

COMPUTER SOFTWARE INNOVATIONS INC

Form 10-K

March 31, 2009

[Table of Contents](#)

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-K**

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

For the fiscal year ended December 31, 2008

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 000-51758

**COMPUTER SOFTWARE INNOVATIONS, INC.**

(Exact name of registrant as specified in its charter)

<p><b>Delaware</b> State or other jurisdiction of  incorporation or organization</p> <p><b>900 East Main Street, Suite T, Easley, SC</b> (Address of principal executive offices)</p> <p style="text-align: center;"><b>(864) 855-3900</b></p> <p style="text-align: center;">Registrant's telephone number, including area code</p>	<p><b>98-0216911</b> (I.R.S. Employer Identification No.)</p> <p><b>29640</b> (Zip Code)</p>
--	--

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

<p><b>Title of each class</b></p> <p style="text-align: center;"><b>Securities registered pursuant to Section 12(g) of the Act:</b></p> <p style="text-align: center;"><b>Common Stock, par value \$0.001 per share</b></p> <p style="text-align: center;">(Title of class)</p>	<p><b>Name of each exchange on which registered</b></p>
---	---

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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer <input type="checkbox"/>	Accelerated filer <input type="checkbox"/>
Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company <input checked="" type="checkbox"/>

## Edgar Filing: COMPUTER SOFTWARE INNOVATIONS INC - Form 10-K

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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter: \$2,506,352

(APPLICABLE ONLY TO CORPORATE REGISTRANTS)

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

Class	Outstanding at March 11, 2009
Common Stock, \$0.001 par value per share	7,181,204 shares

DOCUMENTS INCORPORATED BY REFERENCE

The Company's Proxy Statement for the Annual Meeting of Shareholders to be held on May 7, 2009 is incorporated by reference in this Form 10-K in Part III, Items 10 through 14.

**Table of Contents**

**TABLE OF CONTENTS**

**PART I**

Item 1.	<u>Business</u>	2
Item 1A.	<u>Risk Factors</u>	20
Item 1B.	<u>Unresolved Staff Comments</u>	36
Item 2.	<u>Properties</u>	36
Item 3.	<u>Legal Proceedings</u>	36
Item 4.	<u>Submission of Matters to a Vote of Security Holders</u>	36

**PART II**

Item 5.	<u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	37
Item 6.	<u>Selected Financial Data</u>	37
Item 7.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	37
Item 7A.	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	61
Item 8.	<u>Financial Statements and Supplementary Data</u>	62
Item 9.	<u>Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</u>	86
Item 9A(T).	<u>Controls and Procedures</u>	86
Item 9B.	<u>Other Information</u>	88

**PART III**

Item 10.	<u>Directors, Executive Officers and Corporate Governance</u>	88
Item 11.	<u>Executive Compensation</u>	88
Item 12.	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	88
Item 13.	<u>Certain Relationships and Related Transactions, and Director Independence</u>	89
Item 14.	<u>Principal Accounting Fees and Services</u>	89
Item 15.	<u>Exhibits, Financial Statement Schedules</u>	89

**SIGNATURES**

90

**INDEX TO EXHIBITS**

91

---

**Table of Contents**

**PART I**

**Item 1. Business.**  
**A. Introduction**

Unless the context requires otherwise, (1) Computer Software Innovations, Inc., CSI, we, our, us and the Company refer to the combined business of Computer Software Innovations, Inc., a Delaware corporation, and its subsidiary, CSI Technology Resources, Inc., a South Carolina corporation; (2) VerticalBuyer refers to the Company prior to our 2005 merger; and (3) CSI South Carolina refers to Computer Software Innovations, Inc., a South Carolina corporation, prior to the 2005 merger.

We develop software applications and provide hardware-based technology solutions.

**Software Applications**

Our initial internally developed software product was developed primarily for use in the niche kindergarten through grade 12 ( K-12 ) education market space, and thereafter for local government and other markets. Accordingly the largest portion of our revenues are derived from the K-12 education market space with the local government being one of our fastest growing segments and increasing revenues in the higher education space. Recently acquired products may be used in other markets which we may pursue at some point in our future, but are not a substantial focus at this time. Our products are described in more detail below.

Our internally developed software consists primarily of three product focus groups:

Fund accounting based financial management software

Standards based lesson planning software

Identity lifecycle management and Microsoft Sharepoint development

Our primary software product, fund accounting based financial management software, is developed for those entities that track expenditures and investments by fund, or by source and purpose of the funding. Our fund accounting software is used primarily by public sector and not-for-profit entities. In the initial state of our focus, South Carolina and that of an acquired operation, Alabama, more than 90% of the K-12 school districts run our fund accounting software products. In addition we have implementations in other school districts or local government entities in six other states in the southeast; North Carolina, Georgia, Louisiana, Mississippi, Tennessee and Florida.

In September 2005, we acquired standards-based lesson planning software. The software is designed to allow teachers to create lesson plans that are tied to a state's curriculum standards. These lesson plans may be reviewed by administrators and a report generated to determine the standards that have been met or need to be met. This product provides a relatively new, more structured approach to lesson planning, and the adoption rate is slow as teachers and superintendents must adopt to a greater use of technology within the lesson planning process. The product is in several K-12 schools, but is not currently a significant revenue driver.

