STRATESEC INC
Form 8-K/A
February 13, 2001

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 8-K/A

CURRENT REPORT

Pursuant to Section 13 or 15(d) of the
Securities and Exchange Act of 1934

Date of Report (Date of earliest event reported): November 30, 2000

STRATESEC INCORPORATED
(Exact name of registrant as specified in its charter)

Delaware	1-13427	22-2817302
(State of Incorporation)	(Commission File No.)	(IRS Employer Identification No.)

105 Carpenter Drive, Suite C
Sterling, Virginia 20164
(Address of principal executive offices, including zip code)

(703) 709-8686
(Registrant's telephone number, including area code)

STRATESEC INCORPORATED

Item 7. Financial Statements and Exhibits

Unaudited Pro Forma Combined Balance Sheet dated as of December 31, 1999
Unaudited Pro Forma Combined Statement of Operations for the year ended December 31, 1999
Unaudited Pro Forma Combined Balance Sheet dated as of December 31, 1998
Unaudited Pro Forma Combined Statement of Operations for the year ended December 31, 1998
Report of Independent Accountants
Audited Balance Sheet of Security Systems Integrations, Inc.

dated as of December 31, 1999
Audited Statement of Operations of Security Systems Integrations, Inc. for the year ended December 31, 1999
Audited Statement of Sockholder's Deficit of Security Systems Integrations, Inc. for the year ended December 31, 1999
Audited Statement of Cash Flows of Security Systems Integrations, Inc. for the year ended December 31, 1999
Notes to Financial Statements
Report of Independent Accountants
Audited Balance Sheet of Security Systems Integrations, Inc. dated as of December 31, 1998
Audited Statement of Income and Retained Earnings of Security Systems Integrations, Inc. for the year ended December 31, 1998
Audited Statement of Cash Flows of Security Systems Integrations, Inc. for the year ended December 31, 1998
Notes to Financial Statements

(c) Exhibits. None

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

STRATESEC INCORPORATED

/s/ Albert V. Graves

Albert V. Graves
Chief Financial Officer

Dated: February 13, 2001

February 13, 2001

To the Sole Stockholder and Director
of Security Systems Integrations, Inc.:

We have reviewed the accompanying balance sheet of Security Systems Integrations, Inc. as of September 30, 2000 and the related statements of income, of stockholder's deficit, and of cash flows for the nine month period then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management of Security Systems Integrations, Inc.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

SECURITY SYSTEMS INTEGRATIONS, INC.

BALANCE SHEET

SEPTEMBER 30, 2000

ASSETS

Current assets

Cash and cash equivalents
Accounts receivable
Other current assets

Total current assets

Property and equipment, net
Note receivable from stockholder
Deposit

Total assets

LIABILITIES AND STOCKHOLDER'S DEFICIT

Current liabilities

Accounts payable and accrued expenses
Accrued payroll and related liabilities
Income taxes payable
Notes payable
Deferred income taxes

Total current liabilities

Notes payable

Total liabilities

Stockholder's deficit

Common stock - no par value, 10,000 shares authorized, issued, and outstanding
Accumulated deficit

Total stockholder's deficit

Commitments

Total liabilities and stockholder's deficit

SECURITY SYSTEMS INTEGRATIONS, INC.

STATEMENT OF INCOME

NINE MONTH PERIOD ENDED SEPTEMBER 30, 2000

Revenue

Costs and expenses

Direct materials
Direct labor
Other direct costs
Indirect costs

Income before income taxes

Provision for income taxes

Net income

SECURITY SYSTEMS INTEGRATIONS, INC.

STATEMENT OF STOCKHOLDER'S DEFICIT

NINE MONTH PERIOD ENDED SEPTEMBER 30, 2000

	Common Stock			
	Shares		Amount	Accum De
Balance at December 31, 1999	10,000	$	100	$
Dividends paid	-		-	(1
Net income for the nine month period ended September 30, 2000	-		-	1
Balance at September 30, 2000	10,000	$	100	$

SECURITY SYSTEMS INTEGRATIONS, INC.

