		(4,348,695)		(665,085)
Proceeds from sale of Company common stock		1,255,000		500,000
Principal payments on capital lease obligations		(117,778)		(85,595)
Proceeds from repayment of stockholder loans		-		203,623
Principal payments on stockholder loans		(381,561)		-
Restricted cash		4,334,375		(83,375)
Net cash provided by financing activities		5,271,508		6,965,567
Effect of exchange rate changes on cash and cash equivalents		5,149		5,298
NET (DECREASE) INCREASE IN CASH		(852,073)		616,560
CASH, beginning of period		1,028,146		411,586
CASH, end of period	$	176,073	$	1,028,146

See Notes to Consolidated Financial Statements.

CONVERSION SERVICES INTERNATIONAL, INC.
AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31,

	2005		2004 (as Restated, see Notes 1 and 22)	
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:				
Cash paid for interest	$	558,419	$	276,680
Cash paid for income taxes		-		-
SUPPLEMENTAL DISCLOSURE OF NON-CASH ACTIVITIES:				
During 2005 and 2004, the Company entered into various capital lease arrangements for computer and trade show equipment in the amount of $55,782 and $249,241, respectively.				
On March 4, 2004, the Company acquired DeLeeuw Associates, Inc. The components and allocations of the purchase price were based on the fair value of assets and liabilities acquired as of the acquisition date. The following assets and liabilities were obtained as a result of the acquisition.				
Accounts receivable	$	-	$	975,000
Approved vendor status		-		539,000
Tradename		-		722,000
Goodwill		-		15,844,000
Investment in limited liability company		-		56,000
Current liabilities		-		(286,000)
On June 28, 2004, the Company acquired substantially all of the assets and liabilities of Evoke Software Corporation. The components and allocations of the purchase price were based on the fair value of assets and liabilities acquired as of the acquisition date. The following assets and liabilities were obtained as a result of the acquisition.				
Cash	$	-	$	497,000
Accounts receivable		-		580,000
Customer contracts (six year life)		-		1,962,000
Tradename (indefinite life)		-		651,000
Computer software (three year life)		-		1,381,000
Goodwill		-		10,269,000

Prepaid expenses		-		78,000
Other assets		-		11,000
Furniture and equipment		-		184,000
Deferred revenue		-		(1,254,000)
Deferred compensation		-		(443,000)
Other liabilities		-		(1,302,000)
Minority interest		-		(199,000)

On July 18, 2005, the company sold certain assets and liabilities of Evoke to Similarity Systems. The following assets and liabilities of Evoke were sold to Similarity Systems:

Cash	$	8,000	$	-
Accounts receivable, net		692,000		-
Prepaid expenses		100,000		-
Property and equipment, net		77,000		-
Other assets		5,000		-
Deferred revenue		(1,649,995)		-
Accrued expenses		(163,000)		-

On July 22, 2005, the Company acquired all of the outstanding shares of McKnight Associates, Inc. The components and allocations of the purchase price were based on the fair value of the assets and liabilities acquired as of the acquisition date. The following assets and liabilities were obtained as a result of the acquisition.

Cash	$	116,000	$	-
Accounts receivable		298,000		-
Customer relationships (2.5 year life)		685,000		-
Order backlog (5 month life)		50,000		-
Proprietary presentation format (3 year life)		173,000		-
Goodwill		1,865,000		-
Accounts payable and accrued expenses		(105,000)		-
Deferred tax liability		(363,000)		-

On July 29, 2005, the Company acquired all of the outstanding shares of Integrated Strategies, Inc. The components and allocations of the purchase price were based on the fair value of the assets and liabilities acquired as of the acquisition date. The following assets and liabilities were obtained as a result of the acquisition.

Cash	$	119,000	$	-
Accounts receivable		661,000		-
Prepaid expenses		2,000		-
Fixed assets		2,000		-
Other assets		13,000		-

Goodwill	1,800,000	-
Accounts payable and accrued expenses	(173,000)	-
Notes payable	(241,000)	

See Notes to Consolidated Financial Statements.

**CONVERSION SERVICES INTERNATIONAL, INC.
AND SUBSIDIARIES**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Accounting Policies

Organization and Business

Conversion Services International, Inc. ("CSI") was incorporated in the State of Delaware and has been conducting business since 1990. CSI and its wholly owned subsidiaries (together the "Company") are principally engaged in the information technology services industry in the following areas: strategic consulting, business intelligence, data warehousing, and data management, on credit, to its customers principally located in the northeastern United States.

- On November 1, 2002, the Company acquired the operations of Scosys, Inc. ("Scosys"). Scosys is engaged in the information technology services industry.
- On January 30, 2004, the Company became a public company through its merger with a wholly owned subsidiary of LCS Group, Inc. Although LCS Group, Inc. (now known as Conversion Services International, Inc.) was the legal survivor in the merger and remains the Registrant with the Securities and Exchange Commission, the merger was accounted for as a reverse acquisition, whereby the Company was considered the accounting "acquirer" of LCS Group, Inc. for financial reporting purposes, as the Company's stockholders controlled approximately 76% of the post transaction combined company. Among other matters, reverse merger accounting requires LCS Group, Inc. to present in all financial statements and other public filings, prior historical and other information of the Company, and a retroactive restatement of the Company's historical stockholders' equity. The retroactive restatement took place subsequent to the merger on January 30, 2004.
- On March 4, 2004, the Company acquired DeLeeuw Associates, Inc. and merged the company into DeLeeuw Associates, LLC ("DeLeeuw"), a subsidiary of CSI. DeLeeuw is a management consulting firm specializing in integration, reengineering and project management.
- On May 1, 2004, the Company acquired a 49% interest in Leading Edge Communications Corporation ("LEC"), a provider of enterprise software and services solutions for technology infrastructure management.
- On June 28, 2004, the Company acquired substantially all the assets of Evoke Software Corporation and the stock of Evoke's foreign subsidiaries ("Evoke"), a provider of data discovery, profiling and quality management software. On July 18, 2005, the Company sold certain assets and liabilities of Evoke to Similarity Systems. See Note 5 of the Notes to the Consolidated Financial Statements for further discussion.
- On July 22, 2005, the Company acquired McKnight Associates, Inc. and merged the company into McKnight Associates, Inc. ("McKnight"), a subsidiary of CSI. McKnight is a management consulting firm specializing in data warehousing projects for a variety of clients worldwide.
- On July 29, 2005, the Company acquired Integrated Strategies, Inc. and merged the company into Integrated Strategies, Inc. ("ISI"), a subsidiary of CSI. ISI is a management consulting firm specializing in integration and project management.
- Doorways, Inc. is a wholly owned subsidiary of the Company that is currently dormant.
- LEC Corporation of NJ is a wholly owned subsidiary of the Company that incurs an insignificant amount of payroll expense and has no other operations.
- CSI Sub Corp. (DE) is a wholly owned subsidiary of the Company and is the primary operating entity for the Company.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its subsidiaries, Doorways, Inc., DeLeeuw, Integrated Strategies, Inc., McKnight Associates, LEC Corporation of NJ, and CSI Sub Corp. (DE). All intercompany transactions and balances have been eliminated in the consolidation. Investments in business entities in which the Company does not have control, but has the ability to exercise significant influence

(generally 20-50% ownership), are accounted for by the equity method. The results of Evoke Software Corporation (formerly known as Evoke Asset Purchase Corp. and now known as CSI Sub Corp. II (DE)) have been included in these consolidated financial statements as a component of discontinued operations. Substantially all assets of Evoke were sold to Similarity Systems in July 2005. See Note 5 of the Notes to the Consolidated Financial Statements for further discussion.