In August 2008, we acquired our Identity lifecycle management solutions through our acquisition of Version3, Inc. ( Version3 ). Our identity lifecycle management solutions provide single sign-on, application access management and provisioning based on Microsoft's Identity Lifecycle Management and Microsoft SharePoint deployments. While Version3 solutions are not solely designed for the education market segment, many recent projects have been directed to K-12 and higher education. Prior to the acquisition, CSI was a reseller of Version3 solutions. We anticipate, by joining forces with Version3, synergies will be achieved to expand sales efforts, enhance delivery efficiencies, and allow increased focus on new product development and enhancements to existing solutions. We believe Version3's solutions are more easily scalable to a national level than the Software applications segment's other major proprietary applications, fund accounting solutions, with many solutions having reduced or no integration requirements, depending on the venue, with local or state reporting. Version3 has provided solutions both within and outside our eight-state footprint prior to the acquisition.

## Edgar Filing: COMPUTER SOFTWARE INNOVATIONS INC - Form 10-K

Results of operations related to our software-based solutions are reported through our Software applications segment.

### **Technology Solutions**

We also provide a wide range of technology solutions, including hardware and design, engineering, installation, training and ongoing support and maintenance. Our solutions include computers, networking, security, IP telephony and distance learning and video communication. Results of operations related to our technology-based solutions are reported through our Technology solutions segment.

Due to the focus of our initial software products on the K-12 Education market space, our revenues from our technology solutions are also derived from the K-12 education market space with local government and higher education markets also contributing.

## **Table of Contents**

Our operations are those of our predecessor, Computer Software Innovations, Inc., a South Carolina corporation organized in 1990. The history and development of CSI South Carolina is described in C. History and Development of CSI South Carolina. Our current business operations are described in B. Overview and elsewhere in this Item 1. Business.

Prior to February 10, 2005, the Company was known as VerticalBuyer, Inc. Prior to our merger with CSI South Carolina on February 11, 2005, we were a public shell corporation, having conducted no business operations since September 2001.

In the first quarter of 2005, we concluded a series of recapitalization transactions. On January 31, 2005, a change in control of the Company occurred as a result of the purchase of a majority of our common stock by CSI South Carolina. On February 11, 2005, CSI South Carolina merged into us, and we issued preferred stock, common stock, warrants and certain subordinated notes. In connection with the merger, we changed our name to Computer Software Innovations, Inc.

The merger of CSI South Carolina into us was accounted for as a reverse acquisition, with CSI South Carolina being designated for accounting purposes as the acquirer, and the surviving corporation, VerticalBuyer, Inc., being designated for accounting purposes as the acquiree. Under reverse acquisition accounting, the financial statements of the surviving corporation (VerticalBuyer) are the financial statements of the acquirer (CSI South Carolina). The activities of VerticalBuyer are included only from the date of the transaction forward and represent those operations carried in from CSI- South Carolina. Shareholders equity of CSI-South Carolina, after giving effect for differences in par value, has been carried forward after the acquisition.

The merger and related transactions are described in E. The Merger and Recapitalization.

Our principal executive offices are located at 900 East Main Street, Suite T, Easley, South Carolina 29640. Our telephone number at that location is (864) 855-3900.

We maintain an Internet website at [www.csioutiftters.com](http://www.csioutiftters.com). Certain pertinent information about our business, products and services and recent developments is posted on our website. The information on our website does not constitute a part of this report.

We are registered under section 12(g) of the Exchange Act, and are subject to the information requirements of the Exchange Act. We file annual, quarterly and current reports and other information with the Securities and Exchange Commission ( SEC ). You may read and copy any document that we file at the SEC s public reference room facility located at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room. The SEC maintains an Internet site at <http://www.sec.gov> that contains reports and other information regarding issuers, including us, that file documents with the SEC electronically through the SEC s electronic data gathering, analysis and retrieval system known as EDGAR.

Our common stock is traded in the over-the-counter market under the symbol CSWI.OB. Trade information is reported on the OTC Bulletin Board.

## **B. Overview**

We are a company focused primarily on the education and local government market spaces. The majority of our revenues are derived from this market space and we generally focus on products directed or targeted to this market space.

We develop software and provide hardware-based technology solutions. We monitor our business as two segments, but take advantage of cross-selling and integration opportunities. Our internally developed software is sold and supported through our software applications segment. We provide hardware-based technology solutions through our technology solutions segment. By strategically combining our fund accounting software with our ability to integrate computer and other hardware, we have been successful in providing a variety of technological solutions to over 700 clients located in South Carolina, North Carolina, Georgia, Alabama, Louisiana, Mississippi, Tennessee, and Florida. As a result of our acquisition of Version3 we also have a handful of clients in other states and internationally (Canada and the United Kingdom). We are pursuing a national presence with a primary, initial focus on the southeastern region of the United States.

### **Software Applications Segment**

Our software applications segment develops accounting and administrative software applications that are designed for organizations that employ fund accounting. These organizations include our primary target market: municipalities, school districts and local governments. Our software provides a wide range of functionality to handle public sector and not-for-profit accounting requirements including receipt and tracking of funds, application of purchases, payables, investments and expenditures by fund, and production of financial and informational reports. The software is

## Edgar Filing: COMPUTER SOFTWARE INNOVATIONS INC - Form 10-K

written in modules which can be sold separately or as a fully-integrated package so that information keyed in one module will be updated electronically into other modules to minimize data entry and improve productivity. In addition to the modules covering general accounting functions, specialty modules are also available. The software modules available include:

General (or Fund ) Ledger;

3



**Table of Contents**

Accounts Payable;

Purchasing;

Payroll;

Personnel;

Employee Absence/Substitutes;

Inventory;

Utility Billing; and

Other specialty modules designed for government markets.