STATEMENT OF CASH FLOWS

NINE MONTH PERIOD ENDED SEPTEMBER 30, 2000

Cash flows from operating activities:

Net income

Adjustments to reconcile net income to net cash used in operating activities:
- Depreciation and amortization
- Deferred income taxes
- Increase in:
  - Accounts receivable
  - Other current assets
- Increase (decrease) in:
  - Accounts payable and accrued expenses
  - Accrued payroll and related liabilities
  - Billings in excess of revenue recognized

Income taxes payable

Total adjustments

Net cash used in operating activities

Cash flows from financing activities:

Net borrowings under bank line-of-credit
Principal payments under notes payable
Dividends paid

Net cash used in financing activities

Net decrease in cash and cash equivalents

Cash and cash equivalents, beginning of the nine month period

Cash and cash equivalents, end of the nine month period

SECURITY SYSTEMS INTEGRATIONS, INC.

NOTES TO THE FINANCIAL STATEMENTS

SEPTEMBER 30, 2000

NOTE 1 - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Security Systems Integrations, Inc. (the "Company") was incorporated in the state of Virginia on October 10, 1997. The Company, which is privately held, provides security systems for commercial companies and agencies of the federal government.

The significant accounting policies followed by the Company are described below.

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions regarding certain types of assets, liabilities, revenues, and expenses. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, upon settlement, actual results may differ from estimated amounts.

Revenue recognition

Substantially all of the Company's contract revenue results from contracts with agencies of the federal government. Revenue on fixed-price and cost-reimbursable contracts includes direct costs and allocated indirect costs incurred plus recognized profit. Profit is recognized under fixed-price contracts on the percentage-of-completion basis. Revenue on time-and-material contracts is recognized based upon time (at established rates) and other direct costs incurred. Losses on contracts are provided for in the period they are first determined.

Cash equivalents

The Company considers all highly liquid instruments with original maturities of three months or less to be cash equivalents.

Property and equipment

Property and equipment is stated at cost less accumulated depreciation and amortization. Depreciation and amortization of property and equipment is computed using an accelerated method over the estimated useful lives of five to seven years. Amortization of leasehold improvements is computed using the straight-line method over the shorter of the estimated useful lives of the assets or the term of the related lease.

Income taxes

Income taxes have been recorded using the liability method. The income tax provision includes federal and state income taxes both currently payable and changes in deferred taxes due to differences between financial reporting and tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using the enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse.

NOTE 2 - PROPERTY AND EQUIPMENT

Property and equipment consists of the following at September 30, 2000:

Vehicles	$	116,127
Leasehold improvements		94,386
Computer hardware and software		55,336
Office furniture		28,058
Construction equipment		17,660
		311,567
Less: accumulated depreciation and amortization		(96,834)
	$	214,733

Depreciation and amortization expense aggregated $38,418 for the nine month period ended September 30, 2000.

NOTE 3 - NOTE RECEIVABLE FROM STOCKHOLDER

The note receivable to stockholder is unsecured, with installments of principal and interest (at 7.0%) of $3,260 due monthly through September 2029. During the nine month period ended September 30, 2000, no principal payments were received. The Company's stockholder made no principal payments on the note.

NOTE 4 - NOTES PAYABLE

Notes payable consist of the following at September 30, 2000:

Bank line-of-credit agreement (maximum of $450,000) bearing interest at the bank's prime rate (9.5% at September 30, 2000. This line-of-credit is secured by substantially all of the Company's assets and is guaranteed by the sole stockholder of the Company. This agreement expires, if not renewed, on May 30, 2001.

Note payable to vendor, secured by a truck with a book value of $24,052 at September 30, 2000, with installments of principal and interest (at 8.7%) aggregating $641 due monthly through June 2004.

Note payable to bank, unsecured, with installments of principal and interest (at 7.0%) aggregating $1,349 due monthly through July 2001.

Total notes payable

Less: current portion

Noncurrent portion

The scheduled maturities of the noncurrent portion of the notes payable are as follows as of September 30, 2000:

Years ending September 30,		
2002	$	6,310
2003		6,882
2004		5,567
	$	18,759

Interest expense, which approximates interest paid, aggregated $2,000 for the nine month period ended September 30, 2000.