Revenue recognition

Revenue from consulting and professional services is recognized at the time the services are performed on a project by project basis. For projects charged on a time and materials basis, revenue is recognized based on the number of hours worked by consultants at an agreed-upon rate per hour. For large services projects where costs to complete the contract could reasonably be estimated, the Company undertakes projects on a fixed-fee basis and recognizes revenues on the percentage of completion method of accounting based on the evaluation of actual costs incurred to date compared to total estimated costs. Revenues recognized in excess of billings are recorded as costs in excess of billings. Billings in excess of revenues recognized are recorded as deferred revenues until revenue recognition criteria are met. Reimbursements, including those relating to travel and other out-of-pocket expenses, are included in revenues, and an equivalent amount of reimbursable expenses are included in cost of services and are immaterial.

Business Combinations

Business combinations are accounted for in accordance with SFAS No. 141, "*Business Combinations*" ("SFAS 141"), which requires the purchase method of accounting for business combinations be followed and in accordance with EITF No. 99-12 "*Determination of the Measurement Date for the Market Price of Acquirer Securities Issued in a Purchase Business Combination*" ("EITF 99-12"). In accordance with SFAS 141, the Company determines the recognition of intangible assets based on the following criteria: (i) the intangible asset arises from contractual or other rights; or (ii) the intangible is separable or divisible from the acquired entity and capable of being sold, transferred, licensed, returned or exchanged. In accordance with SFAS 141, the Company allocates the purchase price of its business combinations to the tangible assets, liabilities and intangible assets acquired based on their estimated fair values. The excess purchase price over those fair values is recorded as goodwill. Additionally, in accordance with EITF 99-12, the Company values an acquisition based upon the market price of its common stock for a reasonable period before and after the date the terms of the acquisition are agreed to and announced.

Accounts receivable

The Company carries its accounts receivable at cost less an allowance for doubtful accounts. On a periodic basis, the Company evaluates its accounts receivable and adjusts the allowance for doubtful accounts, when deemed necessary, based upon its history of past write-offs and collections, contractual terms and current credit conditions. During 2005 and 2004, $56,123 and $114,785 of uncollectible accounts receivable were written off against the allowance for doubtful accounts, respectively.

Property and equipment

Property and equipment are stated at cost and includes equipment held under capital lease arrangements. Depreciation is computed principally by an accelerated method and is based on the estimated useful lives of the various assets ranging from three to seven years. Leasehold improvements are amortized over the shorter of the asset life or the remaining lease term on a straight-line basis. When assets are sold or retired, the cost and accumulated depreciation are removed from the accounts and any gain or loss is included in operations.

Expenditures for maintenance and repairs have been charged to operations. Major renewals and betterments have been capitalized.

Goodwill and intangible assets

Goodwill and intangible assets are accounted for in accordance with SFAS No. 142 "*Goodwill and Other Intangible Assets*" ("SFAS 142"). Under SFAS 142, goodwill and indefinite lived intangible assets are not amortized but instead are reviewed annually for impairment, or more frequently if impairment indicators arise. Separable intangible assets that are not deemed to have an indefinite life will continue to be amortized over their estimated useful lives. The Company tests for impairment whenever events or changes in circumstances indicate that the carrying amount of goodwill or other intangible assets may not be recoverable, or at least annually at December 31 of each year. These tests are performed at the reporting unit level using a two-step, fair-value based approach. The first step compares the fair value of the reporting unit with its carrying amount, including goodwill. If the fair value of the reporting unit is less than its carrying amount, a second step is performed to measure the amount of impairment loss. The second step allocates the fair value of the reporting unit to the Company's tangible and intangible assets and liabilities. This derives an implied fair value for the reporting unit's goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized equal to that excess. In the event that the Company determines that the value of goodwill or other intangible assets have become impaired, the Company will incur a charge for the amount of the impairment during the fiscal quarter in which the determination is made.

Goodwill represents the amounts paid in connection with the acquisitions of Scosys, DeLeeuw, Integrated Strategies and McKnight Associates. Additionally, as part of the Scosys, DeLeeuw and McKnight acquisitions, the Company acquired identifiable intangible assets. The Company performed its annual impairment review as of December 31, 2005 and has determined that goodwill related to both the Integrated Strategies and McKnight Associates acquisitions was impaired at that date and, accordingly, recorded impairment charges of approximately $836,000 and $485,000, respectively. The Company performed its annual impairment review as of December 31, 2004 and determined that goodwill and certain intangible assets were impaired at that date and, accordingly, recorded an impairment charge of approximately $12,247,000 primarily relating to goodwill associated with the DeLeeuw acquisition.

Acquired contracts are amortized over a period that approximates the estimated life of the contracts, based upon the estimated annual cash flows obtained from those contracts, generally five years. The approved vendor status intangible asset is being amortized over an estimated life of forty months. The proprietary presentation format intangible asset is being amortized over an estimated life of three years. The customer relationship intangible asset is being amortized over an estimated life of thirty months. The order backlog intangible asset is being amortized over an estimated life of five months.

Deferred financing costs

The Company capitalizes costs associated with the issuance of debt instruments. These costs are amortized on a straight-line basis over the term of the related debt instruments, which currently range from one to three years.

Discount on debt

The Company has allocated the proceeds received from convertible debt instruments between the underlying debt instruments and the detachable warrants, and has recorded the conversion feature as a liability in accordance with SFAS No. 133. The conversion feature and certain other features that are considered embedded derivative instruments, such as a variable interest rate feature, a conversion reset provision and redemption option, have been recorded at their fair value within the terms of SFAS No. 133 as its fair value can be separated from the convertible note and its conversion is independent of the underlying note value. The conversion liability is marked to market each reporting period with the resulting gains or losses shown on the Statement of Operations. The Company has also recorded the resulting discount on debt related to the warrants and conversion feature and is amortizing the discount using the effective interest rate method over the life of the debt instruments. The discount is classified as a deferred financing cost.

Stock compensation

The Company follows Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25") in accounting for its employee stock options. Under APB 25, because the exercise of the Company's employee stock option equals the market price of the underlying stock on the date of grant, no compensation expense is recognized in the Company's consolidated statements of operations. The Company is required under Statement of Financial Accounting Standards (SFAS) 123, "Accounting for Stock-Based Compensation", which established a fair value based method of accounting for stock compensation plans with employees and others to disclose pro forma financial information regarding option grants made to its employees.

