

INDUSTRIAL SERVICES OF AMERICA INC /FL
Form 10-K/A
November 14, 2007

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-K/A

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

For Fiscal Year Ended December 31, 2006

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

For the transition period from _____ to _____

Commission File No.: 0-20979

INDUSTRIAL SERVICES OF AMERICA, INC.
(Exact name of registrant as specified in its charter)

Florida
(State or other jurisdiction of
incorporation or organization)

59-0712746
(I.R.S. Employer
Identification No.)

7100 Grade Lane
P.O. Box 32428
Louisville, Kentucky 40232
(502) 368-1661
(Address, including zip code, and telephone number,
including area code, of registrant's principal executive offices)

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

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

Common Stock, \$.005 par value
(Title of class)

Indicate by check mark if the registrant is a well-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 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.

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

(Check one): Large accelerated filer Accelerated filer Non-accelerated filer

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

Aggregate market value of the 1,861,574 shares of voting Common Stock held by non-affiliates of the registrant at the closing sales price on June 30, 2006: \$10,704,050.

Number of shares of Common Stock, \$.005 par value, outstanding as of the close of business on March 22, 2007: 3,640,899.

DOCUMENT INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement for the 2007 Annual Meeting of Shareholders are incorporated by reference into Item 10 through Item 14 of Part III of this report.

EXPLANATORY NOTE

We are filing this Form 10-K/A, which serves as a first amendment to our Annual Report on Form 10-K for the year ended December 31, 2006, originally filed on March 27, 2007, to provide evidence of the actual execution of the opinions from our external auditors related to our audited financial statements contained in the Form 10-K. Although we included the forms of these opinions in the original filing under Part IV, Item 15, at pages F-1 and F-2 of the original Form 10-K, evidence of the signatures is missing. We have made no other changes to the Form 10-K as filed on March 27, 2007, other than the incorporation by reference from the Form 10-K for the year ended December 31, 2006, originally filed on March 27, 2007, of Exhibits 10.33 through 10.38 and newly executed Rule 13a-14(a) and Section 1350 Certifications.

PART IV

Item 15. Exhibits and Consolidated Financial Statement Schedules.

(a)(1) The following consolidated financial statements of Industrial Services of America, Inc. are filed as a part of this report:

	<u>Page</u>
Report of Independent Registered Public Accounting Firms	F-1

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Consolidated Balance Sheets as of December 31, 2006 and 2005	F-3
Consolidated Statements of Income for the years ended December 31, 2006, 2005 and 2004	F-4
Consolidated Statements of Shareholders' Equity for the years ended December 31, 2006, 2005 and 2004	F-5
Consolidated Statements of Cash Flows for the years ended December 31, 2006, 2005 and 2004	F-6
Notes to Consolidated Financial Statements	F-7
(a)(2) Consolidated Financial Statement Schedules.	
Schedule II--Valuation and Qualifying Accounts for the years ended December 31, 2006, 2005 and 2004	F-28
(a)(3) List of Exhibits	

Exhibits filed with, or incorporated by reference herein, this report are identified in the Index to Exhibits appearing in this report. The Management Agreement and the Consulting Agreement required to be filed as exhibits to this Form 10-K pursuant to Item 14(c) are noted by an asterisk (*) in the Index to Exhibits.

(b) Exhibits.

The exhibits listed on the Index to Exhibits are filed as a part of this report.

(c) Consolidated Financial Statement Schedules.

Schedule II--Valuation and Qualifying Accounts for the year ended December 31, 2006, 2005 and 2004 are incorporated by reference at page F-29 of the ISA Consolidated Financial Statements.

SIGNATURES

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Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report on Form 10-K/A to be signed on its behalf by the undersigned, thereunto duly authorized.

INDUSTRIAL SERVICES OF AMERICA, INC.

Dated: November 13, 2007

By : /s/ Harry Kletter

Harry Kletter, Chairman of the Board
and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report on Form 10-K/A has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated:

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ Harry Kletter</u> Harry Kletter	Chairman of the Board and Chief Executive Officer (Principal Executive Officer)	November 13, 2007
<u>/s/ Alan L. Schroering</u> Alan L. Schroering	Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)	November 13, 2007
<u>/s/ David W. Lester</u> David W. Lester	Director	November 13, 2007
<u>/s/ Orson Oliver</u> Orson Oliver	Director	November 13, 2007
<u>/s/ Roman Epelbaum</u> Roman Epelbaum	Director	November 13, 2007
<u>/s/ Albert Cozzi</u> Albert Cozzi	Director	November 13, 2007

<u>/s/ Craig Feltner</u> Craig Feltner	Director	November 13, 2007
<u>/s/ Richard Ferguson</u> Richard Ferguson	Director	November 13, 2007

INDEX TO EXHIBITS

<u>Exhibit Number</u>		<u>Description of Exhibits</u>
3.1	**	Certificate of Incorporation of ISA is incorporated by reference to Exhibit 3.1 of ISA's report of Form 10-KSB for the year ended December 31, 1995.
3.2	**	Bylaws of ISA are incorporated by reference to Exhibit 3.2 of ISA's report on Form 10-KSB for the year ended December 31, 1995.
10.1	**	Independent Consulting Services Agreement, dated as of March 31, 1995, and executed on June 25, 1996, by and between ISA and Douglas I. Maxwell, III ("Maxwell"), is incorporated by reference to Exhibit 4(a) of ISA Statement on Form S-8 of the Registration, filed on June 26, 1996 (File No. 333-06915).
10.2	**	Confidential Information and Non-Competition Agreement Independent Contractor, dated as of March 31, 1995, and executed on June 26, 1996, by and between ISA and Maxwell, is incorporated by reference to Exhibit 10.1 of Registration Statement on Form S-8 of ISA, filed on June 26, 1996 (File No. 333-06915).
10.3	**	Stock Option Agreement, dated as of March 31, 1995, and executed on June 26, 1996, by and between ISA and Maxwell, is incorporated by reference to Exhibit 4(b) of Registration Statement on Form S-8 of ISA, filed on June 26, 1996 (File No. 333-06915).
10.4	**	Independent Consulting Services Agreement, dated as of March 31, 1995, and executed on June 26, 1996, by and between ISA and Neil C. Sullivan ("Sullivan"), is incorporated by reference to Exhibit 4(a) of Registration Statement on Form S-8 of ISA, filed on June 26, 1996 (File No. 333-06909).
10.5	**	Confidential Information and Non-Competition Agreement Independent Contractor, dated as of March 31, 1995, and executed on June 26, 1996, by and between ISA and Sullivan, is incorporated by reference to Exhibit 10.1 of Registration Statement on Form S-8 of ISA, filed on June 26, 1996 (File No. 333-06909).
10.6	**	Stock Option Agreement, dated as of March 31, 1995, and executed on June 26, 1996, by and between ISA and Sullivan, is incorporated by reference to Exhibit 4(b) of Registration Statement on Form S-8 of ISA, filed on June 26, 1996 (File No. 333-06909).

