Convergent Solutions, Inc.

ANNUAL REPORT 1991

To Our Shareholders

The 1990's mark a turning point for Convergent Solutions – the end of one era and the beginning of another. As the decade matures, we anticipate increased sales of our major software product, fueled by a major repositioning and technology development effort, while our strong core business provides ongoing revenue and profit to keep our bottom line strong.

THE BEGINNING OF A NEW ERA FOR CS/ADS...

Our successful fourth generation language (4GL) software product, CS/ADS, is the premier application development tool in the CTOS marketplace. And, we believe it will continue to hold this leadership position for many years to come. At the same time, we know that confining a software product like ours to one operating system limits growth and so the profit opportunities for Convergent Solutions in the 1990's will lie in migrating our proven CS/ADS tool to other computing environments.

To reach out to more markets and take advantage of the increasing demand for "open" systems and products, we have begun to develop CS/ADS for a variety of operating systems and hardware platforms, with the current development effort focusing on UNIX. Here is a recap of our progress:

In 1989, we created the first UNIX version of CS/ADS. In 1990 and 1991, we introduced this product to the UNIX market on a limited basis and had some major successes, even at this early stage.

In fiscal year 1992, we will step up both product development and marketing and expect more than 50 percent of our CS/ADS license revenues to be from sales into the UNIX market. By 1993, our goal is to have CS/ADS recognized as a leading-edge application development tool in the UNIX marketplace generating substantial revenues and profits.

REACHING THE UNIX UNIVERSE.

Our initial strategy for CS/ADS called for slow and deliberate movement into new markets. This strategy allowed Convergent Solutions to test cautiously, profit from successes and avoid major losses.

The first version of CS/ADS for UNIX offered the UNIX marketplace many advantages, combining CS/ADS's proven superiority as an application development tool with the ability to develop applications that are database, hardware and operating system independent. This is a big plus in today's fast-changing information systems environment, where information system professionals no longer can be certain that the computing environment they use today will be the one they still use 10 or 5 or even 2 years from now. Portability of data and applications becomes a significant advantage our licensees get from CS/ADS that they don't get from proprietary front-end development tools.

We are working to make CS/ADS a tool that can increase the productivity and efficiency of all UNIX application developers. This means creating versions of CS/ADS that are compatible with the broadest range of computers, graphical user interfaces (GUIs) and database management systems (DBMSs). We have already implemented an aggressive schedule of product development so that more and more UNIX users can select CS/ADS.

EXPANSION BECOMES REALITY.

Our objective is to make CS/ADS compatible with as many computers, GUIs and DBMSs as possible. This work began in earnest in fiscal year 1991 and will continue throughout 1992.

The most significant advance in moving CS/ADS into other DBMS platforms is our arrangement with Interbase, a division of Borland International. InterBase will resell a customized version of CS/ADS for use with their relational database management system for UNIX. CS/ADS is sold directly by InterBase and was chosen by them as a front-end tool because of its technical strength and depth of functionality.

A significant sale of CS/ADS to Motorola has already resulted from this arrangement; revenue from this sale will be recognized in first quarter 1992. And, we anticipate that the Convergent Solutions/InterBase

Our work, however, is not yet done. In fiscal year 1992, we expect to make a substantial investment in research and development, the bulk of which will be spent expanding the features of CS/ADS. Most of these improvements will result in the ability to run CS/ADS with a wider variety of DBMSs, GUIs and computers. After the completion of this work, the market for CS/ADS will be much broader than it currently is – and sales are expected to increase.

A FISCALLY STRONG CORPORATE STRUCTURE FUELS CS/ADS EXPANSION.

With the improvements in CS/ADS, we project increased sales for the product in 1992. We realize that our current plans call for an investment in R&D that seems high in relationship to 1991 sales. However, our experience indicates that this expenditure is needed to ensure future success of CS/ADS in the UNIX marketplace.

Fortunately, Convergent Solutions is a diverse firm with many resources, not a one-product company. Therefore, the significant expenditure on CS/ADS research & development will be offset by continued healthy revenues from the two other major areas of the company, MHT Services and DataFocus. Because of the unique markets these groups serve, their businesses are actually improved by today's uncertain economy, rather than hurt by it.

MHT Services derives its primary revenue from tools and consulting services used to convert mainframe Cobol programs from DOS to MVS. With the current soft economy, many companies are reducing computing costs by consolidating data and applications from numerous small processors to large centralized mainframes – hence, the demand for services to convert code from these DOS machines to a CPU running MVS is on the rise. With a backlog of over $800,000, MHT is expected to continue to generate substantial revenue and remain profitable in the coming year.

DataFocus, our wholly owned consulting subsidiary, was certified in fiscal year 1991 as a POSIX test lab. POSIX, a family of IEEE open standards, is the U.S. government's official requirement for "openness" in computer operating systems.

As one of only seven government-certified POSIX test labs in the country, DataFocus anticipates significant revenues from POSIX testing services rendered for computer manufacturers who want to ensure their systems are POSIX-compliant. Additional revenues from consulting and applications development point to a very successful 1992 for DataFocus.

THE FINANCIAL FACTS.

The ongoing success of MHT and DataFocus, combined with our overall financial strength, will enable Convergent Solutions to make the investment in research and development required to help insure a successful future for CS/ADS. Once CS/ADS is enhanced and developed for more computing environments, license revenue – the source of income with the highest profit margin – should yield significant dividends from the research & development expenditure.

In fiscal year 1991, our revenues were $6,550,683 – an increase of 4% over the previous year. The major factor that negatively affected profits was the write-off of the Coding Factory. CoFac's product was not at a level of depth and maturity required by the market and we did not feel that it would pay to invest more time and money in its development.

Overall, our balance sheet is strong. Convergent Solutions has maintained a position of financial stability and strength from the start of the decade – a testament to the quality of our products, people and management, especially in today's uncertain economy.

