

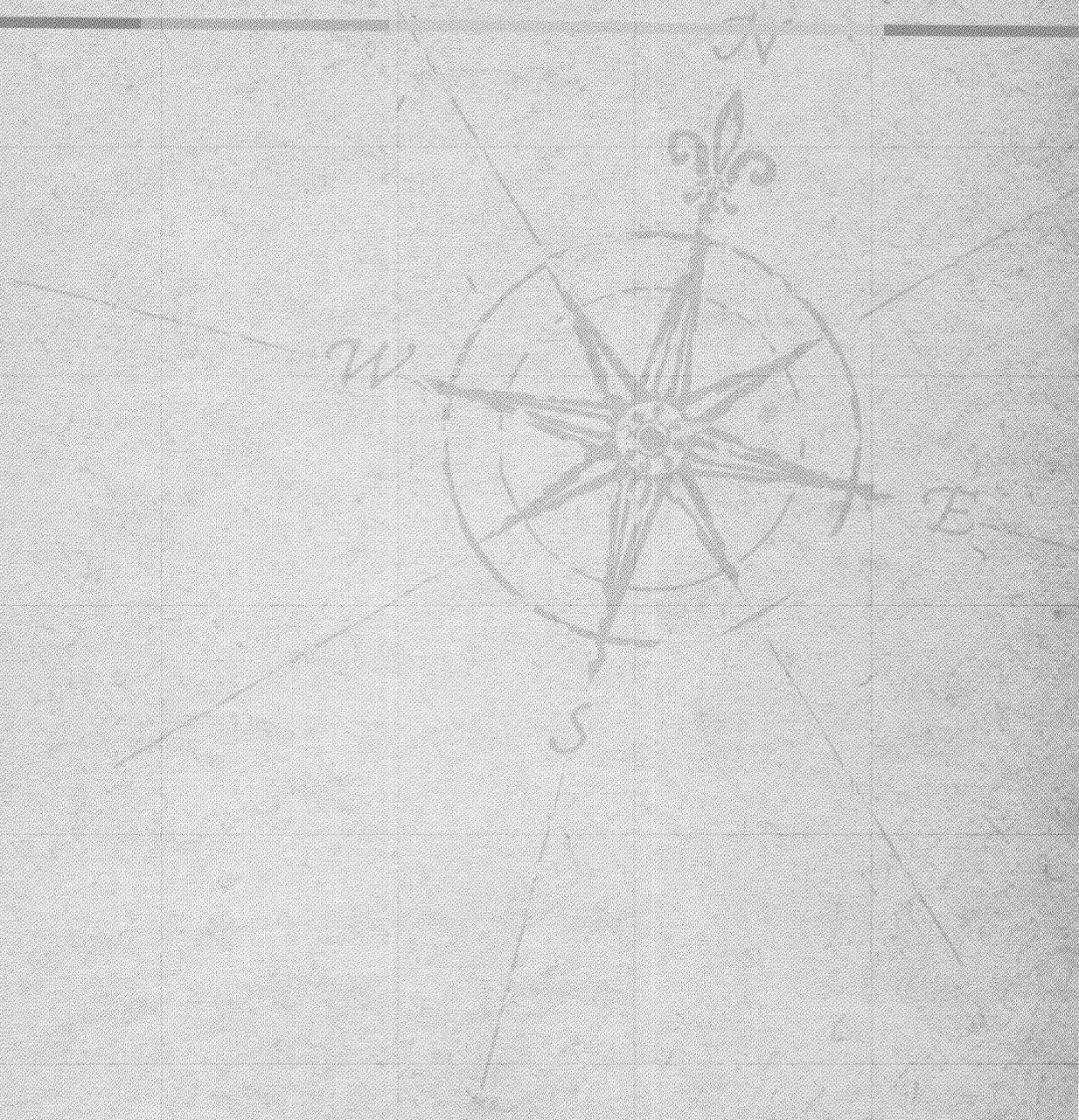


Technology Outfitters

Computers. Software. Innovations.

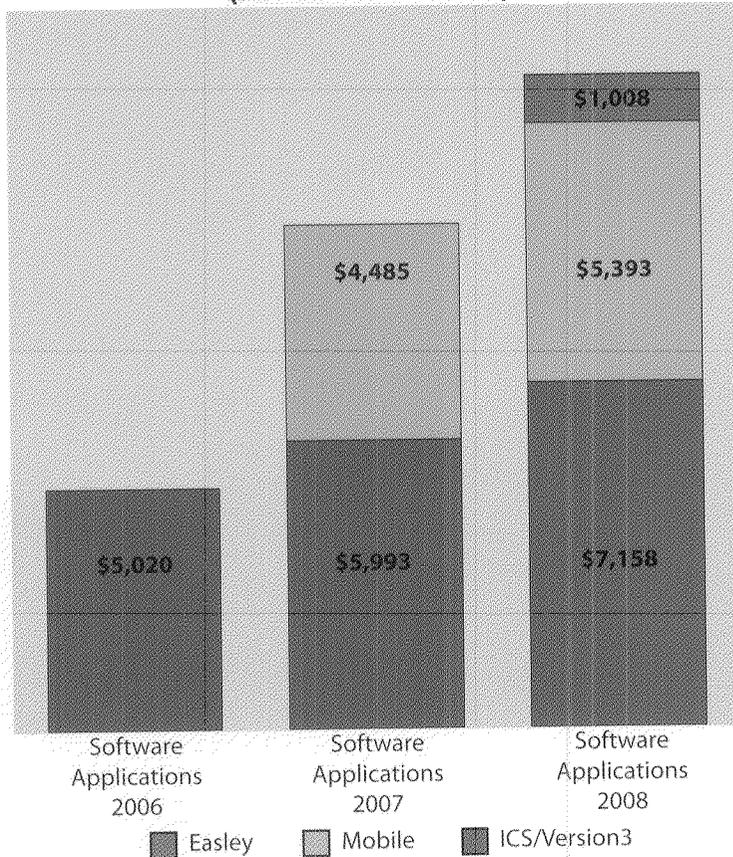


2008 ANNUAL REPORT



TECHNOLOGY
OUTFITTERS

**Software Sales
(Amounts in 000s)**

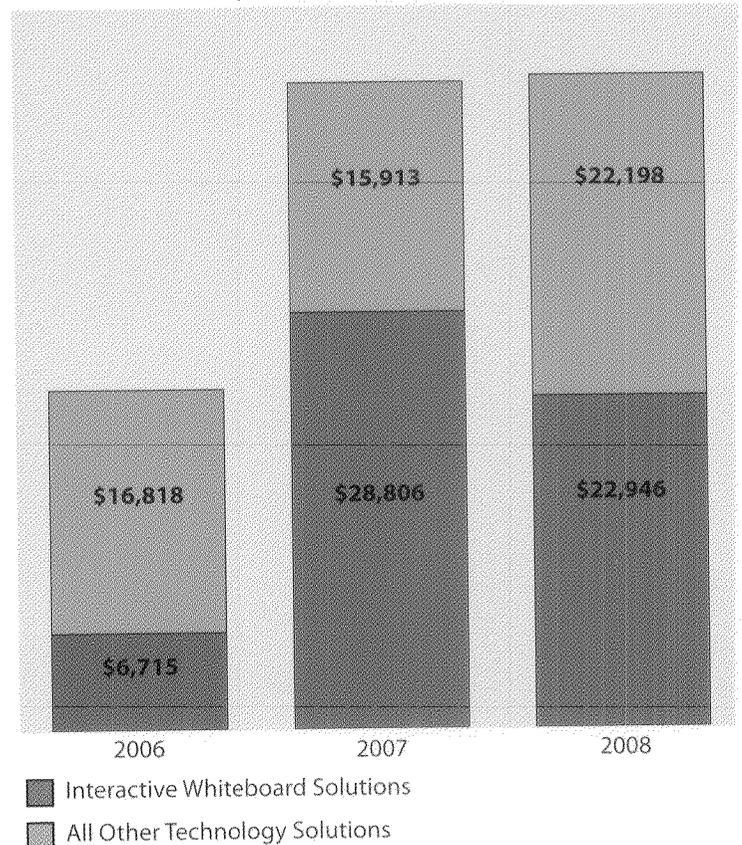


“2008 continued to be an exciting year for our Software Segment as we increased revenue by 29%. Our CSI-Easley and CSI-Mobile segments grew organically 20%, and the acquisitions of ICS and Version3 during the year added another \$1 million in revenue.

We are striving to build the intellectual property portion of our business as well as increase the recurring revenue generated by our software support contracts. We are looking forward to having ICS and Version3 on board for the full year of 2009.”

- Nancy Hedrick, CEO

**Technology Sales
(Amounts in 000s)**



“While the interactive whiteboard and related technologies remained a significant part of our technology segment, we achieved more balance in this area of the business through growth in our infrastructure technology sales. As the Federal Stimulus Package funds are released, we anticipate a positive impact on our technology segment revenues, especially for the interactive classroom technologies and one-to-one laptop initiatives.”

- Nancy Hedrick, CEO

Letter to Shareholders

CSI Shareholders,

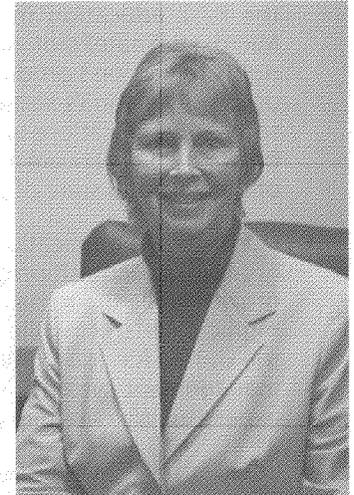
Computer Software Innovations experienced modest growth in our 2008 fiscal year. The Company continued to focus on both organic and acquisition growth opportunities and we are pleased to report success in both. While the economic downturn swirled around us, our CSI Technology Outfitters' team continued to perform and delivered good results. I want to thank them for their efforts during such trying economic times.

- CSI's revenues increased by \$3.5 million or 6% to \$58.7 million.
- Gross profit was approximately \$12.8 million, an increase of \$1.5 million or 13% over 2007.
- Net income was \$1.3 million or earnings of \$0.25 per basic share and \$0.11 per diluted share in 2008 compared with a net income of \$1.7 million or earnings of \$0.46 per basic and \$0.14 per diluted share in 2007.

The Company executed its business strategy to expand geographically while continuing to penetrate more deeply into its existing client base. Our focus on the public sector markets (including the education sector) has served us well. We completed two acquisitions in 2008 growing our customer base, revenues, and focus on proprietary software solutions for the public sector. We continue to focus on efforts to expand our client base to gain economies of scale, including increased technology cross-selling into the acquired Alabama territory. We believe these efforts create potential for the Company to continue its moderate growth into 2009 even as the economic downturn continues. We believe the costs for these efforts will be offset by improved market position and financial performance as we emerge from the current economic crisis. It is our hope the education portion of the American Recovery and Reinvestment Act (the federal stimulus package) will further enhance our financial performance.

We achieved many successes during 2008:

- CSI acquired ICS Systems, Inc. based in Greensboro, North Carolina in April, 2008. The ICS operations have a successful 25-year history in providing municipal financial management solutions, including fund accounting and billing software, hardware, and consultation. The acquisition provides CSI strategic advantages with ICS's valuable market experience and increased penetration in its local government market space. During 2008 we began cross selling our software solutions into the ICS client base.
- CSI also acquired Version3, Inc. based in Columbia, South Carolina in August, 2008.



Nancy Hedrick
Chief Executive Officer and President

Summary of Financial Data					
Amounts in Thousands (000's)					
	2004	2005	2006	2007	2008
Income Statement Data					
Gross Sales	\$22,481	\$ 24,287	\$ 28,554	\$55,197	\$58,703
Cost of Sales	15,412	17,741	22,181	43,876	45,885
Gross Profit	7,069	6,546	6,373	11,321	12,818
SG&A Expense	4,535	6,732	6,616	8,175	9,791
Operating Income (Loss)	2,534	(186)	(243)	3,146	3,027
Income (Loss) Before Income Taxes	2,554	(919)	(978)	2,596	2,378
Net Income (Loss)	1,522	(757)	(879)	1,741	1,342
Per Share Data					
EPS - Basic	\$0.58	\$(0.29)	\$(0.27)	\$0.46	\$0.25
EPS - Diluted	0.58	(0.29)	(0.27)	0.14	0.11

Computer Software Innovations, Inc. (OTCBB:CSWI) is a full service company providing software and technology solutions primarily to public sector organizations. The software solutions include financial management, billing and revenue management, school activity accounting, lesson planning and automated workflow. The technology solutions include IP telephony, IP video surveillance, visual communications, interactive classrooms, network security and traffic monitoring, infrastructure design, wireless solutions, network management, engineering services and hardware solutions. CSI's client base includes school districts, higher education, municipalities, county governments, and other non-profit organizations. Currently, more than 900 public sector organizations utilize CSI's software systems and network integration services. Additional information on CSI can be obtained through its website at www.csioutfitters.com.

Letter to Shareholders (cont.)

Version3 has a portfolio of applications and services that are ideal for the public sector markets served by CSI, particularly the K-12 education market space. The applications include single sign-on, access management, provisioning, and Microsoft SharePoint deployments. The acquisition provides CSI strategic advantages including exercising exclusive rights to Version3 products, infusing CSI product roadmaps with Version3's expert-level Microsoft SharePoint experience, utilizing Version3's software development team, and expanding to a national and international footprint with Version3 software applications which do not require customization for each state. The Version3 solutions provide a natural bridge between our software and technology segments as we are able to wrap systems engineering services around the delivery of the Version3 suite of products.