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- 10.7 ** Acquisition of Assets Agreement, dated as of July 1, 1997, by and between ISA and The Metal Center set forth in an Asset Purchase Agreement, is incorporated by reference, as the sole Exhibit on Form 8-K of ISA, filed July 15, 1997 (File No. 0-20979).
- 10.8 ** Assignment of Contracts, dated September 4, 1997, by and between ISA and MGM Services, Inc. is incorporated by reference to Exhibit 10.11 of ISA's report on Form 10-K for the year ended December 31, 1997.
- 10.9 ** Employment Agreement, dated as of October 15, 1997, by and between ISA and Garber is incorporated by reference to Exhibit 10.12 of ISA's report on Form 10-K for the year ended December 31, 1997.
- 10.10 ** Lease Agreement, dated January 1, 1998, by and between ISA and K&R, is incorporated by reference herein, to Exhibit 10.10 on Form 8-K of ISA, filed March 3, 1998 (File No. 0-20979).*
- 10.11 ** Consulting Agreement, dated as of January 2, 1998, by and between ISA and K&R, is incorporated by reference herein, to Exhibit 10.11 on Form 8-K of ISA, filed March 3, 1998 (File No. 0-20979).*
- 10.12 ** Amendment to Employment Agreement, dated as of February 5, 1998, by and between ISA and Garber, amending original agreement dated October 15, 1997 is incorporated by reference to Exhibit 10.15 of ISA's report on Form 10-K for the year ended December 31, 1997.
- 10.13 ** Stock Option Agreement, effective as of October 31, 1997, by and between ISA and Glenn Bierman is incorporated by reference herein to Exhibit 10.13 of ISA's report on Form 10-K for the year ended December 31, 1999, as filed on April 14, 2000.
- 10.14 ** Stock Option Agreement, effective as of October 27, 1997, by and between ISA and Sean Garber is incorporated by reference herein to Exhibit 10.14 of ISA's report on Form 10-K for the year ended December 31, 1999, as filed on April 14, 2000.
- 10.15 ** Stock Option Agreement, effective as of October 31, 1997, by and between ISA and Sean Garber is incorporated by reference herein to Exhibit 10.15 of ISA's report on Form 10-K for the year ended December 31, 1999, as filed on April 14, 2000.
- 10.16 ** Amendment No. 1 to Option Agreement, effective as of February 5, 1998, by and between ISA and Sean Garber is incorporated by reference herein to Exhibit 10.16 of ISA's report on Form 10-K for the year ended December 31, 1999, as filed on April 14, 2000.
- 10.17 ** Stock Option Agreement, effective as of February 16, 1998, by and between ISA and Harry Kletter is incorporated by reference herein to Exhibit 10.17 of ISA's report on Form 10-K for the year ended December 31, 1999, as filed on April 14, 2000.
- 10.18 ** Consulting Agreement, dated as of June 2, 1998, by and between ISA and Andrew M. Lassak is incorporated by reference herein to Exhibit 10.18 of ISA's report on Form 10-K for the year ended December 31, 1999, as filed on April 14, 2000.
- 10.19 ** Consulting Agreement, dated as of June 2, 1998, by and among ISA, Joseph Charles & Associates, Inc. and Andrew M. Lassak is incorporated by reference

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herein to Exhibit 10.19 of ISA's report on Form 10-K for the year ended December 31, 1999, as filed on April 14, 2000.

10.20	**	Asset Purchase Agreement, effective as of June 1, 1998, by and among ISA, ISA Indiana, Inc., R.J. Fitzpatrick Smelters, Inc., and R.K. Fitzpatrick and Cheryl Fitzpatrick is incorporated by reference herein to Exhibit 10.20 of ISA's report on Form 10-K for the year ended December 31, 1999, as filed on April 14, 2000.
10.21	**	Lease Agreement, effective June 1, 1998, by and between R.K. Fitzpatrick and Cheryl Fitzpatrick, R.J. Fitzpatrick Smelters, Inc., and ISA Indiana, Inc. is incorporated by reference herein to Exhibit 10.21 of ISA's report on Form 10-K for the year ended December 31, 1999, as filed on April 14, 2000.
10.22	**	Environmental Indemnity Agreement, effective as of June 1, 1998, by and between R.K. Fitzpatrick and Cheryl Fitzpatrick, R.J. Fitzpatrick Smelters, Inc., and ISA Indiana, Inc. is incorporated by reference herein to Exhibit 10.22 of ISA's report on Form 10-K for the year ended December 31, 1999, as filed on April 14, 2000.
10.23	**	Promissory Note dated May 8, 1997, from Registrant to Bank of Louisville in the original principal amount of \$2,000,000.00 is incorporated by reference herein to Exhibit 10.23 of ISA's report on Form 10-K for the year ended December 31, 2000, as filed on March 30, 2001.
10.24	**	Loan Agreement dated November 30, 2000, by and between ISA and Bank of Louisville is incorporated by reference herein to Exhibit 10.24 of ISA's report on Form 10-K for the year ended December 31, 2000, as filed on March 30, 2001.
10.25	**	Change in Terms Agreement dated November 30, 2000, by and between ISA and Bank of Louisville is incorporated by reference herein to Exhibit 10.25 of ISA's report on Form 10-K for the year ended December 31, 2000, as filed on March 30, 2001.
10.26	**	Change in Terms Agreement dated March 26, 2001, by and between ISA and Bank of Louisville is incorporated by reference herein to Exhibit 10.26 of ISA's report on Form 10-K for the year ended December 31, 2000, as filed on March 30, 2001.
10.27	**	Penske Lease and Purchase Agreement effective July 8, 2004, for three years at a rental of \$3,000 per month with an option to purchase for \$425,000.
10.28	**	Stock Option Agreement, dated June 11, 1996, by and between ISA and R. Jerry Falkner, is incorporated by reference to Exhibit 10.3 of ISA's report on Form 10-K for the year ended December 31, 1996.
10.29	**	Stock Option Agreement, dated March 1, 2000, by and between ISA and Andrew M. Lassak and related letter agreement dated November 3, 1999 is incorporated by reference herein to Exhibit 10.29 of ISA's report on Form 10-K for the year ended December 31, 2004, as filed on March 4, 2005.
10.30	**	Contract of Purchase, dated March 24, 2005, by and between the Southern States Cooperative, Incorporated and the Harry Kletter Family Limited Partnership (HKFLP), as assigned by assignment of contract of purchase, dated April 24, 2005 from HKFLP to ISA Real Estate, LLC is incorporated by reference herein to Exhibit 10.30 of ISA's report on Form 10-K for the year ended December 31, 2004, as filed on March 4, 2005.
10.31	**	Lease, dated April 30, 2005, from ISA Real Estate, LLC to Southern States Cooperative, Incorporated is incorporated by reference herein to Exhibit 10.31 of

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ISA's report on Form 10-K for the year ended December 31, 2004, as filed on March 4, 2005.

10.32	**	Promissory Note for K&R, LLC in favor of ISA in the principal amount of \$302,160, dated March 25, 2006, and effective December 31, 2005, is incorporated by reference herein to Exhibit 10.32 of ISA's report on Form 10-K for the year ended December 31, 2005, as filed on March 31, 2006.
10.33	**	Loan and Security Agreement dated June 30, 2006, by and between ISA and Fifth Third Bank is incorporated by reference herein to Exhibit 10.33 of ISA's report on Form 10-K for the year ended December 31, 2006, as filed on March 27, 2007.
10.34	**	Promissory Note dated June 30, 2006, from ISA to Fifth Third Bank is incorporated by reference herein to Exhibit 10.34 of ISA's report on Form 10-K for the year ended December 31, 2006, as filed on March 27, 2007.
10.35	**	Revolving Credit Facility Agreement dated December 22, 2006, by and between ISA and BB&T, is incorporated by reference herein to Exhibit 10.35 of ISA's report on Form 10-K for the year ended December 31, 2006, as filed on March 27, 2007.
10.36	**	Promissory Note dated December 22, 2006, from ISA to BB&T, is incorporated by reference herein to Exhibit 10.36 of ISA's report on Form 10-K for the year ended December 31, 2006, as filed on March 27, 2007.
10.37	**	Lease dated as of February 6, 2007, by and between Parks Wood Products, as Lessor, and ISA Real Estate, LLC, as Lessee, is incorporated by reference herein to Exhibit 10.37 of ISA's report on Form 10-K for the year ended December 31, 2006, as filed on March 27, 2007.
10.38	**	Sub-Lease dated as of February 28, 2007, by and between ISA, as Sublessor, and Cohen Brothers of Lexington, Inc., as Sublessee, is incorporated by reference herein to Exhibit 10.38 of ISA's report on Form 10-K for the year ended December 31, 2006, as filed on March 27, 2007.
11		Statement of Computation of Earnings Per Share (See Note 9 to Notes to Consolidated Financial Statements).
16		Letter from Crowe Chizek and Company, LLC dated April 28, 2005, regarding change in certifying accountant is incorporated by reference herein to Exhibit 16 of ISA's report on Form 8-K/A, as filed on April 28, 2005.
31.1		Rule 13a-14(a) Certification of Harry Kletter for the Form 10-K/A for the year ended December 31, 2006.
31.2		Rule 13a-14(a) Certification of Alan Schroering for the Form 10-K/A for the year ended December 31, 2006.
32.1		Section 1350 Certification of Harry Kletter and Alan Schroering for the Form 10-K/A for the year ended December 31, 2006.