In conclusion, we want to thank our employees, our customers and our shareholders for their continued support during this extended period of change and growth. We look forward to great things ahead for Convergent Solutions and its investors for the remainder of the decade.

Ralph Reda

Ralph Reda, President and CEO

January 3, 1992

OVERVIEW

THE COMPANY

Convergent Solutions, Inc. (the "Company") develops and markets computer software products. Since 1984, its principal product is its Application Development System ("CS/ADS") and related maintenance, technical support and training services. CS/ADS is a software system which assists computer programmers in creating and modifying application programs. These programs are both database and operating system independent (i.e., they can be ported from one computing environment to another without modification).

CS/ADS combines the Company's proprietary fourth generation computer language, Processing Definition Language ("PDL"), a data dictionary (i.e., a database that stores and cross-references various application building-blocks), a relational database management system (RDBMS) and various utility programs.

CS/ADS application programs can operate with and are portable across RDBMS products sold by various commercial database software vendors, such as Interbase Software Corporation, a wholly owned subsidiary of Borland International; Oracle Corporation; Informix Software Inc.; and Sharebase Corporation, a wholly owned subsidiary of Teradata Corporation.

CS/ADS application programs can operate on and are portable across a wide range of computers, from many different manufacturers. These computers can operate under any of the following operating systems: UNIX, a system owned by AT&T and utilized by over 100 different computer manufacturers; MS/DOS, a system owned by Microsoft Corp. and used by IBM PCs and PC compatibles; and CTOS, a system owned by Unisys Corporation used in a variety of network-based desktop workstations manufactured by Unisys and by others.

A key strength of CS/ADS is its programming language, PDL. PDL is a language for use by professional programmers. PDL allows instructions and commands to be entered in a functionally oriented and English-like manner rather than in specialized mathematical or technical language. The programming language does far more automatically for programmers than traditional languages.

The Company believes that PDL and the other features of CS/ADS result in an application system that is more independent of its operating environment, is flexible and user friendly, and allows programs to be written, modified and maintained in reduced-time and, therefore, at lower cost than other comparable program development products.

CS/ADS Licenses

Application programs developed using CS/ADS cannot operate directly under the control of a computer's operating system. They require additional software to be installed in the computer, which is provided with either the CS/ADS development system, or with a special version of CS/ADS called a "run time." Therefore, the Company offers two types of CS/ADS licenses: a "development" license, and a "run time" license.

The purchaser of a development license is granted the right to use CS/ADS on one computer system, and is provided with the software on electronic media (usually cartridge tape or floppy disc), and operating manuals. The software is warrantied for 90 days. During this period the Company provides software maintenance service (it provides the customer with any program updates and enhancements, if any, issued during the period) and telephone support to assist the customer in implementing the system. The Company has not experienced any significant costs, nor has any significant amount of products been returned, in connection with its warranty and software maintenance provided thereunder.

Run time licenses provide a customer with the necessary software to enable computers to run application programs written with CS/ADS. The software provided under a run time license does not permit new programs to be written or existing programs to be modified.

Each license is typically granted on a one-time license fee basis for a one-year term and is automatically renewable from year to year thereafter unless the licensee has not performed its obligations thereunder. Thus, the license is, in effect, a perpetual license so long as the licensee is not in default. Each license contains provisions intended to maintain the confidentiality of the proprietary technology and know-how of the Company.

The Company offers three optional services to its CS/ADS customers: maintenance service, technical support service and training. Maintenance service provides the customers with updates, enhancements and modifications of CS/ADS. Technical support service permits customers to telephone the Company to obtain technical assistance in the use and implementation of CS/ADS. The maintenance and technical support services are available on either a monthly or annual basis. The Company has several different training courses depending on the proficiency of the user of CS/ADS. Training is provided either at the Company's Fairfax, Virginia or Laurence Harbor, New Jersey offices, or at the customer's facility, at various fees based upon the type of training desired.

During the fiscal years ended September 30, 1991, 1990 and 1989, sales of CS/ADS licenses and related maintenance, support and training services accounted for 35%, 51%, and 66% of the Company's revenues, respectively.

There are several other products and services that the Company offers to customers. The Company markets a product known as CS/Reporter. This product, developed by the Company, is a report generator and ad hoc query tool that provides end-user access to information and further increases programmer productivity. CS/Reporter operates on computers running UNIX, MS/DOS and CTOS.

The Company also developed and markets CS/VT-Emulator, which allows Unisys CTOS-based workstations to emulate terminals manufactured by Digital Equipment Corporation (DEC). This allows these workstations to access minicomputers and mainframes. For Unisys workstation customers, this eliminates the need for two desktop machines.

Sales of the foregoing products have generated less than 5% of annual revenues for the Company.

The Company also markets consulting services through its wholly-owned DataFocus subsidiary, located in Fairfax, Virginia. DataFocus specializes in building custom software using "open systems" technology (technology that is based on industry-wide and/or government approved standards, rather than on a single vendor's proprietary technology). Its customers are primarily commercial companies and government agencies.

DataFocus concentrates on three major business areas: Open Information Planning, Open Application Development, and Open Systems Engineering. Open Information Planning includes consulting and training in enterprise modeling, data modeling, project management and migration strategies. Open Applications Development involves system definition, database and software design, programming, testing and documentation services. Open Systems Engineering primarily focuses on POSIX (a Portable Operating System Interface Standard) development and testing services. POSIX is an IEEE standard adopted by the United States government. Almost all government procurements of new computers require that manufacturers supply operating systems that comply with the interface standard. Computer manufacturers must prove compliance by undergoing a POSIX certification process. During 1990, DataFocus was one of seven companies nationwide selected as a POSIX test laboratory by the National Institute of Standards and Testing.