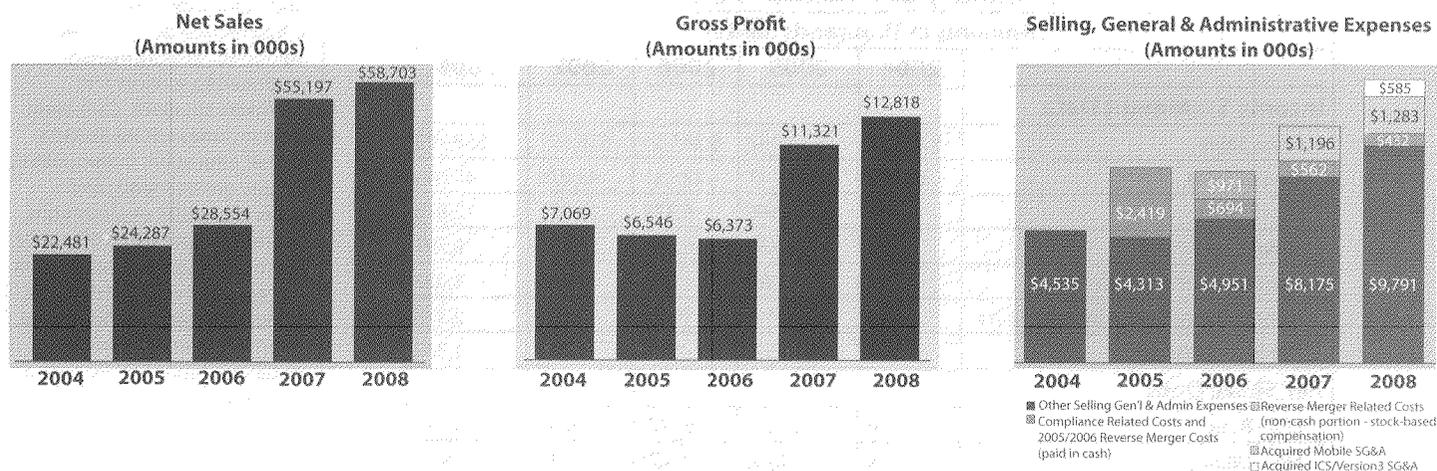
- Our software applications segment increased sales by 29% in 2008 over 2007. This increase was fueled by both organic growth and acquisition growth from the addition of ICS Systems and Version3. 67% of the increased sales was from organic growth while the remaining 33% was from acquisitions. The ICS acquisition expanded penetration in the North Carolina municipal market while the Version3 expanded our client base nationally and internationally (with clients in Canada and the United Kingdom). We continued development and deployment of several add-on solutions for our various financial management systems in 2008 and increased our focus on SharePoint development with the addition of the Version3 expertise. We continue to gain deeper penetration with our financial management systems throughout the Southeast.
- SmartFusion™, the .Net/SQL version of our financial management software, was released in early 2007 to selected accounts. The solution has been well received and upgrades continued in 2008.
- The Company's technology solutions segment experienced phenomenal growth in 2007 and was able to sustain that level of revenue in 2008. Sales increased by \$400,000 to \$45.1 million and gross profit increased by \$300,000 to \$7.3 million. The Connected Classroom solutions (interactive whiteboards, projectors, audio augmentation, and associated services) continued to contribute to this segment but infrastructure sales (Voice over IP, switches, networking, wired and wireless, and other infrastructure solutions) grew 72% over 2007.

As a result of the tremendous efforts and hard work by everyone on our team, we completed many objectives in 2008 which will have a positive impact on our progress in 2009. These include the following:

- Within both our software and technology segments, we continued our emphasis on higher margin solutions.

While our technology segment contributes significantly to our overall profitability, we continued our focus on increasing the higher margin software segment of our business. We grew our software segment both organically and through acquisitions during 2008. Customer support agreements (recurring revenue) contribute 50% of our total software revenue and we remain focused on providing excellent customer service and improving our software solutions in order to retain customers.

The Company has continued to bundle engineering services, project management and technology service contracts with our technology solutions to maintain the margins for our technology segment. We built an Alabama technology team in 2008 in order to cross-sell our technology solutions into the school district client base served by the McAleer acquisition.



Letter to Shareholders (cont.)

- We added sales and marketing personnel in 2008 in order to reach more widely and deeply into our existing client base as well as introduce the Company to new clients. As the economic downturn unfolds, we believe this investment will be even more critical to remain profitable during these challenging times.

For 2009:

CSI anticipates continued technology sales related to the Connected Classroom in North Carolina, South Carolina, and our newly acquired territory in the southern half of Alabama. During 2008 we built a technology sales and delivery team in Alabama and expect sales in this region to grow in 2009. We will continue to sell our other technology offerings throughout our regions. These offerings include IP telephony, network integration services, network security, server/workstation/laptop installations, and wireless technologies.

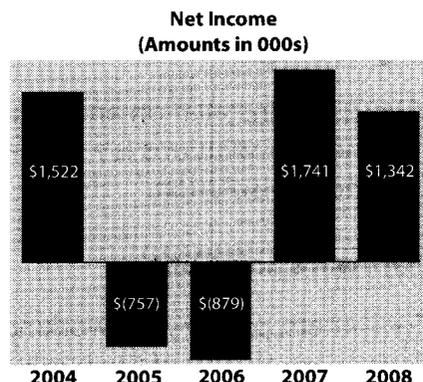
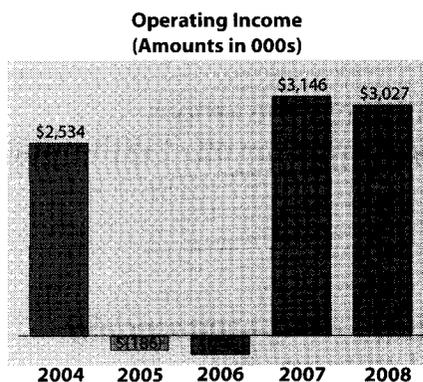
We believe CSI's financial management software segment will continue to expand our footprint and market penetration through the sales of our current financial management solutions (CSI Accounting +Plus, NextGen, ICS, and SmartFusion™). And the Company will continue development of our add-on solutions (e-Government, employee self service, document services, and other work-flow solutions) to provide opportunities to sell back into our existing client base. Our software teams have developed these add-on solutions to be interfaced across our various solution suites.

CSI's Version3 solutions continue to evolve and will likely become a major growth sector within our software segment in 2009. Provisioning, single sign-on, portal solutions, and SharePoint development are all important technologies to offer to the education segment. The provisioning and single sign-on solutions allow automation of many labor-intensive IT processes while the portal and SharePoint technologies offer collaboration opportunities to parents, students, and teachers. The Company's search for acquisitions will continue during 2009, particularly those that will enhance our intellectual property portfolio. We are also actively pursuing companies that will allow us to increase our market penetration, add higher margin sales, and increase our recurring revenue.

We are cautiously optimistic about the impact that the American Recovery and Reinvestment Act (the federal stimulus package) may have on our revenues and profitability in 2009. CSI is heavily focused on the education market (both K-12 and higher education) and a large segment of the stimulus package is directed toward education. We believe school districts will be able to utilize these funds to purchase technology geared to the 21st century classroom (the Connected Classroom) as well as other solutions offered by CSI. We are monitoring the progress of the stimulus package closely in order to determine when funds will be available and how the funds can be spent.

We are pleased with our 2008 performance considering the economic downturn experienced throughout the country and the world during the latter part of 2008. We were able to increase our revenue and remain profitable during a challenging year. And while our public sector clients are facing budget challenges, we anticipate continued demand for our technology and software solutions in 2009. We believe the diversity of our offerings will help us weather the economic storm and build an even stronger company in the future. Management remains focused on sustaining revenues, improving profitability and future earnings, and providing value to our shareholders.

I want to thank all of our employees, shareholders, Directors, and customers for their continued support and commitment. I look forward to sharing news with you during the remainder of 2009.



Nancy K Hedrick

Nancy Hedrick
Chief Executive Officer and
President

Software Applications

1. Finance Management

Our fund accounting and human resource software applications are designed specifically for the public sector. School districts, municipalities, county governments, public libraries, and non-profit organizations utilize our award-winning software.

2. Municipal Billing

Our municipal billing system prepares bills and allows collections to be recorded for utilities, taxes, business licenses and construction permits.

3. School Activities Accounting

School activity funds may be tracked with CSI's EntryPoint Fund Ledger, Accounts Payable, Cash Collections, and Bank Reconciliation modules.

4. Automated Workflow Solutions

Forms may be electronically routed for approval and documents may be scanned, imaged and archived as well as printed, e-mailed or faxed through our automated workflow solutions.

5. Lesson Planning

Our Curriculator® software is a standards based lesson planning system that allows education professionals to create, monitor and document lesson plans and their compliance with state curriculum standards.

Technology Solutions

6. Infrastructure Design

Determining the optimum network infrastructure is a key component when designing an organization's IT systems.

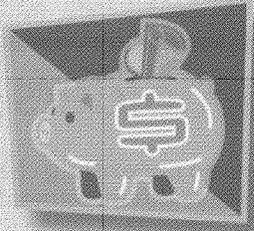
7. Engineering Services

Successful installation and implementation of the various technology solutions is a critical component when offering the total technology solution.

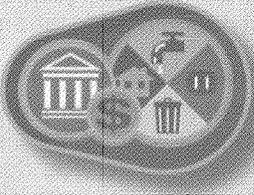
8. Hardware Solutions

Computers, printers, networking products, storage and specialty devices are all part of the hardware solutions we offer.

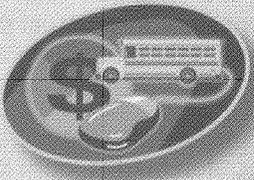
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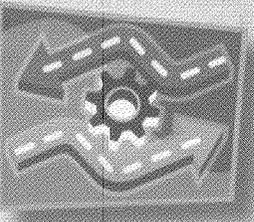
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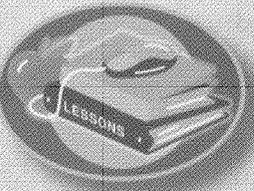
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4



5



Technology Solutions (Cont'd)

9. Wireless Solutions

Establishing a local area network that allows mobile users to utilize wireless radio waves to provide network connectivity in a surrounding area is another of our technology solutions.

10. Network Management

Today's networks are very complex and providing assistance in the management of an organization's networks has become a key offering of our technology solutions segment.

11. IP Telephony

We deliver phone services over an organization's existing network infrastructure by using IP (Internet Protocol).

12. IP Video Surveillance

We provide access to video surveillance using IP (Internet Protocol), allowing anytime/anywhere access to an organization's surveillance system.

13. Visual Communications

Video conferencing, administrative communications, home bound learning and professional development may all be provided through visual communications.

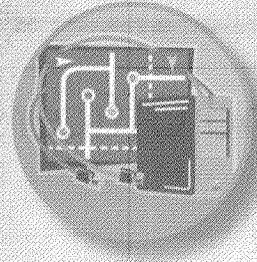
14. Network Security/Traffic Monitoring

Spyware protection, content filtering, email security, spam protection, firewall security and traffic monitoring are all components we offer in this ever-growing technology area.

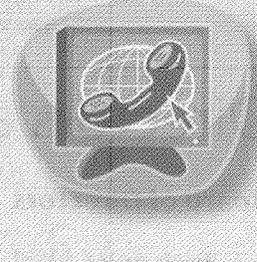
15. Interactive Classroom

We are transforming today's classroom into an interactive learning environment through the use of interactive whiteboards, projectors, wireless tablets and student voting devices.

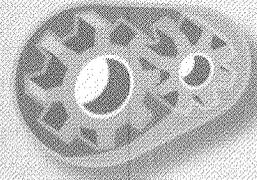
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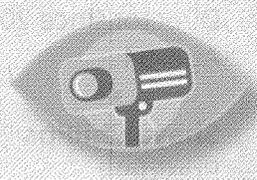
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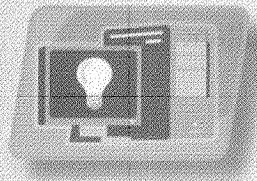
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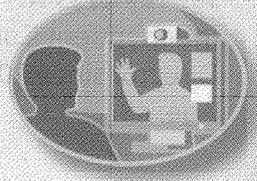
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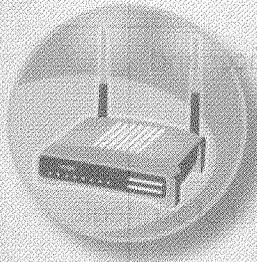
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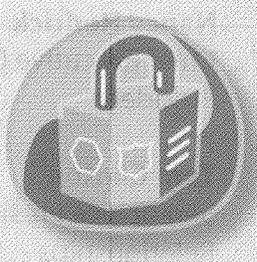
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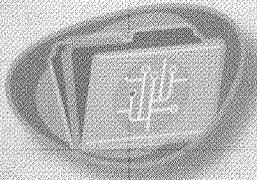
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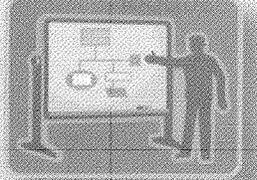
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Directors and Officers

Board of Directors

Anthony Sobel ^{(1),(2)}

Chairman of the Board
Chief Executive Officer,
Montana Metal Products, L.L.C.
Director since 2005
Age: 54

Shaya Phillips ^{(1),(2)}

President
CSSP Technology Services, Inc.
President since 2008
Age: 49

Jeffrey Bryson ^{(1),(2)}

Independent Consultant
Director since 2006
Age: 48

Nancy Hedrick

Chief Executive Officer and President,
Computer Software Innovations, Inc.
Director since 2005
Age: 59

Tom Clinton

Senior Vice President of Strategic Relationships
Computer Software Innovations, Inc.
Director since 2005
Age: 45

(1) Audit Committee (Jeffrey Bryson, Chairman)

(2) Compensation Committee (Shaya Phillips, Chairman)

Corporate Officers

Nancy Hedrick

Chief Executive Officer and
President

Tom Clinton

Senior Vice President of Strategic
Relationships

Bill Buchanan

Senior Vice President of Delivery and
Support

Beverly Hawkins

Senior Vice President of Software Development,
Implementation, and Support

David Dechant

Chief Financial Officer

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2008

OR

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

For the transition period from _____ to _____

Commission file number: 000-51758

COMPUTER SOFTWARE INNOVATIONS, INC.
(Exact name of registrant as specified in its charter)

Delaware
State or other jurisdiction of
incorporation or organization

98-0216911
(I.R.S. Employer
Identification No.)