More detailed information concerning the modules noted above and additional specialty modules is presented in G. Product and Services.

We currently have three competitive fund accounting products which the company continues to develop and support, as appropriate. We also develop new modules as add on products and take existing modules from one product and integrate them with another to reduce development costs and increase revenue opportunities. It is our plan to eventually move to one product platform, taking advantage of the best functionality of all the software products. Accordingly, these products will follow an upgrade path to the latest releases as they are developed.

We provide standards-based lesson planning software. This software is designed to allow teachers to create lesson plans that tie to a state's curriculum standards. Lesson plans may then be reviewed by school administrators and reports generated to determine if standards have been met. Additional information concerning the standards based learning planning software is presented in G. Product and Services.

We also provide identity lifecycle management products and Microsoft SharePoint development. Our identity lifecycle management products provide single sign-ons application access management and provisioning based on Microsoft's Identity Lifecycle Management and Microsoft SharePoint deployments. While Version3 solutions are not solely designed for the education market segment, many recent projects have been directed to K-12 and higher education. Prior to the acquisition, CSI was a reseller of Version3 solutions. We anticipate, by joining forces with Version3, that synergies will be achieved to expand sales efforts, enhance delivery efficiencies, and allow increased focus on new product development and enhancements to existing solutions. We believe Version3's solutions are more easily scalable to a national level than the Software applications segment's other major proprietary applications, fund accounting solutions, with many solutions having reduced or no integration requirements, depending on the venue, with local or state reporting. Version3 has provided solutions both within and outside our eight-state footprint prior to the acquisition.

Our software applications segment includes a staff of software developers, implementers, trainers, sales personnel and applications support specialists focused primarily on the development, sale, deployment and support of our in-house software products. From time-to-time, our applications support specialists also provide support for the technology solutions segment.

Typically, sales of software and related services generate significantly higher margins than sales of hardware. Because revenues in our software applications segment result from sales and support of software products developed for resale, and are coupled with a relatively small volume of related hardware sales (also referred to as software and related services), our software applications segment produces higher margins than our technology solutions segment. Conversely, revenues in our technology solutions segment result primarily from hardware sales, and a relatively smaller amount of integration services (also referred to as hardware sales and related services). Accordingly, our technology solutions segment produces lower margins than our software applications segment.

**Technology Solutions Segment**

Our technology solutions segment has a staff of certified systems engineers capable of providing a broad range of technology solutions to our clients. Certified systems engineers are computer professionals who have passed a test indicating specialized knowledge in the design, planning and implementation of specific computer based technology. These solutions can include, among other capabilities, planning, installation and management of computer, internet telephony, wireless, video conference, security monitoring and distance and classroom learning projects. Through this segment we also provide subsequent support and maintenance of equipment and systems.

In addition, we provide network integration solutions as a value added reseller (selling equipment purchased from vendors to which we have added our engineering services) of computer hardware and engineering services. These technologies include, but are not limited to:

education technologies (distance learning and classroom learning tools, including interactive white board solutions);

**Table of Contents**

IP Telephony and IP Surveillance (sending voice calls and surveillance across the internet using internet protocol ( IP ), a standard method for capturing information in packets);

wide area networking (linking a group of two or more computer systems over a large geographic area, usually by telephone lines or the internet);

wireless networking (linking a group of two or more computer systems by radio waves);

system and network integration (combining different computer programs, processes and hardware such that they operate and communicate seamlessly as a tightly-knit system);

technology planning (developing plans to purchase or upgrade computers, telephone equipment, cabling and software);

project management (overseeing installation of computers, telephone equipment, interactive white board equipment, cabling and software);

hardware/software sales and installation;

support and maintenance (using Novell, Microsoft, Cisco and Citrix certified engineers and other personnel to fix problems); and

system monitoring (proactively monitoring computers and software to detect problems).

In addition to our engineers, our technology solutions segment includes a staff of sales persons, project managers and product specialists. Our technology solutions segment also purchases and resells products from a variety of manufacturers such as Hewlett Packard, Cisco, Microsoft, Novell, Promethean, Tandberg and DIVR, and supports the software applications segment.

Currently our business efforts are focused on the two key operating segments: internally developed software applications and related service and support (our software applications segment ), and other primarily hardware-based technology solutions and related service and support (our technology solutions segment ).

The chart below shows revenues, gross profit and gross margin by business segment for the years ended December 31, 2008 and 2007.