During 1990, the Company purchased certain assets of MHT Services, Inc. which provided various services to the IBM mainframe marketplace. The Company's MHT division focuses on providing conversion technology and consulting services to help customers migrate Cobol applications from IBM's DOS/VSE operating system to IBM's MVS operating system. MHT provides services to Fortune 1000 clients as well as smaller business in the U.S. and Europe.

Marketing

The Company sells its products through its sales force of ten full time sales personnel, through a network of United States and foreign software dealers and through value added resellers (VARs).

The Company's sales force is responsible for direct sales to customers and the relationship with the distributor, dealers and VARs. The Company has expanded its direct sales force to include sales representatives in Laurence Harbor, New Jersey; Fairfax, Virginia; and Denver, Colorado.

At present, the Company has nonexclusive agreements for the sale of its products by 25 dealers, all located outside the United States. Typically, each dealership agreement is for a term of one year and is renewable for successive one year periods provided that the dealer has complied with its obligations. Dealers purchase the Company's products at a discount from list price.

During 1991, the Company signed a distribution agreement with InterBase Software Corporation, a wholly owned

MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The Company's shares of Common Stock are traded in the over-the-counter market and are quoted on the National Market System of NASDAQ under the symbol CSOL.

The following table sets forth, for the period indicated, the high and low bid prices for the Company's shares of Common Stock from October 1, 1989 through September 30, 1991, as reported by NASDAQ:

COMMON STOCK	LOW BID	HIGH BID
Year Ended September 30, 1990		
First Quarter	2 1/8	3 1/4
Second Quarter	2 1/16	2 9/16
Third Quarter	1 9/16	2 1/2
Fourth Quarter	1 1/4	1 15/16
Year Ended September 30, 1991		
First Quarter	1 1/16	1 5/8
Second Quarter	1 3/8	2
Third Quarter	1 1/16	1 7/8
Fourth Quarter	1 1/8	1 5/8

Such over-the-counter market quotations reflect inter-dealer prices, without retail markup, markdown or commission and may not necessarily represent actual transactions.

The Company has more than 1,000 beneficial holders of its Common Stock.

SELECTED FINANCIAL DATA

Operating Data:	For the Year Ended September 30, 1987	1988	1989	1990	1991
Revenues	$4,453,358	$11,219,619	$5,615,168	$6,304,094	**$6,550,683**
Provision for discontinued product line					**$1,592,284**
Income (loss) before cumulative effect of change in accounting principle	$1,400,412	$3,722,718	$625,820	$171,993	**($2,152,963)**
Cumulative effect of change in method of accounting for income taxes			291,000		
Net income (loss)	$1,400,412	$3,722,718	$916,820	$171,993	**($2,152,963)**
Income per common and common equivalent share:					
Before cumulative effect of change in accounting principle	$.45	$.62	$.12	$.03	**($.41)**
Cumulative effect of change in accounting principle			.05		
Net income (loss)	$.45	$.62	$.17	$.03	**($.41)**
Weighted average common and common equivalent shares	3,106,865	6,606,893	6,289,896	5,388,192	**5,293,157**

Balance Sheet Data:	As of September 30, 1987	1988	1989	1990	1991
Working capital	$5,271,638	$6,075,937	$11,290,867	$10,384,126	**$8,870,543**
Total assets	7,291,220	13,800,108	18,236,020	19,897,757	**16,735,785**
Long-term debt	28,843	781,000	—	—	**—**
Shareholders' equity	5,909,675	8,379,262	14,213,083	14,405,076	**11,993,205**

Fiscal year ended September 30, 1991 compared with fiscal year ended September 30, 1990.

Revenues for fiscal 1991 were $6,550,683, an increase of 4% compared with $6,304,094 in fiscal 1990. License sales increased 9% to $3,363,003 from $3,087,839. The increase is attributable to the inclusion of MHT license sales for the full year as compared with only two months in fiscal 1990. Sales of CS/ADS and CoFac (COBOL code generator) license sales decreased by 19% and 49%, respectively, in fiscal 1991 from the prior year. The sales decrease in CS/ADS is related to a decrease in overall sales in the CTOS market and the sales emphasis in entering the UNIX market place. Software development sales increased 39% to $2,659,701 compared with $1,910,975 principally due to the inclusion of MHT consulting services for the full year. Training revenues decreased 57% to $93,833 compared with $218,424.

Investment income decreased 60% to $434,146 in fiscal 1991 compared with $1,086,856 in fiscal 1990. The decrease is due to realized and unrealized losses incurred in the Company's investment account and a reduction in interest rates.

Cost of sales and contract costs were 36% in fiscal 1991 compared with 25% in fiscal 1990, principally as a result of the changes in the mix of business. Due to the lower percentage of license sales (which has high gross profit margin), and an increased percentage of custom software sales (which has lower gross profit margin), the cost of sales increased.

Research and development costs totaled $1,382,278 in fiscal 1991 compared with $1,623,365 in fiscal 1990, of which $611,789 was expensed in fiscal 1991 compared with $505,053 in fiscal 1990.

Operating expenses increased 8% to $4,517,751 in fiscal 1991 compared with $4,168,293 in fiscal 1990 and increased as a percentage of revenues as a result of an increase of sales and marketing costs. The Company discontinued the sale of the Cofac product in July 1991 resulting in a writedown of $1,592,284 primarily consisting of previously capitalized software development costs.

The Company had an income tax benefit of $230,958 in fiscal 1991 as a result of losses incurred for financial statement purposes.

The Company had a net loss of $2,152,963 in fiscal 1991 compared with net income of $171,993 in fiscal 1990. The decrease was attributable principally to the writeoff of capitalized software development costs and the increase in the cost of sales and contract costs discussed above, combined with a decrease in CS/ADS and CoFac license sales.

Fiscal year ended September 30, 1990 compared with fiscal year ended September 30, 1989.

