

U. S. SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 8-K  
CURRENT REPORT

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

Date of Report (Date of earliest event reported) December 31, 1996

FORENSIC TECHNOLOGIES INTERNATIONAL CORPORATION  
(Exact name of registrant as specified in its charter)

Maryland  
(State of other jurisdiction of incorporation)

0-  
(Commission File Number)

52-1261113  
(IRS Employer Identification No.)

2021 Research Drive, Annapolis, Maryland 21401  
(Address of principal executive offices, including Zip Code)

(410) 224-8770  
(Registrant's telephone number, including area code)

FORENSIC TECHNOLOGIES INTERNATIONAL CORPORATION

ITEM 5. OTHER EVENTS

A Form 8K was previously filed on October 15, 1996 reporting the acquisition of Teklicon, Inc. The required financial statements of this acquisition were filed on Form 8K dated November 27, 1996.

In as much as, the above acquisition was accounted for as a pooling of interest, the Company's financial statements have been restated. In order to have current combined financial statements of the Company on file with the Securities and Exchange Commission, this Form 8K includes financial statements restated to include Teklicon, Inc.

ITEM 7. FINANCIAL STATEMENTS AND EXHIBITS

(a) Financial Statements. Audited financial statements of Forensic Technologies International, Corp., Inc., for the years ended December 31, 1995 and 1994.

SIGNATURES

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

FORENSIC TECHNOLOGIES INTERNATIONAL CORPORATION  
(Registrant)

By: /s/ Gary Sindler  
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Gary Sindler  
Executive Vice President and Chief  
Financial Officer

DATED: December 31, 1996

REPORT OF INDEPENDENT AUDITORS

The Board of Directors and Stockholders  
Forensic Technologies International Corporation

We have audited the accompanying consolidated balance sheets of Forensic Technologies International Corporation and subsidiary as of December 31, 1994 and 1995, and the related consolidated statements of operations, stockholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express and opinion on these financial statements based on our audits. We did not audit the fiscal year 1995 financial statements of Teklicon, Inc., a wholly owned subsidiary, which statements reflect \$941,988 of total assets at March 31, 1996 and \$3,053,564 of total revenues for the year then ended. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to data included for Teklicon, Inc., is based solely on the report of the other auditors.

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 and the report of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Forensic Technologies International Corporation and subsidiary at December 31, 1994 and 1995, and the consolidated results of their operations and their cash flows for the years then ended in conformity with generally accepted accounting principles.

Ernst & Young LLP

Baltimore, Maryland  
December 23, 1996

INDEPENDENT AUDITOR'S REPORT

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Teklicon, Inc.  
Mountain View, California

We have audited the accompanying balance sheet of Teklicon (a corporation) as of March 31, 1996 and the related statements of operations, retained earnings, and cash flows for the year then ended. 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 audit.

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 audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above represent fairly, in all material respects, the financial position of Teklicon, Inc. as of March 31, 1996, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles

/s/ Young, Craig & Co.

July 25, 1996

Forensic Technologies International Corporation and Subsidiary  
Consolidated Balance Sheets

	December 31,	
	1994	1995
ASSETS	(Restated)	(Restated)
Current assets:		
Cash and cash equivalents.....	\$ 245,918	\$ 244,925
Accounts receivable, less allowance of \$129,260 in 1994 and \$212,262 in 1995.....	3,579,920	4,633,850
Unbilled receivables, less allowance of \$79,223 in 1994 and \$164,935 in 1995.....	1,907,526	2,230,674
Deferred income taxes.....	149,923	419,310
Prepaid expenses.....	136,577	145,805
	-----	-----
Total current assets.....	6,019,864	7,674,564
Property and equipment:		
Buildings.....	--	411,241
Furniture and equipment.....	5,569,460	6,576,259
Leasehold improvements.....	469,666	677,348
	-----	-----
	6,039,126	7,664,848
Accumulated depreciation and amortization.....	(4,212,054)	(4,784,174)
	-----	-----
	1,827,072	2,880,674
Deferred income taxes.....	55,556	4,090
Other assets.....	168,235	196,662
	-----	-----
Total assets.....	\$ 8,070,727	\$ 10,755,990
	=====	=====

The accompanying notes are an integral part of these financial statements.