The Company follows EITF No. 96-18, “Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services” (“EITF 96-18”) in accounting for stock options issued to non-employees. Under EITF 96-18, the equity instruments should be measured at the fair value of the equity instrument issued. During the year ended December 31, 2004, the Company granted 650,000 stock options to non-employee recipients. In compliance with EITF 96-18, the fair value of these options was determined using the Black-Scholes option pricing model. The Company is recognizing the fair value of these options as expense over the three year vesting period of the options.

Had the Company determined compensation cost based upon the fair value at the grant date for its stock options under SFAS No. 123, the Company’s net loss would have changed to the pro forma amounts indicated below:

		Year ended December 31, 2005		Year ended December 31, 2004
Net loss:				
As reported	$	(4,490,349)	$	(35,348,206)
Add: Stock based compensation expense recorded		33,026		1,466,777
Less: Compensation expense per SFAS 123		(1,243,073)		(2,998,232)
Pro forma	$	(5,700,396)	$	(36,879,661)
Net loss per share:				
As reported				
Basic	$	(0.08)	$	(0.76)
Diluted		(0.08)		(0.76)
Pro forma				
Basic	$	(0.11)	$	(0.79)
Diluted		(0.11)		(0.79)

There were no options granted prior to 2004. The per share weighted average fair value of stock options granted during 2004 was $0.16 per share on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

Expected dividend yield	0.0%
Risk-free interest rate	2.5%
Expected volatility	148.0%
Expected option life (years)	3.0

The per share weighted average fair value of stock options granted during 2005 was $0.71 per share on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

Expected dividend yield	0.0%
Risk-free interest rate	4.34%
Expected volatility	186.6%
Expected option life (years)	3.0

Pro forma information regarding net loss and net loss per share is required by SFAS 123, as amended by SFAS 148, and has been determined as if the Company had accounted for its employee stock options under the fair-value method. The Black-Scholes option pricing model used in this valuation was developed for use in estimating the fair value of

traded options, which have no vesting restrictions and are fully transferable. Option valuation models require the input of highly subjective assumptions. The Company’s stock-based compensation has characteristics significantly different from those of traded options, and changes in the assumptions used can materially affect the fair value estimate.

Concentrations of credit risk

Financial instruments which potentially subject the Company to concentrations of credit risk are cash and accounts receivable arising from its normal business activities. The Company routinely assesses the financial strength of its customers, based upon factors surrounding their credit risk, establishes an allowance for doubtful accounts, and as a consequence believes that its accounts receivable credit risk exposure beyond such allowances is limited. At December 31, 2005, LEC and Comsys accounted for approximately 14% and 12% of the Company's accounts receivable balance, respectively.

The Company maintains its cash with a high credit quality financial institution. Each account is secured by the Federal Deposit Insurance Corporation up to $100,000.

Advertising

The Company expenses advertising costs as incurred. Advertising costs amounted to approximately $380,000 and $152,000 for the years ended December 31, 2005 and 2004, respectively.

Income taxes

The Company accounts for income taxes, in accordance with SFAS No. 109, "Accounting for Income Taxes" ("SFAS 109") and related interpretations, under an asset and liability approach that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in the Company's financial statements or tax returns. In estimating future tax consequences, the Company generally considers all expected future events other than enactments of changes in the tax laws or rates.

The Company records a valuation allowance to reduce the deferred tax assets to the amount that is more likely than not to be realized. The Company's current valuation allowance primarily relates to benefits from the Company's NOL's.

Derivatives

The Company accounts for derivatives in accordance with SFAS No. 133, "*Accounting for Derivative Instruments and Hedging Activities*" ("SFAS 133") and related interpretations. SFAS 133, as amended, requires companies to recognize all derivative instruments as either assets or liabilities in the balance sheet at fair value. The accounting for changes in the fair value of a derivative instrument depends on: (i) whether the derivative has been designated and qualifies as part of a hedging relationship, and (ii) the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, a company must designate the hedging instrument based upon the exposure being hedged as either a fair value hedge, cash flow hedge or hedge of a net investment in a foreign operation. At December 31, 2005, the Company had not entered into any transactions which were considered hedges under SFAS 133.

Financial Instruments

The carrying value of the Company's financial instruments, including cash and cash equivalents, accounts receivable, note receivable, accounts payable and accrued liabilities approximate fair value because of the short maturities of those instruments. Based on borrowing rates currently available to the Company for loans with similar terms, the carrying value of convertible notes and notes payable are also approximate fair value.

We review the terms of convertible debt and equity instruments we issued to determine whether there are embedded derivative instruments, including the embedded conversion option, that are required to be bifurcated and accounted for separately as a derivative financial instrument. Generally, where the ability to physical or net-share settle the conversion option is deemed to be not within the control of the company, the embedded conversion option is required

to be bifurcated and accounted for as a derivative financial instrument liability.

In connection with the sale of convertible debt and equity instruments, we may also issue freestanding options or warrants. Additionally, we may issue options or warrants to non-employees in connection with consulting or other services they provide. Although the terms of the options and warrants may not provide for net-cash settlement, in certain circumstances, physical or net-share settlement is deemed to not be within the control of the company and, accordingly, we are required to account for these freestanding options and warrants as derivative financial instrument liabilities, rather than as equity.

Derivative financial instruments are initially measured at their fair value. For derivative financial instruments that are accounted for as liabilities, the derivative instrument is initially recorded at its fair value and is then re-valued at each reporting date, with changes in the fair value reported as charges or credits to income. For option-based derivative financial instruments, we use the Black-Scholes option pricing model to value the derivative instruments.

In circumstances where the embedded conversion option in a convertible instrument is required to be bifurcated and there are also other embedded derivative instruments in the convertible instrument that are required to be bifurcated, the bifurcated derivative instruments are accounted for as a single, compound derivative instrument.

If freestanding options or warrants were issued and will be accounted for as derivative instrument liabilities (rather than as equity), the proceeds are first allocated to the fair value of those instruments. When the embedded derivative instrument is to be bifurcated and accounted for as a liability, the remaining proceeds received are then allocated to the fair value of the bifurcated derivative instrument. The remaining proceeds, if any, are then allocated to the convertible instrument itself, usually resulting in that instrument being recorded at a discount from its face amount. In circumstances where a freestanding derivative instrument is to be accounted for as an equity instrument, the proceeds are allocated between the convertible instrument and the derivative equity instrument, based on their relative fair values.

The discount from the face value of the convertible debt instrument resulting from the allocation of part of the proceeds to embedded derivative instruments and/or freestanding options or warrants is amortized over the life of the instrument through periodic charges to income, using the effective interest method.

The classification of derivative instruments, including whether such instruments should be recorded as liabilities or as equity, is re-assessed at the end of each reporting period. Derivative instrument liabilities are classified in the balance sheet as current or non-current based on whether or not net-cash settlement of the derivative instrument is expected within 12 months of the balance sheet date.