Revenues for fiscal 1990 increased 12% to $6,304,094 compared with $5,615,168 in fiscal year 1989. License sales increased 5% to $3,087,839 from $2,934,947. The increase in license sales was principally the result of an increase in unit sales of CoFac licenses, offset somewhat by a reduction in unit sales of CS/ADS licenses. Software development sales increased 46% to $1,910,975 in fiscal 1990 compared with $1,306,119 in fiscal 1989 and training and other sales decreased 37% to $218,424 compared with $345,203. The increase in software development sales was principally attributable to growth in the DataFocus subsidiary, and the inclusion of CoFac and MHTRAN consulting services.

Investment income increased 6% to $1,086,856 in fiscal 1990 compared with $1,028,899. This increase was due to an increase in capital gains, which offset lower interest rates and a reduced amount of capital invested.

Cost of sales and contract costs were 25% in fiscal 1990 compared with 22% in fiscal 1989, principally as a result of the changes in the mix of business. Due to the lower percentage of license sales (which has high gross profit margin), and an increased percentage of custom software sales (which has lower gross profit margin), the cost of sales increased.

Software related research and development costs totaled $1,623,365 in fiscal 1990 compared with $1,586,750 for fiscal 1989 of which $505,053 was expensed in fiscal 1991 compared with $388,508 in fiscal 1990. Research and development costs were impacted by development of SQL interface for CS/ADS, and the development of a new release of CoFac.

Operating expenses increased 29% to $4,168,293 in fiscal 1990 compared with $3,231,442 in fiscal 1989 and increased as a percentage of revenues, 66% versus 58% as a result of an increase of sales and marketing costs. This increase was principally due to the expansion of operations resulting from the addition of the MHT Services and Coding Factory divisions and an increase in sales and marketing costs.

Liquidity and Capital Resources

During the last few years the Company has financed its operations, working capital requirements and capital expenditures from operating profits, existing cash and cash equivalents on hand, and short-term investments, as needed.

Working capital at September 30, 1991 was approximately $8.9 million as compared with $10.4 million at September 30, 1990. Current ratios were 4.5 to 1 and 4.3 to 1 in 1991, and 1990, respectively. The Company had no long term debt as of September 30, 1991.

The Company believes that its current funds from operations, cash and cash equivalents on hand, and short-term investments will be sufficient to meet its needs for working capital for the foreseeable future.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Stockholders of
Convergent Solutions, Inc.

We have audited the accompanying consolidated balance sheet of Convergent Solutions, Inc. as of September 30, 1991 and the related statements of operations, shareholders' equity and cash flows for the year 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. The consolidated financial statements of the Company as of September 30, 1990 and 1989 were audited by other auditors who have ceased operations and whose report dated November 16, 1990 expressed an unqualified opinion on those statements.

We conducted our audit in accordance with generally accepted auditing standards. 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 1991 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Convergent Solutions, Inc. as of September 30, 1991 and the consolidated results of its operations and cash flows for the year then ended in conformity with generally accepted accounting principles.

Coopers & Lybrand

Coopers & Lybrand

Princeton, New Jersey
November 6, 1991

INDEPENDENT AUDITORS' REPORT

Board of Directors
Convergent Solutions, Inc.
Laurence Harbor, New Jersey

We have audited the accompanying consolidated balance sheets of Convergent Solutions, Inc. and Subsidiary as of September 30, 1990 and 1989, and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended September 30, 1990. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. 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 Convergent Solutions, Inc. and Subsidiary as of September 30, 1990 and 1989, and the results of their operations and their cash flows for each of the three years in the period ended September 30, 1990, in conformity with generally accepted accounting principles.

Laventhol + Horwath

LAVENTHOL & HORWATH
Certified Public Accountants
New York, New York

November 16, 1990

The above is a copy of the audit report on the consolidated financial statements of Convergent Solutions, Inc. previously issued by Laventhol & Horwath, Certified Public Accountants who filed for bankruptcy on November 21, 1990 and ceased performing auditing and accounting services.

CONVERGENT SOLUTIONS, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
SEPTEMBER 30,

ASSETS	1991	1990
Current assets:		
Cash and cash equivalents	$ 4,718,422	$ 4,459,413
Short-term investments, net of valuation allowance of $20,744 in 1991	4,896,341	6,656,839
Accounts receivable, net of allowance for doubtful accounts of $92,000 in 1991 and $10,000 in 1990	1,479,245	1,371,395
Prepaid expenses and other	347,277	564,533
Recoverable income taxes	—	421,831
Total current assets	11,441,285	13,474,011
Equipment and leasehold improvements, net	568,020	760,876
Excess of cost over net assets acquired, net of accumulated amortization of $648,784 in 1991 and $443,784 in 1990	376,216	581,216
Investment in lease residuals	1,389,812	1,399,029
Unamortized computer software costs, net of accumulated amortization of $2,769,897 in 1991 and $1,122,861 in 1990	2,755,485	3,632,032
Investments, net of valuation allowance of $123,507 in 1991	150,619	—
Deposits and other	54,348	50,593
Total non-current assets	4,726,480	5,662,870
	$16,735,785	$19,897,757

LIABILITIES AND SHAREHOLDERS' EQUITY	1991	1990
Current liabilities:		
Accounts payable:		
Trade	$ 333,556	$ 67,439
Stock brokers, net of valuation allowance of $214,081 in 1991	929,754	2,179,394
Accrued expenses	512,562	383,686
Accrued costs of discontinued product line	167,785	—
Revenues billed in advance	627,085	459,366
Total current liabilities	2,570,742	3,089,885
Deferred income taxes, non-current	2,171,838	2,402,796
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, $.01 par; authorized 5,000,000 shares; none issued		
Common stock, $.01 par; authorized 20,000,000 shares; issued and outstanding 5,291,720 in 1991 and 5,389,025 in 1990	52,917	53,890
Capital in excess of par	7,933,040	8,067,468
Retained earnings	4,130,755	6,283,718
Net unrealized loss on long-term investments	(123,507)	—
	11,993,205	14,405,076
	$16,735,785	$19,897,757