NOTE 5 - INCOME TAXES

The provision for income taxes consists of the following for the nine month period ended September 30, 2000:

Current income taxes	
Federal	$ 657,000
State	123,000
Deferred income taxes	
Federal	(25,000)
State	(5,000)
	$ 750,000

Deferred income taxes reflect temporary differences in the recognition of revenue and expenses for tax reporting and financial statement purposes. These temporary differences relate principally to the use of the cash basis of accounting for income tax purposes (prior to January 1, 1999).

During the nine month period ended September 30, 2000, the Company paid no income taxes.

NOTE 6 - RETIREMENT PLAN

Effective January 1, 2000, the Company implemented a defined contribution 401(k) profit sharing plan (the Plan) for all employees. Participants must have at least three months of service and be at least 21 years of age to be eligible to participate in the Plan. Participants may make voluntary contributions to the Plan up to the maximum amount allowable by law, but not to exceed 15% of their annual compensation. Company contributions to the Plan are at the discretion of management and vest ratably over five years, beginning with the second year of participation. No Company contributions to the Plan were made for the nine month period ended September 30, 2000.

NOTE 7 - CONCENTRATIONS OF CREDIT RISK

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist primarily of cash and cash equivalents and accounts receivable. The Company's management believes the risk of loss associated with cash and cash equivalents is very low since cash and cash equivalents are maintained in financial institutions. However, at September 30, 2000, the Company had cash and cash equivalents on deposit with a financial institution that exceeded the federally insured limit. To date, accounts receivable have been derived primarily from contracts with agencies of the federal government. Accounts receivable are generally due within 30 days and no collateral is required. The Company maintains reserves for potential credit losses and historically such losses have been insignificant and within management's expectations.

NOTE 8 - COMMITMENTS

The Company leases office space for its headquarters, and other offices, under the terms of noncancelable operating leases, which expire at various dates through December 31, 2002. The following is a schedule by year of the future minimum lease payments required under operating leases, which have initial or remaining terms in excess of one year as of September 30, 2000:

Years ending September 30,	
2001	122,000
2002	120,000
2003	30,000
	$ 272,000

During 1999, the Company entered into a lease agreement for office space from its stockholder. The Company recorded lease expense aggregating $90,000 in connection with this lease during the nine month period ended September 30, 2000. This lease agreement provides for payments of $10,000 per month through December 31, 2002.

Rent expense aggregated $124,674 for the nine month period ended September 30, 2000.

NOTE 9 - SUBSEQUENT EVENT

Effective November 30, 2000, the Company merged with STRATESEC, Incorporated under an agreement whereby the Company's stockholder surrendered all issued and outstanding shares of the Company's common stock in exchange for 2,000,000 shares of STRATESEC, Incorporated common stock.

STRATESEC INCORPORATED
UNAUDITED PRO FORMA COMBINED BALANCE SHEET
SEPTEMBER 30, 2000

	STRATESEC	SSI
ASSETS		
Current Assets		
Cash and cash equivalents	$ 228,523	$ -
Accounts receivable, net of allowance for doubtful accounts	4,237,962	928,640
Costs and estimated earnings in excess of billings on uncompleted contracts	3,608,966	135,288
Inventory and other assets, net of allowance	937,558	104,372
Total current assets	9,013,009	1,168,300
Property, equipment and other, net	603,474	592,010
	$ 9,616,483	$ 1,760,310
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Line of credit and other current debt obligations	1,480,237	437,215
Accounts payable	2,780,641	219,992

Billings in excess of costs and estimated earnings on uncompleted contracts	393,603	-
Accrued expenses and other	903,945	1,415,081
Total current liabilities	5,558,426	2,072,288
Long-Term Liabilities		
Capital lease obligations, less current maturities	43,515	-
Commitments and Contingencies	-	-
Shareholders' Equity		
Common stock	86,300	100
Treasury stock	(612,814)	-
Additional paid-in capital	24,908,964	-
Retained earnings (accumulated deficit)	(20,367,908)	(312,078)
	4,014,542	(311,978)
	$ 9,616,483	$ 1,760,310

STRATESEC INCORPORATED
UNAUDITED PRO FORMA COMBINED STATEMENT OF OPERATIONS For the nine months ended September 30, 2000