Equity investments

Prior to the Company's acquisition of DeLeeuw in 2004, DeLeeuw had acquired a non-controlling interest in DeLeeuw International (a company formed under the laws of Turkey). The Company accounts for its share of the income (losses) of this investment under the equity method.

The Company acquired 49% of all issued and outstanding shares of common stock of LEC as of May 1, 2004. The acquisition was completed through a Stock Purchase Agreement between the Company and the sole stockholder of LEC. In connection with the acquisition, the Company (i) repaid a bank loan on behalf of the seller in the amount of $35,000; (ii) repaid an LEC bank loan in the amount of $38,000; and (iii) satisfied an LEC obligation for $10,000 of prior compensation to an employee. The Company accounts for its share of the income (losses) of this investment under the equity method.

Foreign Currency Translation

Local currencies are the functional currencies for Evoke's foreign subsidiaries. Assets and liabilities are translated using the exchange rates in effect at the balance sheet date. Income and expenses are translated at the average exchange rates during the period. Translation gains and losses not reflected in earnings are reported as a component of stockholders' equity. Foreign currency translation gains (losses) are included as a component of the gain (loss) from discontinued operations.

Comprehensive Income

Accumulated other comprehensive income is comprised of foreign currency translation gains and losses which have been excluded from net income. The Company has reported the components of comprehensive income on the consolidated statements of stockholders' equity.

Restatement of Previously Issued Financial Statements

We have amended the annual reports for the year ended December 31, 2004 and quarterly reports of the quarters ended September 30, 2004, March 31, 2005, June 30, 2005 and September 30, 2005 to revise the accounting for the convertible term note, warrants and options and related registration rights in connection with our financing transaction entered into with Laurus Master Funds, Ltd. ("Laurus") and Sands Brothers Venture Capital LLC, Sands Brothers Venture Capital III LLC and Sands Brothers Venture Capital IV LLC (collectively "Sands") during 2004.

As a result of the restatement, warrants and options have been reclassified as derivative liabilities. The warrants and options had previously been measured based on a relative fair method and are now measured at their full fair value and will be marked to market on each balance sheet date.

Embedded derivatives contained in the convertible debenture and the secured line of credit are now bifurcated from the host debt and measured at fair value and classified as derivative liabilities. These embedded derivatives will also be marked to market on each balance sheet date.

The resulting debt discount will be amortized over the period of the convertible debt and the secured line of credit as interest and other expenses in our accompanying consolidated statements of operations.

The effect on our accompanying consolidated balance sheet as of December 31, 2004 was an increase in liabilities by $6,555,091 and corresponding decrease in stockholders' equity of $6,748,621. The effect on our consolidated statements of operations for the year ended December 31, 2004 was an increase in our net loss of $2,077,192. Basic and diluted earning per share for the year ended December 31, 2004 changed from loss per share $0.71 to $0.76, which gives effect to the 1:15 reverse stock split on September 21, 2005.

For the impact of the restatement for the periods noted above, see Note 22 of the Consolidated Financial Statements.

Reclassification

Certain amounts in prior periods have been reclassified to conform to the 2005 financial statement presentation.

Use of estimates

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

Note 2: Liquidity

The Company has incurred net losses and negative cash flows from operating activities for the three months ended March 31, 2006 and the years ended December 31, 2005 and 2004, and has an accumulated deficit of $40.1 million at December 31, 2005.

As of December 31, 2005, the Company had a cash balance of approximately $0.2 million. As of March 31, 2006, Company had cash on hand and amounts available under its line of credit of approximately $2.7 million.

Our primary liquidity needs are for working capital and debt service (see Notes 11, 12 and 13 to the consolidated financial statements). Our primary sources of liquidity are cash flows from operations, borrowings under our revolving credit facility, and various short and long term financings. Certain short term note holders have agreed to extend their maturity dates of the Notes on a month-to-month basis until the Company raises sufficient funds to pay the Notes in full. Amounts outstanding under the Notes at December 31, 2005 was $1.5 million. In addition, Mr. Scott Newman, Mr. Glenn Peipert and Mr. Robert C. Deleeuw have agreed to personally support our cash requirements to enable us to fufill our obligations through June 1, 2007, to the extent necessary, up to $1.5 million based on their ability to sell their Company common stock in order to provide the necessary financing.

Although the Company has negative working capital at December 31, 2005 and March 31, 2006, and has incurred significant operating losses, the Company believes existing cash plus funds provided by operations, borrowing capacity under the line of credit and projected borrowing against, or the guarantees of the primary stockholders should be sufficient to fund operations through January 1, 2007. Nevertheless, the Company is presently exploring various financing alternatives, including debt or additional sales of equity securities in order to finance the core business of the Company and help provide adequate working capital for operations. There is no assurance that funds will be provided by operations or that such additional financing will be available, or if available, will be available on acceptable terms. Should the Company experience significant shortfalls in planned revenues, or experience unforeseen fixed expenses, the Company believes it has the ability to make additional reductions to variable expenses to extend its capital. Any decision or ability to obtain financing through debt or through equity investment will depend on various factors, including, among others, financial market conditions, strategic acquisition and investment opportunities, and developments in the Company's markets. The sale of additional equity securities or future conversion of any convertible debt would result in additional dilution to the Company's stockholders.

Note 3: Recently Issued Accounting Pronouncements

SFAS No. 123 (Revised 2004) (“SFAS No. 123R”), “Share-Based Payment,” issued in December 2004, is a revision of FASB Statement 123, “Accounting for Stock-Based Compensation” and supersedes APB Opinion No. 25, “Accounting for Stock Issued to Employees,” and its related implementation guidance. The Statement focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. SFAS No. 123R requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award (with limited exceptions). That cost will be recognized over the period during which an employee is required to provide service in exchange for the award. On March 29, 2005, the SEC issued Staff Accounting Bulletin No. 107 (“SAB No. 107”), which provides the Staff’s views regarding interactions between SFAS No. 123R and certain SEC rules and regulations and provides interpretations of the valuation of share-based payments for public companies.

SFAS No. 123(R) permits public companies to adopt its requirements using one of two methods:

(1) A “modified prospective” method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS No. 123(R) for all share-based payments granted after the effective date and (b) based on the requirements of SFAS No. 123 for all awards granted to employees prior to the effective date of SFAS No. 123(R) that remain unvested on the effective date.

(2) A “modified retrospective” method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under SFAS No. 123 for purposes of pro forma disclosures either (a) all prior periods presented or (b) prior interim periods of the year of adoption.

This statement is effective for the beginning of the first annual reporting period that begins after June 15, 2005, therefore, we will adopt the standard in the first quarter of fiscal 2006 using the modified prospective method. As permitted by SFAS No. 123, we currently account for share-based payments to employees using the intrinsic value method prescribed in APB Opinion 25 and, as such, generally recognize no compensation cost for employee stock options. Although we have not completed our assessment, we believe the impact on our consolidated financial position or results or operations will not be material given the current number of outstanding stock options. The effect on our results of operations of expensing stock options using the Black-Scholes method is presented in the disclosure of pro forma net income and earnings per share in Note 1 – Accounting Policies. SFAS No. 123(R) also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required under current literature. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption.