*Denotes a management contract of ISA required to be filed as an exhibit pursuant to Item 601(10)(iii) of Regulation S-K under the Securities Act of 1933, as amended.

**Previously filed.

**INDUSTRIAL SERVICES OF AMERICA, INC.
AND SUBSIDIARIES**

CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006, 2005 and 2004

INDUSTRIAL SERVICES OF AMERICA, INC.
AND SUBSIDIARIES
Louisville, Kentucky

CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006, 2005 and 2004

CONTENTS

REPORTS OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRMS 1

FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEETS 3

CONSOLIDATED STATEMENTS OF INCOME 4

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY 5

CONSOLIDATED STATEMENTS OF CASH FLOWS 6

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS 7

SUPPLEMENTARY INFORMATION

VALUATION AND QUALIFYING ACCOUNTS 28

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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Board of Directors and Shareholders

Industrial Services of America, Inc. and Subsidiaries

Louisville, Kentucky

We have audited the accompanying consolidated balance sheets of Industrial Services of America, Inc. and Subsidiaries as of December 31, 2006 and 2005 and the related consolidated statements of operations, shareholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Industrial Services of America, Inc. and Subsidiaries as of December 31, 2006 and 2005, and the results of its operations and its cash flows for the years then ended, in conformity with U. S. generally accepted accounting principles. Also, in our opinion, the related consolidated financial statements schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

/s/ Mountjoy & Bressler, LLP

Louisville, Kentucky

March 19, 2007

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders

Industrial Services of America, Inc. and Subsidiaries

Louisville, Kentucky

We have audited the accompanying consolidated statements of operations, shareholders' equity and cash flows of Industrial Services of America, Inc. and Subsidiaries for the year ended December 31, 2004. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audit 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 audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, Industrial Services of America, Inc. and Subsidiaries' results of its operations and its cash flows for the year ended December 31, 2004, in conformity with U. S. generally accepted accounting principles. Also, in our opinion, the related consolidated financial statements schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

/s/ Crowe Chizek and Company, LLC
Crowe Chizek and Company, LLC

Louisville, Kentucky

January 28, 2005, except for Notes 3 and 6,

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as to which the date is March 25, 2005

2.

INDUSTRIAL SERVICES OF AMERICA, INC.
AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
December 31, 2006 and 2005

	<u>2006</u>	<u>2005</u>
ASSETS		
Current assets		
Cash	\$ 1,331,807	\$ 1,721,301
Accounts receivable - trade (after allowance for doubtful accounts of \$100,000 in 2006 and \$50,000 in 2005) (Note 1)	5,026,441	4,502,845
Net investment in sales-type leases (Note 5)	50,586	65,797
Inventories (Note 1)	3,428,226	2,488,609
Deferred income taxes (Note 4)	106,725	78,385
Other	<u>88,113</u>	<u>120,012</u>
Total current assets	10,031,898	8,976,949
Net property and equipment (Note 1)	8,152,606	7,604,712
Other assets		
Net investment in sales-type leases (Note 5)	186,215	236,801
Notes receivable - related party (Note 6)	238,566	264,390
Goodwill (Note 1)	560,005	560,005
Other assets	<u>162,527</u>	<u>241,615</u>
	<u>1,147,313</u>	<u>1,302,811</u>
	<u>\$ 19,331,817</u>	<u>\$ 17,884,472</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Current maturities of long term debt (Note 3)	\$ 149,431	-
Current maturities of capital lease obligations (Note 8)	228,533	\$ 118,945
Accounts payable	4,545,057	8,282,281

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Income tax payable	1,185,717	109,129
Other current liabilities	<u>399,062</u>	<u>1,357,903</u>
Total current liabilities	6,507,800	9,868,258
Long-term liabilities		
Long-term debt (Note 3)	2,790,460	-
Capital lease obligations (Note 8)	67,853	152,889
Deferred income taxes (Note 4)	<u>219,399</u>	<u>413,570</u>
	3,077,712	566,459
Commitments (Note 8)		
Shareholders' equity		
Common stock, \$.005 par value: 10,000,000 shares authorized, 4,295,000 and 4,255,000 shares issued in 2006 and 2005, 3,640,899 and 3,566,408 shares outstanding in 2006 and 2005, respectively	21,475	21,275
Additional paid-in capital	3,194,816	3,113,819
Retained earnings	7,234,990	5,046,411
Treasury stock at cost, 654,101 and 688,592 shares in 2006 and 2005	<u>(704,976)</u>	<u>(731,750)</u>
	<u>9,746,305</u>	<u>7,449,755</u>
	<u>\$ 19,331,817</u>	<u>\$ 17,884,472</u>

See accompanying notes to consolidated financial statements.

3.

INDUSTRIAL SERVICES OF AMERICA, INC.
AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
Years ended December 31, 2006, 2005 and 2004

2006

2005

2004

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Revenue from services	\$ 15,387,241	\$ 84,451,367	\$ 93,275,079
Revenue from product sales	<u>46,694,807</u>	<u>32,930,492</u>	<u>46,312,997</u>
Total Revenue	62,082,048	117,381,859	139,588,076
Cost of goods sold for services	13,984,314	80,600,770	89,443,927
Cost of goods sold for product sales	40,284,368	29,175,791	41,942,233
Reduction of cost of goods sold	<u>(1,272,241)</u>	<u>-</u>	<u>-</u>
Total Cost of goods sold	52,996,441	109,776,561	131,386,160
Selling, general and administrative	<u>5,609,959</u>	<u>5,816,605</u>	<u>5,564,023</u>
Income before other income (expense)	3,475,648	1,788,693	2,637,893
Other income (expense)			
Interest expense	(212,722)	(74,016)	(191,586)
Interest income	195,662	126,578	56,783
Gain (loss) on sale of assets	22,990	(2,649)	(15,727)
Other income (expense), net	<u>32,930</u>	<u>3,424</u>	<u>21,832</u>
	<u>38,860</u>	<u>53,337</u>	<u>(128,698)</u>
Income before income taxes	3,514,508	1,842,030	2,509,195
Income tax provision (Note 4)	<u>1,325,929</u>	<u>740,433</u>	<u>1,012,001</u>
Net income	<u>\$ 2,188,579</u>	<u>\$ 1,101,597</u>	<u>\$ 1,497,194</u>
Basic earnings per share	<u>\$.61</u>	<u>\$.31</u>	<u>\$.43</u>
Diluted earnings per share	<u>\$.61</u>	<u>\$.31</u>	<u>\$.42</u>

See accompanying notes to consolidated financial statements.

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INDUSTRIAL SERVICES OF AMERICA, INC.
AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
Years ended December 31, 2006, 2005 and 2004

	<u>Common Stock</u>		Additional	Retained	<u>Treasury Stock</u>		<u>Total</u>
	<u>Shares</u>	<u>Amount</u>	<u>Paid-in Capital</u>	<u>Earnings</u>	<u>Shares</u>	<u>Cost</u>	
Balance as of January 1, 2004	3,935,000	\$ 19,675	\$ 1,950,221	\$ 2,801,167	(729,200)	\$ (753,897)	\$ 4,017,166
Exercise of stock options and related tax benefits	320,000	1,600	647,985	-	-	-	649,585
Treasury stock distribution to employees	-	-	58,685	-	49,668	50,936	109,621
Cash dividend	-	-	-	(353,547)	-	-	(353,547)
Net income	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,497,194</u>	<u>-</u>	<u>-</u>	<u>1,497,194</u>
Balance as of December 31, 2004	4,255,000	21,275	2,656,891	3,944,814	(679,532)	(702,961)	5,920,019
Treasury stock distribution to employees	-	-	5,551	-	940	973	6,524
Repurchase of common stock	-	-	-	-	(10,000)	(29,762)	(29,762)
Tax benefits related to common stock options	-	-	451,377	-	-	-	451,377
Net income	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,101,597</u>	<u>-</u>	<u>-</u>	<u>1,101,597</u>
Balance as of December 31, 2005	4,255,000	21,275	3,113,819	5,046,411	(688,592)	(731,750)	7,449,755
Treasury stock purchase	-	-	-	-	(5,509)	(16,338)	(16,338)
Exercise of stock options and related tax benefits	40,000	200	80,997	-	40,000	43,112	124,309
Net income	<u>-</u>	<u>-</u>	<u>-</u>	<u>2,188,579</u>	<u>-</u>	<u>-</u>	<u>2,188,579</u>
Balance as of December 31, 2006	<u>4,295,000</u>	<u>\$ 21,475</u>	<u>\$ 3,194,816</u>	<u>\$ 7,234,990</u>	<u>(654,101)</u>	<u>\$ (704,976)</u>	<u>\$ 9,746,305</u>