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended September 30, 1991	1990	1989
Revenues:			
Software licenses	$ 3,363,003	$3,087,839	$2,934,947
Software development support and maintenance contracts	2,659,701	1,910,975	1,306,119
Training	93,833	218,424	345,203
Interest and other investment income	434,146	1,086,856	1,028,899
	6,550,683	6,304,094	5,615,168
Expenses:			
Cost of sales and contract costs	2,212,780	1,324,379	1,019,243
Operating expenses	4,517,751	4,168,293	3,231,442
Research and development costs	611,789	505,053	388,508
Provision for discontinued product line (principally write-off of capitalized software development costs)	1,592,284		
Interest expense	—	58,230	71,695
	8,934,604	6,055,955	4,710,888
Income (loss) before income taxes and cumulative effect of change in accounting principle	(2,383,921)	248,139	904,280
Income tax (benefit) provision	(230,958)	76,146	278,460
Income (loss) before cumulative effect of change in accounting principle	(2,152,963)	171,993	625,820
Cumulative effect of change in method of accounting for income taxes	—	—	291,000
Net income (loss)	$(2,152,963)	$ 171,993	$ 916,820
Income (loss) per common and common equivalent share:			
Income (loss) before effect of change in method of accounting for income taxes	$ (.41)	$ .03	$ .12
Cumulative effect of change in method of accounting for income taxes			.05
Net income (loss)	$ (.41)	$ .03	$ .17
Weighted average common and common equivalent shares outstanding	5,293,157	5,388,192	6,289,896

See notes to consolidated financial statements.

CONVERGENT SOLUTIONS AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED SEPTEMBER 30,

	1991		1990		1989	
Cash flows from operating activities:						
Net income (loss)		**$(2,152,963)**		$171,993		$916,820
Adjustments to reconcile net income (loss) to net cash provided by operating activities:						
Depreciation	**$205,114**		$222,095		$176,678	
Amortization of unamortized computer software costs	**383,831**		328,771		102,140	
Amortization of costs over net assets acquired	**205,000**		205,000		205,000	
Provision for discontinued product line	**1,592,284**					
Provision for doubtful accounts	**82,000**				(41,815)	
Investment valuation reserve	**234,825**					
Loss on issuance of warrants	**12,500**					
Deferred taxes	**(230,958)**		76,146		99,435	
(Increase) decrease in assets:						
Accounts receivable	**(189,850)**		(481,790)		3,896,198	
Prepaid expenses and other	**212,988**		(304,521)		(828,705)	
Recoverable income taxes	**421,831**		76,195			
Increase (decrease) in liabilities:						
Accounts payable and accrued expenses	**323,599**		(126,353)		102,522	
Taxes payable					(703,697)	
Deferred revenue	**167,719**		121,858		(873,876)	
Total adjustments		**3,420,883**		117,401		2,133,880
Net cash provided by operating activities		**1,267,920**		289,394		3,050,700
Cash flows from investing activities:						
Payments for purchase of property	**(97,831)**		(232,849)		(386,795)	
Unamortized computer software costs	**(770,489)**		(1,118,312)		(1,198,242)	
Proceeds from sale of investments	**11,023,175**		27,535,902		1,682,000	
Payments for investments	**(11,025,082)**		(26,483,482)		(6,336,651)	
Investment in lease residuals	**9,217**					
Repayment of note payable			(775,000)			
Proceeds from note receivables			172,675			
Payment for assets purchased from the Coding Factory Incorporated			(500,000)			
Payment for assets purchased from MHT Services Incorporated			(190,623)			
Net cash used in investing activities		**(861,010)**		(1,591,689)		(6,239,688)
Cash flows from financing activities:						
Purchase of common stock warrants	**(45)**				(67,429)	
Repayments of equipment loans			(6,301)		(22,653)	
Proceeds from sale of common stock and warrants	**5,000**		20,000			
Proceeds from exercise of stock options, rights and warrants					5,691,585	
Purchase of common stock	**(152,856)**				(707,155)	
Net cash provided by (used in) financing activities		**(147,901)**		13,699		4,894,348
Net increase (decrease) in cash and cash equivalents		**259,009**		(1,288,596)		1,705,360
Cash and cash equivalents, beginning of year		**4,459,413**		5,748,009		4,042,649
Cash and cash equivalents, end of year		**$4,718,422**		$4,459,413		$5,748,009

See notes to consolidated financial statements.

CONVERGENT SOLUTIONS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
SUPPLEMENTAL DISCLOSURE

	Years Ended September 30, 1991	1990	1989
Supplemental disclosure of cash flow information:			
Cash paid during the year for:			
Interest	$ —	$ 58,230	$ 71,695
Income taxes	—	—	1,058,094
	$ —	$ 58,230	$1,129,789
Supplemental disclosure of non-cash investing and financing activities:			
Fair value of assets acquired from MHT Services, Inc.		$ 200,623	
Liabilities assumed		(10,000)	
Cash payment for purchase of assets		$ 190,623	

CONVERGENT SOLUTIONS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
YEARS ENDED SEPTEMBER 30, 1989, 1990 AND 1991

	Common Stock Shares	Common Stock Amount	Capital in Excess of Par	Retained Earnings	Net Unrealized Loss on Long-Term Investments	Total
Balance, September 30, 1988	3,656,700	$36,567	$3,147,790	$5,194,905		$8,379,262
Purchase of common stock	(200,000)	(2,000)	(705,155)			(707,155)
Exercise of stock options	8,400	84	2,016			2,100
Purchase of common stock warrants			(67,429)			(67,429)
Exercise of common stock warrants, net of expenses of $52,290	1,913,925	19,139	5,670,346			5,689,485
Net income				916,820		916,820
Balance, September 30, 1989	5,379,025	53,790	8,047,568	6,111,725		14,213,083
Exercise of stock options	10,000	100	19,900			20,000
Net income				171,993		171,993
Balance, September 30, 1990	5,389,025	53,890	8,067,468	6,283,718		14,405,076
Net unrealized loss on long-term investments					$(123,507)	(123,507)
Issuance of common stock warrants			12,500			12,500
Purchase of common stock warrants			(45)			(45)
Purchase of common stock	(117,305)	(1,173)	(151,683)			(152,856)
Exercise of stock options	20,000	200	4,800			5,000
Net loss				(2,152,963)		(2,152,963)
Balance, September 30, 1991	5,291,720	$52,917	$7,933,040	$4,130,755	$(123,507)	$11,993,205