Forensic Technologies International Corporation and Subsidiary  
Consolidated Balance Sheets (Continued)

	December 31,	
	1994	1995
	(Restated)	(Restated)
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 610,492	\$ 1,171,201
Borrowings under line of credit	572,239	2,110,391
Accrued compensation expense	406,386	933,841
Income taxes payable	161,563	208,296
Current portion of deferred revenue	333,333	138,889
Current portion of capital lease obligations	322,251	63,463
Accrued loss on disposal of discontinued operations	--	478,828
Other current liabilities	245,752	310,554
Total current liabilities	2,652,016	5,415,463
Deferred revenue, less current portion	138,889	--
Long-term debt and capital lease obligations, less current portion	81,671	206,747
8% Convertible Subordinated Debentures, due to stockholders	1,800,000	1,800,000
Series A Redeemable Convertible Preferred Stock, \$.01 par value, stated at redemption value	1,560,000	1,560,000
Common Stock subject to repurchase	--	310,930
Commitments and contingent liabilities	--	--
Stockholders' equity:		
Common stock, \$.01 par value:		
Class A:		
Authorized shares -- 9,800,000; Shares issued and outstanding and not subject to repurchase - 2,231,613 in 1994 and 1,989,059 in 1995	22,316	19,891
Class B:		
Authorized shares -- 6,300,000; Issued and outstanding shares -- 1,688,400 in 1994 and 1,524,600 in 1995	16,884	15,246
Additional paid-in capital	987,922	850
Retained earnings	883,313	1,455,773
Less: Unearned compensation recorded upon issuance of common stock	(72,284)	(28,910)
Total stockholders' equity	1,838,151	1,462,850
Total liabilities and stockholders' equity	\$8,070,727	\$10,755,990

The accompanying notes are an integral part of these financial statements.

Forensic Technologies International Corporation and Subsidiary  
Consolidated Statements of Operations

	Years Ended December 31,	
	1994	1995
	(Restated)	(Restated)
Revenues	\$20,253,897	\$23,381,303
Direct cost of revenues	10,499,161	11,366,249
Selling, general and administrative expenses	8,319,848	9,886,791
Total costs and expenses	18,819,009	21,253,040
Other income (expenses):	1,434,888	2,128,263
Interest and other income	172,527	41,669
Interest expense	(281,850)	(263,824)
	(109,323)	(222,155)
Income from continuing operations before income taxes	1,325,565	1,906,108
Income taxes	552,278	778,665
Income from continuing operations	773,287	1,127,443
Discontinued operations:		
Loss from discontinued operations (net of income tax benefit of \$44,460)	--	(65,074)
Loss on disposal of discontinued operations (net of income tax benefit of \$248,520)	--	(365,109)
Net income	\$ 773,287	\$ 697,260
Earnings Per Share Data:		
Per common and common equivalent share:		
Income from continuing operations	\$ 0.33	\$ 0.49
Net income	\$ 0.33	\$ 0.31
Per common share, assuming full dilution:		
Income from continuing operations	\$ 0.25	\$ 0.37
Net income	\$ 0.25	\$ 0.23

The accompanying notes are an integral part of these financial statements.

Forensic Technologies International Corporation and Subsidiary  
Consolidated Statements of Stockholders' Equity (as restated)

	Class A Common Stock	Class B Common Stock	Additional Paid-in Capital	Retained Earnings
	-----	-----	-----	-----
Balance at January 1, 1994	\$22,610	\$19,152	\$1,118,754	\$339,532
Award of 323,400 shares of Class B Common Stock under the 1992 Employee Stock Bonus Award Program		3,234	8,316	
Repurchase of 550,200 shares of Class B Common Stock		(5,502)	(14,148)	
Repurchase of 29,400 shares of Class A Common Stock	(294)			(104,706)
Purchase of options to purchase 105,000 shares of Class A Common Stock			(125,000)	
Amortization of unearned compensation				
Dividends paid on Series A Redeemable Convertible Preferred Stock (\$.19 per share)				(124,800)
Net income for 1994.				773,287
	-----	-----	-----	-----
Balance at December 31, 1994	22,316	16,884	987,922	883,313
Repurchase of 163,800 shares of Class B Common Stock		(1,638)	(4,212)	
Repurchase of 184,514 shares of Class A Common Stock	(1,845)		(722,510)	
Amortization of unearned compensation				
Dividends paid on Series A Redeemable Convertible Preferred Stock (\$.19 per share)				(124,800)
Reclassification of Class A Common Stock subject to repurchase	(580)		(310,350)	
Other			50,000	
Net income for 1995				697,260
	-----	-----	-----	-----
Balance at December 31, 1995	\$19,891	\$15,246	\$ 850	\$1,455,773
	=====	=====	=====	=====