	STRATESEC	SSI	Pro Adjus
Earned revenues	$11,864,407	$6,801,143	
Cost of earned revenues	7,618,788	3,894,127	
Gross profit	4,245,619	2,907,016	
Selling, general and administrative expenses	3,584,799	1,009,473	
Operating income (loss)	660,820	1,897,543	
Interest and financing fees	(295,185)	68,388	
Income (loss) before income taxes	365,635	1,965,931	
Provision for income taxes		750,000	
Net income (loss)	$ 365,635	$1,215,931	
Net income (loss) per share - basic	$ 0.05	$ -	
Net income per share - diluted	$ 0.04	$ -	
Weighted average common shares outstanding - basic	7,941,397	-	
Weighted average common shares outstanding - diluted	8,216,487	-	

STRATESEC INCORPORATED
UNAUDITED PRO FORMA COMBINED BALANCE SHEET
DECEMBER 31, 1999

	STRATESEC	SSI
ASSETS		
Current Assets		
Cash and cash equivalents	$ 2,831	$ 3,081,612
Accounts receivable, net of allowance for doubtful accounts	2,233,262	188,112
Costs and estimated earnings in excess of billings on uncompleted contracts	2,865,886	-
Inventory and other assets, net of allowance	250,393	4,856
Total current assets	5,352,372	3,274,580
Property, equipment and other, net	621,096	630,428
	$ 5,973,468	$ 3,905,008
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Line of credit and other current debt obligations	844,392	20,319
Accounts payable	2,931,260	346,856
Billings in excess of costs and estimated earnings on uncompleted contracts	234,338	3,111,351
Accrued expenses and other	627,156	482,398
Total current liabilities	4,637,146	3,960,924
Long-Term Liabilities		
Debt obligations, less current maturities	94,570	34,800
Commitments and Contingencies	-	-
Shareholders' Equity		
Common stock	68,902	-
Treasury stock	(409,564)	-
Additional paid-in capital	22,315,957	100
Accumulated deficit	(20,733,543)	(90,816)
	1,241,752	(90,716)
	$ 5,973,468	$ 3,905,008

STRATESEC INCORPORATED
UNAUDITED PRO FORMA COMBINED STATEMENT OF OPERATIONS
For the year ended December 31, 1999

	STRATESEC	SSI	Pro Adjus
Earned revenues	$10,631,131	$4,085,308	
Cost of earned revenues	7,443,087	2,795,119	
Gross profit	3,188,044	1,290,189	
Selling, general and administrative expenses	3,878,103	436,027	
Operating income (loss)	(690,059)	854,162	
Interest and financing fees	(242,779)	-	
Income (loss) before income taxes	(932,838)	854,162	
Provision for income taxes	-	(325,000)	
Net income (loss)	$ (932,838)	$ 529,162	
Net income (loss) per share - basic	$ (0.15)	$ -	
Net income per share - diluted	N/A	$ -	
Weighted average common shares outstanding - basic	6,099,435	-	
Weighted average common shares outstanding - diluted	N/A	-	

STRATESEC INCORPORATED
UNAUDITED PRO FORMA COMBINED BALANCE SHEET
DECEMBER 31, 1998

	STRATESEC	SSI
ASSETS		
Current Assets		
Cash and cash equivalents	$ 442,582	$ 112,480
Cash - restricted	1,900,000	-
Accounts receivable, net of allowance for doubtful accounts	1,297,176	1,305,710
Costs and estimated earnings in excess of billings on uncompleted contracts	1,440,485	-
Inventory and other assets, net of allowance	228,462	3,557
Total current assets	5,308,705	1,421,747
Property, equipment and other, net	519,031	79,965
	$ 5,827,736	$ 1,501,712

LIABILITIES AND SHAREHOLDERS' EQUITY

Current Liabilities		
Line of credit and other current debt obligations	1,871,076	-
Accounts payable	1,455,840	113,830
Billings in excess of costs and estimated earnings on uncompleted contracts	102,132	646,523
Accrued expenses and other	1,008,955	153,656
Total current liabilities	4,438,003	914,009
Long-Term Liabilities		
Capital lease obligations, less current maturities	167,430	-
Commitments and Contingencies	-	-
Shareholders' Equity		
Common stock	61,035	-
Treasury stock	(181,851)	-
Additional paid-in capital	21,143,824	401,345
Retained earnings (accumulated deficit)	(19,800,705)	186,358
	1,222,303	587,703