INDUSTRIAL SERVICES OF AMERICA, INC.
AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31, 2006, 2005 and 2004

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Cash flows from operating activities			
Net income	\$ 2,188,579	\$ 1,101,597	\$ 1,497,194
Adjustments to reconcile net income to net cash from operating activities			
Depreciation and amortization	1,745,905	1,709,668	1,538,161
Stock distribution to employees	-	6,524	109,621
Deferred income taxes	(222,511)	(213,538)	335,023
Tax benefit of stock options exercised	-	451,377	213,444
Provision for doubtful accounts	50,000	(25,000)	-
(Gain) loss on sale of property and equipment	(22,990)	2,649	15,727
Change in assets and liabilities			
Receivables	(573,596)	4,099,483	472,524
Net investment in sales-type leases	65,797	(94,360)	79,754
Inventories	(939,617)	(336,235)	(445,279)
Other assets	110,987	102,797	(167,573)
Accounts payable	(3,737,224)	(3,800,395)	1,580,173
Other current liabilities	<u>117,747</u>	<u>854,163</u>	<u>221,581</u>
Net cash from operating activities	(1,216,923)	3,858,730	5,450,350
Cash flows from investing activities			
Proceeds from sale of property and equipment	81,700	101,797	3,188
Purchases of property and equipment	(2,166,331)	(1,817,885)	(1,845,073)
Payments from/(advances to) related party	<u>25,824</u>	<u>37,770</u>	<u>(302,160)</u>
Net cash from investing activities	(2,058,807)	(1,678,318)	(2,144,045)
Cash flows from financing activities			
Payments on capital lease obligation	(161,626)	(559,039)	(159,073)
Proceeds from long-term debt	10,710,875	-	-
Payments on long-term debt	(7,770,984)	(1,000,000)	(2,762,908)
Proceeds from exercise of common stock options	124,309	-	436,141
Payment of cash dividend	-	-	(353,547)
Purchases of common stock	<u>(16,338)</u>	<u>(29,762)</u>	<u>-</u>
Net cash from financing activities	<u>2,886,236</u>	<u>(1,588,801)</u>	<u>(2,839,387)</u>

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Net change in cash	(389,494)	591,611	466,918
Cash at beginning of year	<u>1,721,301</u>	<u>1,129,690</u>	<u>662,772</u>
Cash at end of year	<u>\$ 1,331,807</u>	<u>\$ 1,721,301</u>	<u>\$ 1,129,690</u>
Supplemental disclosure of cash flow information			
Cash paid for interest	\$ 212,722	\$ 74,016	\$ 191,586
Cash paid for taxes	604,652	173,140	710,384
Supplemental disclosure of noncash investing and financing activities:			
Equipment purchased under capital leases	186,178	-	-

6.

INDUSTRIAL SERVICES OF AMERICA, INC.
AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006, 2005 and 2004

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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Nature of Business: The recycling division of Industrial Services of America, Inc. and its subsidiaries (ISA) purchases and sells ferrous and nonferrous materials and fiber scrap on a daily basis at our two wholly owned subsidiaries, ISA Recycling, LLC (located in Louisville, Kentucky) and ISA Indiana, Inc. (serving southern Indiana). ISA also provides products and services to meet the waste management needs of its customers related to ferrous, non-ferrous and corrugated scrap recycling, management services and waste equipment sales and rental. Our management services division represents contracts with retail, commercial and industrial businesses to handle their waste disposal needs, primarily by subcontracting with commercial waste hauling and disposal companies. Our customers and subcontractors are located throughout the United States, Canada and Mexico. ISA's waste equipment sales and services division (WESSCO) installs or repairs equipment and rental equipment on a same day basis. Each of our segments bills separately for its products or services. Generally, services and products are not bundled for sale to individual customers. The products or services have value to the customer on a standalone basis.

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Revenue Recognition: ISA records revenue for its recycling and equipment sales divisions upon delivery of the related materials and equipment to the customer. We provide installation and training on all equipment and we charge these costs to the customer, recording revenue in the period we provide the service. We are the middleman in the sale of the equipment and not a manufacturer. Any warranty is the responsibility of the manufacturer and therefore we make no estimates for warranty obligations. Allowances for equipment returns are made on a case-by-case basis. Historically, returns of equipment have not been material.

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Our management services division provides our customers evaluation, management, monitoring, auditing and cost reduction of our customers' non-hazardous solid waste removal activities. We recognize revenue related to the management aspects of these services when we deliver the services. We record revenue related to this activity on a gross basis because we are ultimately responsible for service delivery, have discretion over the selection of the specific service provided and the amounts to be charged, and are directly obligated to the subcontractor for the services provided. We are an independent contractor. If we discover that third party service providers have not performed, either by auditing of the service provider invoices or communications from our customers, we then resolve the service delivery dispute directly with the third party service supplier.

(Continued)

INDUSTRIAL SERVICES OF AMERICA, INC.
AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006, 2005 and 2004

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

In our management services division, the customer contacts us for service. We determine the type of waste removal service required to meet the customer's needs, and we use our discretion to choose from a selection of approved third party service suppliers. Upon our authorization, the third party service supplier uses its own trucking to remove waste materials from the customer's location. We pay the third party service suppliers on several different payment terms after we have received payment from the customers who are billed monthly. We recognize revenue after assessing the satisfactory performance of the service by the third party service supplier. Assessment includes our review of landfill weight tickets provided by the third party service supplier documenting completion of the contracted service.

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We record sales-type leases at the net present value of future minimum lease payments. Interest income related to the lease is recognized over the life of the lease. At the inception of the lease, any difference between the net present value of future cash flows and the basis of the leased asset (carrying value plus initial direct costs, less present value of any residual) is recorded as a gain or loss.

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Accounts Receivable and Allowance for Doubtful Accounts: Accounts receivable consist primarily of amounts due from customers from product and brokered sales. The allowance for doubtful accounts totaled \$100,000 and \$50,000 at December 31, 2006 and 2005, respectively. Our determination of the allowance for doubtful accounts includes a number of factors, including the age of the balance, past experience with the customer account, changes in collection patterns and general industry conditions. Interest is not normally charged on receivables. Potential credit losses from our significant customers could adversely affect our results of operations or financial condition. While we believe our allowance for doubtful accounts is adequate, changes in economic conditions or any weakness in the steel and metals industry could adversely impact our future earnings. We charge off losses to the allowance when we deem further collection efforts will not provide additional recoveries.

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Major Customer: We used to derive a significant portion of our revenues from one primary customer, The Home Depot, accounting for approximately 56% and 51% of 2005 and 2004 total revenues, respectively, and approximately 24% and 23% of 2005 and 2004 total gross profit, respectively. The revenue from this former customer represented approximately 77% and 76% of CWS revenues in 2005 and 2004, respectively. At December 31, 2005, amounts due from this former customer were \$293,936. We currently have no significant customer concentration.

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Principles of Consolidation: The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, ISA Indiana, Inc. and ISA Recycling, LLC. Upon consolidation, all intercompany accounts, transactions and profits have been eliminated.

(Continued)

INDUSTRIAL SERVICES OF AMERICA, INC.
AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006, 2005 and 2004

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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Common Control: The Company conducts significant levels of business (see Note 6) with K&R, LLC (K&R), which is owned by the Company's principal shareholder. Because these entities are under common control, operating results or the financial position of the Company may be materially different from those that would have been obtained if the entities were autonomous.

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Estimates: In preparing the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management must make estimates and assumptions. These estimates and assumptions affect the amounts reported for assets, liabilities, revenues and expenses, as well as affecting the disclosures provided. Future results could differ from the current estimates.