	Unearned Compensation	Total
	-----	-----
Balance at January 1, 1994.	\$(139,073)	\$ 1,360,975
Award of 323,400 shares of Class B Common Stock under the 1992 Employee Stock Bonus Award Program		11,550
Repurchase of 550,200 shares of Class B Common Stock		(19,650)
Repurchase of 29,400 shares of Class A Common Stock		(105,000)
Purchase of options to purchase 105,000 shares of Class A Common Stock		(125,000)
Amortization of unearned compensation	66,789	66,789
Dividends paid on Series A Redeemable Convertible Preferred Stock (\$.19 per share)		(124,800)
Net income for 1994		773,287
	-----	-----
Balance at December 31, 1994	(72,284)	1,838,151
Repurchase of 163,800 shares of Class B Common Stock		(5,850)
Repurchase of 184,514 shares of Class A Common Stock		(724,355)
Amortization of unearned compensation	43,374	43,374
Dividends paid on Series A Redeemable Convertible Preferred Stock (\$.19 per share)		(124,800)
Reclassification of Class A Common Stock subject to repurchase		(310,930)
Other		50,000
Net income for 1995		697,260
	-----	-----
Balance at December 31, 1995	\$ (28,910)	\$ 1,462,850
	=====	=====

The accompanying notes are an integral part of these financial statements.

Forensic Technologies International Corporation and Subsidiary  
Consolidated Statements of Cash Flows

	Years Ended December 31,	
	1994	1995
	(Restated)	(Restated)
Cash flow from operating activities		
Net income	\$ 773,287	\$ 697,260
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	864,596	637,837
Amortization	17,152	20,835
Non-cash compensation	66,789	43,374
Provision for doubtful accounts	41,370	168,714
Deferred income taxes	(139,424)	(217,921)
Loss on disposal of assets	--	26,281
Loss on disposal of discontinued Annapplix division	--	613,629
Gain on sale of technology	(121,989)	--
Changes in operating assets and liabilities:		
Unbilled receivables	(307,329)	(423,885)
Accounts receivable	28,624	(971,907)
Income taxes refundable	121,867	--
Prepaid expenses	45,367	(9,228)
Accounts payable	(317,408)	560,709
Accrued compensation expense	59,885	527,455
Income taxes payable	166,297	96,732
Deferred revenue	(333,333)	(333,333)
Other current liabilities	(214,624)	64,802
Net cash provided by operating activities	751,127	1,501,354
Cash flow from investing activities		
Proceeds from sale of marketable securities	202,370	--
Purchase of property and equipment	(625,454)	(1,608,939)
Proceeds from sale of property and equipment	--	22,608
Acquisition of Applix Software Computer Service	--	(200,000)
Purchase of other assets	(96,934)	(40,975)
Net cash used in investing activities	(520,018)	(1,827,306)
Cash flow from financing activities		
Proceeds from issuance of Class B Common Stock	11,550	--
Repurchase of Class B Common Stock	(19,650)	(5,850)
Repurchase of Class A Common Stock and purchase of options to purchase Class A Common Stock	(65,000)	(724,355)
Net borrowings (repayments) under line of credit	(242,761)	1,538,152
Payments of capital lease obligations	(434,970)	(358,188)
Dividends paid	(124,800)	(124,800)
Net cash provided by (used in) financing activities	(875,631)	324,959
Net decrease in cash and cash equivalents	(644,522)	(993)
Cash and cash equivalents at beginning of year	890,440	245,918
Cash and cash equivalents at end of year	\$ 245,918	\$ 244,925

The accompanying notes are an integral part of these financial statements.



FORENSIC TECHNOLOGIES INTERNATIONAL CORPORATION AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 1995

1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation of Financial Statements

Description of Business

Forensic Technologies International Corporation and Subsidiary (the Company) provides communication, engineering, and other trial support services to the litigation industry. These services include event investigation and analysis, expert testimony, courtroom visual presentation, computer animation and simulation, jury analysis and selection, exposure assessment and computerized document storage and retrieval. The Company has seven offices serving all regions of the United States.

On September 30, 1996 the Company acquired all of the outstanding common stock of Teklicon, Inc. ("Teklicon") in exchange for 415,000 shares of common stock. The acquisition was accounted for as a pooling of interests and, accordingly, the Company's financial statements have been restated for all periods prior to the merger to include the financial position, results of operations, and cash flows of Teklicon. The accompanying consolidated balance sheets at December 31, 1994 and 1995 include the financial position of Teklicon at March 31, 1995 and March 31, 1996, respectively, the fiscal year-end of Teklicon. The accompanying consolidated statements of operations, stockholders' equity and cash flows for the years ended December 31, 1994 and 1995 include the results of operations and cash flows of Teklicon for its fiscal years ended March 31, 1995 and 1996, respectively.

Principles of Consolidation

The consolidated financial statements include the accounts of a wholly-owned subsidiary. All significant intercompany transactions have been eliminated.