See notes to consolidated financial statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION:

The consolidated financial statements include the accounts of Convergent Solutions, Inc. and its wholly-owned subsidiary, DataFocus Incorporated (collectively, the "Company"). All significant intercompany accounts and transactions have been eliminated.

ORGANIZATION:

The Company is engaged primarily in developing and marketing software products. Revenues are principally generated from software products as follows:

1. Licensing of proprietary software.
2. Support and maintenance of proprietary software.
3. Training data processing personnel.
4. Development of software under contracts.

CASH EQUIVALENTS:

The Company considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

INVESTMENTS:

Investments are stated at the lower of cost or market value.

RESEARCH AND DEVELOPMENT COSTS:

The Company incurs research and development costs in connection with developing proprietary software. Such research and development costs are charged to operations as incurred, a total of $611,789, $505,053 and $388,508 for fiscal 1991, 1990 and 1989, respectively, were expensed.

CAPITALIZED COMPUTER SOFTWARE COSTS:

The Company capitalizes certain costs of computer software development. These costs totaled $770,489, $1,118,312 and $1,198,242 for fiscal 1991, 1990 and 1989, respectively, and consist of costs relating to the coding and testing performed subsequent to establishing the products' technological feasibility. Amortization of the costs to develop product begins when the product becomes available for general release to the customer and is based on the gross revenues earned in relation to total estimated gross revenues of the product, but in no event less than the straight-line amortization based on the economic life of the product (ranging from three to five years). In 1991, 1990 and 1989, $383,831, $328,771 and $102,140, respectively, was charged to cost of sales. Additionally, capitalized software development costs of $1,263,205 were written off in 1991 due to the discontinuation of several software product lines (see Note 3).

EQUIPMENT AND LEASEHOLD IMPROVEMENTS:

Equipment and leasehold improvements are stated at cost. Depreciation is being provided on the straight-line method over the estimated useful lives of the assets. Amortization of leasehold improvements is being provided on the straight-line method over the shorter of the life of the lease or the estimated useful lives of the assets.

Asset costs and related accumulated depreciation are eliminated from the accounts when an asset is disposed of or retired, with any resultant gain or loss included in results of operations.

Revenue and Cost Recognition:

Revenues from software development contracts are recognized on the percentage-of-completion method, measured by the stage of the job completed. Contract costs include all direct labor and consultation costs and those indirect costs related to contract performance. In the event that the current estimate of the total contract costs indicate a loss will be incurred, the Company will recognize a loss currently in operations related to work in process and subsequently adjust its percentage of completion basis. Selling, general and administrative costs are charged to operating expense as incurred.

Revenues from the licensing of proprietary software are recognized upon delivery, in accordance with the contract terms.

Training revenue is recognized as services are provided and billed.

The Company provides maintenance consisting of program updates and enhancements and technical support to customers with software licenses. After a ninety-day warranty period for initial licenses, the Company receives a fee for these services. These revenues, which are generally billed in advance, consist of maintenance and other items that are recognized into income on a straight-line basis over the term of the contract. Costs, which are not material, are expensed as incurred.

Income Taxes:

Deferred income taxes are provided for temporary differences in reporting operating results for income tax and financial reporting purposes. These differences relate primarily to the following: the temporary differences between tax and financial reporting, the capitalization of certain production costs of computer software for financial statement reporting and expensing these costs for tax purposes, the deferred tax expense due to temporary differences on the investment in lease residuals and the utilization of loss carry-forwards.

The Company adopted Statement of Financial Accounting Standards No. 96, "Accounting for Income Taxes" ("SFAS no. 96") as of October 1, 1988. This change resulted in income of $291,000 in fiscal 1989, representing the adjustment for the cumulative effect on prior years of applying SFAS No. 96.

Income per Common and Common Equivalent Share:

Income per common and common equivalent share is based on the weighted average number of common and common equivalent shares outstanding in each of the three years ended September 30, 1991.

Excess of Cost over Net Assets Acquired:

The excess of cost over net assets acquired of DataFocus Incorporated is attributable to the value of the employee organization acquired and is being amortized on a straight-line basis over five years.

Reclassifications:

Certain prior year amounts have been reclassified to conform to 1991 presentation.

2. ACQUISITIONS

MHT Services, Inc. (MHT):

On July 31, 1990, the Company acquired substantially all of the operating assets, except cash and accounts receivable, of MHT for $190,623 in cash. The Company has entered into a five year employment agreement with the president of MHT with a base salary adjusted for incentives based on the division's pre-tax profits. The Company issued, in connection with this acquisition, options to purchase 100,000 shares of the Company's common stock at $1.44 per share and an option to purchase 5,000 shares of the Company's common stock at $2.67 per share.

3. DISCONTINUED PRODUCT LINES

In July 1991, the Company discontinued several software product lines, principally related to its acquisition of CoFac in 1989. Accordingly, the Company is no longer capitalizing any software costs related to these product lines and has provided for the following costs as of June 30, 1991:

- Writeoff of capitalized software development costs of $1,263,205.
- Provision for ongoing costs related to discontinued product lines of $243,506. As of September 30, 1991, approximately $167,700 of these expenses were still accrued.
- Writeoff of certain fixed assets related to CoFac of $85,573.