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Inventories: Our inventories primarily consist of ferrous and non-ferrous scrap metals and are valued at the lower of average purchased cost or market. Quantities of inventories are determined based on our inventory systems and are subject to periodic physical verification using estimation techniques including observation, weighing and other industry methods. We would recognize inventory impairment when the market value, based upon current market pricing, falls below recorded value or when the estimated volume is less than the recorded volume of the inventory. We would record the loss in cost of goods sold in the period during which we identified the loss.

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Some commodities are in saleable condition at acquisition. We purchase these commodities in small amounts until we have a truckload of material available for shipment. Some commodities are not in saleable condition at acquisition. These commodities must be torched, sheared or baled. We do not have work-in-process inventory that needs to be manufactured to become finished goods. We include processing costs in inventory for all commodities by gross ton. Processing costs in ferrous inventory totaled \$387,751 at December 31, 2006 and \$242,295 at December 31, 2005. Processing costs in non-ferrous inventory totaled \$86,101 at December 31, 2006 and \$71,595 at December 31, 2005. Ferrous inventory of \$1,667,937 at December 31, 2006 was comprised of \$382,445 in raw materials and \$1,285,492 of finished goods. Ferrous inventory of \$1,380,050 at December 31, 2005 was comprised of \$402,041 in raw materials and \$978,009 of finished goods. Non-ferrous inventory of \$1,678,655 at December 31, 2006 was comprised of \$451,289 in raw materials and \$1,227,366 of finished goods. Non-ferrous inventory of \$961,085 at December 31, 2005 was comprised of \$196,508 in raw materials and \$764,577 of finished goods. We charged \$2,353,435 in general and administrative processing costs to COS for the year ended December 31, 2006 and \$2,015,733 for the year ended December 31, 2005.

(Continued)

INDUSTRIAL SERVICES OF AMERICA, INC.
AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006, 2005 and 2004

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Inventory also includes all types of industrial waste handling equipment and machinery held for resale such as compactors, balers, and containers. Other inventory includes cardboard and baling wire. Inventories as of December 31, 2006 and 2005 consist of the following:

	<u>2006</u>	<u>2005</u>
Ferrous materials	\$ 1,667,937	\$ 1,380,050
Non-Ferrous materials	1,678,655	961,085
Waste Equipment Machinery	56,200	120,922
Other	<u>25,434</u>	<u>26,552</u>
	<u>\$ 3,428,226</u>	<u>\$ 2,488,609</u>

Property and Equipment: Property and equipment are stated at cost and depreciated on a straight line basis over the estimated useful lives of the related property. Assets under capital lease obligations are amortized over the term of the capital lease.

Property and equipment as of December 31, 2006 and 2005 consist of the following:

	<u>Life</u>	<u>2006</u>	<u>2005</u>
Land		\$ 1,581,550	\$ 1,581,550
Equipment and vehicles	1-10 years	9,759,509	8,535,479
Office equipment	1-7 years	1,600,034	1,521,783
Rental equipment	3-5 years	4,238,555	3,376,443
Building and leasehold improvements	5-40 years	<u>2,329,886</u>	<u>2,292,331</u>
		19,509,534	17,307,586
Less accumulated depreciation and amortization		<u>11,356,928</u>	<u>9,702,874</u>
		<u>\$ 8,152,606</u>	<u>\$ 7,604,712</u>

Depreciation expense for the years ended December 31, 2006, 2005 and 2004 was \$1,745,905, \$1,709,668 and \$1,538,161. Of the \$1,745,905 depreciation expense recognized in 2006, \$1,325,035 was recorded in cost of sales, and \$420,870 was recorded in general and administrative expense.

(Continued)

10.

INDUSTRIAL SERVICES OF AMERICA, INC.
AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006, 2005 and 2004

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

A typical term of our rental equipment leases is five years. The revenue stream is based on monthly usage and recognized in the month of usage. We record purchased rental equipment, including all installation and freight charges, as a fixed asset. We are typically responsible for all repairs and maintenance expenses on rental equipment. Based on existing agreements, future operating lease revenue from rental equipment for each of the next five years is estimated to be:

2007	\$1,586,285
2008	1,350,700
2009	1,200,620
2010	786,468
2011	<u>293,990</u>
	<u>\$5,218,063</u>

Goodwill and Other Intangible Assets: Goodwill and certain intangible assets are no longer amortized but are assessed at least annually for impairment with any such impairment recognized in the period identified. We perform our annual goodwill impairment test internally at December 31 and at the level of the recycling reporting unit to which all the goodwill is related. We determine whether to impair goodwill by comparing the fair value of the recycling reporting unit as a whole (the present value of expected cash flows) to its carrying value including goodwill. Since the recycling reporting unit's fair value exceeds its carrying value, no further computations are required.

Income Taxes: Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Statement of Cash Flows: The statement of cash flows has been prepared using a definition of cash that includes deposits with original maturities of three months or less.

(Continued)

11.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Earnings Per Share: Basic earnings per share is computed by dividing net income by the weighted average number of common shares outstanding during the year. Diluted earnings per share is computed by dividing net income by the weighted average number of common shares outstanding plus the dilutive effect of stock options.

Stock Option Plans: During the year ended December 31, 2004 we granted options to purchase shares of our common stock to several of our officers and outside directors. We applied APB Opinion No. 25 in accounting for our employees' stock option agreements. There was no compensation charged to operations in 2006, 2005, and 2004 related to these options.

We have an employee stock option plan under which we may grant options for up to 400,000 shares of common stock, which are reserved by the board of directors for issuance of stock options. The exercise price of each option is equal to the market price of our stock on the date of grant. The maximum term of the option is five years.

On January 1, 2006, we adopted SFAS No. 123R (Revised 2004), Share-Based Payment, using the modified prospective method. The impact of adopting SFAS 123R on our consolidated results of operations depends on the level of future option grants and the fair value of the options granted at such future dates, as well as the vesting periods provided by such awards. Existing outstanding options did not result in additional compensation expense upon adoption of SFAS 123R since all outstanding options were fully vested.

	<u>2006</u>	<u>2005</u>	<u>2004</u>
<u>Net income (loss)</u>			
Net income, as reported	\$ <u>2,188,579</u>	\$ <u>1,101,597</u>	\$ <u>1,497,194</u>
<u>Basic earnings (loss) per share</u>			
As reported	\$ <u>.61</u>	\$ <u>.31</u>	\$ <u>.43</u>
<u>Diluted earnings (loss) per share</u>			
As reported	\$ <u>.61</u>	\$ <u>.31</u>	\$ <u>.42</u>

(Continued)

INDUSTRIAL SERVICES OF AMERICA, INC.
AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006, 2005 and 2004

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Following is a summary of stock option activity and number of shares reserved for outstanding options for the years ended December 31, 2006, 2005 and 2004:

	Number of <u>Shares</u>	Weighted Average Exercise Price <u>Per Share</u>	Exercise Price Per <u>Share</u>	Maximum Remaining Term of Options <u>Granted</u>	Weighted Average Grant Date Fair Value <u>of Options</u>
Balance as of January 1, 2004	591,000	\$1.75	\$1.25 to \$3.00	1 to 5 years	\$1.12
Exercised	(320,000)	\$1.41	\$1.41	-	-
Expired	<u>(231,000)</u>	\$2.31	\$1.25 to \$3.00	-	-
Balance as of December 31, 2004	40,000	\$1.25	\$1.25	1 to 3 years	\$1.21
Expired	<u>(20,000)</u>	\$1.25	\$1.25	-	-
Balance as of December 31, 2005	20,000	\$1.25	\$1.25	1 to 3 Years	\$1.21
Exercised	<u>(20,000)</u>	\$1.25	\$1.25	-	-
Balance as of December 31, 2006	<u>-</u>	-	-	-	-

(Continued)

13.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

SFAS No. 123 (Revised 2005), Share-Based Payment, applies to awards granted or modified by ISA after July 1, 2005. Compensation cost is also to be recorded for prior option grants that vest after that date. The effect of adopting SFAS 123R on ISA's consolidated results of operations depends on the level of future option grants and the fair value of the options granted at such future dates, as well as the vesting periods provided by such awards and, therefore, cannot currently be estimated. There is no significant effect on ISA's consolidated financial position since total stockholders' equity is not impacted.