FORENSIC TECHNOLOGIES INTERNATIONAL CORPORATION AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 1995 - (Continued)

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

The Company uses estimates to determine the amount of the allowance for doubtful accounts necessary to reduce accounts receivable and unbilled receivables to their expected net realizable value. The Company estimates the amount of the required allowance by reviewing the status of significant past-due receivables and analyzing historical bad debt trends. The Company has not experienced significant variations in the estimate of the allowance for doubtful accounts, due primarily to credit policies, collection experience, and a lack of concentration of accounts receivable.

Significant Accounting Policies

Cash Equivalents

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

Property and Equipment

Property and equipment is stated at cost and depreciated using the straight-line method. Buildings are depreciated over a period of 40 years, furniture and equipment is depreciated over estimated useful lives ranging from 5 to 7 years, and leasehold improvements are amortized over the lesser of the estimated useful life of the asset or the lease term.

FORENSIC TECHNOLOGIES INTERNATIONAL CORPORATION AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 1995 - (Continued)

Revenue Recognition

The Company derives most of its revenues from professional service activities. The majority of these activities are provided under "time and materials" billing arrangements, and revenues, consisting of fees and expenses, are recorded as work is performed and expenses are incurred. Revenues recognized in excess of amounts billed to clients have been recorded as unbilled receivables in the accompanying consolidated balance sheets.

The Company also enters into fixed price contracts for its litigation support services that are accounted for using the percentage-of-completion method. Income for these contracts is recognized based on the percentage of contract completion determined by the total expenses incurred to date as a percentage of total estimated expenses at the completion of the contract.

Direct Cost of Revenues

Direct cost of revenues consists primarily of billable employee compensation and related payroll benefits, the cost of consultants assigned to revenue generating activities, and direct expenses billable to clients. Direct cost of revenues does not include an allocation of overhead costs.

Accounting for Impairment of Long-lived Assets and for Long-lived Assets to Be Disposed of

In 1995 the Company adopted the provisions of Financial Accounting Standards Board Statement No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of, issued in March 1995. The Statement prescribes the accounting for the impairment of long-lived assets, such as property, plant and equipment and intangible assets, as well as the accounting for long-lived assets that are held for disposal. The adoption of this Statement in 1995 did not have a material impact on the reported results of operations of the Company.

Under Statement No. 121, the Company is not required to actively search for impairments of assets that are employed in the business or to perform an asset-by-asset analysis to determine whether an impairment exists. Instead, a review is necessary only when events or circumstances indicate that an impairment might exist. When one or more indicators are present, assets are grouped at the lowest level for which there are identifiable cash flows. Then the expected future undiscounted cash flows from the use and eventual disposal of each group of assets are estimated and compared with the carrying amount of that group of assets. If the sum of the estimated undiscounted cash flows is less than the carrying amount of the assets, an impairment loss will be recorded. The impairment loss is measured by comparing the fair value

FORENSIC TECHNOLOGIES INTERNATIONAL CORPORATION AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 1995 - (Continued)

of the assets with their carrying amount. Assets held for disposal are reported at the lower of the assets' carrying amount or fair value less costs related to the assets' disposition.

Stock Options Granted to Employees

The Company records compensation expense for all stock-based compensation plans using the intrinsic value method prescribed by APB Opinion No. 25, Accounting for Stock Issued to Employees. In October 1995 the Financial Accounting Standards Board issued FASB Statement No. 123, Accounting for Stock-Based Compensation, which encourages companies to recognize expense for stock-based awards based on their estimated value on the date of grant. Statement No. 123, effective for 1996, does not require companies to change their existing accounting for stock-based awards, but if the new fair value method is not adopted, pro forma income and earnings per share data should be provided in the footnotes to the financial statements. The Company intends to continue to account for stock-based compensation plans using the intrinsic value method, and will supplementally disclose in its 1996 consolidated financial statements the required pro forma information as if the fair value method had been adopted.

Income Taxes

The Company uses the liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

FORENSIC TECHNOLOGIES INTERNATIONAL CORPORATION AND SUBSIDIARY  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 DECEMBER 31, 1995 - (Continued)

2. EARNINGS PER SHARE

The following table summarizes the computations of share amounts used in the computation of earnings per share presented in the accompanying consolidated statements of operations.