4. INVESTMENTS

At September 30, 1991 and 1990, the book and quoted market values and gross unrealized gains and losses of the investment portfolios are as follows:

1991	Cost	Valuation Reserve	Book Basis	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
Short-Term						
Long Positions	$4,917,085	$ (20,744)	$4,896,341	$146,597	$ —	$5,042,938
Short Positions	(715,673)	(214,081)	(929,754)	—	—	(929,754)
	$4,201,412	$(234,825)	$3,966,587	$146,597	$ —	$4,113,184
Long-Term	$ 274,126	$(123,507)	$ 150,619	$ —	$ —	$ 150,619

1990	Cost	Valuation Reserve	Book Basis	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
Short-Term						
Long Positions	$6,656,839	$ —	$6,656,839	$ 38,838	$356,428	$6,339,249
Short Positions	(2,179,394)	—	(2,179,394)	429,690	18,940	(1,768,644)
	$4,477,445	$ —	$4,477,445	$468,528	$375,368	$4,570,605

Net unrealized gains and losses on investment transactions are determined on the specific identification cost basis. During fiscal 1991, net realized losses of $264,822 and net unrealized losses of $234,825, as a result in certain changes between cost and market values of investments, are included in the determination of net income. Net unrealized losses of $123,507 on long-term investments are included as a reduction of shareholders' equity at September 30, 1991. For the years ended September 30, 1990 and 1989, net realized gains amounted to $171,131 and $0, respectively.

5. EQUIPMENT AND LEASEHOLD IMPROVEMENTS

Equipment and leasehold improvements, net consist of the following:

	1991	1990
Computer equipment and other	**$1,269,070**	$1,158,922
Furniture and fixtures	**543,512**	566,432
Leasehold improvements	**112,631**	102,028
	1,925,213	1,827,382
Less, accumulated depreciation and amortization	**1,357,193**	1,066,506
	$ 568,020	$ 760,876

6. INVESTMENT IN LEASE RESIDUALS

The Company is the lessor in a lease agreement dated May 31, 1988 under which computer equipment having an estimated economic life of ten years was leased for a term of seven years. In connection with the purchase of the leased equipment, a non-recourse promissory note was entered into. This note requires quarterly payments of $524,455 including interest, commencing on August 31, 1988 and ending on May 31, 1995. The note is collateralized by a first lien on the property. Under the current leases of equipment, the rental income payable to the Company is equal to the quarterly note payments. The Company will recognize earnings from the investment in lease residuals in the final years of the lease beginning in fiscal 1993 when the revenue from the leases exceeds the debt requirements and upon the sale of leased assets.

In January 1989, the Company's leasing agent filed for bankruptcy under Chapter 11 and has advised the Company that it is reviewing the leases to determine whether it intends to reject or assume the leases. The Company's leasing agent has continued to service the leases and, in the opinion of management, is likely to continue to service them in the future.

7. SHAREHOLDERS' EQUITY

PREFERRED STOCK:

The Company's certificate of incorporation includes a class of 5,000,000 shares of Preferred Stock, par value of $.01 per share. The Board of Directors has the authority to provide for the issuance and related terms thereto of preferred stock without action by the shareholders. As of September 30, 1991 and 1990, no shares of Preferred Stock have been issued.

STOCK OPTIONS:

The Company has an Employee Stock Option Plan ("The Plan") and a 1989 Stock Option Plan ("The 1989 Plan"), whereby options to purchase 800,000 shares of Common Stock for each plan could be issued to key employees of the Company and, in the case of the 1989 Plan, they can also be issued to non-employee directors and consultants. In March 1989, the Board of Directors elected to terminate The Plan as to all shares not then subject to outstanding options. Each member of the Board of Directors Option Committee will automatically receive options to purchase 5,000 shares on each anniversary date of their appointments for as long as such member remains on the Committee. Options generally have a term of five years and become exercisable over a period of one to three years. At September 30, 1991, a total of 195,301 shares are available to be issued under the 1989 Plan.

Activity relating to these stock option plans is as follows:

Shares under option at September 30, 1988		
($.25 to $3.50)		491,400
Granted ($3.00 to $3.78 per share)		157,700
Exercised ($.25 per share)		(8,400)
Cancelled ($2.00 to $3.50 per share)		(2,000)
Shares under option at September 30, 1989		
($.25 to $3.87)		638,700
Granted ($1.44 to $3.13 per share)		570,500
Exercised ($2.00 per share)		(10,000)
Cancelled ($2.00 to $3.00 per share)		(38,000)
Shares under option at September 30, 1990		
($.25 to $3.87 per share)		1,161,200
Granted ($1.19 to $2.00 per share)		53,499
Exercised ($.25 per share)		(20,000)
Cancelled ($1.44 to $3.19 per share)		(129,500)
Shares under option at September 30, 1991		
($1.19 to $3.62 per share)		1,065,199
Options exercisable as of September 30:		
1990	505,850	
1991	618,883	

In addition to options granted under the Plans, the Company also has outstanding, at September 30, 1991, options to purchase 173,000 shares of Common Stock at $1.44 to $3.00 per share and, at September 30, 1990, options to purchase 258,000 shares of Common Stock at $1.44 to $3.00 per share.

The options outstanding were issued to officers and directors of the Company. The number of these options exercisable on September 30, 1991 and 1990 are 60,000 and 40,000, respectively. During the year ended September 30, 1990, a Director exercised his option and purchased 10,000 shares at $2.00 per share.

COMMON STOCK WARRANTS:

On March 14, 1991, the Company issued warrants to purchase 250,000 shares of the Company's Common Stock at a price of $2.75 per share to T.H. Lehman Inc., holder of 16% of the Company's Common Stock, which expire on March 14, 1994. These warrants replaced warrants to purchase 1,000,000 shares of the Company's Common Stock which were issued to T.H. Lehman Inc. in 1989 and had an expiration date of March 14, 1991. The warrants issued in 1991 were valued at a nominal price of $.05 per share and, accordingly, the Company recorded warrant issuance expense of $12,500.