In December 2004, the FASB issued SFAS No. 153, "Exchanges of Nonmonetary Assets", an amendment of APB Opinion No. 29. SFAS 153 eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets in paragraph 21 (b) of APB Opinion No. 29, "Accounting for Nonmonetary Transactions" (""APB 29"), and replaces it with an exception for exchanges that do not have commercial substance. SFAS 153 specifies that a nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS 153 is effective for the fiscal periods beginning after June 15, 2005 and the Company will adopt this Statement in the first quarter of 2006. The Company currently does not anticipate that the effects of the statement will materially affect its consolidated financial position or consolidated results of operations upon adoption.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections - A Replacement of APB Opinion No. 20 and FASB Statement No. 3" ("SFAS No. 154"). SFAS No. 154 requires the retrospective application to prior periods' financial statements of changes in accounting principle, unless it is impractible to determine either the period-specific effects or cumulative effect of the accounting change. SFAS No. 154 also requires that a change in depreciation, amortization, or depletion method for long-lived non-financial assets be accounted for as a change in accounting estimate affected by a change in accounting principle. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2004 and we will adopt this provision, as applicable, during fiscal year 2006.

In February 2006, the FASB issued SFAS 155 - "Accounting for Certain Hybrid Financial Instruments—an amendment of FASB Statements No. 133 and 140." This Statement amends FASB Statements No. 133, Accounting for Derivative Instruments and Hedging Activities, and No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. This Statement resolves issues addressed in Statement 133 Implementation Issue No. D1, "Application of Statement 133 to Beneficial Interests in Securitized Financial Assets." This Statement:

a. Permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation

b. Clarifies which interest-only strips and principal-only strips are not subject to the requirements of Statement 133

c. Establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation

d. Clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives

e. Amends Statement 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument.

This Statement is effective for all financial instruments acquired or issued after the beginning of our first fiscal year that begins after September 15, 2006. The fair value election provided for in paragraph 4(c) of this Statement may also be applied upon adoption of this Statement for hybrid financial instruments that had been bifurcated under paragraph 12 of Statement 133 prior to the adoption of this Statement. Earlier adoption is permitted as of the beginning of our fiscal year, provided we have not yet issued financial statements, including financial statements for any interim period, for that fiscal year. Provisions of this Statement may be applied to instruments that we hold at the date of adoption on an instrument-by-instrument basis. The Company is currently reviewing the effects of adoption of this statement but it is not expected to have a material impact on our financial statements.

In March 2005, the FASB issued FIN No. 47, "Accounting for Conditional Asset Retirement Obligations - an interpretation of FASB Statement No. 143 "Accounting for Asset Retirement Obligations ("SFAS No. 143")" ("FIN 47"). FIN 47 clarifies that the term *conditional asset retirement obligation* as used in SFAS No. 143, refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. Accordingly, an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. The liability for the conditional asset retirement obligation should be recognized when incurred. This Interpretation also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. FIN 47 is effective for fiscal periods beginning after December 15, 2005, and we will adopt this provision, as applicable, during fiscal year 2006.

Note 4 - Mergers and acquisitions

Acquisition of McKnight Associates

On July 22, 2005, the Company entered into (and simultaneously consummated) a merger agreement with McKnight Associates. In consideration of this merger agreement, the Company paid the following consideration: $500,000 in cash, the commitment to pay an additional $250,000, in cash, by June 2006 (the Company paid Mr. McKnight $125,000 in March 2006), the issuance of 909,091 shares of the Company common stock, plus the assumption of substantially all of the liabilities of McKnight.

The components of the purchase price were allocated to the various assets and liabilities of McKnight Associates as follows:

COMPONENTS OF PURCHASE PRICE (in thousands):

Value of common stock	$	1,773
Cash consideration		922
Acquisition costs		24
	$	2,719

ALLOCATION OF PURCHASE PRICE (in thousands):

Cash	(116)	
Accounts receivable	(298)	
Goodwill	(1,865)	(indefinite life)
Customer relationship	(685)	(2.5 year estimated life)
Order backlog	(50)	(5 month estimated

			life)
Proprietary presentation format		(173)	(3 year estimated life)
Deferred tax liability		363	
Accounts payable and accrued expenses		105	
	$	-	

Acquisition of Integrated Strategies

On July 29, 2005 the Company, entered into (and simultaneously consummated) an agreement and plan of merger (the "Agreement") among ISI Merger Corp., a Delaware corporation and wholly owned subsidiary of the Company ("Merger Sub"), Integrated Strategies, Inc., a Delaware corporation ("ISI"), ISI Consulting, LLC, a Delaware limited liability company ("LLC"), and Adam and Larry Hock, individual majority stockholders and members of ISI and LLC, respectively (the "Majority Stockholders"). Pursuant to the Agreement, ISI and LLC merged with and into Merger Sub and the Company and Merger Sub paid the following consideration: $2,050,000 in cash (reduced by certain amounts), the issuance by Merger Sub of a promissory note in the amount of $580,000 (which was later reduced), the issuance by the Company of a subordinated promissory note in the amount of $165,000, and the assumption of substantially all the liabilities of ISI and LLC. The Agreement also provides for the commitment, subject to certain revenue and profit thresholds (as described in the Agreement), to pay additional cash and issue shares of the Company common stock. On August 1, 2005, Merger Sub changed its name to Integrated Strategies, Inc.

Exclusive of contingent consideration, the components of the purchase price were allocated to the various assets and liabilities of Integrated Strategies as follows:

COMPONENTS OF PURCHASE PRICE (in thousands):

Cash	$	2,148	
Promissory notes		241	
Acquisition costs		28	
	$	2,417	
ALLOCATION OF PURCHASE PRICE (in thousands):			
Cash		(119)	
Accounts receivable		(661)	
Prepaid expenses		(3)	
Property and equipment, net		(2)	
Goodwill		(1,792)	(Indefinite life)
Other assets		(13)	
Accounts payable and accrued expenses		173	
	$	-	

The pro forma consolidated statements of operations for the years ended December 31, 2004 and 2005, respectively, set forth below gives effect to the acquisitions of McKnight Associates, Inc. and Integrated Strategies, Inc. as if they occurred on January 1, 2004.

	Year ended December 31, 2005	Year ended December 31, 2004
Revenues	$ 32,440,262	$ 32,083,229
Net Loss	$ (3,487,152)	$ (22,449,341)
Net Loss per share	$ (0.07)	$ (0.48)

Note 5 - Discontinued Operations

In July 2005, the Board of Directors approved, and the Company completed, the sale of substantially all of the assets of Evoke Software Corporation and received aggregate consideration of $645,000 cash, the assumption by Similarity Systems and Similarity Vector Technologies, Ltd. of certain liabilities, 821,053 shares which are issuable by Similarity subject to the Company's satisfactory completion of certain post-closing obligations, and an earnout in an amount equal to 13% of certain Similarity revenues. The maximum earnout consideration to which the Company is entitled under this agreement is $1,400,000 and would be received over a three year period. CSI changed the name of its "Evoke Software Corporation" subsidiary to "CSI Sub Corp II (DE)" in August 2005.