	December 31,	
	1994	1995
	(Restated)	(Restated)
<b>COMMON AND COMMON EQUIVALENT SHARES:</b>		
Weighted average number of common stock outstanding during the period	2,279,063	2,157,606
Options to purchase common stock issued within one year of registration statement.	41,700	41,700
Dilutive effect of other options and warrants.	41,686	83,530
	2,362,449	2,282,836
	2,362,449	2,282,836
<b>COMMON SHARES, ASSUMING FULL DILUTION:</b>		
Weighted average number of shares of common stock outstanding during the period	2,279,063	2,157,606
Options to purchase common stock issued within one year of registration statement.	41,700	41,700
Dilutive effect of other options and warrants	41,686	125,373
Assumed conversion of Series A Redeemable Convertible Preferred Stock.	655,200	655,200
Assumed conversion of 8% Convertible Subordinated Debentures	378,000	378,000
	3,395,649	3,357,879
	3,395,649	3,357,879

FORENSIC TECHNOLOGIES INTERNATIONAL CORPORATION AND SUBSIDIARY  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 DECEMBER 31, 1995 - (Continued)

Earnings per common and common equivalent share is based upon the average number of shares of common stock outstanding during each year, adjusted for the dilutive effect of common stock equivalents determined using the treasury stock method. The computations also assume that the dilutive effect (determined using the treasury stock method) of certain options and warrants issued within one year of the Company's initial filing to register common stock for sale to the public in March 1996 are outstanding for all periods, as required by the SEC.

Earnings per common share, assuming full dilution, is calculated on the same basis as the previously described primary computation, except that the calculation in 1994 and 1995 assumes that the Series A Redeemable Convertible Preferred Stock and the 8% Convertible Subordinated Debentures were converted on the first day of the fiscal year, and that the fair value of the Company's common stock on the last day of the fiscal year (rather than the average fair value during the year) is used to determine the dilutive effect of stock options.

3. SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

The Company paid interest of \$276,839 and \$491,375 and income taxes of \$408,272 and \$628,984 during fiscal years 1994 and 1995, respectively.

The Company entered into the following non-cash investing and financing activities:

	Years ended December 31,	
	1994	1995
Acquisition of equipment under capital leases	\$ 47,305	\$ 175,368
Redemption of Class A Common Stock and purchase of option to purchase Class A Common Stock in exchange for software	\$165,000	\$ --

4. ACQUISITIONS AND DISCONTINUED OPERATIONS

On September 30, 1996, the Company issued 415,000 shares of its common stock for all of the outstanding common stock of Teklicon. Teklicon is based in Mountain View, California and provides expert witness testimony to attorneys and businesses. The merger has been accounted for as a pooling-of-interests and, accordingly, the Company's financial statements have been restated for all periods prior to the acquisition to include the financial position, results of operations and cash flows of Teklicon. Revenues and net income for the individual entities are as follows:

	Forensic Technologies International Corporation	Teklicon	Combined
Year Ended	-----	-----	-----
December 31, 1994:			
Revenues	\$ 17,547,055	\$ 2,706,842	\$ 20,253,897
Net income	\$ 638,830	\$ 134,457	\$ 773,287
December 31, 1995:			
Revenues	\$ 20,327,739	\$ 3,053,564	\$ 23,381,303
Net income (loss)	\$ 705,893	\$ (8,633)	\$ 697,260

On February 1, 1995, the Company acquired for \$200,000 in cash certain assets of a sole proprietorship doing business as "Applix Software Computer Service", and formed the Annapplix division of the Company. The Annapplix division is a provider of general data processing consulting services and network administration services, and is considered a separate segment of the Company's operations.

FORENSIC TECHNOLOGIES INTERNATIONAL CORPORATION AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 1995 - (Continued)

The acquisition was accounted for using the purchase method of accounting and the results of operations of the acquired business are included in the accompanying 1995 consolidated statement of operations from February 1, 1995, the date of acquisition, through December 31, 1995. The excess of the cost of the acquisition over the fair value of the assets acquired of \$135,604 was recorded as goodwill and is amortized using the straight-line method over 15 years.

In January 1996, the Board of Directors and management of the Company committed to a formal plan to sell the Annapplix division based on an assessment that the division was not complementary to its core litigation support services. In March 1996, the Company agreed to sell the division to a group including the former owner, who currently manages the division as an officer of the Company, and certain other officers and stockholders of the Company. The Company sold the furniture, equipment, and intangible assets of the division in exchange for cash of \$150,000, and retained ownership of billed and unbilled accounts receivable, buildings and accounts payable. The effective date of the sale was April 1, 1996.

The Company has recorded the results of operations and estimated loss on the sale of Annapplix as a discontinued operation in the 1995 consolidated financial statements. The estimated loss on the sale of \$365,109 includes an accrual of \$285,000 for the estimated operating losses, net of the related income tax benefit, for the period from January 1, 1996 through March 31, 1996, the date of disposal.