<i>(in thousands)</i>	<b>Year Ended December 31, 2008</b>	<b>Year Ended December 31, 2007</b>
<b>Revenues</b>		
Software applications segment	\$ 13,559	\$ 10,478
Technology solutions segment	\$ 45,144	\$ 44,719
<b>Revenues</b>	<b>\$ 58,703</b>	<b>\$ 55,197</b>
<b>Gross Profit</b>		
Software applications segment	\$ 5,514	\$ 4,362
Technology solutions segment	\$ 7,304	\$ 6,959

## Edgar Filing: COMPUTER SOFTWARE INNOVATIONS INC - Form 10-K

Gross Profit	\$	12,818	\$	11,321
--------------	----	--------	----	--------

### *Gross Margin*

Software applications segment	40.7%		41.6%
Technology solutions segment	16.2%		15.6%
Gross Margin	21.8%		20.5%

Additional information concerning segment financial information is set forth under Management's Discussion and Analysis of Financial Condition and Results of Operations. The increase in the margin has been driven primarily by an increase in the margin in the larger dollar Technology solutions segment, partially offset by the decrease in the Software applications segment margin from the addition of acquired software businesses, which have historically reported lower margins than CSI's ongoing software operations.

---

## **Table of Contents**

### **C. History and Development of CSI – South Carolina**

#### **Initial Development**

Our current business operations are those of CSI – South Carolina. CSI – South Carolina was incorporated under the name of Compu-Software, Inc. as a South Carolina corporation on January 12, 1990.

#### **Events Leading Up to 2005 Restructuring**

On February 10, 2005, CSI – South Carolina and VerticalBuyer, its then 77% owned subsidiary and an inactive shell company, entered into the Agreement and Plan of Merger. The agreement provided that CSI – South Carolina would merge into VerticalBuyer, with VerticalBuyer being the surviving corporation. As a result, CSI – South Carolina became a publicly held company reporting to the SEC. Also on February 10, 2005, CSI – South Carolina and Barron Partners LP ( Barron ) entered into definitive agreements for a preferred stock investment in the Company following its merger with CSI – South Carolina. The merger and other transactions contemplated by the Barron letter of intent and definitive agreements were consummated February 11, 2005 and are described in more detail in E. The Merger and Recapitalization below.

#### **D. Subsidiaries**

Our consolidated financial statements continue to include CSI Technology Resources, Inc. as a wholly-owned subsidiary. However, this subsidiary no longer has any significant operations or separate accounting. Its former operations are now accounted for within CSI, except that CSI Technology Resources, Inc. is still named in certain contracts. At a future date, these contracts may be transferred to the parent and the subsidiary deactivated, subject to a review of any tax and legal consequences. As the Company files a consolidated tax return and has been accounting for all activities through CSI, there should be no financial or tax implications related to the formal procedures which would be undertaken to deactivate the subsidiary.

We have no other subsidiaries.

#### **E. The Merger and Recapitalization**

In the first quarter of 2005, the Company completed a series of recapitalization transactions which began January 31, 2005 with a change in control due to the purchase of a majority of our common stock by CSI – South Carolina. These culminated on February 11, 2005 with the merger of CSI – South Carolina into VerticalBuyer, our issuance of preferred stock, common stock, common stock warrants and certain subordinated notes, and the change of our name to Computer Software Innovations, Inc.

#### **Description of Merger and Related Investment Transactions**

##### *The Merger*

On February 10, 2005, VerticalBuyer and CSI – South Carolina executed an Agreement and Plan of Merger. On February 11, 2005, CSI – South Carolina merged into VerticalBuyer, with VerticalBuyer continuing as the surviving corporation. In the merger, the former stockholders of CSI – South Carolina received, in exchange for their shares of CSI – South Carolina common stock, two sets of notes totaling \$3,624,800 and \$1,875,200, respectively, and 2,526,905 shares of our common stock. Such consideration was in addition to a \$3,460,000 pre-merger dividend by CSI – South Carolina to its five shareholders. The set of notes totaling \$3,624,800 was repaid to the former CSI – South Carolina shareholders immediately following the merger from the proceeds of the preferred stock and the \$1,875,200 subordinated note issued to Barron, as described under Sale of Preferred Stock and Warrants below. Subordinated notes payable to the former shareholders of CSI – South Carolina totaling \$1,875,200 remained outstanding following the merger. Amounts outstanding under these notes totaled \$975,200 as of December 31, 2008.

The shares of the common stock of VerticalBuyer previously held by CSI – South Carolina, representing approximately 77% of VerticalBuyer's issued and outstanding capital stock, were cancelled in the merger. The remaining stockholders of VerticalBuyer retained their existing shares, subject to the 40 to 1 reverse stock split. Such minority stockholders had appraisal rights as provided in accordance with Delaware law, whereby they could elect to have their shares repurchased by the surviving corporation. No minority stockholders elected to exercise their appraisal rights.

##### *Sale of Preferred Stock and Warrants*

## Edgar Filing: COMPUTER SOFTWARE INNOVATIONS INC - Form 10-K

On February 10, 2005, VerticalBuyer entered into a Preferred Stock Purchase Agreement with Barron, a micro-cap fund. Pursuant to the agreement, on February 11, 2005, immediately following the consummation of the merger, we issued to Barron 7,217,736 shares of our newly created Series A Convertible Preferred Stock in exchange for the payment of \$5,042,250. The agreement also provided that Barron would lend the merged company an additional \$1.9 million, in the form of a subordinated note on the same terms as the subordinated notes payable to the former CSI South Carolina shareholders in the merger. Barron was also issued two warrants to purchase in the aggregate 7,217,736 shares of our common stock. The preferred stock is convertible into common stock on a one-for-one basis. The exercise prices of the warrants were originally \$1.3972 and \$2.0958 per share. Each warrant is exercisable for half of the total warrant shares. The terms and conditions of the warrants are identical except with respect to exercise price.