STRATESEC INCORPORATED
UNAUDITED PRO FORMA COMBINED STATEMENT OF OPERATIONS
For the year ended December 31, 1998

	STRATESEC	SSI	Pro Adjus
Earned revenues	$ 6,624,523	$1,781,447	
Cost of earned revenues	4,792,838	1,267,469	
Provision for contract adjustment	2,491,156	-	
Gross profit	(659,471)	513,978	
Selling, general and administrative expenses	4,426,339	207,620	
Recovery of legal judgment	(1,655,000)	-	
Operating income (loss)	(3,430,810)	306,358	
Interest and financing fees	(91,890)	-	
Income (loss) before income taxes	(3,522,700)	306,358	
Provision for income taxes	-	(120,000)	
Net income (loss)	$(3,522,700)	$ 186,358	

Net income (loss) per share - basic	$ (0.58)	$ -	
Net income per share - diluted	N/A	$ -	
Weighted average common shares outstanding - basic	6,099,435	-	
Weighted average common shares outstanding - diluted	N/A	-	

REPORT OF INDEPENDENT ACCOUNTANTS

February 6, 2001

To the Sole Stockholder and Director
of Security Systems Integrations, Inc.:

In our opinion, the accompanying balance sheet and the related statements of income, of stockholder's deficit, and of cash flows present fairly, in all material respects, the financial position of Security Systems Integrations, Inc. (an S Corporation) at December 31, 1999 and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of management; our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of these statements in accordance with auditing standards generally accepted in the United States of America which 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for the opinion expressed above.

SECURITY SYSTEMS INTEGRATIONS, INC.

BALANCE SHEET

DECEMBER 31, 1999

ASSETS

Current assets

Cash and cash equivalents
Accounts receivable
Other current assets

Total current assets

Property and equipment, net
Note receivable from stockholder
Deposit

Total assets

LIABILITIES AND STOCKHOLDER'S DEFICIT

Current liabilities

Accounts payable and accrued expenses
Accrued payroll and related liabilities
Billings in excess of revenue recognized
Income taxes payable
Notes payable
Deferred income taxes

Total current liabilities

Notes payable

Total liabilities

Stockholder's deficit

Common stock - no par value, 10,000 shares authorized, issued, and outstanding
Accumulated deficit

Total stockholder's deficit

Commitments

Total liabilities and stockholder's deficit

SECURITY SYSTEMS INTEGRATIONS, INC.

STATEMENT OF INCOME

YEAR ENDED DECEMBER 31, 1999

Revenue	$	4,085,308

Costs and expenses	
Direct materials	1,436,262
Direct labor	570,227
Other direct costs	788,630
Indirect costs	436,027
	3,231,146
Income before income taxes	854,162
Provision for income taxes	(325,000)
Net income	$ 529,162

SECURITY SYSTEMS INTEGRATIONS, INC.

STATEMENT OF STOCKHOLDER'S DEFICIT

YEAR ENDED DECEMBER 31, 1999

	Common Stock		Reta Earn (Accum Defi
	Shares	Amount	
Balance at December 31, 1998	10,000	$ 401,345	$
Dividends paid	-	(401,245)	(
Net income for the year ended December 31, 1999	-	-	
Balance at December 31, 1999	10,000	$ 100	$

SECURITY SYSTEMS INTEGRATIONS, INC.

STATEMENT OF CASH FLOWS

YEAR ENDED DECEMBER 31, 1999

Cash flows from operating activities:

Net income

Adjustments to reconcile net income to net cash provided by operating activities:

Depreciation and amortization

Deferred income taxes

(Increase) decrease in:

Accounts receivable

Other current assets

Increase in:

Accounts payable and accrued expenses

Accrued payroll and related liabilities

Billings in excess of revenue recognized

Income taxes payable

Total adjustments

Net cash provided by operating activities

Cash flows from investing activities:

Purchases of property and equipment, net

Increase in note receivable from stockholder

Principal repayments under note receivable from stockholder

Increase in deposit

Net cash used in investing activities

Cash flows from financing activities:

Proceeds from notes payable

Principal payments under notes payable

Dividends paid

Net cash used in financing activities

Net increase in cash and cash equivalents

Cash and cash equivalents, beginning of the year

Cash and cash equivalents, end of the year

SECURITY SYSTEMS INTEGRATIONS, INC.