During 1995, Annapplix reported revenues of \$3.2 million and loss before an income tax benefit of \$109,534. Expenses attributable to the segment include interest expense related to debt incurred to purchase assets used by the division and an allocation of \$80,000 of other consolidated interest that is not directly attributable to or related to other operations. The allocated interest, consisting of interest expense on the line of credit, is allocated based on the ratio of the net assets to be sold to total consolidated net assets excluding the balance of the line of credit.

5. BORROWINGS UNDER LINE OF CREDIT

The Company has a demand line of credit with a bank due on May 31, 1996 under which the Company may borrow up to \$3.1 million, subject to restrictions based on the available collateral. Borrowings under this line of credit bear interest at the London Interbank Offered Rate plus 2.5%, and are secured by all of the Company's assets not otherwise pledged as collateral. The estimated average borrowing rate during 1994 and 1995 was 8.1% and 8.3%, respectively. In connection with this credit line, the Company is required to maintain a minimum tangible net worth and comply with certain other financial ratios and covenants.

FORENSIC TECHNOLOGIES INTERNATIONAL CORPORATION AND SUBSIDIARY  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 DECEMBER 31, 1995 - (Continued)

6. DEFERRED REVENUE

On June 22, 1993, the Company entered into an agreement with an unrelated entity whereby the Company agreed to market the entity's litigation consulting related services and granted to the entity the exclusive worldwide right to market the Company's litigation consulting related products and services through May 31, 1996. In consideration for this agreement, the Company was paid \$1,000,000, which is being recognized as revenue over the term of the agreement. For the years ended December 31, 1994 and 1995, the Company has recognized \$333,333, and \$333,333, respectively, as revenue. At December 31, 1995, the remaining \$138,889 is recorded as deferred revenue in the balance sheet.

7. LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS

Long-term Debt

Long-term debt consists of a \$79,920 mortgage note payable to a bank bearing interest at the prime rate plus 1.5% and secured by the related building. The note requires monthly payments of \$444 through December 1, 1998 and a lump-sum payment of the entire principal on January 1, 1999.

Capital Leases

The Company leases furniture and equipment under capital leases. Property and equipment includes the following amounts for leases that have been capitalized:

	1994	1995
Furniture and equipment	\$ 2,395,701	\$ 2,476,290
Less accumulated amortization	1,996,887	2,148,630
	\$ 398,814	\$ 327,660

Amortization of leased assets is included in depreciation and amortization expense.

Future minimum payments under capital lease obligations consist of the following at December 31, 1995:



FORENSIC TECHNOLOGIES INTERNATIONAL CORPORATION AND SUBSIDIARY  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 DECEMBER 31, 1995 - (Continued)

1996	\$ 74,590
1997	49,455
1998	33,022
1999	31,857
2000	28,898
	-----
Total minimum lease payments	217,822
Amounts representing interest	27,532
	-----
Present value of net minimum lease payments (including current portion of \$63,463)	\$190,290
	=====

8. CONVERTIBLE SUBORDINATED DEBENTURES

On July 21, 1994 the Company issued \$1,800,000 of 8% Convertible Subordinated Debentures to its stockholders, due no later than July 15, 2000. The Debentures bear interest at a rate of 8% per annum, payable semi-annually on January 15 and July 15, beginning on January 15, 1994. The Company may, at its option, pay any accrued interest due by issuing additional debentures. During 1994 and 1995, the Company expensed and paid \$144,000 of interest to the holders of the Debentures.

In May 1996 the Company completed its initial public offering and the Debentures converted into 378,151 shares of Class A Common Stock.

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9. SERIES A REDEEMABLE CONVERTIBLE PREFERRED STOCK AND CLASS A COMMON STOCK

The Company had authorized the issuance of 655,200 shares of Series A Redeemable Convertible Preferred Stock ("Preferred Stock"). At December 31, 1994 and 1995, 655,200 shares were outstanding. Each share of Preferred Stock converted into 655,200 shares of Class A Common Stock immediately prior to the closing of the Company's initial public offering in May 1996. The holders of the Company's Preferred Stock had certain rights, including redemption rights, as described below.

Rights of Holders of Series A Redeemable Convertible Preferred Stock

The holders of the Preferred Stock were entitled to receive, when declared by the Board of Directors, cumulative semi-annual dividends at the annual rate of \$.19 per share.

Each share of Preferred Stock had a preference on liquidation of \$2.38 per share plus accrued and unpaid dividends, and was convertible at the option of the holder at any time into an equivalent number of shares of Class A Common Stock, subject to adjustment in certain circumstances.