---

## **Table of Contents**

Both the conversion of the preferred stock and the exercise of the warrants are subject to restrictions on ownership that limit Barron's beneficial ownership of our common stock. Initially, Barron was generally prohibited from beneficially owning greater than 4.99% of our common stock, and such restriction could be waived by Barron upon 61 days prior notice. It was the intention of the Company and Barron that the preferred stockholder never acquire greater than 4.99% of the Company's common stock and never be deemed an affiliate or control person under federal securities laws. For avoidance of doubt, Barron and we agreed to remove the 61 day waiver provision and to impose a non-waivable beneficial ownership cap of 4.9%. These agreements were implemented on November 7, 2005. Pursuant to the terms of the Certificate of Designation governing the preferred stock, and the warrants, the ownership cap may not be amended or waived without the approval of the common stockholders of the Company, excluding for such vote all shares held by the holders of preferred stock and warrants (including Barron) and any directors, officers or other affiliates of the Company.

The warrants may be exercised on a cashless basis. In such event, we would receive no proceeds from their exercise. So long as we maintain an effective registration statement for the shares underlying the warrants, a warrant holder is prohibited from utilizing a cashless exercise.

On December 29, 2006, we entered into an agreement with Barron to divide, amend and restate the warrants. In particular, a portion of such warrants were reduced in price. One warrant was amended and divided into two warrants, one for 1,608,868 shares of common stock at an exercise price of \$0.70 per share and another for 2,000,000 shares of common stock at the original exercise price of \$1.3972 per share. The second warrant was likewise amended and divided into two warrants, one exercisable for 1,608,868 shares of common stock at a price of \$0.85 per share and another for 2,000,000 shares of common stock at the original exercise price of \$2.0958 per share.

Information on the accounting treatment of the warrants is presented in "Registration Rights Agreement" below.

### **Registration Rights Agreement**

In conjunction with the Preferred Stock Purchase Agreement, the Company also entered into a Registration Rights Agreement with Barron on February 10, 2005, whereby we agreed to register the shares of common stock underlying the preferred stock and warrants to be sold to Barron. Under the initial terms of the Registration Rights Agreement, the Company was obligated to file, within 45 days following the execution of the Registration Rights Agreement, a registration statement covering the resale of the shares. The agreement also obligated us to use our best efforts to cause the registration statement to be declared effective by the SEC within 120 days following the closing date of the registration rights agreement (February 11, 2005) or generally such earlier date as permitted by the SEC. Barron may also demand the registration of all or part of such shares on a one-time basis and, pursuant to "piggy-back rights," may require us (subject to carveback by a managing underwriter) to include such shares in certain registration statements we may file. We are obligated to pay all expenses in connection with the registration of the shares. Previously, we were liable for liquidated damages in the event the registration of shares was not effected pursuant to the agreement.

Under the terms of the initial Registration Rights Agreement, liquidated damages were triggered if we failed (i) to file the registration statement within 45 days from February 11, 2005, (ii) to cause such registration statement to become effective within 120 days from February 10, 2005, or (iii) to maintain the effectiveness of the registration statement. These requirements were subject to certain allowances: 45 "Amendment Days" during any 12-month period to allow the Company to file post-effective amendments to reflect a fundamental change in the information set forth in the registration statement, and "Black-out Periods" of not more than ten trading days per year in our discretion, during which liquidated damages would not be paid.

Under the initial terms of the Registration Rights Agreement with Barron, the liquidated damages were payable in cash at a rate of 25% per annum on Barron's initial preferred stock and warrant investment of \$5,042,250. Because the liquidated damages were payable in cash, under Emerging Issues Task Force ("EITF") 00-19 "Accounting for Derivative Financial Instruments Indexed to and Potentially Settled in a Company's Own Stock" a potential obligation (referred to under EITF 00-19 as a derivative financial instrument) existed until the registration became effective. Accordingly, the entire proceeds of the preferred stock issuance except for the par value were allocated to the warrants and recorded as a liability on the balance sheet at the date of the transaction.

It was not the intent of either CSI or Barron that the Registration Rights Agreement result in the majority of the proceeds from the preferred stock and warrant issuance being recorded as a liability rather than equity. In response, on November 7, 2005, CSI and Barron entered into an amendment to the Registration Rights Agreement that eliminated cash liquidated damages and replaced them with liquidated damages in the form of additional shares of Series A Convertible Preferred Stock. Pursuant to the amendment, 2,472 shares of preferred stock were to be issued to Barron for each day when liquidated damages were triggered. The amendment also resolved a conflict in the initial Registration Rights Agreement whereby some time periods for registration and liquidated damages were determined with respect to the date of the agreement (February 10, 2005) while others utilized the closing date of the agreement (February 11, 2005). Under the amended agreement, all such periods are determined in relation to February 11, 2005.





## **Table of Contents**

Prior to the execution of the amendment, Barron agreed to waive any liquidated damages through November 30, 2005 pursuant to a waiver dated September 30, 2005. Barron had also waived liquidated damages on three prior occasions. In exchange, during the fourth quarter of 2005 we paid Barron \$50,000 and agreed to cause the registration statement to become effective under the Registration Rights Agreement on or before November 30, 2005. We entered into a fifth waiver extending the required effectiveness date until January 31, 2006 and a sixth waiver extending the required effectiveness until February 28, 2006. Our registration statement was declared effective by the SEC on February 14, 2006.