900 East Main Street, Suite T, Easley, SC
(Address of principal executive offices)

29640
(Zip Code)

(864) 855-3900

Registrant's telephone number, including area code

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

Title of each class

Name of each exchange on which registered

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

Common Stock, par value \$0.001 per share
(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

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

SEC
Mail Processing
Section
APR 24 2009
Washington, DC
105

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

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes

No

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

(APPLICABLE ONLY TO CORPORATE REGISTRANTS)

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

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

DOCUMENTS INCORPORATED BY REFERENCE

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

TABLE OF CONTENTS

PART I	
Item 1.	Business 2
Item 1A.	Risk Factors 20
Item 1B.	Unresolved Staff Comments 36
Item 2.	Properties 36
Item 3.	Legal Proceedings 36
Item 4.	Submission of Matters to a Vote of Security Holders 36
PART II	
Item 5.	Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities 37
Item 6.	Selected Financial Data 37
Item 7.	Management's Discussion and Analysis of Financial Condition and Results of Operations 37
Item 7A.	Quantitative and Qualitative Disclosures about Market Risk 61
Item 8.	Financial Statements and Supplementary Data 62
Item 9.	Changes in and Disagreements With Accountants on Accounting and Financial Disclosure 86
Item 9A.(T)	Controls and Procedures 86
Item 9B.	Other Information 88
PART III	
Item 10.	Directors, Executive Officers and Corporate Governance 88
Item 11.	Executive Compensation 88
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters 88
Item 13.	Certain Relationships and Related Transactions, and Director Independence 89
Item 14.	Principal Accounting Fees and Services 89
Item 15.	Exhibits, Financial Statement Schedules 89
SIGNATURES 90	
INDEX TO EXHIBITS 91	

PART I

Item 1. Business.

A. Introduction

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

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

Software Applications

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

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

- Fund accounting based financial management software
- Standards based lesson planning software
- Identity lifecycle management and Microsoft Sharepoint development

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

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

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

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

Technology Solutions

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

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

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

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

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

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

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

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

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

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

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

B. Overview

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

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

Software Applications Segment

Our software applications segment develops accounting and administrative software applications that are designed for organizations that employ fund accounting. These organizations include our primary target market: municipalities, school districts and local governments. Our software provides a wide range of functionality to handle public sector and not-for-profit accounting requirements including receipt and tracking of funds, application of purchases, payables, investments and expenditures by fund, and production of financial and informational reports. The software is written in modules which can be sold separately or as a fully-integrated package so that information keyed in one module will be updated electronically into other modules to minimize data entry and improve productivity. In addition to the modules covering general accounting functions, specialty modules are also available. The software modules available include:

- General (or “Fund”) Ledger;

- Accounts Payable;
- Purchasing;
- Payroll;
- Personnel;
- Employee Absence/Substitutes;
- Inventory;
- Utility Billing; and
- Other specialty modules designed for government markets.

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

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

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

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

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

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

Technology Solutions Segment

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

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

- education technologies (distance learning and classroom learning tools, including interactive white board solutions);
- IP Telephony and IP Surveillance (sending voice calls and surveillance across the internet using internet protocol (“IP”), a standard method for capturing information in packets);
- wide area networking (linking a group of two or more computer systems over a large geographic area, usually by telephone lines or the internet);
- wireless networking (linking a group of two or more computer systems by radio waves);
- system and network integration (combining different computer programs, processes and hardware such that they operate and communicate seamlessly as a tightly-knit system);
- technology planning (developing plans to purchase or upgrade computers, telephone equipment, cabling and software);
- project management (overseeing installation of computers, telephone equipment, interactive white board equipment, cabling and software);
- hardware/software sales and installation;
- support and maintenance (using Novell, Microsoft, Cisco and Citrix certified engineers and other personnel to fix problems); and
- system monitoring (proactively monitoring computers and software to detect problems).

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

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

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

<i>(in thousands)</i>	<u>Year Ended December 31, 2008</u>	<u>Year Ended December 31, 2007</u>
<i>Revenues</i>		
Software applications segment	\$ 13,559	\$ 10,478
Technology solutions segment	\$ 45,144	\$ 44,719
Revenues	<u>\$ 58,703</u>	<u>\$ 55,197</u>
<i>Gross Profit</i>		
Software applications segment	\$ 5,514	\$ 4,362
Technology solutions segment	\$ 7,304	\$ 6,959
Gross Profit	<u>\$ 12,818</u>	<u>\$ 11,321</u>
<i>Gross Margin</i>		
Software applications segment	40.7%	41.6%
Technology solutions segment	16.2%	15.6%
Gross Margin	21.8%	20.5%

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

C. History and Development of CSI – South Carolina

Initial Development

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

Events Leading Up to 2005 Restructuring

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

D. Subsidiaries

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

We have no other subsidiaries.

E. The Merger and Recapitalization

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

Description of Merger and Related Investment Transactions

The Merger

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

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

Sale of Preferred Stock and Warrants

On February 10, 2005, VerticalBuyer entered into a Preferred Stock Purchase Agreement with Barron, a “micro-cap” fund. Pursuant to the agreement, on February 11, 2005, immediately following the consummation of the merger, we issued to Barron 7,217,736 shares of our newly created Series A Convertible Preferred Stock in exchange for the payment of \$5,042,250. The agreement also provided that Barron would lend the merged company an additional \$1.9 million, in the form of a subordinated note on the same terms as the subordinated notes payable to the former CSI – South Carolina shareholders in the merger. Barron was also issued two warrants to purchase in the aggregate 7,217,736 shares of our common stock. The preferred stock is convertible into common stock on a one-

for-one basis. The exercise prices of the warrants were originally \$1.3972 and \$2.0958 per share. Each warrant is exercisable for half of the total warrant shares. The terms and conditions of the warrants are identical except with respect to exercise price.

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

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

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

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

Registration Rights Agreement

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

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

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

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

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

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

F. Our Niche in the Governmental and Educational Technology Market

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

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

G. Products and Services

CSI Fund Accounting Software

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

- Sales of software licenses to new clients;
- Sales of new/additional modules to existing clients;
- Installation of software;
- Data conversion from legacy systems;
- End user training;
- Guaranteed service agreements; and
- Sales of third party products to enhance functionality of CSI Accounting+*Plus*.

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

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

required by our clients but moving to the SQL and .Net platform will allow us to be more competitive on both a regional and national level.

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

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

<p><u>Accounting Modules</u></p> <p>Accounts Payable</p> <p>Accounts Receivable</p> <p>Budget Preparation</p> <p>Check Reconciliation</p> <p>Cost Allocation</p> <p>Fixed Assets</p> <p>Fund Ledger</p> <p>Payroll</p> <p>Purchasing</p> <p>System Manager</p>	<p><u>Specialty Modules</u></p> <p>Audit Reporting</p> <p>Claims Reimbursement</p> <p>Food Service Reporting</p> <p>Inventory</p> <p>Pupil Activity Accounting</p> <p>Warehouse Requisitions</p> <p>Employee Self Service</p> <p>Online Bill Pay</p>
<p><u>Payroll / Personnel Support Modules</u></p> <p>Absent Employee Tracking</p> <p>Applicant Tracking</p> <p>Available Substitutes</p> <p>Insurance and Benefits</p> <p>Personnel</p>	<p><u>Municipal Modules</u></p> <p>Business License</p> <p>Cash Collections</p> <p>Construction Permits</p> <p>Utility Billing</p>

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

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

Standards Based Lesson Planner

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

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

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

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

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

Version3 - Identity Lifecycle Management Software and Microsoft SharePoint Services

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

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

Hardware Sales and Related Support Services

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

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

- Our focus on the K-12 sector has led to our developing relationships with vendors who specialize in technologies for the classroom. **Promethean Collaborative Classroom Solutions** offers what we consider to be the industry-leading solution for transforming the classroom into an interactive learning environment. Using Promethean's ActivBoards, students are able to use a stylus on a special electronic white board to interact with computer projected images. The computer reacts to the stylus activity and projects the results. Although there are other competitive products in the marketplace, by having an exclusive sales arrangement (except for certain distributor relationships) to market an industry-leading solution in North Carolina, South Carolina, and southern Alabama, we believe we are better able to maintain gross margins than would otherwise be possible. In addition to selling the ActivBoards, we offer installation services, end user training and market complementary products (e.g., projectors, PC Tablets) to be used with the boards for the collaborative classroom. Our classroom solutions are currently a primary, substantial revenue generator, and have generated between one-third and one-half of our total revenues in recent years.
- Significant focuses in the technology solutions segment include IP (internet packet-based) telephony, wireless, system security and routing/switching. We have a strategic relationship with **Cisco Systems, Inc.** ("Cisco"), a worldwide leader in networking for the Internet and technology innovation, whereby Cisco provides the hardware necessary to implement these systems. We purchase the majority of our Cisco equipment through Ingram Micro. Ingram Micro is a multi-national distributor of technology hardware. Although we are an indirect reseller of Cisco products, we periodically work closely with Cisco representatives, particularly on large sales. This relationship occasionally produces customer leads and referrals. We also encourage our employees to pursue Cisco technical certifications, as such certifications as well as the achievement of certain sales volumes of Cisco products can make

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

- We deploy desktops, notebook computers, personal devices and file servers in a variety of client network environments. We have a strategic relationship with **Hewlett Packard** (“HP”), which produces technology solutions that span information technology infrastructure, personal computing and access devices, global services and imaging and printing for consumers, enterprises and small and medium business. We provide professional services to deploy these devices. Our relationship with HP consists primarily of the purchase of personal computers, servers, printer equipment and infrastructure devices for resale. We purchase these products on an individual purchase order basis under a standard, nonexclusive reseller agreement. In addition to purchases directly from HP, we have arms-length business relationships with certain customers whereby the customers have elected to name us as their authorized HP representative. As the named representative, and as an incentive for the customer to approve us as their authorized HP representative, we provide various forms of assistance which can include assisting the customer in identifying the specific HP products that will meet its needs, summarizing and processing orders on behalf of the customer with HP, and providing certain support and HP authorized repair and maintenance for which we are separately compensated by HP. To provide these services, some of our personnel have received training and certifications from HP. As the named representative of HP, we assist the customers in placing their orders directly with, and we receive commissions from HP, rather than acting as the purchaser and reseller of HP’s products. Due to the volume of business we do with HP, we also work very closely with HP representatives and receive support which may include special quantity or other pricing in competitive situations with products from other manufacturers, and may receive customer leads or referrals from time to time.
- In order to offer visual communication equipment to our clients and prospective clients in order to allow video conferencing, administrative communications, home bound learning and professional development, we have developed a business relationship with **Tandberg**. In the education environment, Tandberg provides worldwide access to people, places and experiences without time or travel constraints. Through the public sector and business environment, Tandberg offers solutions in providing more efficient and effective training to employees, saving travel, time and money. Tandberg solutions include cameras, monitors, videophones and software.

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

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

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

Our technical services include the following:

- **Consulting Services**
 - Project Management
 - Deployment Management
 - Procurement Management
 - Product Evaluation Management
 - Outsourcing Management

- **Network Services**
 - Network Needs Analysis
 - Network System Design
 - Network System Integration
 - Network System Implementation
 - Network System Maintenance
- **Convergence Services**
 - Integration Needs Analysis
 - Integration Design
 - Integration Implementation
 - Integration Maintenance
- **Support Services**
 - Hardware Support
 - Network Support
 - Convergence Support
 - Network Operating Systems Support
 - Collaboration Systems Support

H. Strategy

In addition to our sales of software applications, technology solutions and related support and maintenance services, we provide technology consulting, including network and systems integration services as a part of our solutions sales efforts. These services also generate a significant amount of revenue by increasing demand for computer hardware equipment that we sell. Our marketing strategy is to provide a suite of software products coupled with full service integration of the hardware solutions that support those products and other back-office functions. We also seek to provide ongoing technical support, monitoring and maintenance services to support the client's continuing needs. We also market our hardware solutions and ability to provide a wide level of services and support independent from our software solutions. Such marketing to a fund accounting based organization may also lead to future software sales and integration services.

By providing a client the ability to call one solution provider and circumvent the difficulties that often arise when dealing with multiple vendors, we believe we are able to achieve higher long-term client satisfaction and a competitive advantage in the marketplace. Repeat business from our existing customer base has been key to our success and we expect it will continue to play a vital role in our growth. Over the past ten years we have retained more than 90% of our software customers. Our focus is on nurturing long-standing relationships with existing customers while establishing relationships with new customers.

Software

Fund Accounting Software

New Product Development

We continue to market the primary CSI software, including acquired software applications, which contain the functionality required by our clients. However, we are in the process of rewriting these applications or for acquired products, integrating added functionality using the latest Microsoft application programming tools and current Microsoft data storage and retrieval technologies. The new release, SmartFusion, will allow us to expand more easily into additional states. We will continue to expand our product offerings to meet the needs of our clients both in the current version and in the new version.

Service+Plus

Our new service offering provides version protection for major releases of the software without additional fees, free attendance to seminars accessed remotely by use of the internet, free user conference attendance and disaster recovery (off-site data storage).

Hosted Services (ASP)

We offer an ASP (Application Service Provider or CSI hosted) solution to new clients whereby they can access the software on CSI servers and run it remotely over the internet at a fixed monthly cost. Under this business model, the client can forego the significant up-front investment required to purchase computer hardware and install the software at its location.

Managed Backup Service

In late 2006, we began offering an automated data backup and restoration system, Gemini, which protects our clients' data and critical information. Our Gemini and Gemini-warmsite software provides a simple, secure and reliable way for our clients to back up their data offsite, ensuring the data that is integral to their organization's day to day operations is safely and easily maintained, in the event of a system crash or other disaster. Our Gemini-warmsite software and related services includes secure offsite backup, while the

necessary hardware and communications equipment needed to run the clients' operations is housed in our data center facility, in a constant state of operational readiness.