Each share of Preferred Stock was subject to redemption at any time after May 8, 1996 for \$2.38 per share at the option of the holder.

The holders of Preferred Stock had substantially the same voting rights as the holders of Class A Common Stock.

Shares Reserved for Future Issuance

The Company has reserved 1,291,105 shares of Class A Common Stock for future issuance upon the conversion of 8% Convertible Subordinated Debentures, Series A Redeemable Convertible Preferred Stock, Class B Common Stock and outstanding stock options.

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10. EMPLOYEE STOCK BONUS AWARD PROGRAM AND CLASS B COMMON STOCK

The Company has adopted the 1992 Employee Stock Bonus Award Program (the Program) which authorized the issuance of 1,500,000 shares of Class B Common Stock. Each employee under the level of senior management is eligible to receive shares under the Program. The Company issued 323,400 shares during 1994, under the Program. Compensation charged to selling, general and administrative expense during 1994 related to these awards was \$11,550.

The Company determines the amount of compensation expense to record based on an estimate of the value of the Class B Common Stock at the date of grant, as approved by the Board of Directors. The estimated value of 100 shares of Class B Common Stock is equal to the estimated value of one share of Class A Common Stock (the conversion rate of Class B Common Stock into Class A Common Stock). The estimated value of Class B Common Stock granted to employees was \$.0357 per share in 1994.

The holders of the Class B Common Stock are not entitled to vote on any matter submitted to a vote of stockholders, nor do they have any preemptive rights. Subject to the preference of the Preferred Stock, dividends will be declared and paid on the Class B Common Stock whenever dividends are declared and paid on the Class A Common Stock. The amount of dividend payable to each holder of Class B Common Stock is the dividend that would be received if the Class B Common Stock were converted into shares of Class A Common Stock.

The Class B Common Stock automatically converted into 15,246 shares of Class A Common Stock upon the closing of the Company's initial public offering in May 1996.

11. RESTRICTED STOCK GRANTS

During 1991, the Company approved a stock issuance whereby key employees were granted and issued 201,839 restricted shares of the Company's Class A Common Stock subject to certain vesting provisions expiring in equal annual amounts over a four-year period. As of December 31, 1994, all of these shares were fully vested.

During 1992, the Company awarded an additional 72,853 shares of restricted Class A Common Stock to a key employee, subject to certain vesting provisions expiring in equal annual amounts over a four-year period. As of December 31, 1995, 12,142 of these shares remain subject to vesting provisions.

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The market value of the shares awarded was recorded as unearned compensation at the date of issuance and reported as a separate component of stockholders' equity. The unearned compensation is being charged to expense as earned over the four-year vesting period. Compensation charged to selling, general and administrative expense was \$66,789 and \$43,365 in 1994, and 1995, respectively.

12. STOCK OPTION PLAN

The 1992 Stock Option Plan was approved by the stockholders of the Company in May 1992. The plan provides for the granting to key employees and directors of incentive and non-qualified stock options to purchase up to 1,212,548 shares of Class A Common Stock. Incentive stock options granted under the plan allow for the purchase of Class A Common Stock at prices not less than the fair market value of the Class A Common Stock at the date of grant for a term of no more than ten years. Non-qualified stock options granted under the plan allow for the purchase of Class A Common Stock at prices not less than 50% of the fair market value of the Class A Common Stock at the date of grant, for a term of no more than ten years. Vesting provisions for individual awards are at the discretion of the Board of Directors.

The following table summarizes the option activity under the Plan for the two-year period ended December 31, 1995:

	1994	1995
	-----	-----
Options outstanding at January 1	125,059	209,059
Options granted.....	84,000	35,700
Options exercised.....	--	--
Options forfeited.....	--	(2,100)
	-----	-----
Options outstanding at December 31.....	209,059	242,659
	=====	=====
Options exercisable at December 31.....	--	103,849
	=====	=====
Average exercise price per share for options granted during the year	\$ 3.57	\$ 4.76
	=====	=====
Weighted-average exercise price per share of outstanding options at end of year.....	\$ 2.86	\$ 3.13
	=====	=====

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13. FAIR VALUES OF FINANCIAL INSTRUMENTS

The carrying amount of the Company's financial instruments, consisting primarily of cash and cash equivalents, accounts receivable, unbilled receivables, accounts payable, and borrowings under the line of credit approximate fair value. The 8% Convertible Subordinated Debentures and Convertible Redeemable Preferred Stock automatically converted into Class A Common Stock upon the closing of the Company's initial public offering in May 1996. Because of the conversion, the securities are not considered financial instruments.