On December 29, 2006, in conjunction with the repricing of a portion of the warrants described above under Sale of Preferred Stock and Warrants, the Registration Rights Agreement was amended. We agreed to extend the registration period by one year until February 11, 2009 plus that number of days during which the registration has not been effective during that term of the agreement. Barron agreed to waive any further liquidated damages under the Registration Rights Agreement. Prior to the amendment, the failure by the Company to maintain the effectiveness and availability of a registration statement, in excess of certain black-out and other exception periods, subjected the Company to liquidated damages in the form of 2,472 shares of Series A Convertible Preferred Stock per day. Absent the amendment, liquidated damages would have been payable for a portion of November and all of December 2006. The waiver by Barron ran through February 11, 2007, when the liquidated damages provisions of the Registration Rights Agreement expired. Accordingly, the liquidated damages provisions have been effectively eliminated.

### **F. Our Niche in the Governmental and Educational Technology Market**

There are approximately 3,100 counties (according to the U.S. Dept. of Census), 36,000 cities and towns (according to the National League of Cities) and more than 14,000 school districts (according to the National Center for Education Statistics) in the United States. Each of these organizations is a potential candidate for an integrated financial management system as well as for various technology services and products. Since many local governments are moving toward outsourcing of information technology services, even more opportunities are available for our services. In 2008, the sale of software, hardware and services to education and local government entities represented approximately 89% and 9% of our total revenues. While sales to non-educational, non-governmental organizations accounted for approximately 2% of our total sales.

Our customer base is discussed in more detail under L. Customers below.

### **G. Products and Services**

#### **CSI Fund Accounting Software**

We provide the CSI Fund Accounting Software (CSI Accounting+*Plus*) to a variety of clients in an integrated financial management system. We generate revenue from CSI Accounting+*Plus* as outlined below. Each of the products and services creating these sources of revenue is described in the remainder of this section.

Sales of software licenses to new clients;

Sales of new/additional modules to existing clients;

Installation of software;

Data conversion from legacy systems;

End user training;

Guaranteed service agreements; and

## Edgar Filing: COMPUTER SOFTWARE INNOVATIONS INC - Form 10-K

Sales of third party products to enhance functionality of CSI Accounting+*Plus*.

Prior to 1999, our proprietary fund accounting system was a DOS-based product. DOS, or Disk Operating System, was the personal computer operating software used widely before the release of Microsoft's Windows® software. In July 1999, we released a Windows® based version of the system as CSI Accounting+*Plus*. This product was written with Microsoft's Visual FoxPro® database, a relational database, and utilizes Crystal Reports®, an industry standard report generator. Over the next four years, approximately 120 software clients upgraded from the DOS based system to the new product. For our clients, this upgrade process included data conversion, installation and training on the new system and, in many cases, a hardware upgrade. The CSI Accounting+*Plus* system has also been installed in approximately 175 new clients during the period from 1999 to 2008. In addition to software sales, we offer ongoing customer support for the accounting software. This support is provided under a guaranteed service agreement, providing the client with phone support, online user assistance and routine updates to the software.

While we continue to market the Visual FoxPro® version, the CSI Accounting+*Plus* system is currently being rewritten with Microsoft's .Net (pronounced dot-net) and SQL (pronounced sequel and standing for Structured Query Language) database technologies. This new version, SmartFusion, will provide improved performance, scalability, more flexible data access and native data-tagging (XML or Extensible Mark-up Language) web support. SQL and .Net have become the industry standards for software development, and XML has become an industry standard for data tagging and retrieval. We have already completed the conversion of the majority of our core accounting and personnel modules, with the municipal modules still in progress. We anticipate completing the municipal modules over the remainder of 2009 and into the beginning of 2010. The current CSI product contains the functionality required by our clients but moving to the SQL and .Net platform will allow us to be more competitive on both a regional and national level.

**Table of Contents**

A new software service option called *Service+Plus* has also been developed. This plan will provide the normal coverage of a guaranteed service agreement but will also include version protection: clients will get new major releases of the software without additional fees. *Service+Plus* will also provide clients free attendance to webinars (seminars which may be attended remotely by use of the internet), free user conference attendance, one free Crystal Reports® training class each year, disaster recovery (off-site data storage) and discounts on additional software modules, training and engineering services.

The CSI Accounting+*Plus* software suite is designed as a modular solution. The modules are sold separately to enable customers to pick and choose only those modules that are needed to provide desired functionality. Major modules in the software suite are shown in the following table:

**Accounting Modules**

Accounts Payable  
Accounts Receivable  
Budget Preparation  
Check Reconciliation  
Cost Allocation  
Fixed Assets  
Fund Ledger  
Payroll  
Purchasing  
System Manager

**Specialty Modules**

Audit Reporting  
Claims Reimbursement  
Food Service Reporting  
Inventory  
Pupil Activity Accounting  
Warehouse Requisitions  
Employee Self Service  
Online Bill Pay

**Payroll / Personnel Support Modules**

Absent Employee Tracking  
Applicant Tracking  
Available Substitutes  
Insurance and Benefits  
Personnel

**Municipal Modules**

Business License  
Cash Collections  
Construction Permits  
Utility Billing

Our development team writes and maintains the CSI Accounting+*Plus* modules. The support of these modules includes routine enhancements, governmentally required changes (e.g., Form W-2 format changes) and problem fixes. We provide updates to the CSI system through our website.