Reseller Model

In order to move into new regions and states, we may pursue a reseller model in those areas where it will be the most expedient way to introduce our primary software application. There are often information technology organizations established in an area that have sales staff in place to market our products.

Lesson Planning Software

Product Acquisition

In September 2005, we acquired a standards based lesson planning software product, which we have renamed "curriculator™" standards based lesson planner. The software product, potential customer list, install base and all related rights purchased did not constitute a material addition to the business. This software is designed to allow teachers to create lesson plans that are tied to a state's curriculum standards. These lesson plans may then be reviewed by school administrators and reports may be generated to determine the standards that have been met or need to be met. This is particularly important as school systems develop higher accountability standards. In addition, the federal "No Child Left Behind Act" legislation has focused greater attention on schools' adequate yearly progress ("AYP") and meeting curriculum standards is an important component of these measurements. Standards based lesson planning software allows a school to document its compliance with the curriculum standards as a component of its compliance with the "No Child Left Behind Act" legislation.

Product Enhancement

We have rewritten the lesson planning software to be web-enabled. In addition, we are building in curriculum standards for all states.

Market Penetration

Addressing "No Child Left Behind Act" requirements and meeting state curriculum standards are issues for educators in every state. We plan to use telemarketing, our web presence, attendance at educational trade shows and direct mail campaigns to introduce and sell our lesson planning software nationally. Our initial efforts are focused on the southeastern states. This product provides a relatively new, more structured approach to lesson planning, and the adoption rate is slow as teachers and superintendents must adopt to a greater use of technology within the lesson planning process. The product is in several K-12 schools, but is not currently a significant revenue driver.

Identity Lifecycle Management and Microsoft SharePoint Development

Product Acquisition

In August 2008 we acquired Version3, Inc. ("Version3") and their various intellectual property. These solutions are centered around Identity Lifecycle Management (ILM) and SharePoint Development. Specific solutions include:

- Version3 Simple Sign On ILM Connect automates provisioning of user account management, including establishing user rights and logins to various applications and home folder moves.
- Version3 Simple Sign On Web Edition provides a web-based single sign on solution to a Microsoft based network including connection management, application publishing, multifactor authentication, kiosk login support, application auditing and management, logon macro utilities, and system tools.
- Version3 Simple Sign On Enhanced Authentication integrates with Microsoft to allow users to move seamlessly and transparently between applications and domains with improved security.

- Version3 Simple Sign On Access Control provides a graphically based way to manage basic access to resources including drive mappings, connections from workstations to printers, publishing of application icons, and automation of events.

SharePoint development includes designing portals to provide a central point of collaboration for students, parents, and educators as well as other custom SharePoint deployments.

Product Enhancements

The solutions mentioned above are continually being enhanced to meet clients' needs as well as address changes in Microsoft's product suite.

Market Penetration

While the solutions discussed above could be directed toward various verticals, we are focusing our efforts on the K-12 and higher education market. CSI's existing customer base includes school districts throughout the Southeast and our existing sales teams are now marketing the Version3 solutions to these clients. We have also implemented a telesales effort focused into other areas with positive success. As opportunities are uncovered, we are able to provide webinars to overview the solutions and then provide , indepth demonstrations. The ability to sell the solutions without having to have 'feet on the street' in various geographies allows us to sell throughout the United States as well as internationally.

Technology

Expansion of Offerings

We are continually seeking new hardware offerings to present to our clients. Our spending on research and development is generally insignificant. As old technologies expire and new technologies emerge we work to stay a short distance behind the new product curve, adopting primarily those solutions that are proven in the marketplace. As a reseller with internal technical personnel and more than 900 public sector clients, we are periodically approached by vendors and manufacturers to expand into new territories or represent new or additional products to our existing customer base and, on occasion to other customer verticals. We also pursue the opportunities within our existing verticals. (We could, in the future, but currently have no plans to devote significant resources in the pursuit of other verticals). For example, new product opportunities we evaluate could include additional products in the following market spaces in which we are already engaging: storage solutions, database technologies such as standardized data-tagging (XML or Extensible Mark-up Language) applications for improved data retrieval, internet based audio and video distribution (equipment used to broadcast audio and video communications), metropolitan wireless (city-wide wireless public internet access and city-wide wireless network access by city employees) and additional service capabilities. As with our other hardware-based solutions, we plan to enter into reseller arrangements with equipment and solutions providers or manufacturers who already have experience and can provide installation, support, equipment warranties and technical training to our personnel to offer additional solutions to our existing client base and new customers. Except for internally developed software or acquired products, we enter new areas as a reseller as opportunities arise and customer needs present themselves. This approach allows us to mitigate the risk of a product not having sufficient demand or profitability. By doing this, we forego the investment in inventory a manufacturer or large distributor would have to commit to a new product. We are already proposing solutions involving some of these areas, including metropolitan wireless networking for small towns and housing communities, although they do not yet represent a significant portion of our business. We typically do not commit significant resources to them unless we achieve reasonable profitability on the initial opportunities. Periodically, certain products introduced at a new client site, in response to a client's specific needs or requests and to maintain or improve the client relationship, never become a significant portion of our business. Other products become significant contributors to profitability and we add them as a standard offering to our client base.

Managed Services and Guaranteed Service Agreements

In addition to guaranteed service agreements on our software products, we offer guaranteed service agreements on many of our hardware offerings. Guaranteed service agreements allow us to increase our recurring revenue.

Geographic Expansion

We are pursuing a national presence with a primary, initial focus on the southeastern region of the United States.

Generally, our technology offerings require hands-on implementation and support. In order to expand into new geographic territories, we must find qualified personnel in an area to service our business. The need for hands-on implementation and support may also require investment in additional physical offices and other overhead. We believe our approach is conservative. Our strategy is to limit the number of new target areas until they become cash flow positive before expanding into additional ones. Accordingly, we intend to expand the geographic reach of our technology offerings from our primary client locations of South Carolina, North Carolina and Georgia to surrounding states methodically over time. The January 2007 acquisition of McAleer reflects this strategy of geographic

expansion. Through McAleer, we have gained a presence in five states not previously served by CSI: Alabama, Mississippi, Louisiana, Tennessee and Florida. In addition, the August 2008 acquisition of Version3 added some additional installations in other states, Canada and the United Kingdom, further expanding our geographic reach on a more limited basis.

We may accelerate expansion if we find complementary businesses in other regions that we are able to acquire. Until such time as we are able to find appropriate acquisitions, our geographic reach for the technology solutions segment is likely to be limited to the southeast for the next several years. Our marketing efforts to expand into new territories may include telemarketing, attendance at trade shows, and direct mail in addition to personal contact.

We are able to deliver software applications, demonstrations and training over the internet and deliver support by internet or phone. Accordingly, for our software applications segment, we plan to expand our geographic reach to a national level more quickly than for our technology solutions segment. Software marketing efforts may include attendance at national trade shows and national telemarketing, direct mail and web advertising.

Growth Through Acquisitions

Our competitive markets are occupied by a number of competitors, many substantially larger than we, and with significantly greater geographic reach. We believe that to remain competitive, we need to take advantage of acquisition opportunities that arise which may help us achieve greater geographic presence and economies of scale. We may also utilize acquisitions, whenever appropriate, to expand our technological capabilities and product offerings. One significant reason for our entering into the merger and recapitalization transaction in February 2005 was to allow us to access public capital markets as a source of funding to permit us to grow through acquisitions. In addition, the merger transaction facilitated the sale of warrants, the exercise of which (absent a cashless exercise) represents a significant potential source of capital. While we may use a portion of any cash proceeds to pay down debt on an interim basis, we intend to use any additional liquidity and/or availability of assets generated by the paydown and remaining proceeds to fund acquisitions.

We believe our markets contain a number of attractive acquisition candidates. We foresee expanding through acquisitions of one or more of the following types of software and technology organizations:

- Developers and resellers of complementary software, such as time and attendance, workflow management, tax appraisals and assessment, education, court and law enforcement related products.
- Software companies with operations in the public educational and governmental market segments.
- Consulting firms providing high level professional services. We believe this type of acquisition would enhance our offering of technology planning and project management.

Our business strategy provides that we will examine the potential acquisition of companies and businesses within our industry. In determining a suitable acquisition candidate, we will carefully analyze a target's potential to add to and complement our product mix, expand our existing revenue base, improve our margins, expand our geographic coverage, strengthen our management team and, above all, improve stockholder returns. More specifically, we have identified the criteria listed below, by which we evaluate potential acquisition targets in an effort to gain the synergies necessary for successful growth of the Company:

- Access to new customers and new geographic markets
- Protection of current customer base from competition
- Removal or reduction of market entry barriers for our entry to new markets
- Opportunity to gain operating leverage and increased profit margins
- Diversification of sales by customer and/or product
- Improved vendor pricing from increased volume and/or existing vendor relationships
- Improvements in product/service offerings
- Protection of and ability to expand mature product lines
- Ability to attract public capital and increased investor interest

We are unable to predict the nature, size or timing of any acquisition. We can give no assurance that we will reach agreement or procure the financial resources necessary to fund any acquisition, or that we will be able to successfully integrate or improve returns as a result of any such acquisition.

We continue to seek out and hold preliminary discussions with various acquisition candidates. However, we have not entered into any agreements or understandings for any acquisitions that management deems material.

I. Acquisitions

McAleer Computer Associates, Inc.

On January 2, 2007, we consummated the purchase of substantially all of the assets and business operations of McAleer Computer Associates. The terms and conditions governing this acquisition were set forth in an agreement dated November 27, 2006. The total

purchase price was \$4,050,000. We did not assume any liabilities of McAleer, other than certain leases and obligations of McAleer under ongoing customer contracts. We are operating the acquired business as a division of the Company under the name “CSI McAleer Technology Outfitters,” and retain the business location in Mobile, Alabama. We sometimes refer to McAleer as “CSI-Mobile.”

McAleer was primarily a provider of financial management software to the education K-12 market. In operation for over twenty-five years, its current footprint included installations in Alabama, Georgia, Mississippi, Louisiana, Tennessee and Florida. The addition of McAleer allows us to expand our reach from the primary three-state market where we were doing business prior to the acquisition to an eight-state footprint throughout the Southeast. We believe the acquisition constituted a significant move in implementing our stated strategy of geographic expansion, with an ultimate goal of achieving a national presence.

We believe McAleer has a reputation for delivering quality customer service. We are utilizing McAleer staff to continue to service its existing clients. We have been able to capitalize on the Mobile location to market expanded technology and service offerings to the broader geographic area and have secured clients for CSI-Easley in the local government (city and county) markets within the added geographic footprint. In contrast to CSI, McAleer has not historically focused on the local government market or provided as broad a range of technology solutions.

The majority of McAleer’s revenues are related to the licensing and annual support agreements for its fund accounting software, with a smaller amount (approximately 10% to 15%) related to hardware. Hardware revenues include servers sold for the software to run on, and other indirectly related products and services. Accordingly, we report the majority of McAleer’s software and related services through our Software applications segment. A small amount of revenues may be recorded through our Technology solutions segment, consistent with our practices prior to the McAleer acquisition.

For more detailed financial information with respect to the acquisitions, see the financial information for the year ended December 31, 2008 included in Note 3, “Acquisitions” to our audited consolidated financial statements dated December 31, 2008 included in this Form 10-K.

ICS Systems, Inc.

On March 31, 2008, we consummated the acquisition, effective April 1, 2008, of substantially all the assets and business operations of ICS Systems, Inc. (“ICS”). ICS, located in Colfax, North Carolina (near Greensboro) was a developer, provider and consultant with respect to fund accounting and billing software for the local government market space in that state. We sometimes refer to former ICS operations as “CSI-Greensboro”. The ICS transaction is discussed in more detail in Note 3 to our audited consolidated financial statements included in this Form 10-K.

Version3, Inc.

Also as previously disclosed, in furtherance of our acquisition strategy, on August 18, 2008, we consummated the acquisition effective August 14, 2008 of substantially all the assets and business operations of Version3, Inc. (“Version3”). Version3, located in Columbia, South Carolina, was a developer, provider and consultant with respect to solutions that facilitate single sign-on, application access management and provisioning based on Microsoft’s Identity Lifecycle Management, and Microsoft SharePoint deployments. CSI was a reseller of Version3 solutions due to the application of the products to its education market segment. The Version3 transaction is discussed in more detail in Note 3 to our audited consolidated financial statements included in this Form 10-K.

We are unable to predict the nature, size or timing of any acquisition. We can give no assurance that we will reach agreement or procure the financial resources necessary to fund any acquisition, or that we will be able to successfully integrate or improve returns as a result of any such acquisition. We continue to pursue and enter into preliminary discussions with various acquisition candidates. However, the Company has not entered into agreements or understandings for any acquisitions which management deems material.

J. Sales, Marketing and Distribution

We market our products and services through direct sales throughout North Carolina, South Carolina, Georgia, Alabama, Mississippi, Louisiana, Tennessee and Florida. We have been expanding our direct sales team to cover the larger southeastern United States region. Our inside sales staff provides lead generation and support to the direct sales team.

We have twenty outside sales persons, including a Senior Vice-President of Strategic Relationships, a Vice President of Software Sales and a Vice President of Technology Sales, a Sales Manager, and eight additional employees on our inside sales staff. In line with our expansion plans described above under “—H. Strategy,” we plan to expand both of these teams further as we expand our geographic presence. Other employees are involved in selling on a daily basis. Engineers and trainers have excellent opportunities to sell additional products and services to clients while delivering services.

Our marketing efforts include participation in various trade shows (for municipalities, counties and education), road shows to showcase various products and services, and mailings to target specific products and services.

Our inside sales staff provides leads to the outside staff and also produces proposals to be delivered to prospects and clients. In 2004, the software inside sales staff began making outbound calls to pre-qualify leads for the outside sales staff. This has proven successful and we continue to expand these calls through the use of telesales personnel, both internal and external.