14. INCOME TAXES

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

	1994	1995
	-----	-----
Deferred tax assets:		
Allowance for doubtful accounts	\$ 83,393	\$150,879
Loss on disposal of discontinued Annapplix division	--	246,097
Accrued vacation	34,643	64,030
Deferred revenue	188,889	55,556
Other	6,666	10,756
Total deferred tax assets	----- 313,591	----- 527,318
Valuation allowance for deferred tax assets	--	--
Deferred tax assets after valuation allowance	----- 313,591	----- 527,318
Deferred tax liability:		
Use of cash basis for income tax purposes by Teklicon, Inc.	82,895	79,831
Prepaid expenses	25,217	24,087
Net deferred tax asset	----- \$205,479 =====	----- \$423,400 =====

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Income tax expense attributable to continuing operations consisted of the following:

	1994	1995
	-----	-----
Current:		
Federal.....	\$ 538,378	\$575,119
State.....	152,147	152,085
	-----	-----
	690,526	727,204
Deferred (benefit):		
Federal.....	(108,247)	37,714
State.....	(30,001)	13,747
	-----	-----
	(138,248)	51,461
	-----	-----
	\$ 552,278	\$778,665
	=====	=====

The Company's provision for income taxes resulted in effective tax rates that varied from the statutory federal income tax rate as follows:

	1994	1995
	-----	-----
Expected federal income tax provision at 34%	\$450,692	\$648,077
Expenses not deductible for tax purposes	20,886	31,383
State income taxes, net of federal benefit	74,375	107,295
Other	6,325	(8,090)
	-----	-----
	\$ 552,278	\$ 778,665
	=====	=====

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15. OPERATING LEASES

The Company leases office space under noncancelable operating leases that expire in various years through 2003. The leases for certain office space contain provisions whereby the future rental payments may be adjusted for increases in maintenance and insurance above specified amounts. The Company also leases certain furniture and equipment in its operations under operating leases having initial terms of less than one year.

Future minimum payments under noncancelable operating leases with initial terms of one year or more consist of the following at December 31, 1995:

1996	\$ 746,512
1997	757,588
1998	732,741
1999	590,481
2000	345,155
Thereafter	1,148,484
	-----
Total minimum lease payments	\$4,320,961
	=====

Rental expense consists of the following for the year ended December 31, :

	1994	1995
	-----	-----
Furniture and equipment	\$ 79,450	\$ 99,146
Office and storage	863,280	818,962
	-----	-----
	\$942,730	\$918,108
	=====	=====

16. EMPLOYEE BENEFIT PLAN

The Company maintains a qualified defined contribution plan which covers substantially all employees. Under the plan, participants are entitled to make both pre-tax and after-tax contributions. The Company matches a percentage of participant contributions, limited to 6% of the participant's eligible compensation. The percentage match is based on each participant's respective years of service. The Company recorded expense of \$102,175, and \$116,201, during 1994 and 1995, respectively, related to this plan.

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17. COMMITMENTS

The Company has entered into an agreement with a former employee to repurchase or cause another to purchase 29,018 shares of Class A Common Stock at \$4.76187 per share in January 1996 and 29,022 shares of Class A Common Stock at \$5.95238 per share in January 1997. The former employee retains all ownership rights in the Class A Common Stock until repurchase. This commitment of \$310,930 is classified as Common Stock subject to repurchase in the accompanying balance sheet at December 31, 1995. In January 1996 the Company paid the former employee the installment due of \$138,180 and retired the Common Stock repurchased.

18. SUBSEQUENT EVENTS

On January 12, 1996, the Board of Directors approved the issuance of options to purchase 184,800 shares of Class A Common Stock to key employees. The exercise price of the granted shares is \$6.38 per share, or the estimated fair market value of a share of Class A Common Stock at the date of grant, and the options vest ratably over a three-year period. These options are included in the earnings per share computation, as discussed in Note 2, Earnings Per Share.

On January 26, 1996, the Board of Directors approved a 4.2-for-1 stock split of the Company's Class A Common Stock. The application of anti-dilution provisions effectively resulted in a 4.2-for-1 split of the Class B Common Stock and Series A Redeemable Preferred Stock. The stated par values of the common and preferred stocks were not changed. All share and per share amounts have been restated to retroactively reflect the split of the Class A Common Stock and effective split of the Class B Common Stock and Series A Redeemable Preferred Stock.

The Board of Directors on January 26, 1996 advised, and at the March 20, 1996 annual meeting of stockholders, the stockholders approved, amended and restated articles of incorporation that, among other things changed the authorized number of shares of preferred stock of all classes to 4,000,000 shares upon the closing of the initial public offering in May 1996. Upon the closing of the initial public offering, no shares of preferred stock were outstanding.