The 821,053 shares and the earnout noted above as consideration to be received by the Company are both contingent upon certain post-closing events. However, as a result of Informatica Corporation's acquisition of Similarity Systems in February 2006, the Company received $2,050,000 as a final payment on all future consideration related to our agreement with Similarity.

Total assets and liabilities of Evoke, as of the date of the sale, were as follows:

Cash	$ 35,026
Accounts receivable, net	692,459
Prepaid expenses	101,115
Property and equipment, net	77,878
Intangible assets, net	1,694,044
Other assets	4,850
	$ 2,605,372
Accounts payable and accrued expenses	$ (503,238)
Deferred revenue	(1,649,995)
Due to CSI	(1,482,312)
Minority interest	(75,067)
	$ (3,710,612)

The Company is liquidating the portion of Evoke that was not acquired by Similarity Systems. As a result of the divestiture and liquidation of the Evoke subsidiary, the Company recorded a charge for uncollectible intercompany receivables to Evoke amounting to $1,482,312. Transaction costs related to the sale were $44,000. The Company reported a gain on disposal of the Evoke subsidiary of $49,148 which is included as a component of other income (expense).

The Evoke revenue by line of business, and loss from discontinued operations is as follows:

	For the year ended December 31, 2005	2004
Revenue:		
Services	$ 58,184	$ 132,834
Software	646,269	108,623
Support and maintenance	862,118	1,031,953
Other	5,512	
	$ 1,572,083	$ 1,273,410
Net loss	$ (1,153,119)	$ (12,650,908)

Note 6 - Property and equipment

Property and equipment consisted of the following:

	December 31, 2005	December 31, 2004
Computer equipment	$ 998,339	$ 979,494
Furniture and fixtures	161,543	232,648
Leasehold improvements	92,459	216,306
	1,252,341	1,428,448
Accumulated depreciation	(834,872)	(840,873)
	$ 417,469	$ 587,575

Depreciation and amortization expense related to property and equipment totaled $0.1 million and $0.1 million for 2005 and 2004, respectively.

Note 7 - Intangible assets

	December 31, 2005	December 31, 2004	Amortization period
Customer contracts	$ 414,000	$ 1,876,424	5 years
Computer software	-	1,381,000	3 years
Approved vendor status	538,814	538,814	40 months
Customer relationships	685,000	-	2.5 years
Tradename	722,000	722,000	Indefinite
Proprietary presentation format	173,000	-	3 years
Order backlog	50,500	-	5 months
Proprietary rights and rights to the name of Scosys, Inc.	20,000	20,000	Indefinite
	2,603,314	4,538,238	
Accumulated amortization	(740,350)	(911,142)	
	$ 1,862,964	$ 3,627,096	

The estimated amortization expense for the next five years related to other finite-lived intangible assets is estimated to be as follows:

		Amortization of Intangible assets
2006		576,107
2007		488,385
2008		56,472
Thereafter		-
	$	1,120,964

Note 8 - Deferred financing costs

The Company has incurred and capitalized financing costs in connection with two financing transactions consummated during 2004. These costs were deferred and are being amortized over the life of the related financing agreement. The following illustrates the components of the deferred financing costs:

		Year Ended December 31, 2005		Year Ended December 31, 2004
Laurus Master Fund	$	766,270	$	766,270
Sands Brothers		127,039		127,039
	$	893,309	$	893,309
Accumulated amortization		(467,604)		(126,767)
	$	425,705	$	766,542

Note 9 - Discount on debt

The Company has recorded the discounts on its debt instruments due to both warrant issuances and embedded derivatives contained in convertible notes as deferred charges. These deferred charges are being amortized to interest expense over the life of the related debt instruments, which currently range from one to five years. The following illustrates the components of the discount on debt and their applicable amortization period:

		December 31, 2005		December 31, 2004	Amortization period
Laurus Master Fund	$	2,276,345	$	6,658,490	36 months
Sands Brothers		1,080,000		1,000,000	12-15 months
Taurus Advisory Group		1,500,000		1,500,000	5 years
		4,856,345		9,158,490	
Accumulated amortization		(678,917)		(941,212)	
	$	4,177,428	$	8,217,278	

Note 10 - Line of credit

In August 2004, we replaced our $3.0 million line of credit with North Fork Bank with a revolving line of credit with Laurus Master Fund, Ltd. (“Laurus”), whereby we had access to borrow up to $6.0 million based upon eligible accounts

receivable. A portion of Laurus's revolving line of credit was used to pay off all outstanding borrowings from North Fork Bank. This revolving line, effectuated through a $2.0 million convertible minimum borrowing note and a $4.0 million revolving note, provided for advances at an advance rate of 90% against eligible accounts receivable, with an annual interest rate of prime rate (as reported in the Wall Street Journal) plus 1%, and matured in three years. We had no obligation to meet financial covenants under the $2.0 million convertible minimum borrowing note or the $4.0 million revolving note. This line of credit is secured by substantially all the corporate assets. Both the $2.0 million convertible minimum borrowing note and the $4.0 million revolving note provided for conversion at the option of the holder of the amounts outstanding into our common stock at a fixed conversion price of $2.10 per share.

105

Additionally, in exchange for a $5,000,000 secured convertible term note bearing interest at prime rate (as reported in the Wall Street Journal) plus 1%, Laurus had established a $5.0 million account to be used only for acquisition targets identified by us that were approved by Laurus in Laurus' sole discretion. We had no obligation to meet financial covenants under the $5.0 million secured convertible term note. This note was convertible into our common stock at a fixed conversion price of $2.10 per share. This note was to mature in three years. We issued Laurus a common stock purchase warrant that provided Laurus with the right to purchase 800,000 shares of our common stock. The exercise price for the first 400,000 shares acquired under the warrant is $4.35 per share, the exercise price for the next 200,000 shares acquired under the warrant is $4.65 per share, and the exercise price for the final 200,000 shares acquired under the warrant is $5.25 per share. The common stock purchase warrant expires on August 15, 2011. We paid $0.75 million in brokerage and transaction closing related costs. These costs were deducted from the $5.0 million restricted cash balance being provided to us by Laurus.

In May 2005, Laurus elected to convert $1,000,000 of debt underlying the minimum borrowing note into the Company's common stock. As a result of this conversion, the Company obtained $1,000,000 of additional borrowing capacity under its revolving line of credit and in return, issued 476,191 shares of Company common stock to Laurus.

In July 2005, the Company entered into amendments of the notes dated August 16, 2004 between the Company and Laurus. Pursuant to the amendment, the Company released $4,327,295 (the "Funds") to Laurus, which was being held in the Restricted Account (which was available to the Company for acquisitions) and issued an amended and restated convertible note in the principal amount of $749,000. In satisfaction of the balance of the accrued interest and any liquidated damages to which it was entitled pursuant the Registration Rights Agreement entered into in August 2004, the Company issued an option to purchase 333,334 shares of the Company's common stock at a purchase price of $0.015 per share. Laurus fully exercised this option to purchase Company stock on August 1, 2005. Laurus also agreed to extend the required filing date and effective date of the Registration Statement. For accounting purposes, the Company recorded this transaction as an early extinguishment of debt and recognized the remaining discount on debt and liability as a component of other income (expense).