Our outside sales personnel call on existing and prospective clients. Owing to our wide range of product and service offerings and rapidly changing technology, we believe there are sales opportunities within the existing client base. Recurring sales account for a significant part of our overall revenue. Our sales teams are segmented by geography and also product segments (technology and software). Depending on the product or service being offered, we may call upon an information technology director, city manager, director of finance, director of operations, utility manager or curriculum coordinator.

K. Key Suppliers

Our relationship with Promethean is established through a reseller agreement, under which we are able to sell interactive whiteboard products on an exclusive basis in two states, South Carolina and North Carolina. In early 2008, we entered into an affiliate relationship with another vendor, providing us the opportunity to sell Promethean products in certain counties in the state of Alabama. For 2009 our affiliate relationship was changed to a direct relations line. The exclusive reseller agreements provide us with the ability to sell Promethean products into these markets, as well as additional opportunities to sell our related project management and technical services. Sales of Promethean products, and related connected classroom technologies, and services represented approximately 39% of sales revenues in 2008 and 52% in 2007.

One January 8, 2008, CSI was re-certified as a Cisco Premier certified partner pursuant to an Indirect Channel Partner Agreement between the Company and Cisco Systems, Inc. The re-certification is effective through March 26, 2009. The agreement grants us a limited, nonexclusive, revocable license to receive from authorized distributors and distribute to end users both those Cisco products made available to the authorized distributors and Cisco's proprietary rights in those products. The prices we pay for the Cisco products are set by the authorized distributors. In 2008, sales of Cisco products accounted for 20% of our sales revenue. In 2007, that number was 12%.

Pursuant to a Hewlett Packard U.S. Business Development Partner Agreement, we were appointed a Business Development Partner for the purchase and resale or sublicense of Hewlett Packard's products, services and support. In this capacity, we will purchase Hewlett Packard's products, services and support from authorized distributors and resell them to end users. The agreement was originally effective until May 31, 2005, and we received notification that it has been extended in its current form until June 30, 2007. On November 8, 2007, the Company was notified electronically that the agreement had been renewed through May 31, 2009. We purchase products both through HP and through authorized distributors. We also assist our customers in placing orders directly with HP when we act as a sales agent and customer representative. In such cases we record no revenue except for commissions received on the sales. Sales of Hewlett Packard products accounted for 3% of sales revenues in 2008 and 4% in 2007. In addition, we received commissions on customer orders of Hewlett Packard products of \$730,562 (1% of 2008 gross sales) in 2008 and \$753,971 (1% of 2007 gross sales) in 2007.

L. Customers

Our customers are predominantly educational institutions (K-12 and higher education), municipalities, non-profit organizations and other local governments. We sold services and products to more than 1,000 customers during 2008. Our top ten customers accounted for 37% of the 2008 gross revenues. Twenty-one customers constituted approximately 50% of the 2008 gross revenues, but no customer constituted more than 10% of gross revenues. Two of our customers combined accounted for at least 15% of our revenues, the Greenville County, South Carolina school district and the Wayne County, North Carolina school district. Due to the nature of the large technology projects we install, it is not unusual for a relatively small number of customers to account for the majority of sales. It is not unusual for customers to have ongoing projects extending across several years.

2008 Revenues by Market Type		2008 Revenues by State	
Sector	%	State	%
Public – Education	89%	Alabama	10%
Public – Government	9%	Georgia	7%
Other	2%	North Carolina	23%
		South Carolina	59%
		Other	1%

M. Competition

The market for the services that we provide is highly competitive, includes a large number of competitors, and is subject to rapid change. Our primary competitors include participants from a variety of market segments, including publicly and privately held firms, systems and consulting and implementation firms, application software firms and service groups of computer equipment companies. Competition is generally based on quality of products and customer support, timeliness, cost of services, relevant targeted expertise and return on investment.

In the fund accounting software market, there are a handful of national companies and many regional companies that have carved a niche in their region much as CSI has done in the southeast. On a national level these include divisions of Tyler Technologies, particularly MUNIS and INCODE, and divisions of Sungard Data Systems, Sungard Bi-Tech and Sungard Pentamation.

The hardware and technology services market tends to have more regional rather than national competitors. In some cases hardware vendors, such as Hewlett Packard, offer engineering services that are in direct competition with our engineering services. On a national level, Pomeroy IT Solutions is the primary competitor in the IT products and services market.

We were recognized by VAR Business Magazine as one of the top 500 network integration companies in the United States (the VAR Business 500) in 2004, 2005, 2006, 2007 and 2008. Additionally, in 2005, we were one of three finalists for the Educational Solution Provider of the Year award also presented by VAR Business Magazine, and in 2008 we were named the CRN Magazine Fast Growth Education Specialist.

There is a disadvantage to this recognition in that we are now highly visible as potential competition for those with whom we compete for business. Virtually all of the companies listed on the VAR Business 500 and Government VAR 100 are competitors or potential competitors of ours. The VAR Business 500 and Government VAR 100 lists include IBM Global Services, EDS, Lockheed Martin IT, Accenture and Computer Sciences, to name a few. Most of the companies are significantly larger than we are, and some may enter our market space should they choose to do so. While we believe we will be able to continue to compete effectively in the future, there is no guarantee we will be able to do so or achieve any future recognition.

As CSI begins to market our products and services nationally, we will continue to compete with the same national companies and will be faced with additional regional competitors in the new markets we enter.

We believe a primary strategic advantage of CSI is combining the sale of our fund accounting software with network integration and hardware sales and services. We believe that providing one-stop shopping with a single point of contact is a material benefit to our clients and that this has been a key factor in our successful penetration of the educational and governmental software and technology markets in South Carolina, North Carolina and Georgia. Although competitors exist in these markets, we believe very few organizations offer the blend of services and products that is available through CSI. We are expanding into surrounding states with the goal of leveraging this strategic advantage in new areas.

Customer Service

Our historical growth has been, in large part, due to the high level of repeat business from our existing client base. This is evidenced by a greater than 90% client retention rate by our Software applications segment and significant recurring sales opportunities to this client base through our Technology solutions segment. We believe clients continue to utilize our products and services due to our focus on customer service, attention to detail and regular follow-up. We strive to have technical and customer service staff members available to address swiftly the needs, questions or concerns of clients. Specifically, our software customer service includes user conferences, a support desk access and a website, which offers documentation and downloadable upgrades.

Ability to Carry Out a Broad Range of Projects of Varying Scope

We strive to be agile and adaptable in fulfilling the technology needs of our clients, traits which are instilled in our corporate culture. We have managed multi-million dollar, multi-year projects for our clients, as well as requests for projects of a much smaller scale. We believe that our clients appreciate our range and flexibility in meeting their technology requirements.

Long-term Relationships with Clients

A large percentage of revenue continues to flow from our existing client base. The preservation of these client relationships is a high priority of our management team. We believe the longevity of these relationships evidences a high degree of customer satisfaction.

Seamless Implementation of Software and Hardware

Because of our dual capabilities with respect to providing both software and integration services, we believe that we are able to coordinate the implementation of software and hardware, minimizing disruption to our client's day-to-day operations.

Diversification of Products and Service

Our products and services can address the needs of many departments within an educational facility, city or county. We offer a wide variety of services and products, including financial software, workflow management solutions, network integration products and services, specialized classroom technologies, IP telephony and IP surveillance, distance learning technology and wireless solutions.

N. Intellectual Property

We develop new software as part of our business activities. The software products we develop are generally works made for hire, prepared by our employees within the scope of their employment and with copyright ownership vesting in the Company pursuant to the Copyright Act of 1976. We routinely license software to our customers through unwritten, implied nonexclusive licenses, the terms of which are commensurate with our copyright protection in the software. Licenses for our products are ordinarily on a site license or user-based license basis. Generally, implied licenses are created by law when an express, written agreement does not exist between the parties. An implied license provides certain rights to the licensee, and typically such rights would be those the copyright owner would have given to the licensee as customarily given in the industry for similar types of software products. Other than password protection of the software for preventing unauthorized access to the software and/or the Company receiving actual knowledge of a violation of its licenses, we have no formal methods in place for monitoring compliance with our licenses. Our software is generally entitled to receive copyright protection automatically, by operation of law, upon its creation. Copyright protection provides protection against unauthorized copies and derivative versions of the software being made. Copyright protection may also provide protection against the unauthorized distribution, public performance and display of the software. We typically do not assign our copyrights in our software to our customers. We have not, however, pursued registration of copyrights for our software under the Copyright Act nor have we pursued obtaining patents on the software we develop.

The length of such implied licenses of our software is generally coextensive with the length of the applicable copyright term provided for by federal law. Currently, the term for copyright protection is the life of the author of the software, plus 70 years. For software works that are "made for hire" (as defined by the Copyright Act), the length of the copyright term is 95 years from the first publication.

Enforcement of the implied licenses on our software would be primarily on copyright infringement grounds and/or on common law principles pertaining to implied licenses. Violations of copyrights on our software could include, among other things, unauthorized distribution of our software, and unauthorized derivative works being made of our software (such as by reverse engineering), each of the foregoing being rights uniquely held by the copyright owner.

O. Software Development

In 2008, we spent and capitalized \$919,000 on software development. In 2007, we spent and capitalized \$1,058,000. Our software development efforts focus on the implementation of known technological capabilities applied to common business processes to enhance our existing products. Historically, to date we have spent no material efforts on technological innovation for which the feasibility has been unknown. Efforts may increase following the Version3 acquisition which product focus may result in increasing efforts toward research and development. Software development amounts not related to research and development have been accounted for as deferred software development costs and are amortized over the economic life of the related product (generally three to four years).

P. Government Regulations

Procurement Regulations

We are subject to certain laws, regulations, policies and procedures governing the procurement by local governmental units of goods and services generally. These vary by jurisdiction, and there is a wide variance in the policies and procedures with which we must comply among our clients. For example, some governmental units require that we strictly comply with a request for proposal, some of our projects are subject to bid, and in others, the official handling procurement has considerable discretion. We have integrated compliance with these governmental procurement requirements into our sales process. As a result, the sales cycle associated with our products tends to be complex and lengthy. Factors contributing to the length and complexity of the sales cycle are the potential need to

provide written responses to product demonstrations, customizing software to meet a particular customer's needs and the integration of our products with third party products.

Also, the governmental entities that comprise our customer base generally have the ability to terminate a contract for convenience, typically on a year-to-year basis. This right could adversely impact us, particularly in the case of technology solution projects we may be performing or ongoing service agreements that we may have in place. Although the potential for termination of a governmental customer for convenience exists, we have no significant history of contracts being terminated in this manner.

Impact of Regulations on Maintenance of our Software

With respect to our software products, compliance with existing and future and government regulations is a potential cost to CSI. Upon certain changes in law, we may be required to review the construction and content of our software to determine what impact, if any, the changes will have on the underlying rules tables in, and the operation of, our software. For example, our fund accounting systems have to be modified as the federal and state governments change reporting requirements. Modifications for Form W-2, Form 1099, various health and retirement reporting and payroll tax table updates are a few examples of the changes that may need to be made.

If a regulatory change does impact our software, modification will need to be made at a cost and burden to CSI. In an extreme case, the software may be required to be rewritten entirely. This cost may potentially be passed on to customers in the form of product updates and product service agreements, but in certain circumstances the costs will be absorbed by us entirely. For example, if we have a support agreement with a customer for a software product serviced, but no longer sold, by CSI, then our cost for updating the software may not be fully recoverable from the customer, but instead may be limited by the terms of the support agreement.

Federal E-Rate Program

Because we participate in the federal E-Rate Program, we are subject to the rules and regulations of that program. These rules and regulations are continually reviewed and modified and we must stay current with these changes. The risk factor entitled "*A significant portion of our revenue stems from sales to schools receiving funding through the E-Rate Program. A loss of such funding could have a material adverse impact on our revenues and financial condition,*" contains additional information about the E-Rate program. Approximately 12% and 3% of our 2008 and 2007 revenues, respectively, were generated from the E-Rate program. The Company and its customers compete for federal funds with many other entities and projects. As a result the revenue we receive from the federal E-Rate Program can be volatile.

Q. Employees

As of December 31, 2008, we had 228 full-time employees and five part-time employees. Our relationship with our employees is good. Many employees have worked at CSI for more than five years, some more than ten years. Full-time staff are assigned to the following areas:

Technical/Support Services/Training	66
Software Product Development	36
Engineering Services/Project Management	55
Sales/Sales Support	44
Administration/Finance/Internal Information Technology	27
	<hr/>
	228

Item 1A. Risk Factors.

Risk Factors Relating to Our Company

Our customers are predominantly educational institutions, municipalities, non-profit organizations, and other local governments. Negative trends in governmental spending patterns or failure to appropriate funds for our contracts, whether due to budgetary constraints or otherwise, may have an adverse impact on sales revenues.

Approximately 98% of our revenues are generated from sales of software, hardware and services to county and city governments and school districts. We expect that sales to public sector customers will continue to account for substantially all of our revenues in the future. Many of these contracts are subject to annual review and renewal by the local governments, and may be terminated at any time on short notice. Our dependence on county and city governments and school districts for the sales of our products and services renders our revenue position particularly susceptible to downturns in revenues as a result of changes in governmental spending patterns and the contract award process.

Because we must comply with governmental procurement regulations and undergo governmental approval processes, the sales cycle associated with our products is typically complex and lengthy. This puts us at risk of having to incur significant sales expenses with no assurance that a sale will be consummated and revenues received. Future regulations could increase the magnitude of this risk.

For each contract with a public sector customer, we are typically subject to a procurement process, which can include a competitive bid process and governmental acceptance reviews. The process is often onerous and can include a detailed written response addressing, among other things, the design of software that addresses customer-specified needs, the integration of our products with third-party products and product demonstrations. Future laws and regulations could increase the demands and costs of this process. There is a risk that we could expend significant funds and management resources in complying with the procurement and governmental review rules, only to ultimately fail to close the sale. The procurement process can also be subject to political influences, award protests initiated by unsuccessful bidders and changes in budgets or appropriations which are beyond our control. Reacting or responding to any such influences or protests may involve considerable expense and delay, and may result in termination, reduction or modification of the awarded contract. Our failure to consummate sales after incurring significant expenses to comply with lengthy procurement processes would reduce our profitability and adversely affect our financial condition.