Effective as of May 5, 2006, we entered into an agreement with Andrew M. Lassak to settle Mr. Lassak's claims against us in Lassak v. Industrial Services of America, Inc., et al, No. 04-423-CA (Fla. 19th Cir. Ct. filed June 2, 2004). Lassak's demands and claims included rights to purchase 240,500 shares of our common stock for \$1.25 per share, rights to purchase 149,500 shares of our common stock for \$3.00 per share, and demand and piggyback registration rights as well as cashless exercise rights with respect to such options. Since the inception of the suit, we have disputed Lassak's claims and have denied any liability for Lassak's claims and demands. Pursuant to the settlement agreement, we allowed Lassak to exercise a reduced number of the options he was seeking - 40,000 at an exercise price of \$1.25 per share. Lassak tendered to us the full exercise price for the 40,000 options and we filed a registration statement for the underlying shares with the Securities and Exchange Commission on May 24, 2006. The registration was declared effective by the Securities and Exchange Commission on June 12, 2006. We then delivered 40,000 registered shares to Lassak, thereby satisfying all our requirements under the settlement agreement and effectively concluding this matter. The estimated fair value of these options is approximately \$270,000. Additional expense of \$34,309 associated with the value of the options was recognized in the third quarter of 2006 and the remaining \$235,691 was recognized in prior years 1998-2001.

Fair Values of Financial Instruments: We estimate the fair value of our financial instruments using relevant market information and other assumptions. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, prepayments and other factors. Changes in assumptions or market conditions could significantly affect these estimates. As of December 31, 2006 and 2005, the estimated fair value of our financial instruments approximated book value. The fair value of our debt approximates its carrying value because the majority of our debt bears a floating rate of interest based on the prime rate. There is no readily available market by which to determine fair market value of our fixed term debt; however, based on existing interest rates and prevailing rates as of each year end, we have determined that the fair value of our fixed rate debt approximates book value.

(Continued)

14.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Impact of Recently Issued Accounting Standards:

SFAS No. 154, Accounting Changes and Error Corrections, replaces APB Opinion No. 20, Accounting Changes, and FASB Statement No. 3, Reporting Accounting Changes in Interim Financial Statements, and changes the requirements for the accounting for and reporting of a change in accounting principle. SFAS No. 154 applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. SFAS No. 154 requires retrospective application to prior periods' financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS No. 154 was issued May 2005 and is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. We do not expect this standard to significantly impact our financial statements.

SFAS No. 157, Fair Value Measurements, defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). SFAS No. 157 also stipulates that, as a market-based measurement, fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability, and establishes a fair value hierarchy that distinguishes between (a) market participant assumptions developed based on market data obtained from sources independent of the reporting entity (observable inputs) and (b) the reporting entity's own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs). SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years, although earlier application is encouraged. We do not expect this standard to significantly impact our financial statements.

Interpretation No. 48, Accounting for Uncertainty in Income Taxes--an interpretation of FASB Statement No. 109 (issued June 2006), clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. This Interpretation is effective for fiscal years beginning after December 15, 2006. The adoption of this standard on January 1, 2007 did not have an impact on our consolidated financial statements.

(Continued)

15.

NOTE 2 - NOTE PAYABLE TO BANK

On December 22, 2006, ISA executed a new revolving credit facility with BB&T increasing the borrowing line from \$5.0 million to \$10.0 million to provide ISA with working capital to support the current needs of our business. This revolving credit facility has a three year term expiring December 22, 2009, and provides for advances of up to eighty percent (80%) of ISA's eligible accounts receivable and up to the forty percent (40%) of eligible inventory, and up to one hundred (100%) of ISA's net book value of eligible equipment less an outstanding indebtedness on the equipment. The revolving credit facility bears interest at the one month Libor rate, as published in the Wall Street Journal, plus two and twenty-five one-hundredths percent (2.25%) per annum which was 7.57% as of December 31, 2006, and is secured by all ISA assets (except rental fleet equipment). The revolving credit facility contains certain restrictive and financial covenants. At December 31, 2006, ISA was in compliance with all restrictive covenants.

NOTE 3 - LONG-TERM DEBT

Long-term debt as of December 31, 2006 and 2005 consists of the following:

	<u>2006</u>	<u>2005</u>
Note payable to a bank secured by our rental fleet equipment with a fixed interest rate of 6.83% and monthly payments of \$23,047. The maturity date under this agreement is June 2011 with a ten-year amortization schedule.	\$ 1,929,016	\$ -
Revolving credit facility with a bank secured by all assets except for rental fleet equipment with a variable interest rate of Libor plus 2.25% and no required monthly principal payments. The maturity date under this agreement is December 2009.	<u>1,010,875</u>	<u>-</u>
	2,939,891	-
Less current maturities	<u>149,431</u>	<u>-</u>
	<u>\$2,790,460</u>	<u>\$ -</u>

The annual maturities of long-term debt as of December 31, 2004 are as follows:

2007	\$ 149,431
2008	159,962
2009	1,182,111
2010	183,305
2011 and thereafter	<u>1,265,082</u>
Total	<u>\$ 2,939,891</u>

(Continued)

December 31, 2006, 2005 and 2004

NOTE 4 -- INCOME TAXES

The income tax provision (benefit) consists of the following for the years ended December 31, 2006, 2005 and 2004:

		<u>2006</u>	<u>2005</u>	<u>2004</u>
Federal				
	Current	\$ 1,178,483	\$ 780,181	\$ 448,275
	Deferred	<u>(174,958)</u>	<u>(203,543)</u>	<u>343,916</u>
		1,003,525	576,638	792,191
State				
	Current	369,957	173,790	228,703
	Deferred	<u>(47,553)</u>	<u>(9,995)</u>	<u>(8,893)</u>
		<u>322,404</u>	<u>163,795</u>	<u>219,810</u>
		<u>\$ 1,325,929</u>	<u>\$ 740,433</u>	<u>\$ 1,012,001</u>

A reconciliation of income taxes at the statutory rate to the reported provision is as follows:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Federal income tax at statutory rate	\$1,194,933	\$ 629,083	\$ 853,127
State and local income taxes, net of federal income tax effect	212,787	106,257	145,074
Permanent differences	(43,702)	-	-
Other differences, net	<u>(38,089)</u>	<u>5,093</u>	<u>13,800</u>
	<u>\$1,325,929</u>	<u>\$ 740,433</u>	<u>\$ 1,012,001</u>

The permanent differences of \$(43,702) and the other differences, net of \$(38,089) are due to a decreased taxable base of the common stock awarded to Andrew J. Lassak in the second quarter of 2006. This decrease was mutually agreed upon in the fourth quarter of 2006.

(Continued)

17.

NOTE 4 - INCOME TAXES (Continued)

Significant components of the Company's deferred tax liabilities and assets as of December 31, 2006 and 2005 are as follows:

	<u>2006</u>	<u>2005</u>
Deferred tax liabilities		
Tax depreciation in excess of book	\$ 278,929	\$ 529,530
Tax amortization in excess of book	<u>114,666</u>	<u>89,598</u>
Gross deferred tax liabilities	393,595	619,128
Deferred tax assets		
Property taxes	39,495	44,025
Allowance for doubtful accounts	43,000	24,206
Book amortization in excess of tax	174,196	205,558
Inventory capitalization	13,887	10,154
Other	<u>10,343</u>	<u>-</u>
Gross deferred tax assets	<u>280,921</u>	<u>283,943</u>
Net deferred tax liabilities	<u>\$ (112,674)</u>	<u>\$ (335,185)</u>

NOTE 5 - SALES-TYPE LEASES

The Company is the lessor of equipment under sales-type lease agreements having terms of three to five years, with the lessees having the option to acquire the equipment at the termination of the leases. All costs associated with this equipment are the responsibility of the lessees.