The Company also issued an amended and restated convertible secured revolving note in the principal amount of $4.5 million in favor of Laurus which amended the $4 million Revolving Note executed in August 2004. In connection with this note, the Company and Laurus entered into an Overadvance Letter Agreement, pursuant to which Laurus made a loan to the Company in excess of the amount available using the Company accounts receivable as collateral in the principal amount of $2.7 million. The Company utilized the $2.7 million which was advanced to it by Laurus to acquire McKnight Associates, Inc., Integrated Strategies, Inc. and ISI Consulting, LLC. Except as noted above, all terms of the August 2004 agreements continued to remain in effect.

On November 30, 2005, the Company (i) amended and restated the convertible term note in the principal amount of $749,000 by reducing the conversion rate of such note from $2.10 to $1.00, (ii) amended and restated the secured revolving convertible note by increasing the principal amount available from $4,500,000 to $5,500,000 and reducing the conversion rate from $2.10 to $1.00, and (iii) amended and restated the secured convertible minimum borrowing note in the principal amount of $2,000,000 by reducing the fixed conversion price from $2.10 to $0.65.

As a result of the issuance of warrants, the Company has recorded a discount on debt (valued at $2.2 million as of December 31, 2005) and a liability. The discount is being amortized over the remaining term of the debt instrument, and the liability is being adjusted to fair value using an option-pricing model. Additionally, the convertible notes contain embedded derivatives pertaining to the conversion feature, conversion reset provision, redemption option and variable interest rate feature in the notes, and the Company has recorded a discount on debt and a liability to reflect the fair value of these derivatives.

The note and related agreements contain several events of default which include:

- failure to pay interest, principal payments or other fees when due;
- failure to pay taxes when due unless such taxes are being contested in good faith;
- breach by us of any material covenant or term or condition of the notes or any agreements made in connection therewith;
- default on any indebtedness to which we or our subsidiaries are a party;
- breach by us of any material representation or warranty made in the notes or in any agreements made in connection therewith;
- attachment is made or levy upon collateral securing the Laurus debt which is valued at more than $150,000 and is not timely mitigated.
- any lien created under the notes and agreements is not valid and perfected having a first priority interest;
- assignment for the benefit of our creditors, or a receiver or trustee is appointed for us;
- bankruptcy or insolvency proceeding instituted by or against us and not dismissed within 30 days;
- the inability to pay debts as they become due or cease business operations;
- sale, assignment, transfer or conveyance of any assets except as permitted;
- a person or group becomes beneficial owner of 35% on fully diluted basis of the outstanding voting equity interest or the present directors cease to be the majority on the Board of Directors;
- indictment or threatened criminal indictment, or commencement of threatened commencement of any criminal or civil proceeding against the Company or any executive officer; and
- common stock suspension for five consecutive days or five days during any 10 consecutive days from a principal market, provided that we are unable to cure such suspension within 30 days or list our common stock on another principal market within 60 days.

If we default on the notes and the holder demands all payments due and payable, the cash required to pay such amounts would most likely come out of working capital, which may not be sufficient to repay the amounts due. The default payment shall be 130% of the outstanding principal amount of the note (reduced to 115% in February 2006), plus accrued but unpaid interest, all other fees then remaining unpaid, and all other amounts payable thereunder. In addition, since we rely on our working capital for our day to day operations, such a default on the note could materially adversely affect our business, operating results or financial condition to such extent that we are forced to restructure, file for bankruptcy, sell assets or cease operations. Further, our obligations under the notes are secured by substantially all of our assets. Failure to fulfill our obligations under the notes and related agreements could lead to loss of these assets, which would be detrimental to our operations. As of April 17, 2006, the Company does not believe that it is in default of any of the provisions of the Laurus agreements.

As of December 31, 2005, approximately $4.7 million was outstanding under the revolving line of credit and Overadvance Letter Agreement. The interest rate on the revolving line and the overadvance letter was 8.25% as of December 31, 2005.

Note 11 - Short Term Notes Payable

In July 2005, the Company obtained two $250,000 short term loans from certain investors represented by Taurus. Both notes bear interest at 8% per annum. The first note is dated July 6, 2005 and initially matured on September 5, 2005. The maturity date for this note has been extended to May 6, 2006. The second note is dated July 22, 2005 and originally matured on September 22, 2005. The maturity date for this note has been extended to April 22, 2006. These short term note holders have agreed to extend their maturity date on a month-to-month basis until the Company raises sufficient funds to repay the notes.

In July 2005, in conjunction with the acquisition of Integrated Strategies, the Company issued a short term note in the principal amount of $165,000 payable to Adam Hock and Larry Hock, the former principle stockholders of Integrated

Strategies. This note bears interest at 5% per annum and matures on October 28, 2006.

In December 2005, the Company obtained a $1,000,000 short term loan from certain investors represented by Taurus. This note bears interest at 8% per annum. The note is dated December 19, 2005 and initially matured on January 31, 2006. The maturity date for this note has been extended to June 1, 2006. These investors received a warrant to purchase 277,777 shares of our common stock with an exercise price of $0.675 per share. The warrant expires in December 2008. As of December 31, 2005, the Company had borrowed $500,000 under this note. These short term note holders have agreed to extend their maturity date on a month-to-month basis until the Company raises sufficient funds to repay the notes.

Using the Black-Scholes option pricing model, the Company calculated the relative fair value of the warrant to purchase 277,777 shares of Company common stock to be $111,111. This relative fair value has been recorded as a reduction of the $1,000,000 liability and an addition to additional paid-in capital. This amount is being amortized to interest expense over the term of the debt instrument. The assumptions used in the relative fair value calculation are as follows: Company stock price on December 19, 2005 of $0.54 per share; exercise price of the warrants of $0.675 per share; three year term; volatility of 162.52%; annual rate of dividends of 0%; and a risk free interest rate of 4.5%.

Note 12 - Financial Instruments

Laurus

The Notes are hybrid instruments which contain both freestanding derivative financial instruments and more than one embedded derivative feature which would individually warrant separate accounting as a derivative instrument under SFAS No. 133. The freestanding derivative financial instruments include the warrant, which was valued individually, and totaled $2,394,000 at the date of inception. The various embedded derivative features have been bundled together as a single, compound embedded derivative instrument that has been bifurcated from the debt host contract, referred to as the “Compound Embedded Derivative Liability”. The single compound embedded derivative features include the conversion feature within the notes, the conversion reset feature, the early redemption option and the interest rate adjustments. The value of the single compound embedded derivative liability was bifurcated from the debt host contract and recorded as a derivative liability, which resulted in a reduction of the initial carrying amount (as unamortized discount) of the notes. The unamortized discount is amortized to interest expense using the effective interest method over the life of the notes, or 36 months.