8. MAJOR CUSTOMERS AND EXPORT SALES

Revenue from major customers and export revenues (primarily from Europe) were as follows:

	Year Ended September 30,		
	1991	**1990**	**1989**
Major customers:			
Various agencies of the United States government	**$1,482,876**	$1,234,632	$1,743,000
Customer which acted as a distributor of the Company's products as well as an end-user of the Company's services	**855,684**	1,398,856	1,161,000
Other customer	**882,894**	956,263	
Export sales	**1,803,072**	1,192,942	1,037,000

9. INCOME TAXES

The income tax (benefit) provision consists of the following:

	Year Ended September 30,		
	1991	**1990**	**1989**
Current:			
State and local			$ 60,619
Federal			
Deferred:			
State and local	**$ 155,086**	$ 10,000	56,578
Federal	**(386,044)**	66,146	161,263
	$ (230,958)	$ 76,146	$ 278,460

The income tax (benefit) provisions in 1991 and 1989 were affected by approximately $452,094 and $92,500, respectively, due to utilization of research expenditure credits.

For tax reporting purposes, the Company has approximately $1,400,000 of net operating loss carryforwards expiring by September 30, 2005 and approximately $452,000 in research expenditure credits expiring from September 30, 2002 through September 30, 2005.

A reconciliation between the Federal statutory tax rate and the effective tax rate is as follows:

	Year Ended September 30,		
	1991	1990	1989
Federal income tax rate	**34.0%**	34.0%	34.0%
State and local income taxes	**8.5**	4.0	5.9
Alternative minimum tax, net of credit	**12.9**		
Benefit of excess refunds	**(7.4)**		
Benefit of loss	**(25.0)**		
Investment tax and increased research expenditure credits and other items	**(13.4)**	(7.3)	(9.2)
Effective tax rate	**9.7%**	30.7%	30.7%

The provisions for deferred income taxes result from temporary differences having the following tax effect:

	Year Ended September 30,		
	1991	1990	1989
Temporary differences between tax and financial reporting	**$(961,286)**	$(341,000)	$(338,000)
Investment in lease residuals	**108,970**	417,146	1,014,341
Discontinued product line	**(189,060)**		
Alternative minimum tax, net of credit	**307,166**		
Benefit of research expenditure tax credits	**(210,486)**		(92,500)
Detriment (benefit) of loss carryforwards	**713,738**		(366,000)
	$(230,958)	$ 76,146	$ 217,841

10. COMMITMENTS AND CONTINGENCIES

LEASES:

As of September 30, 1991, the Company was obligated under the non-cancelable operating leases as follows:

Year Ending September 30,	Amount
1992	$173,941
1993	115,961
Total	$289,902

The lease agreements require the Company to pay certain expenses, including maintenance costs and a percentage of real estate taxes.

Rental expense for all operating leases totaled $427,184, $423,031 and $380,532 for the years ended September 30, 1991, 1990 and 1989, respectively.

BONUS PLAN:

The Company has adopted various bonus plans with certain key employees of the Company and of the Companies it has purchased which are based on a percentage of profits or revenues of these entities. For the years ended September 30, 1991, 1990 and 1989, respectively, approximately $97,000, $138,000 and $110,000 were expensed under these plans.

EMPLOYMENT AGREEMENTS:

The Company has employment arrangements with several key employees which provide for the continuation of salary and other compensation aggregating approximately $350,000 for terms ranging through 1993.

11. COST OF SALES AND CONTRACT COSTS

Cost of sales and contract costs consist of the following:

	Year Ended September 30,		
	1991	1990	1989
Software licenses	**$1,143,306**	$826,753	$297,448
Software development contracts	**1,003,907**	409,082	617,900
Training	**65,567**	88,544	103,895
	$2,212,780	$1,324,379	$1,019,243

12. CONCENTRATION OF CREDIT RISK AND FINANCIAL INSTRUMENTS

Financial instruments which potentially subject the Company to concentration of credit risk consist principally of cash equivalents, investments and accounts receivable. The Company generally places its cash equivalents and investments with high credit quality financial institutions and limits the amount of credit exposure to any one financial institution. Concentrations of credit risk with respect to accounts receivable are limited due to the large number of customers comprising the Company's customer base and their dispersion across many different industries and geographies.

Realization of the Company's investment in lease residuals (Note 6) is dependent on, among other things, the maintenance of the user leases and related rental income as well as the ultimate sale of equipment under lease. In January 1989, the Company's leasing agent filed for bankruptcy under Chapter 11 and has advised the Company that it is reviewing the leases to determine whether it intends to reject or assume the leases. The Company's leasing agent has continued to service the leases and, in the opinion of management, is likely to continue to service them in the future.

The Company also has obligations arising from financial instruments sold short. These obligations are subject to the volatility of market conditions. The Company is required to maintain certain cash balances for margin requirements related to these financial instruments.

13. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

	1991			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(In thousands, except per share amounts)			
Revenues	$1,713	$1,491	$1,282	$2,065
Income (loss) before income taxes	29	(250)	(2,010)	(153)
Net income (loss)	21	(237)	(1,448)	(489)
Earnings (loss) per share	—	(.04)	(.27)	(.10)
Weighted average common and common equivalent shares outstanding	5,336	5,309	5,326	5,293

	1990			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(In thousands, except per share amounts)			
Revenues	$1,324	$1,442	$1,380	$2,158
Income (loss) before income taxes	82	68	(32)	130
Net income (loss)	63	39	(32)	102
Earnings (loss) per share	.01	—	—	.02
Weighted average common and common equivalent shares outstanding	5,384	5,389	5,389	5,389