Changes in governmental procurement regulations may increase our costs, and non-compliance could negatively impact our ability to compete.

Government organizations require compliance with various legal and other special considerations in the procurement process. The adoption of new or modified procurement regulations could harm us by increasing the costs of competing for sales or by impacting our ability to perform government contracts. Any violation, intentional or otherwise, of these regulations could result in fines and/or debarment from award of additional government contracts, which could negatively affect our profitability and harm our business reputation.

Compliance with procurement processes and regulations may require us to disclose trade secrets or other confidential business information, which may place us at a competitive disadvantage.

We may, depending on the particular procurement, be required to disclose trade secrets and commercially sensitive information to the governmental entity making the procurement in order to place a bid or respond to a request for proposal. While mechanisms may be in place for protecting such information, disclosure could occur through a Freedom of Information Act release, thereby potentially compromising our confidential information.

Governmental contracts may contain terms not contained in typical private sector sales contracts that may be unfavorable to us. These terms may have the effect of raising our compliance costs or interrupting our revenue stream, either or both of which could negatively impact our income position.

Governmental contracts may contain terms that could adversely impact our sales revenues or increase our costs of doing business. Such terms may include profit limitations and rights of a particular governmental agency to terminate a contract for convenience or if funds are unavailable. We have no significant history of contracts being terminated in this manner; however, we can give no assurances this will not occur in the future. Also, in some cases we may be subject to liquidated damages for defective products and/or delays or interruptions caused by systems failures. Payments under some public sector contracts are subject to achieving implementation milestones and we could in the future have differences with customers as to whether milestones have been achieved.

Modifying our software products to comply with existing and future governmental regulations may increase our operating costs and have a negative impact on our profitability.

From time to time, it may be necessary to revise and update our software products to comply with changes in laws relating to the subject matter with which our software deals. For example, we may have to revise our fund accounting software to comply with changes in reporting requirements. Examples of such changes include modifications for Form W-2, Form 1099 and various health and retirement reporting and payroll tax table updates. The extent of any required revisions will depend upon the nature of the change in law. It is possible that in some cases, the costs of compliance may be passed on to the customer, but in other cases, we may be forced to absorb some or all of the costs. Any absorption of compliance costs would have an adverse impact on profits.

Most of our maintenance agreements are for a term of one year. If our customers do not renew their annual maintenance and support agreements for our products and services, or if they do not renew them on terms that are favorable to us, the reduction in revenues would have an adverse impact on our financial condition.

As the end of the term of a maintenance agreement approaches, we seek to renew the agreement with the customer. Maintenance agreements represented 14% of our total revenue for the 2008 fiscal year and 10% of our total revenue for the 2007 fiscal year. Due to this characteristic of our business, if our customers chose not to renew their maintenance and support agreements with us on terms beneficial to us, our business, operating results and financial condition could be harmed.

We derive a material portion of our revenue from the sale of our fund accounting software. We believe that the use by our customers of our software also gives us a competitive advantage in our providing system integration services, including the sale of hardware, to these customers. Reduced acceptance of our fund accounting software and upgrades of such software could have a direct and indirect adverse impact on our revenues.

We derive a material amount of our revenue from the sale of our fund accounting software and related services, and revenue from this product line and related services is expected to remain a material component of our revenue for the foreseeable future. For the 2008 and 2007 fiscal years, software sales and related services for fund accounting software accounted for approximately 7.2% and 6.2% of our total revenues, respectively. We generally grant non-exclusive licenses to our products on a perpetual basis and deliver new versions and enhancements to customers who purchase annual maintenance and support. We also provide our software under rental arrangements, including ASP (Application Service Provider or CSI hosted) type models. As a result, our future license, services and maintenance revenue are substantially dependent on sales to new customers. In addition, if demand for our fund accounting software declines, we believe we would lose a competitive advantage in providing system integration services, and our technology segment revenues could also decline.

We encounter long sales cycles, particularly for our largest customers, which could have an adverse effect on the amount, timing and predictability of our revenue and sales.

Potential customers, particularly large clients, generally commit significant resources to an evaluation of available software and require us to expend substantial time, effort and money educating them as to the value of our software and services. Sales of our core software products to these larger customers often require an extensive education and marketing effort.

We could expend significant funds and management resources during the sales cycle and ultimately fail to close the sale. Our core software product sales cycle averages approximately six to twelve months. Our sales cycle for all of our products and services is subject to significant risks and delays over which we have little or no control, including:

- our customers' budgetary constraints;
- the timing of our clients' budget cycles and approval processes;
- our clients' willingness to replace their current methods or software solutions;
- our need to educate potential customers about the uses and benefits of our products and services;
- the timing and expiration of our clients' current outsourcing agreements for similar services; and
- the governmental procurement risk described elsewhere in "Risk Factors."

If we are unsuccessful in closing sales after expending significant funds and management resources or if we experience delays as discussed above, it could have a material adverse effect on the size, timing and predictability of our revenue.

We are dependent on strategic relationships with our vendors, and our business would be materially and adversely affected if we were to lose our existing, or fail to gain additional, strategic relationships.

The segment of our business that includes hardware sales and related support services is dependent upon the strong relationships that have been established with our vendors. We purchase equipment from these vendors and add our engineering services to provide a total solution to the customer. Without the vendor products, we would lose the margin on the hardware sale as well as the margin provided by our engineering services.

These relationships could be terminated if we fail to:

- maintain adequate certified systems engineers (computer professionals who have passed a test indicating specialized knowledge in the design, planning and implementation of specific computer-based technology) and staff that can implement and support the vendors' products;
- receive satisfactory feedback from our customers; or
- pay for purchased equipment and services on a timely basis.

The constant rate of new developments in technology can significantly impact demand. The introduction of new technology by us, our competition or suppliers could defer customer purchases, and large swings in demand for new technology could impact the ability of our suppliers to deliver the technology products we sell, or for us to install the software solutions we develop. The deferral of customer purchase decisions, or the inability of our suppliers or us to meet demand on a timely basis due to the introduction of new technology, could negatively impact our profitability. Conversely, our ability to access new technology timely or develop innovative solutions could improve revenues and profitability.

Manufactured hardware products are the most significant volume of revenues reported in our business. They also contribute significantly to our profitability reported through our Technology solutions segment. We are constantly pursuing new technology to add to our portfolio of offerings.

When improved technology is announced but not yet available, customers may defer their purchases until such new technology is available. Such deferral could delay revenues and negatively impact our profitability.

Also, when improved technology is introduced suppliers are frequently unable to supply or deliver and install products in quantities sufficient to meet initial demand. This can also result in a rationing of deliveries.

If our suppliers deliver products to our competition in lieu of, or at a reduced rate of delivery to us, or if we are unable to deliver our products timely, our customers could pursue purchasing from other sources. This could negatively impact our revenue and profitability.

Even in the event that our customers could not find the product elsewhere, a delay in delivery could result in a deferral of our revenues to future periods and lost profitability in the near term. We may be unable to recover such lost profits.

The introduction of new technology by a competitor or by us could also cause a change in customer purchase habits, or defer or eliminate customer purchases of currently available products developed by us or then available from our suppliers.

Management has not seen any impact from these factors resulting in a substantial downturn in buying patterns, but cannot guarantee that a downturn due to such factors will not occur in the future. Management believes delay in supply or postponement by customers of delivery has, from time to time, deferred as much as 10% to 15% of reported annual revenues between quarters. However, it is impossible for us to quantify the total impact on historically reported results due to these factors; nor can we predict the future potential impact, if any.

Our failure to compete successfully could cause our revenue or market share to decline.

Our market is fragmented, competitive and rapidly evolving, and there are limited barriers to entry for some aspects of this market. Our Software applications segment has three primary sources of competition:

- software developers offering integrated specialized products designed to address specific needs of governmental organizations;
- custom-developed products created either internally or outsourced to custom service providers; and
- software developers offering general products not designed to address specific needs of governmental organizations.

Our Technology solutions segment is subject to competition by both regional and national technology solutions providers, including those listed by VAR Business Magazine as the top 500 network integration companies in the United States.

The companies with which we compete, and other potential competitors, may have greater financial, technical and marketing resources and generate greater revenue and better name recognition than we do. If one or more of our competitors or potential competitors were to merge or form a strategic relationship with another of our competitors, the change in the competitive landscape could adversely affect our ability to compete effectively. For example, a large diversified software enterprise, such as Microsoft, Oracle or PeopleSoft, could decide to enter the market directly, including through acquisitions. Also, in the same manner, large hardware and technology solutions providers, such as IBM Global Services, EDS and Lockheed Martin IT could negatively impact our ability to compete in the technology solutions market.

Loss of significant clients could hurt our business by reducing our revenues and profitability.

Our success depends substantially upon retaining our significant clients. Generally, we may lose clients due to conversion to a competing service provider. We cannot guarantee that we will be able to retain long-term relationships or secure renewals of short-term relationships with our significant clients in the future. Our top ten clients constituted approximately 37% and 46% of our revenue for the 2008 and 2007 fiscal years, respectively. The loss of a significant portion or all of these clients would have a material adverse effect on our profitability and financial condition.

We face a number of obstacles in implementing our strategic expansion into new geographic markets. Overcoming these obstacles will require an expenditure of material financial resources and significant efforts by management and other employees. Our failure to succeed in our efforts to penetrate new markets in a timely fashion could adversely affect our profits and margins and our revenue growth.

As we move forward with our growth strategy, we anticipate expanding into new geographic regions. We have achieved the most significant penetration in South Carolina, North Carolina, Georgia and Alabama. We continue our efforts related to moving into surrounding states. While expanding geographic markets provides a good opportunity to extend existing customer bases and increase revenue, breaking into a new market can prove difficult. There are obstacles to successfully entering new geographic markets, including limited market knowledge and relationships, little brand awareness, and no established sales presence or regional client references. We anticipate that initial penetration will be slow but will accelerate over time. We cannot accurately predict the time required to build customer relationships, the rate at which new market penetration can be accomplished, or the costs necessary to expand.

To support the expansion process we plan to hire additional sales personnel, as needed to help penetrate new geographic regions, which could represent a significant investment. While management believes the continued investment will be prudent, periodically there may be an initial short-term negative impact on earnings. Due to the length of our typical software sales closing cycle, six to twelve months, coupled with the obstacles to market penetration discussed above, we cannot predict how long it will take for us to recover these costs.

We may not be able to manage our future growth efficiently or profitably. Increased demands on our human resources and infrastructure due to planned expansion, if not accompanied by increases in revenues, could negatively impact our profitability.

We have experienced significant personnel and infrastructure growth since our inception, and are continuing this expansion to address potential market opportunities. For example, we are expanding the size of our outside and inside sales staff, strengthening our telesales department and increasing our marketing and product development efforts to support a broader geographic reach and expanded product offerings. If these increases in personnel do not produce the intended growth in revenues, there can be no assurance that we will maintain profitability. Additionally, an increase in revenues will result in increased demands on our maintenance and support services professionals in order to maintain service quality. If we are unable to address sufficiently these additional demands on our personnel, operations, systems, procedures and resources, our profitability and growth might suffer.

Because competition for highly qualified personnel is intense, we may not be able to attract and retain the employees we need to support our planned growth.

To execute our plans for continuing growth, we will need to increase the size, and maintain the quality of, our sales force, software development staff and our professional services organization. To meet our objectives, we must attract and retain highly qualified personnel with specialized skill sets focused on the educational and local government market. Competition for qualified personnel can be intense, and we might not be successful in attracting and retaining them. The pool of qualified personnel with experience working with or selling to nonprofit organizations is limited overall and specifically in Easley, South Carolina, where our principal office is located. Our ability to maintain and expand our sales, product development and professional services teams will depend on our ability to recruit, train and retain top quality people with advanced skills who understand selling to, and the specific needs of, educational institutions and local governments. For these reasons, we have from time to time in the past experienced, and we expect to continue to experience in the future, difficulty in hiring and retaining highly skilled employees with appropriate qualifications for our business. In addition, it takes time for our new sales and services personnel to become productive, particularly with respect to obtaining and supporting major customer accounts. In particular, we plan to continue to increase the number of services personnel to attempt to meet the needs of our customers and potential new customers. In addition to hiring services personnel to meet our needs, we might also engage additional third-party consultants as contractors, which could have a negative impact on our earnings. If we are unable to hire or retain qualified personnel, if newly hired personnel fail to develop the necessary skills or if they reach productivity slower than anticipated, it would be more difficult for us to sell our products and services. As a result, we could experience a shortfall in revenue or earnings, and not achieve our planned growth.

As a result of the relatively low margins associated with the sale of hardware, our technology solutions segment produces substantially lower gross margins than our software applications segment. Our overall gross profit margin may be adversely affected if revenues of our technology solutions segment rise as a percentage of total revenues. In turn, this could result in reduced net income.

For the fiscal years ended December 31, 2008 and 2007, our software applications segment reported gross margins of 40.7% and 41.6%, respectively. In contrast, our technology solutions segment for such periods reported gross margins of 16.2% and 15.6%, respectively. Accordingly, an increase in hardware and related sales in our technology solutions segment relative to software revenues in our software applications segment could harm our overall gross margin. A shift in our product mix toward lower margin products would adversely affect our overall profitability if increases in volume of lower margin products did not offset the effect of changes in product mix. A decline in margins may also be received negatively by investors. Since establishing our technology solutions business in 1999, we have seen a continual increase in the amount of hardware we have been able to sell. Hardware pricing is highly

competitive and product life-cycles can be short. We have recently been able to benefit from identifying, selling and implementing new products (for example, IP telephony and classroom learning tools) with higher margins as a result of selling such products before what we believe to be the midpoint of their life-cycles. As market penetration and competition increase for these products, margins and sales of these products may decline. As current hardware based products mature, there can be no assurance that we will identify new products with equal margins or opportunities for greater volume to replace existing products.