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 1999

NOTE 1 - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Security Systems Integrations, Inc. (the "Company") was incorporated in the state of Virginia on October 10, 1997. The Company, which is privately held, provides security systems for commercial companies and agencies of the federal government.

The significant accounting policies followed by the Company are described below.

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions regarding certain types of assets, liabilities, revenues, and expenses. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, upon settlement, actual results may differ from estimated amounts.

Revenue recognition

Substantially all of the Company's contract revenue results from contracts with agencies of the federal government. Revenue on fixed-price and cost-reimbursable contracts includes direct costs and allocated indirect costs incurred plus recognized profit. Profit is recognized under fixed-price contracts on the percentage-of-completion basis. Revenue on time-and-material contracts is recognized based upon time (at established rates) and other direct costs incurred. Losses on contracts are provided for in the period they are first determined. Amounts billed in excess of revenue recognized is reflected as a liability on the accompanying balance sheet.

Cash equivalents

The Company considers all highly liquid instruments with original maturities of three months or less to be cash equivalents.

Property and equipment

Property and equipment is stated at cost less accumulated depreciation and amortization. Depreciation and amortization of property and equipment is computed using an accelerated method over the estimated useful lives of five to seven years. Amortization of leasehold improvements is computed using the straight-line method over the shorter of the estimated useful lives of the assets or the term of the related lease.

Income taxes

Income taxes have been recorded using the liability method. The income tax provision includes federal and state income taxes both currently payable and changes in deferred taxes due to differences between financial reporting and tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using the enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse.

NOTE 2 - PROPERTY AND EQUIPMENT

Property and equipment consists of the following at December 31, 1999:

Vehicles	$ 116,127
Leasehold improvements	94,386
Computer hardware and software	55,336
Office furniture	28,058
Construction equipment	17,660
	311,567
Less: accumulated depreciation and amortization	(58,416)
	$ 253,151

Depreciation and amortization expense aggregated $39,349 for the year ended December 31, 1999.

NOTE 3 - NOTE RECEIVABLE FROM STOCKHOLDER

The note receivable to stockholder is unsecured, with installments of principal and interest (at 7.0%) of $3,260 due monthly through September 2029. During the year ended December 31, 1999, principal payments of $161,511 were received in excess of the amounts required by the note receivable, accordingly, the balance has been classified as noncurrent.

NOTE 4 - NOTES PAYABLE

Notes payable consist of the following at December 31, 1999:

Note payable to vendor, secured by a truck with a book value of $40,087 at December 31, 1999, with installments of principal and interest (at 8.7%) aggregating $641 due monthly through June 2004.

Note payable to bank, unsecured, with installments of principal and interest (at 7.0%) aggregating $1,349 due monthly through July 2001.

Total notes payable

Less: current portion

Noncurrent portion

The scheduled maturities of the noncurrent portion of the notes payable are as follows as of December 31, 1999:

Years ending December 31,		
2001	$	15,028
2002		6,448
2003		7,032
2004		6,292
	$	34,800

Interest expense, which approximates interest paid, aggregated $1,888 for the year ended December 31, 1999.

NOTE 5 - INCOME TAXES

The provision for income taxes consists of the following for the year ended December 31, 1999:

Current income taxes		
Federal	$	241,000
State		45,000
Deferred income taxes		
Federal		33,000
State		6,000
	$	325,000

Deferred income taxes reflect temporary differences in the recognition of revenue and expenses for tax reporting and financial statement purposes. These temporary differences relate principally to the use of the cash basis of accounting for income tax purposes (prior to the year ended December 31, 1999).

During the year ended December 31, 1999, the Company paid no income taxes.

NOTE 6 - CONCENTRATIONS OF CREDIT RISK

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist primarily of cash and cash equivalents and accounts receivable. The Company's management believes the risk of loss associated with cash and cash equivalents is very low since cash and cash equivalents are maintained in financial institutions. However, at December 31, 1999, the Company had cash and cash equivalents on deposit with a financial institution that exceeded the federally insured limit by approximately $3,100,000. To date, accounts receivable have been derived primarily from contracts with agencies of the federal government. Accounts receivable are generally due within 30 days and no collateral is required. The Company maintains reserves for potential credit losses and historically such losses have been insignificant and within management's expectations.