In order to correct the consolidated financial statements so that they comply with US generally accepted accounting principles, the Company previously restated the consolidated financial statements as of December 31, 2004 to reclassify the Laurus warrants from additional paid in capital to liabilities and interest expense effective September 2004 to reflect that the registration rights agreement into which the Company entered in connection with its issuance of the warrants requires the Company to pay liquidated damages, which in some cases could exceed a reasonable discount for delivering unregistered shares and thus would require the warrants to be classified as a liability until the earlier of the date the warrants are exercised or expire. In accordance with EITF 00-19, *“Accounting for Derivative Financial Instruments Indexed To, and Potentially Settled In, a Company’s Own Stock”,* the Company has allocated a portion of the offering proceeds to the warrants based on their fair value. EITF 00-19 also requires that the Company revalue the warrants as a derivative instrument periodically to compute the value in connection with changes in the underlying stock price and other assumptions, with the change in value recorded as other expense or other income.

In conjunction with the Laurus credit facility, Laurus was paid a fee of $749,000, in August 2004, and received a seven-year warrant to purchase up to 800,000 shares of the Company’s common stock at prices ranging from $4.35 to $5.25 per share. The warrant, which is exercisable immediately, was valued at $2,394,000 using a Black-Scholes option pricing model. The value of the warrant and the fees paid to Laurus were recorded as a discount to the note and are being amortized over the term of the loan using the effective interest method.

The Laurus notes were amended in July 2005 and this amendment was accounted for as an extinguishment of the debt, however, it has been determined that the proper accounting treatment is to account for the transaction as an early extinguishment of debt. In order to correct the financial statements so that they comply with US generally accepted accounting principles, the Company has restated the consolidated financial statements and this amendment to the note was accounted for as an extinguishment of debt in accordance with EITF 96-19 *"Debtor's Accounting for a Modification or Exchange of Debt Instruments."* Accordingly, the unamortized discounts, of the warrants and the compound embedded derivatives, aggregating $4,954,482 and the fair value of the 333,333 options to purchase Company common stock issued in connection with the amendment, amounting to approximately $772,000, were included in the Company's determination of the debt extinguishment recorded in the third quarter of fiscal year 2005. The $244,000 aggregate gain from these transactions accounted for as an early extinguishment of debt included in other income (expense) for the year ended December 31, 2005.

108

The Laurus agreements were amended again in November 2005 and this amendment was treated as an early extinguishment of debt by the Company. The unamortized discounts aggregating $3,291,000 and the fair value of the warrant and embedded derivative liability amounting to $1,439,000 were included in the Company's determination of the debt extinguishment recorded in the fourth quarter of fiscal 2005. The aggregate loss of $1,852,000 from these transactions were accounted for as an extinguishment of debt is included in other expenses for the year ended December 31, 2005.

The Company determined the fair value of the warrants as of the following issuance dates:

As of August 16, 2004, the Company used the Black-Scholes option-pricing model with the following assumptions: an expected life equal to the contractual term of the warrants (seven years); no dividends; a risk free rate of return of 3.89%; and a volatility of 150.0%. Using these assumptions, the Black-Scholes option-pricing model yielded a value of $1,199,000 for the warrants with a $4.35 exercise price, $598,000 for the warrants with a $4.65 exercise price, and $597,000 for the warrants with a $5.25 exercise price for an aggregate fair value of $2,394,000.

The Company performed the same calculation as of September 30, 2004 to revalue the warrants as of that date. In using the Black-Scholes option-pricing model, the Company used an expected life of 6.87 years; an underlying stock price of $3.45 per share; no dividends; a risk free rate of 3.79% and volatility of 150.0%. The resulting aggregate allocated value of the warrants as of September 30, 2004 equaled $2,622,000.

The Company performed the same calculation as of December 31, 2004 to revalue the warrants as of that date. In using the Black-Scholes option-pricing model, the Company used an expected life of 6.62 years; an underlying stock price of $3.67 per share; no dividends; a risk free rate of 3.94% and volatility of 150.0%. The resulting aggregate allocated value of the warrants as of December 31, 2004 equaled $2,781,000. The change in fair value of the warrants resulted in an amount of $387,000 and included as part of financial instruments for the year ended December 31, 2004.

For the year ended December 31, 2005, the Company performed the Black-Scholes calculation to revalue the warrants as of that date. In using this model, the Company used an expected life of 5.62 years; an underlying stock price of $0.41 per share; no dividends; a risk free rate of 4.36% and volatility of 150.0%. The resulting aggregate allocated value of the warrants as of December 31, 2005 equaled $264,000. The change in fair value of the warrants resulted in an amount of ($2,517,000) and is included as a charge to financial instruments for the year ended December 31, 2005.

Upon the earlier of the warrant exercise or the expiration date, the warrant liability will be reclassified into stockholders' equity. Until that time, the warrant liability will be recorded at fair value based on the methodology described above. Changes in the fair value during each period will be recorded as other income or other expense. Liquidated damages under the registration rights agreement will be expensed as incurred and will be included in operating expenses.

The Company is also restating the consolidated financial statements to record an embedded derivative liability rather than the beneficial conversion feature previously recorded of $4,100,000 as of December 31, 2004.

Using a probability-weighted discounted cash flow model, the fair value of the Compound Embedded Derivative Liability was computed at $4,265,000, $4,519,000 and $725,000 at August 16, 2004 (date of inception), December 31, 2004 and December 31, 2005, respectively. The model replicated the economics of the notes and applied different events based on various conditions likely to occur over the life of the note. Multiple scenarios were used in the model and the underlying assumptions below were applied. The value of this single, compound embedded derivative instrument was bifurcated from the debt host contract and recorded as a derivative liability which resulted in a reduction of the initial carrying amount (as unamortized discount) to the notional amounts of the convertible notes.

109

Sands

The Notes are hybrid instruments which contain both freestanding derivative financial instruments and more than one embedded derivative feature which would individually warrant separate accounting as a derivative instrument under SFAS No. 133. The freestanding derivative financial instruments include the warrant, which was valued individually, and totaled $1,563,000 at the date of inception. The various embedded derivative features have been bundled together as a single, compound embedded derivative instrument that has been bifurcated from the debt host contract, referred to as the "Compound Embedded Derivative Liability". The single compound embedded derivative features include the conversion feature within the notes, the conversion reset feature, the early redemption option, and the interest rate adjustments. The value of the single compound embedded derivative liability was bifurcated from the debt host contract and recorded as a derivative liability, which resulted in a reduction of the initial carrying amount (as unamortized discount) of the notes. The unamortized discount is amortized to interest expense using the effective interest method over the life of the notes, or 12 months.

In order to correct the financial statements so that they comply with US generally accepted accounting principles, the Company previously restated the consolidated financial statements as of December 31, 2004 to reclassify the Sands warrants from additional paid in capital to liabilities and interest expense effective September 2004 to reflect the registration rights agreement into which the Compa