If our products fail to perform properly due to undetected errors or similar problems, or fail to comply with government regulations, our business could suffer, and we could become subject to product or general liability or errors and omissions claims. Such claims could be time-consuming and costly. Furthermore, any negligence or misconduct on the part of our consultants could result in financial or other damages to our customers, for which they may bring claims against us.

Complex software such as ours often contains undetected errors or bugs. Software errors are frequently found after introduction of new software or enhancements to existing software. We continually introduce new products and new versions of our products. If we detect any errors before we ship a product, we might have to delay product shipment for an extended period of time while we address the problem. We might not discover software errors that affect our new or current products or enhancements until after they are deployed, and we may need to provide enhancements to correct such errors. Therefore, it is possible that, despite testing by us, errors may occur in our software. These errors, as well as any negligence or misconduct on the part of our consultants, could result in:

- harm to our reputation;
- lost sales;
- delays in commercial release of our software;
- product liability, general liability or errors and omissions claims;
- delays in, or loss of, market acceptance of our products;
- license terminations or renegotiations; and
- unexpected expenses and diversion of resources to remedy errors.

Furthermore, our customers may use our software together with products from other companies. As a result, when problems occur, it might be difficult to identify the source of the problem. Even when our software does not cause these problems, the existence of these errors might cause us to incur significant costs, divert the attention of our technical personnel from our product development efforts, impact our reputation and cause significant customer relations problems.

Our failure to obtain or integrate third-party technologies could delay the development of our software and increase our costs.

We intend to continue licensing technologies from third parties, including applications used in our research and development activities and technologies which are integrated into our products. These technologies may not continue to be available to us on commercially reasonable terms or at all. Our inability to obtain any of these licenses could delay product development until equivalent technology can be identified, licensed and integrated. This inability in turn would harm our business and operating results. Our use of third-party technologies exposes us to increased risks, including, but not limited to, risks associated with the integration of new technology into our products, the diversion of our resources from development of our own proprietary technology and our inability to generate revenue from licensed technology sufficient to offset associated acquisition and maintenance costs.

Our success depends on our ability to respond quickly to changing technology. We believe that we must develop new software programs and services utilizing modern technology in order to maintain our competitive position and profitability.

The market for our products and services is characterized by rapid technological change, evolving industry standards in computer hardware and software technology, changes in customer requirements and frequent new product introductions and enhancements. The introduction of products embodying new technologies and the emergence of new industry standards can cause customers to delay their purchasing decisions and render existing products obsolete and unmarketable. The life cycles of our software products are difficult to estimate. As a result, our future success will depend, in part, upon our ability to continue to enhance existing products and to develop and introduce in a timely manner new products with technological developments that satisfy customer requirements and achieve market acceptance. We may not be able to successfully identify new product opportunities and develop and bring new products to market in a timely and cost-effective manner. In addition, products, capabilities or technologies developed by others could render our products or technologies obsolete or noncompetitive or shorten product life cycles. If we are unable to develop on a timely and cost-effective basis new software products or enhancements to existing products, or if new products or enhancements do not achieve market acceptance, we may not be able to compete effectively or maintain or grow our revenues.

Software development is inherently complex, particularly development for multi-platform environments. In addition, our customers demand broad functionality and performance. As a result, major new product enhancements and new products can require long

development and testing periods before they are released commercially. We have on occasion experienced delays in the scheduled introduction of new and enhanced products, and future delays could increase costs and delay revenues.

We have made significant investments in software development and our growth plans are premised in part on generating substantial revenue from new product introductions and future enhancements to existing products. New product introductions and enhancements involve significant risks. For example, delays in new product introductions and enhancements, or less-than-anticipated market acceptance, are possible and would have an adverse effect on our revenue and earnings. We cannot be certain that our new products or enhancements will meet customer performance needs or expectations when shipped or that they will be free of significant software defects or bugs. If they do not meet customer needs or expectations, for whatever reason, upgrading or enhancing these products could be costly and time consuming.

In addition, the selling price of software products tends to decline significantly over the life of the product. If we are unable to offset any reductions in the selling prices of our products by introducing new products at higher prices or by reducing our costs, our revenue, gross margin and operating results would be adversely affected.

Advances in technology can require retraining and additional certifications for existing personnel or hiring of more qualified personnel. The most significant portion of our investment in software development is related to labor. If our personnel are unable to keep up with changing technologies or we are unable to attract, hire, and retain personnel having the qualifications needed to engineer, manage and implement technological advances, our competitive position may erode. Erosion of our competitive position could have an adverse effect on our revenues and profitability.

If the security of our software is breached, we could suffer significant costs and damage to our reputation.

Fundamental to the use of our products is the secure collection, storage and transmission of confidential information. Third parties may attempt to breach our security or that of our customers and their databases. We may be liable to our customers for any breach in such security, and any breach could harm our customers, our business and our reputation. Any imposition of liability, particularly liability that is not covered by insurance or is in excess of insurance coverage, could harm our reputation, our business and our operating results. Also, computers, including those that utilize our software, are vulnerable to computer viruses, physical or electronic break-ins and similar disruptions. Such disruptions could lead to interruptions, delays or loss of data and we may be required to expend significant capital and other resources to protect further against security breaches or to rectify problems caused by any security breach.

Future acquisitions could prove difficult to integrate, disrupt our business, dilute stockholder value and strain our resources.

One significant reason for our entering into the merger and recapitalization transaction in February 2005 was to allow us to access public capital markets as a source of funding to permit us to grow through acquisitions. In addition, the merger transaction facilitated the sale of warrants, the exercise of which (absent a cashless exercise) represents a significant potential source of capital. Our markets are occupied by a number of competitors, many substantially larger than we, and with significantly greater geographic reach. We believe that to remain competitive, we need to take advantage of acquisition opportunities that arise which may help us achieve greater geographic presence and economies of scale. We may also utilize acquisitions to, whenever appropriate, expand our technological capabilities and product offerings.

While we may use a portion of any cash proceeds generated by operations or obtained from capital sources to pay down debt on an interim basis, we intend to use any remaining proceeds or availability from a debt related pay down to fund acquisitions. Pursuant to this strategic plan, we intend to acquire companies, products, services and/or technologies that we feel could complement or expand our existing business operations, augment our market coverage, enhance our technical capabilities, provide us with important customer contacts or otherwise offer growth opportunities. Acquisitions and investments involve numerous risks, including:

- improper valuation of the acquired business;
- difficulties in integrating operations, corporate cultures, technologies, services, accounting and personnel;
- difficulties in supporting and transitioning customers of acquired companies;
- diversion of financial and management resources from existing operations;
- risks of entering new sectors of the educational and governmental market;
- potential loss of key employees;
- inability to generate sufficient revenue to offset acquisition or investment costs; and
- consumption of significant capital and cash flow to the detriment of other business opportunities and needs.

Acquisitions also frequently result in recording of goodwill and other intangible assets. These intangible assets are subject to potential impairments in the future as well as allocations, including write-ups to depreciable assets, which could negatively impact our future operating results. In addition, if we finance acquisitions by issuing equity securities or securities convertible into equity securities, our existing stockholders could be diluted. Such dilution could in turn affect the market price of our stock. Moreover, financing an acquisition with debt would result in higher leverage and interest costs. As a result, if we fail to evaluate and execute acquisitions properly, we might not achieve the anticipated benefits. We may also incur costs in excess of what we anticipate.

Acquisitions also may impact our margins. In 2007 the decline in our software applications margin was primarily driven by the addition of McAleer operations, and in 2008 by the ICS and Version3 acquisitions which have historically reported lower margins. The acquisition of a technology business, with its even lower margins than the software applications addition, could also decrease the margin significantly. We cannot predict the timing of acquisitions or the margins of those entities we may acquire, or their impact on our overall margins.

There can be no assurance suitable acquisition candidates will be available of sufficient size or in sufficient numbers, that we will be able to procure adequate financing, or that we will be able to successfully purchase or profitably manage acquired companies. We can give no assurance that future acquisitions will further the successful implementation of our overall strategy or that acquisitions ultimately will produce returns that justify the investment. In addition, we may compete for acquisitions and expansion opportunities with companies that have significantly greater resources than we do.

We continue to seek out and hold preliminary discussions with various acquisition candidates. However, we have not entered into agreements or understandings for any acquisition which management deems material.

Our ability to raise capital in the future may be limited and our failure to raise capital when needed could prevent us from executing our growth strategy.

The timing and amount of our working capital and capital expenditure requirements may vary significantly depending on many factors, including:

- market acceptance of our products and services;
- the need to adapt to changing technologies and technical requirements;
- the existence of opportunities for expansion; and
- access to and availability of sufficient management, technical, marketing and financial personnel.

If our capital resources are not sufficient to satisfy our liquidity needs, we may seek to sell additional equity or obtain other financing. We may not be able to obtain sufficient additional financing, if required, in amounts or on terms acceptable to us, or at all.

Under certain circumstances, holders of warrants to purchase shares of our common stock may be able to exercise those warrants pursuant to a cashless exercise. A cashless exercise may adversely impact our business strategy.

The terms of the warrants held by Barron permit the cashless exercise of the warrants under certain circumstances. A cashless exercise would not result in capital inflow to the Company, which may hinder the implementation of our business strategy, one element of which is to expand through acquisition.

We currently do not have any pending or issued patents, but we rely upon trademark, copyright and trade secret laws to protect our proprietary intellectual property rights, which might not provide us with adequate protection. The loss or compromising of our rights in our intellectual property could adversely affect our competitive position and raise our costs.

Our success and ability to compete depend to a significant degree upon the protection of our software and other proprietary technology rights. We might not be successful in protecting our proprietary technology, and our proprietary rights might not provide us with a meaningful competitive advantage. To protect our proprietary technology, we rely on a combination of trademark, copyright and trade secret laws, as well as nondisclosure agreements. Each of these affords only limited protection. Moreover, we have no patent protection for Accounting+Plus software, which is one of our core products. Any inability to protect our intellectual property rights could seriously harm our competitive position, operating results and financial condition.

In addition, the laws of some foreign countries do not protect our proprietary rights in our products to the same extent as do the laws of the United States. Despite the measures taken by us, it may be possible for a third party to copy or otherwise obtain and use our proprietary technology and information without authorization. Policing unauthorized use of our products is difficult, and litigation could become necessary in the future to enforce our intellectual property rights. Any litigation could be time consuming and expensive to prosecute or resolve, result in substantial diversion of management attention and resources, and materially harm our business, financial condition and results of operations.

Because we generally do not have written software licenses, we must rely primarily on implied licenses and copyrights to protect our software. The enforcement of implied licenses and copyrights may be time-consuming and costly.

Enforcement of the implied licenses on our software would be primarily based on copyright infringement grounds and/or on common law principles pertaining to implied licenses. Proving a breach of contract relating to a violation of an implied license may be difficult. Violations of copyrights on our software could include, among other things, unauthorized copies of the software being made, unauthorized distribution of our software, and unauthorized derivative works being made of our software (such as by reverse engineering). While each of the foregoing rights are held by a copyright owner, copyright infringement may be difficult to prove, whereas a violation of an express license may be more readily provable and may provide additional rights and remedies than available through copyright protection. Therefore, we may have to expend significant time and financial resources should the need arise to enforce an implied license or copyright.

Claims that we infringe upon third parties' intellectual property rights could be costly to defend or settle.

Litigation regarding intellectual property rights is not unusual in the software industry. We expect that software products and services may be increasingly subject to third-party infringement claims as the number of competitors in our industry segment grows and the functionality of products in different industry segments overlaps. We may from time to time encounter disputes over rights and obligations concerning intellectual property. Although we believe that our intellectual property rights are sufficient to allow us to market our software without incurring liability to third parties, third parties may nevertheless bring claims of infringement against us. Such claims may be with or without merit. Any litigation to defend against claims of infringement or invalidity could result in substantial costs and diversion of resources. Furthermore, a party making such a claim could secure a judgment that requires us to pay substantial damages. A judgment could also include an injunction or other court order that could prevent us from selling and/or servicing our software. Our business, results of operations and financial condition could be harmed if any of these events occurred.

In addition, we have agreed, and will likely agree in the future, to indemnify certain of our customers against certain claims that our software infringes upon the intellectual property rights of others. We could incur substantial costs in defending ourselves and our customers against infringement claims. In the event of a claim of infringement, we and our customers might be required to obtain one or more licenses from third parties. We, or our customers, might be unable to obtain necessary licenses from third parties at a reasonable cost, if at all. Defense of any lawsuit or failure to obtain any such required licenses could harm our business, operating results and financial condition.

Increasing government regulation of electronic commerce could reduce our revenues and increase our costs.

We are subject not only to regulations applicable to businesses generally but also to laws and regulations directly applicable to electronic commerce. We deliver marketing, shareholder and customer information, product demonstrations, new software and software updates, technical support and training over the internet. We also sell services whereby a customer may access and use our software to load and manage their organization's data over the internet. Although there are currently relatively few laws and regulations governing electronic commerce, state, federal and foreign governments may adopt laws and regulations applicable to our business. Any such legislation or regulation could increase our operating costs as we are forced to comply, or increase the operating costs to our customers. In any such event, customers may decide not to use our products and services. Any new laws or regulations in the following areas could cause us to incur new compliance expenses, or otherwise adversely affect our business:

- user security and privacy;
- the pricing and taxation of internet use or goods and services offered or provided via the internet;
- the online distribution of specific material, content or services over the internet; and
- the content of websites or other internet marketing abilities (e.g., "do not call" (do not contact) registry requirements).

A significant portion of our revenues stems from sales to schools receiving funding through the E-Rate Program. A loss of such funding could have a material adverse impact on our revenues and financial condition.

We participate in the E-Rate Program, a government program providing funding for telecommunications, internet access and internal connections for schools that have a very high free and reduced lunch rate count. Schools and school districts that have developed an approved technology plan may receive funds to implement the plan. Service providers may sell to such schools and districts through an open and competitive bidding process. We have received funding through the E-Rate program since 2001, which has in previous years represented up to 25% of our total revenues. The Schools and Libraries Division of the Universal Service Administrative Company, which administers the program, may conduct audits with respect to previous funding years. If the Schools and Libraries Division were to find that either we or the school to which we have made sales did not comply with the rules and regulations of the program, previous funding may have to be repaid and we could be barred from future bidding under the program. To date, we have not had to repay any money received in connection with the program, nor have we been cited for any material violation of program guidelines.