Future lease payments receivable under sales-type leases at December 31, 2006 are as follows:

2007	\$ 94,020
2008	84,920
2009	66,720
2010	<u>50,040</u>
Minimum lease payments receivable	295,700
Less unearned income	<u>(58,899)</u>
Net investment in sales-type leases	236,801
Less current portion	<u>(50,586)</u>
	<u>\$ 186,215</u>

(Continued)

INDUSTRIAL SERVICES OF AMERICA, INC.
AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006, 2005 and 2004

NOTE 6 - RELATED PARTY TRANSACTIONS

The Company enters into various transactions with related parties including the Company's principal shareholder and an affiliated company owned by the Company's principal shareholder (K&R). A summary of these transactions is as follows:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
<u>Balance sheet accounts:</u>			
Accounts receivable	\$ _____ -	\$ _____ -	\$ _____ -
Notes receivable	\$ <u>238,566</u>	\$ <u>264,390</u>	\$ <u>302,160</u>
Deposits (included in other long-term assets)	\$ <u>62,106</u>	\$ <u>62,106</u>	\$ <u>62,106</u>
<u>Income statement activity:</u>			
Rent expense	\$ <u>505,272</u>	\$ <u>505,272</u>	\$ <u>505,272</u>
Consulting fees	\$ <u>240,000</u>	\$ <u>240,000</u>	\$ <u>240,000</u>

ISA leases its corporate offices, processing property and buildings in Louisville, Kentucky for \$42,106 per month from K&R pursuant to the K&R Lease. Deposits include one month of rent in advance in the amount of \$42,106. In 2004, we paid for repairs totaling \$302,160 that we made to the buildings and property that we lease from K&R, located at 7100 Grade Lane, Louisville, Kentucky. K&R executed an unsecured promissory note, dated March 25, 2005, but effective December 31, 2004, to us for the principal sum of \$302,160. K&R makes payments on the promissory note of principal and interest in ninety-six (96) monthly installments of \$3,897.66. Failure of K&R to make any payment when due under this note within fifteen (15) days of its due date shall constitute a default. After the fifteen day period, the note shall bear interest at a rate equal to fifteen percent (15%) per annum and we have the right to exercise our remedies to collect full payment of the note.

In an addendum to the K&R lease as of January 1, 2005, the rent was increased \$4,000 as a result of the improvements made to the property in 2004. For years 2005 and 2006, the payments to K&R by the Company of \$4,000 for additional rent and the payment from K&R to the Company of \$3,897.66 for the promissory note were offset.

(Continued)

19.

NOTE 6 - RELATED PARTY TRANSACTIONS (Continued)

The Company entered into an agreement with K&R for consulting services related to the scrap metal and paper recycling operations and related equipment sales and services. The agreement remains in effect until December 31, 2007, with automatic renewals thereafter unless one party provides written notice to the other party of its intent not to renew at least six months in advance of the next renewal date. The agreement requires that we make annual payments to K&R of \$240,000 in equal monthly installments of \$20,000. Deposits include one month of consulting services in advance in the amount of \$20,000. ISA's Chairman is compensated through these consulting fees .

NOTE 7 - EMPLOYEE RETIREMENT PLAN

The Company maintains a defined contribution retirement plan under Section 401(k) of the Internal Revenue Code which covers substantially all employees. Eligible employees may contribute a maximum of 15% of their annual salary. Under the plan, the Company matches 25% of each employee's voluntary contribution up to 6% of their gross salary. The expense under the plan for 2006, 2005 and 2004 was \$33,438, \$31,996 and \$28,950, respectively.

NOTE 8 - LEASE COMMITMENTS

Operating Leases:

The Company leases its Louisville, Kentucky facility from a related party (see Note 6) under an operating lease expiring December 2007. The rent was adjusted in January 2003 per the agreement to monthly payments of \$42,106 through December 2007. In addition, the Company is also responsible for real estate taxes, insurance, utilities and maintenance expense.

The Company leases a facility in Dallas, Texas for management services operations. The agreement provided that monthly payments of \$2,457 were paid through September 2005. The lease was renewed effective October 1, 2005 for a period of two years with monthly payments of \$2,525. The Company also leases other machinery and equipment under operating leases which expire through February 2009.

We lease a facility in Lexington, Kentucky for \$4,500 per month; the lease terminates December 31, 2012. We have subleased this property for a term commencing March 1, 2007 and ending December 31, 2012 for \$4,500 per month. If for any reason the sublessee defaults, we remain liable for the remainder of the lease payments through December 31, 2012.

On February 6, 2007, we leased 7.7 acres of real property, including a 38,000 square foot warehouse and a 400 square foot office, in Pineville, Louisiana for \$5,250 per month for twenty-four months beginning March 1, 2007 and ending February 28, 2009, with an option to purchase the property for a purchase price of \$575,000.

(Continued)

20.

NOTE 8 -- LEASE COMMITMENTS (Continued)

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Future minimum lease payments for operating leases as of December 31, 2006 are as follows:

2007	\$ 612,246
2008	80,554
2009	42,243
2010	<u>3,375</u>
Future minimum lease payments	<u>\$ 738,418</u>

Total rent expense for the years ended December 31, 2006, 2005 and 2004 was \$784,954, \$809,270 and \$773,139, respectively.

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Capital Leases:

The Company leases various pieces of equipment which qualify as capital leases. These lease arrangements require monthly lease payments expiring at various dates through November 2009.

The following is a summary of assets held under capital leases which are included in property and equipment:

	<u>2006</u>	<u>2005</u>
Equipment	\$ 757,513	\$ 571,335
Less accumulated depreciation	<u>168,904</u>	<u>159,525</u>
	<u>\$ 588,609</u>	<u>\$ 411,810</u>

The following is a schedule of future annual minimum lease payments under the capitalized lease arrangements, together with the present value of net minimum lease payments at December 31, 2006.

2007	\$ 233,992
2008	60,786
2009	<u>7,475</u>
Total future minimum lease payments	302,253
Less amount representing interest	<u>(5,867)</u>
Present value of net minimum lease payments	296,386
Less current portion	<u>(228,533)</u>
Capital Lease Obligations	<u>\$ 67,853</u>

(Continued)

21.

NOTE 9 - PER SHARE DATA

The computation for basic and diluted earnings per share is as follows:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Basic earnings per share			
Net income	\$ 2,188,579	\$ 1,101,597	\$ 1,497,194
Weighted average shares outstanding	<u>3,602,872</u>	<u>3,575,202</u>	<u>3,473,887</u>
Basic earnings per share	<u>\$.61</u>	<u>\$.31</u>	<u>\$.43</u>
Diluted earnings per share			
Net income	\$ 2,188,579	\$ 1,101,597	\$ 1,497,194
Weighted average shares outstanding	3,602,872	3,575,202	3,473,887
Add dilutive effect of assumed exercising of stock options	<u>10,218</u>	<u>18,608</u>	<u>118,912</u>
Diluted average shares outstanding	<u>3,613,090</u>	<u>3,593,810</u>	<u>3,592,799</u>
Diluted earnings per share	<u>\$.61</u>	<u>\$.31</u>	<u>\$.42</u>

NOTE 10 - SEGMENT INFORMATION

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The Company's operations include three primary segments: ISA Recycling, Computerized Waste Systems (CWS), and Waste Equipment Sales & Service (WESSCO). ISA Recycling provides products and services to meet the needs of its customers related to ferrous, non-ferrous and fiber recycling at two locations in the Midwest. CWS provides waste disposal services including contract negotiations with service providers, centralized billing, invoice auditing, and centralized dispatching. WESSCO sells, leases, and services waste handling and recycling equipment.

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The Company's three reportable segments are determined by the products and services that each offers. The recycling segment generates its revenues based on buying and selling of ferrous, non-ferrous and fiber scrap; CWS's revenues consist of charges to customers for waste disposal services; and WESSCO sales and lease income comprise the primary source of revenue for this segment. The components of the column labeled "other" are selling, general and administrative expenses that are not directly related to the three primary segments.

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The accounting policies of the three segments are the same as those described in the summary of significant accounting policies (Note 1). We evaluate segment performance based on gross profit or loss and the evaluation process for each segment includes only direct expenses and selling, general and administrative costs, omitting any other income and expense and income taxes.

(Continued)

22.