On January 1, 2007, CSI acquired the fund accounting software of McAleer Computer Associates, Inc. ( McAleer or CSI- Mobile ), targeted at the K-12 education market space and on March 31, 2008, CSI acquired the fund accounting software of ICS Systems, Inc. ( ICS or CSI-Greensboro ), targeted at the local government market space, neither of which are available in Microsoft .Net and SQL versions. Both products include modules similar to those included in CSI Accounting+*Plus* which is being rewritten in Microsoft .Net and SQL as SmartFusion (as discussed above). These acquired products continue to be marketed, sold and supported in areas surrounding their installed client base. The goal is to merge the functionality of these acquired products into a single SmartFusion product over time.

**Standards Based Lesson Planner**

In September 2005, we acquired the Standards Based Lesson Planning software. The software is designed to allow teachers to create lesson plans that are tied to a state's curriculum standards. These lesson plans may then be reviewed by school administrators and a report generated to determine the standards that have been met or need to be met. This is particularly important as school systems develop higher accountability standards. In addition, the federal legislation of No Child Left Behind Act has focused greater attention on schools' adequate yearly progress ( AYP ), and meeting curriculum standards is an important component of these measurements. Standards based lesson planning software allows a school to document its compliance with the curriculum standards as a component of its compliance with the No Child Left Behind Act legislation.

We have converted this product to a Microsoft SQL database and internet-based product and are marketing it as curriculum standards based lesson planner. The product is ready to market and we are currently developing a strategic marketing plan designed to accomplish profitable objectives and positive return. We continue to add functionality to the product based on feedback from current user groups. Costs related to identifying such functionality and their technological feasibility are expensed while costs related to programming of known technologically feasible improvements are capitalized.

## Edgar Filing: COMPUTER SOFTWARE INNOVATIONS INC - Form 10-K

We believe the addition of this product, while not yet material, may provide significant additional revenue in the future as we are able to offer an additional product to our existing school-based customers. However, we can give no assurance that this software product

## Table of Contents

will in fact prove successful. We believe the product can achieve sufficient acceptance in the market place to cover our investment. If at anytime we were to determine it would not, at the time we reached such determination, we would write down all or the applicable portion of the capitalized costs related to this product based on projected cash flows. As of December 31, 2008, since the product acquisition, we have capitalized approximately \$530,000 related to this product, and have received approximately \$65,000 in revenues.

We believe the product may also provide a source of additional contacts and referrals. The gross profit received from each sale of this product may be significantly less than that of our traditional fund accounting software. As a result, we intend to use telesales as a cost effective method of generating additional contacts, have a dedicated sales representative, and may use the Internet as a medium for demonstrations and software delivery, in order to minimize selling and delivery costs.

### **Version3 - Identity Lifecycle Management Software and Microsoft SharePoint Services**

In August 2008, we acquired the Identity Lifecycle Management software of Version3. The Identity Lifecycle Management software enhances the services provided under Microsoft's identity lifecycle management framework with Microsoft's Active Directory as a core. The products facilitate single sign-on, application management and single point provisioning of identities in multiple applications. The Version3 applications team also periodically provides new application development of portals and other functionality based on SharePoint services for third-parties, including Microsoft and other large enterprises (many of the details of which are restricted due to confidentiality agreements). We plan to retain, for the foreseeable future, the brand name of Version3 to refer to this suite of products and services and the focus of our organization on these solutions.

While Version3 solutions are not solely designed for the education market segment, many recent projects have been directed to K-12 and higher education. Prior to the acquisition, CSI was a reseller of Version3 solutions. We anticipated, by joining forces with Version3, that synergies will be achieved to expand sales efforts, enhance delivery efficiencies, and allow increased focus on new product development and enhancements to existing solutions. We believe Version3's solutions are more easily scalable to a national level than the Software applications segment's other major proprietary applications, fund accounting solutions, with many solutions both within and outside our eight-state footprint and a few international installations in Canada and one in the United Kingdom prior to the acquisition.

### **Hardware Sales and Related Support Services**

Our technology solutions segment provides network system solutions to more than 200 educational and local governmental organizations in South Carolina, North Carolina and Georgia. We also plan to market technology solutions into the five additional states where we have a presence as a result of the McAleer acquisition, and have already begun doing so in Alabama. This segment provides professional network integration services as well as network computing solutions to our customers. We strive to deliver high-quality hardware, software and related professional services to help our customers plan, acquire, implement, manage and upgrade their organizations' information systems.

We have established associations with some of the largest vendors in the industry, and with others whom we believe offer innovative products. We believe that strong industry relationships will further enhance our competitive position. We have developed and maintain the following major vendor relationships:

Our focus on the K-12 sector has led to our developing relationships with vendors who specialize in technologies for the classroom. **Promethean** Collaborative Classroom Solutions offers what we consider to be the industry-leading solution for transforming the classroom into an interactive learning environment. Using Promethean's ActivBoards, students are able to use a stylus on a special electronic white board to interact with computer projected images. The computer reacts to the stylus activity and projects the results. Although there are other competitive products in the marketplace, by having an exclusive sales arrangement (except for certain distributor relationships) to market an industry-leading solution in North Carolina, South Carolina, and southern Alabama, we believe we are better able to maintain gross margins than would otherwise be possible. In addition to selling the ActivBoards, we offer installation services, end user training and market complementary products (e.g., projectors, PC Tablets) to be used with the boards for the collaborative classroom. Our classroom solutions are currently a primary, substantial revenue generator, and have generated between one-third and one-half of our total revenues in recent years.