NOTE 7 - COMMITMENTS

The Company leases office space for its headquarters, and other offices, under the terms of noncancelable operating leases, which expire at various dates through December 31, 2002. The following is a schedule by year of the future minimum lease payments required under operating leases, which have initial or remaining terms in excess of one year as of December 31, 1999:

Years ending December 31,	
2000	$ 125,000
2001	122,000
2002	120,000
	$ 367,000

During 1999, the Company entered into a lease agreement for office space from its stockholder. The Company recorded lease expense aggregating $40,000 in connection with this lease during the year ended December 31, 1999. This lease agreement provides for payments of $10,000 per month through December 31, 2002.

Total rent expense aggregated $83,443 for the year ended December 31, 1999.

NOTE 8 - SUBSEQUENT EVENTS

Effective January 1, 2000, the Company implemented a defined contribution 401(k) profit sharing plan (the Plan) for all employees. Participants must have at least three months of service and be at least 21 years of age to be eligible to participate in the Plan. Participants may make voluntary contributions to the Plan up to the maximum amount allowable by law, but not to exceed 15% of their annual compensation. Company contributions to the Plan are at the discretion of management. The Company contributions vest ratably over five years, beginning with the second year of participation.

Effective November 30, 2000, the Company merged with STRATESEC, Incorporated under an agreement whereby the Company's stockholder surrendered all issued and outstanding shares of the Company's common stock in exchange for 2,000,000 shares of STRATESEC, Incorporated common stock.

REPORT OF INDEPENDENT ACCOUNTANTS

February 6, 2001

To the Sole Stockholder and Director
of Security Systems Integrations, Inc.:

In our opinion, the accompanying balance sheet and the related statements of income and retained earnings and of cash flows present fairly, in all material respects, the financial position of Security Systems Integrations, Inc. (an S Corporation) at December 31, 1998 and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of management; our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of these statements in accordance with auditing standards generally accepted in the United States of America which 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for the opinion expressed above.

SECURITY SYSTEMS INTEGRATIONS, INC.

BALANCE SHEET

DECEMBER 31, 1998

ASSETS

Current assets

Cash and cash equivalents
Accounts receivable
Other current assets

Total current assets

Property and equipment, net

Total assets

LIABILITIES AND STOCKHOLDER'S EQUITY

Current liabilities

Accounts payable and accrued expenses
Accrued payroll and related liabilities
Billings in excess of revenue recognized
Deferred income taxes

Total current liabilities

Stockholder's equity

Common stock - no par value, 10,000 shares authorized, issued, and outstanding	
Retained earnings	
Total stockholder's equity	
Commitments	
Total liabilities and stockholder's equity	

SECURITY SYSTEMS INTEGRATIONS, INC.

STATEMENT OF INCOME AND RETAINED EARNINGS

YEAR ENDED DECEMBER 31, 1998

Revenue	$ 1,781,447
Costs and expenses	
Direct labor	226,736
Direct materials	499,636
Other direct costs	541,097
Indirect costs	207,620
	1,475,089
Income before income taxes	306,358
Provision for income taxes	(120,000)
Net income	186,358
Retained earnings, beginning of the year	0
Retained earnings, end of the year	$ 186,358

SECURITY SYSTEMS INTEGRATIONS, INC.

STATEMENT OF CASH FLOWS

YEAR ENDED DECEMBER 31, 1998

Cash flows from operating activities:

Net income

Adjustments to reconcile net income to net cash used in operating activities:
Depreciation and amortization
Deferred income taxes
Increase in:
Accounts receivable
Other current assets
Accounts payable and accrued expenses
Accrued payroll and related liabilities
Billings in excess of revenue recognized

Total adjustments

Net cash used in operating activities

Cash flows from investing activity:

Purchases of property and equipment, net

Cash flows from financing activity:

Proceeds from the sale of common stock

Net increase in cash and cash equivalents

Cash and cash equivalents, beginning of the year

Cash and cash equivalents, end of the year

SECURITY SYSTEMS INTEGRATIONS, INC.