INDUSTRIAL SERVICES OF AMERICA, INC.
AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006, 2005 and 2004

NOTE 10 - SEGMENT INFORMATION (Continued)

Segment

ISA Recycling

CWS

WESSCO

Other

Totals

2006

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Recycling revenues	\$ 44,967,023	\$ -	\$ -	\$ -	\$ 44,967,023
--------------------	---------------	------	------	------	---------------

Equipment sales, services

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and leasing revenues	-	-	1,727,784	-	1,727,784
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Management fees	-	15,387,241	-	-	15,387,241
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Cost of goods sold	(39,448,957)	(12,712,073)	(835,411)	-	(52,996,441)
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Selling, general and

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administrative expenses	<u>(1,431,251)</u>	<u>(1,479,302)</u>	<u>(542,433)</u>	<u>(2,156,973)</u>	<u>(5,609,959)</u>
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Segment profit (loss)	<u>\$ 4,086,815</u>	<u>\$ 1,195,866</u>	<u>\$ 349,940</u>	<u>\$ (2,156,973)</u>	<u>\$ 3,475,648</u>
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Segment

ISA Recycling

CWS

WESSCO

Other

Totals

2006

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Cash	\$	136,803	\$	16,254	\$	-	\$	1,178,750	\$	1,331,807
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Accounts receivable	3,903,681	1,089,080	-	33,680	5,026,441
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Inventories	3,357,832	-	70,394	-	3,428,226
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Net property and

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equipment	3,971,773	156,756	1,997,911	2,026,166	8,152,606
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Goodwill	560,005	-	-	-	560,005
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Other assets	<u>96.848</u>	<u>10.637</u>	<u>75.397</u>	<u>649.850</u>	<u>832.732</u>
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Segment assets	<u>\$ 12,026,942</u>	<u>\$ 1,272,727</u>	<u>\$ 2,143,702</u>	<u>\$ 3,888,446</u>	<u>\$ 19,331,817</u>
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ISA Recycling

CWS

WESSCO

Other

Totals

2005

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Recycling revenues	\$ 29,952,938	\$ -	\$ -	\$ -	\$ 29,952,938
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Equipment sales, services

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and leasing revenues	-	-	2,977,554	-	2,977,554
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Management fees	-	84,451,367	-	-	84,451,367
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Cost of goods sold	(27,271,712)	(80,600,770)	(1,904,079)	-	(109,776,561)
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Selling, general and

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administrative expenses	<u>(987,930)</u>	<u>(2,051,475)</u>	<u>(612,180)</u>	<u>(2,165,020)</u>	(5,816,605)
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Segment profit (loss)	<u>\$ 1,693,296</u>	<u>\$ 1,799,122</u>	<u>\$ 461,295</u>	<u>\$ (2,165,020)</u>	<u>\$ 1,788,693</u>
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(Continued)

23.

INDUSTRIAL SERVICES OF AMERICA, INC.
AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006, 2005 and 2004

Segment

ISA Recycling

CWS

WESSCO

Other

Totals

2005

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Cash	\$	332,351	\$	111,738	\$	500	\$	1,276,712	\$	1,721,301
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Accounts receivable	2,596,053	1,793,547	85,431	27,814	4,502,845
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Inventories	2,352,375	-	136,234	-	2,488,609
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Net property and

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equipment	3,282,130	310,769	1,788,285	2,223,528	7,604,712
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Goodwill	560,005	-	-	-	560,005
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Other assets	<u>132,346</u>	<u>25,845</u>	<u>85,164</u>	<u>763,645</u>	<u>1,007,000</u>
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Segment assets	<u>\$ 9,255,260</u>	<u>\$ 2,241,899</u>	<u>\$ 2,095,614</u>	<u>\$ 4,291,699</u>	<u>\$ 17,884,472</u>
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Segment

ISA Recycling

CWS

WESSCO

Other

Totals

2004

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Recycling revenues	\$ 43,262,813	\$ -	\$ -	\$ -	\$ 43,262,813
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Equipment sales, services

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and leasing revenues	-	-	3,050,184	-	3,050,184
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Management fees	-	93,275,079	-	-	93,275,079
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Cost of goods sold	(40,129,036)	(89,443,927)	(1,813,197)	-	(131,386,160)
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Selling, general and

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administrative expenses	<u>(846,631)</u>	<u>(1,862,000)</u>	<u>(588,882)</u>	<u>(2,266,510)</u>	<u>(5,564,023)</u>
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Segment profit (loss)	<u>\$ 2,287,146</u>	<u>\$ 1,969,152</u>	<u>\$ 648,105</u>	<u>\$ (2,266,510)</u>	<u>\$ 2,637,893</u>
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(Continued)

24.

INDUSTRIAL SERVICES OF AMERICA, INC.
AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006, 2005 and 2004

NOTE 11-- CONTINGENCY/LITIGATION SETTLEMENT

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On June 2, 2004, Andrew M. Lassak filed a Complaint against us in the City of Stuart, Martin County, Florida. In the complaint, Lassak alleged that we breached our contracts with him by failing and refusing to release and register 390,000 shares of stock. He claims he was entitled to "piggyback" registration rights relating to the Form S-3 Registration Statement that we filed for the benefit of Falkner as well as "demand" registration rights. He sought specific performance of the contracts and damages that occurred by ISA not releasing and registering the underlying shares relating to his options sooner.

On August 6, 2004 we filed a Motion to Dismiss or in the Alternative Motion for More Definite Statement. At a hearing before the Court on September 20, 2004, the judge granted our Motion without prejudice, allowing Lassak to amend the Complaint. Lassak filed an Amended Complaint on December 27, 2004, which restated his previous claims and made a number of new claims including claims of federal and state securities fraud. The Amended Complaint also named Harry Kletter individually as a defendant. In June 2005, Lassak filed a Second Amended Complaint which is substantially similar to the first Amended Complaint. We filed an Answer and Affirmative Defenses to the Second Amended Complaint as well as a Motion to Dismiss on behalf of Harry Kletter that remains pending.

Effective as of May 5, 2006, we entered into an agreement with Mr. Lassak to settle Mr. Lassak's claims against us in *Lassak v. Industrial Services of America, Inc., et al*, No. 04-423-CA (Fla. 19th Cir. Ct. filed June 2, 2004). Lassak's demands and claims included rights to purchase 240,500 shares of our common stock for \$1.25 per share, rights to purchase 149,500 shares of our common stock for \$3.00 per share, and demand and piggyback registration rights as well as cashless exercise rights with respect to such options. Since the inception of the suit, we have disputed Lassak's claims and have denied any liability for Lassak's claims and demands. Pursuant to the settlement agreement, we allowed Lassak to exercise a reduced number of the options he was seeking -- 40,000 at an exercise price of \$1.25 per share. Lassak tendered to us the full exercise price for the 40,000 options and we filed a registration statement for the underlying shares with the Securities and Exchange Commission on May 24, 2006. The registration was declared effective by the Securities and Exchange Commission on June 12, 2006. We then delivered 40,000 registered shares to Lassak, thereby satisfying all our requirements under the settlement agreement and effectively concluding this matter. The estimated fair value of these options is approximately \$270,000. We recognized additional expense of \$34,309 associated with the value of the options in the third quarter of 2006 and we had recognized the remaining \$235,691 in prior years 1998-2001.

(Continued)

INDUSTRIAL SERVICES OF AMERICA, INC.
AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006, 2005 and 2004

NOTE 12 -- SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

1st

2nd

3rd

4th

Year

2006

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Revenue	\$14,484,020	\$17,702,634	\$ 15,331,235	\$14,564,159	\$ 62,082,048
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Income before other

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income (expense)	688,693	1,007,525	511,167	1,268,263	3,475,648
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Net income	416,526	602,757	439,568	729,728	2,188,579
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Basic earnings per share	0.12	0.17	0.12	0.20	0.61
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Diluted earnings per share	0.12	0.17	0.12	0.20	0.61
----------------------------	------	------	------	------	------

1st

2nd

3rd

4th

Year

2005

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Revenue	\$29,674,470	\$33,399,907	\$ 34,579,729	\$19,727,753	\$117,381,859
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Income before other

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income (expense)	257,610	52,887	546,168	632,028	1,788,693
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Net income	149,088	211,679	325,294	415,536	1,101,597
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Basic earnings per share	0.04	0.06	0.09	0.12	0.31
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Diluted earnings per share	0.04	0.06	0.09	0.12	0.31
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