Significant focuses in the technology solutions segment include IP (internet packet-based) telephony, wireless, system security and routing/switching. We have a strategic relationship with **Cisco Systems, Inc.** (Cisco), a worldwide leader in networking for the Internet and technology innovation, whereby Cisco provides the hardware necessary to implement these systems. We purchase the

## Edgar Filing: COMPUTER SOFTWARE INNOVATIONS INC - Form 10-K

majority of our Cisco equipment through Ingram Micro. Ingram Micro is a multi-national distributor of technology hardware. Although we are an indirect reseller of Cisco products, we periodically work closely with Cisco representatives, particularly on large sales. This relationship occasionally produces customer leads and referrals. We also encourage our employees to pursue Cisco technical certifications, as such certifications as well as the achievement of certain sales volumes of Cisco products can make

## Table of Contents

us eligible for certain incentives periodically offered by Cisco. We also participate in certain state contract pricing frameworks that Cisco has established with public entities. Purchases from Ingram Micro are made on an individual purchase order basis. We have no formal agreements with Ingram Micro.

We deploy desktops, notebook computers, personal devices and file servers in a variety of client network environments. We have a strategic relationship with **Hewlett Packard** ( HP ), which produces technology solutions that span information technology infrastructure, personal computing and access devices, global services and imaging and printing for consumers, enterprises and small and medium business. We provide professional services to deploy these devices. Our relationship with HP consists primarily of the purchase of personal computers, servers, printer equipment and infrastructure devices for resale. We purchase these products on an individual purchase order basis under a standard, nonexclusive reseller agreement. In addition to purchases directly from HP, we have arms-length business relationships with certain customers whereby the customers have elected to name us as their authorized HP representative. As the named representative, and as an incentive for the customer to approve us as the named representative, we provide various forms of assistance which can include assisting the customer in identifying the specific HP products that will meet its needs, summarizing and processing orders on behalf of the customer with HP, and providing certain support and HP authorized repair and maintenance for which we are separately compensated by HP. To provide these services, some of our personnel have received training and certifications from HP. As the named representative of HP, we assist the customers in placing their orders directly with, and we receive commissions from HP, rather than acting as the purchaser and reseller of HP's products. Due to the volume of business we do with HP, we also work very closely with HP representatives and receive support which may include special quantity or other pricing in competitive situations with products from other manufacturers, and may receive customer leads or referrals from time to time.

In order to offer visual communication equipment to our clients and prospective clients in order to allow video conferencing, administrative communications, home bound learning and professional development, we have developed a business relationship with **Tandberg**. In the education environment, Tandberg provides worldwide access to people, places and experiences without time or travel constraints. Through the public sector and business environment, Tandberg offers solutions in providing more efficient and effective training to employees, saving travel, time and money. Tandberg solutions include cameras, monitors, videophones and software.

Our relationship with Promethean is established through a reseller agreement, under which we are able to sell interactive whiteboard products on an exclusive basis (except for certain distributor relationships) in two states and a portion of a third, South Carolina, North Carolina and southern Alabama. In early 2008 we entered into an affiliate relationship with another vendor, providing us the opportunity to sell Promethean products in certain counties in the state of Alabama. In early 2009, our affiliate relationship was changed to be an exclusive reseller relationship with Promethean. Both the exclusive reseller agreements and the affiliate agreement provided us with the ability to sell both Promethean products into these markets, as well as provide additional opportunities to sell our related project management and technical services.

Our relationships with Cisco, HP and Tandberg are established through standard reseller agreements. These agreements make us eligible to resell products on a generally non-exclusive basis, many in specifically authorized geographic regions, and make us eligible, from time to time, for periodic promotions, special offers and manufacturing standard volume discounts and rebates, when offered. Occasionally we may request special pricing for large volume deals, particularly in competitive situations, which may be approved on a case by case basis. Due to our sales and marketing success on behalf of vendors, we have been asked from time to time to represent products in new geographic regions and to new customer verticals. As we expand we may exploit these opportunities as they come available and as we have the financial justification to create the physical presence to do so.

In addition to the above relationships, we also have developed relationships with Microsoft, Novell, Packeteer, Symantec, Citrix and other hardware-based solution providers, which are on similar terms with those of Cisco, HP and Tandberg, and some of whose products we may purchase either from the manufacturers or through our distributor relationship with Ingram Micro (discussed above). We also have one additional vendor, Synnex. Our purchases from Synnex, like those from Ingram Micro, have, at times, equaled more than 10% of our annual purchase volume. Synnex is also a distributor of technology hardware. We have no formal agreement with Synnex and, like Ingram Micro, purchase technology accessories on a purchase order by purchase order basis. The products purchased from Synnex are also readily available through other vendors.

Our technical services include the following:

**Consulting Services**

Project Management

Deployment Management

Procurement Management

Product Evaluation Management

Outsourcing Management



**Table of Contents**

**Network Services**

Network Needs Analysis

Network System Design

Network System Integration

&#149