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 1998

NOTE 1 - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Security Systems Integrations, Inc. (the "Company") was incorporated in the state of Virginia on October 10, 1997. The Company, which is privately held, provides security systems for commercial companies and agencies of the federal government.

The significant accounting policies followed by the Company are described below.

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions regarding certain types of assets, liabilities, revenues, and expenses. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, upon settlement, actual results may differ from estimated amounts.

Revenue recognition

Substantially all of the Company's contract revenue results from contracts with agencies of the federal government. Revenue on fixed-price and cost-reimbursable contracts includes direct costs and allocated indirect costs incurred plus recognized profit. Profit is recognized under fixed-price contracts on the percentage-of-completion basis. Revenue on time-and-material contracts is recognized based upon time (at established rates) and other direct costs incurred. Losses on contracts are provided for in the period they are first determined. Amounts billed in excess of revenue recognized is reflected as a liability on the accompanying balance sheet.

Cash equivalents

The Company considers all highly liquid instruments with original maturities of three months or less to be cash equivalents.

Property and equipment

Property and equipment is stated at cost less accumulated depreciation and amortization. Depreciation and amortization of property and equipment is computed using an accelerated method over the estimated useful lives of five to seven years. Amortization of leasehold improvements is computed using the straight-line method over the shorter of the estimated useful lives of the assets or the term of the related lease.

Income taxes

Income taxes have been recorded using the liability method. The income tax provision includes federal and state income taxes both currently payable and changes in deferred taxes due to differences between financial reporting and tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using the enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse.

NOTE 2 - PROPERTY AND EQUIPMENT

Property and equipment consists of the following at December 31, 1998:

Computer hardware and software	$	60,523
Vehicles		30,000

Office furniture		6,509
Leasehold improvements		2,000
		99,032
Less: accumulated depreciation and amortization		(19,067)
	$	79,965

Depreciation and amortization expense aggregated $19,067 for the year ended December 31, 1998.

NOTE 3 - INCOME TAXES

The provision for income taxes consists of the following for the year ended December 31, 1998:

Deferred income taxes		
Federal	$	101,000
State		19,000
	$	120,000

Deferred income taxes reflect temporary differences in the recognition of revenue and expenses for tax reporting and financial statement purposes. These temporary differences relate principally to the use of the cash basis of accounting for income tax purposes.

At December 31, 1998, the Company has net operating loss carryforwards available to offset future taxable income of approximately $213,000. If not used, the Company's net operating loss carryforwards will expire in 2018.

During the year ended December 31, 1998, the Company paid no income taxes.

NOTE 4 - CONCENTRATIONS OF CREDIT RISK

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist primarily of cash and cash equivalents and accounts receivable. The Company's management believes the risk of loss associated with cash and cash equivalents is very low since cash and cash equivalents are maintained in financial institutions. However, at December 31, 1998, the Company had cash and cash equivalents on deposit with a financial institution that exceeded the federally insured limit. To date, accounts receivable have been derived primarily from contracts with agencies of the federal government. Accounts receivable are generally due within 30 days and no collateral is required. The Company maintains reserves for potential credit losses and historically such losses have been insignificant and within management's expectations.

NOTE 5 - COMMITMENTS

The Company leases office space for its headquarters under the terms of a noncancelable operating lease, which expires on December 31, 2002, with its sole stockholder. The following is a schedule by year of the future minimum lease payments required under operating leases, which have initial or remaining terms in excess of one year as of December 31, 1998:

Years ending December 31,	
1999	$ 68,000
2000	125,000
2001	122,000
2002	120,000
	$ 435,000

Rent expense aggregated $23,229 for the year ended December 31, 1998.

NOTE 6 - SUBSEQUENT EVENTS

Effective January 1, 2000, the Company implemented a defined contribution 401(k) profit sharing plan (the Plan) for all employees. Participants must have at least three months of service and be at least 21 years of age to be eligible to participate in the Plan. Participants may make voluntary contributions to the Plan up to the maximum amount allowable by law, but not to exceed 15% of their annual compensation. Company contributions to the Plan are at the discretion of management. The Company contributions vest ratably over five years, beginning with the second year of participation.

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