The current recession has adversely impacted our primary client base – education and local government customers - by reducing their revenues from various taxes. This could negatively impact the ability of such potential clients to purchase the Company's products. Although increased appropriations for education under the 2009 Recovery Act could offset or even increase the ability of education and local government customers to purchase the Company's products, such stimulus funding could be delayed, negatively impacting the Company's revenues in the short term.

As 2008 progressed, the United States slid into what has been described by economic and financial analysts as a "recession." Reductions in business and consumer spending impact our primary client base -- education and local government customers -- by reducing their revenues from sales tax. Reductions in property values also impact our clients through reductions in property taxes. Such reductions have the potential to decrease the amount of funds available for the software and technology solutions CSI provides. As a result of the impact of the recession on our customers, in recent months we have seen a moderate increase in the amount of projects postponed or changed as a result of customer budget cuts, which has resulted in an extension of our sales closing cycles. We do not know how long this current recession will last, and thus cannot predict with certainty how long this trend in increasing sales closing cycles will last.

In an attempt to jumpstart the economy, President Obama signed into law The American Recovery and Reinvestment Act of 2009 ("Recovery Act") on February 17, 2009. The Recovery Act included spending for relief for state government and education budget shortfalls, and funding of specific initiatives including expanding educational opportunities. We have learned school districts are actually going to receive several blocks of money – Stabilization funds, Title I and IDEA (Individuals with Disabilities Education Act), E2T2 (Enhancing Education Through Technology), etc. These initiatives and incentives may have a direct, positive impact on our financial results, and may defray, offset or even overcompensate for the negative impact of budget shortfalls in our customer markets. However, we still cannot be certain what dollars will be available to fund the types of software and technology projects we provide or when those dollars will begin to flow. Due to the uncertainties as to when the funds will be distributed; where, and how much might be available; what eligible projects we might be able to propose and win; and whether suppliers are capable of meeting the potential increase in demand, we cannot predict what impact, if any, the Recovery Act will have on our financial results.

Therefore, we expect our top and bottom line performance for the first quarter of 2009 to be below the same quarter of the prior year and may more closely resemble the fourth quarter of 2008. In addition, the results for our second quarter of 2009 may also be below the prior year as we await the settlement of uncertainties surrounding the Recovery Act and as we maintain our operations at a level capable of capitalizing on what we believe is significant potential for upside from the future spending of Recovery Act funds.

The requirements of being a public company, particularly the requirement to report financial results publicly and on a quarterly basis and compliance requirements under Sarbanes-Oxley, have increased our administrative costs and may reduce our profitability in future periods in comparison to our reported historical results of operations. These requirements may also distract management from business operations.

As a public company, we are subject to a number of requirements, including the reporting requirements of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and the Sarbanes-Oxley Act of 2002. The Exchange Act requires, among other things, that we file annual, quarterly and current reports with respect to our business and financial condition. The Sarbanes-Oxley Act requires, among other things, that we maintain effective disclosure controls and procedures and internal controls for financial reporting.

Prior to February 11, 2005, we were a public shell with virtually no operations and had limited staff with highly technical accounting and public reporting expertise. In the first quarter of 2005, we entered into a complex merger and resumed public reporting of significant operations. Considerable additional effort is required to maintain and improve the effectiveness of disclosure controls and procedures and internal controls over financial reporting to meet the demands of a public reporting environment. Particularly, substantial additional resources are required in light of Section 404 of the Sarbanes-Oxley Act and the related regulations regarding our required assessment of our internal controls over financial reporting beginning with our fiscal 2007 Annual Report on Form 10-K and our independent registered public accounting firm's audit of that assessment beginning with our fiscal 2009 Annual Report on Form 10-K. These requirements have made it necessary for us to hire additional and more technical personnel and engage external resources. Public company requirements have increased our administrative costs and may reduce our profitability in future periods in comparison to our reported historical results.

Significant management oversight will also be necessary in light of these requirements. As a result, our management's attention might be diverted from other business concerns, which could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Our inability to attract and retain qualified personnel to adequately manage the implementation of these requirements in a timely fashion might adversely impact our compliance with Section 404. Any failure to comply with Section 404 as required may harm our financial position, reduce investor confidence, cause a decline in the market price for our common stock and subject us to costly litigation.

Failure to comply with certain standards could result in a conclusion that there are significant deficiencies or material weaknesses in our internal control over financial reporting, and management may be unable to declare our internal control over financial reporting effective.

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods required by the SEC. These disclosure controls include controls and procedures designed to ensure that such information is accumulated and communicated to our management to allow timely decisions regarding required disclosures. Our management, under the direction of our chief executive officer and chief financial officer, evaluate the design and effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of each quarter. Based on such evaluations, these officers have, in the past, concluded that our disclosure controls and procedures have not been effective, and that certain weaknesses in our internal control over financial reporting have existed. These weaknesses or deficiencies included both needed improvements in our controls and processes, and the need to hire personnel and purchase resources to support the needs of a public company. Prior to February 11, 2005, we were a public shell with virtually no operations and had limited need for staff with highly technical accounting and public reporting expertise. In addition, our predecessor, CSI – South Carolina, was a private company and likewise had no need for staff with technical accounting and public reporting expertise. In the first quarter of 2005, we entered into a complex merger and resumed public reporting of significant operations. It was not until May 6, 2005 that we hired a chief financial officer with prior public reporting experience who is accustomed to dealing with more complex accounting matters.

While these weaknesses have been mitigated through changes in processes, increased hiring of internal personnel, engagement of external personnel with sufficient technical experience, and purchases of software resources to support our efforts, it was not until the fourth quarter of 2007 that management was able to conclude that our disclosure controls and internal control over financial reporting were effective. These conclusions followed our implementation of controls and processes in connection with the Sarbanes-Oxley Act legislation.

Even with these changes and our declaration of effectiveness, due to the increasing number and complexity of pronouncements, emerging issues and releases, and reporting requirements and regulations, we expect there will continue to be some risks related to our financial disclosures. We believe that such risks have been reasonably mitigated following our implementation of the Sarbanes-Oxley Act requirements in late 2007. However, the process of identifying risk areas and implementing financial disclosure controls and internal controls over financial reporting required under the Sarbanes-Oxley Act continues to be complex and subject to significant judgment. This process may result in the identification in the future of areas where we may need additional resources or changes in processes. Additionally, due to the complexity and judgment involved in this process, we cannot guarantee that we may not find or have pointed out to us, including by our auditors following their future required independent assessment of our controls, additional areas needing improvement or resulting in a future assessment that our controls are or have become ineffective as a result of overlooked or newly created significant deficiencies or unmitigated risks.

We may discover and report additional weaknesses in our internal controls. Reporting deficiencies could harm our financial position, reduce investor confidence, cause a decline in the market price for our common stock and subject us to costly litigation.

Effective internal controls are necessary for us to provide reliable financial reports and effectively prevent fraud. If we cannot provide reliable financial reports or prevent fraud, our results of operations could be misstated and our reputation may be harmed.

The PCAOB has defined a material weakness as a “significant control deficiency, or combination of deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.” A material weakness does not necessarily mean that a material misstatement has occurred or will occur, but that it could occur.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act). Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of published financial statements in accordance with generally accepted accounting principles.

However, because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or the degree of compliance with policies may deteriorate.

While we have declared our internal control over financial reporting effective as of the period ended December 31, 2008, we cannot assure you that the measures we have taken to date or further measures will ensure that we will be able to implement and maintain adequate controls over our financial processes and reporting to prevent any failure or deficiency. Any deficiencies or failures in internal controls or reporting deficiencies or failures could harm the financial position of our business, reduce investor confidence, cause a decline in the market price for our common stock, and subject us to costly litigation.

Our management has limited experience in managing a public company, which could hamper our ability to function effectively as a public company.

Our management team has historically operated our business as a privately-owned corporation. Except for our CFO, hired May 6, 2005, the individuals who now constitute our senior management did not have experience managing a publicly-traded company prior to our reverse merger. In particular, management is inexperienced in utilizing sophisticated forecasting or long term historical analysis of data that may be used for projecting future operating and financial results with a significant degree of consistency and accuracy. Due to the limited number of our personnel with experience with publicly-traded companies, any unexpected departure of our CFO could result in our inability to comply fully with accounting pronouncements and public filing requirements on a timely basis. If we are unable to comply, our financial condition could be adversely affected.

In addition, although we are in the process of updating our systems and processes to public company standards, such systems and processes in many aspects still reflect those of a non-public corporation. As a result, we cannot assure you that we will be able to execute our business strategy as a public company. You should be especially cautious in drawing conclusions about the ability of our management team to provide guidance or other forward looking information regarding our operating or financial results with a reasonable degree of consistency and accuracy.

The development and enhancement of our software requires significant capital expenditures that we may not be able to make if we were to experience significant revenue reductions. Our failure or delay in developing and enhancing our software could seriously erode our competitive position.

Software technology is characterized by rapid technological change and evolving industry standards that require continuous development and enhancements to our software applications. Significant resources, primarily in the form of salaries and benefits, are required to keep up with these changes. We are in the process of rewriting our software applications to take advantage of current technologies. If we were to experience significant revenue reductions, our ability to implement these changes could be delayed or eliminated, eroding our competitive position and adversely affecting our revenues and financial condition.

We do not anticipate repaying our subordinated notes which mature on March 31, 2009 and which subordinated notes have, at times, been in default. While we expect to extend the due date, any failure to obtain the continued cooperation of the holders or a restructuring of the subordinated notes could result, among other things, in a cross-default under our bank credit facility. Such result could have a material adverse effect on our liquidity position and our ability to fund operations.

Although we possessed adequate availability on the original May 9, 2006 due date to repay the subordinated notes, management believed that cash flow from operations and remaining availability under the bank facility following such a drawdown would not be sufficient to fund ongoing working capital needs. We also anticipated that such a refunding of the subordinated notes with bank debt would have caused us to fail to comply with equity related covenants with the bank, given that the subordinated notes are treated as equity for such ratios. Accordingly, after consultation with the bank and the holders of the subordinated notes, we determined it was not in the best interest of all stakeholders to pay the notes at maturity, and the subordinated notes remained due and payable. In the best interest of all parties we intentionally defaulted on the payment, and, from time to time have remained in default. Pursuant to an agreement dated April 23, 2008 among the noteholders and the Company, the maturity date of the notes was formally extended until March 31, 2009. As a result of our failure to pay the notes when originally due, we pay a default interest rate of 15%, both on the principal balance and any interest not paid quarterly. From time to time we have deferred the payment of interest to preserve working capital. Specifically, we took this action in the first and second quarters of 2007 as a precautionary measure considering the cash requirement needed for the acquisition of the McAleer operations. Subsequently, we paid this and other interest due and no interest was in arrears as of December 31, 2008. From time to time we have made partial principal payments on the notes and may do so in the future, depending on cash flows, additional sources of funds (such as proceeds from the sale of warrants), working capital needs and our ability to comply with our standard bank facilities' covenants when doing so.

We do not anticipate repaying the subordinated notes upon the March 31, 2009 extended maturity. We intend to seek and expect to obtain another extension of the term of the subordinated notes from the noteholders. However, we can give no assurances as to whether those efforts will be successful.

Our subordinated noteholders have cooperated with us in the deferral of payment on the subordinated notes. We anticipate the continued cooperation of the noteholders and the ultimate resolution with future payments or other restructuring of our subordinated debt. Looking forward, considering our growth and acquisition strategy, we believe it unlikely that we will be able to generate sufficient operating cash flow so as to permit repayment of the subordinated notes with draws under the revolving credit facility. Instead, we believe the subordinated notes will more likely be restructured or repaid from long term capital sources. The subordinated notes may, for example, be refinanced as part of the financing of future acquisitions, or repaid from the proceeds of the exercise of warrants by Barron. However, we can give no assurance that we will be able to successfully restructure, extend or repay the subordinated notes, or that the noteholders will continue to cooperate. Our bank lender has likewise consented with respect to the subordinated notes and has granted a waiver relating to their nonpayment. The notes are subordinated to our senior bank debt, and we believe the ability of the noteholders to have direct recourse against us is limited. However, the holders of the subordinated notes may

take actions that could adversely affect the Company, including acting to accelerate the subordinated debt, thereby potentially triggering a default under our credit facility with our bank. Such noteholders also may take legal or other adverse collection actions against the Company. We can therefore give no assurances as to what adverse collection actions the subordinated noteholders might take, and the impact such actions and default might otherwise have on our other creditors and our financial condition. However, we do not anticipate any of the noteholders taking any action detrimental to us. It should be noted that five of the subordinated noteholders are currently significant stockholders of the Company, and four of these are executive officers. The sixth noteholder, Barron, holds all our preferred stock.

We may not be able to repay our credit facility which matures in June 2010. Our future funding needs may outstrip the amount of our bank facility. Any failure to repay or secure renewal or refinancing of the bank credit facility, or our inability to increase it in the future, could have a material adverse affect on our liquidity position and our ability to fund operations.

On September 14, 2007, we entered into agreements with our senior lender, RBC Centura Bank. The primary purpose was to increase the amount of our credit facilities in order to provide for our expanding working capital and other credit needs. Specifically, the Company's revolving facility was increased from \$5.5 million to \$7.0 million. The revolving facility is priced at one month LIBOR plus 2.5% and expires on June 30, 2010. Availability under the revolving facility is determined pursuant to a borrowing base equal to 80% of the Company's eligible accounts receivable and 50% of the Company's eligible inventory up to \$1,000,000. The revolving facility and our equipment facility are secured by substantially all of our assets. In January 2007, the revolver, which was originally established in connection with our reverse merger in 2005, was increased to support the McAleer acquisition.

While we have drawn on our line significantly and paid it down from time to time, we cannot guarantee that cash flow from operations will be sufficient to repay our line of credit facility at the time it is due and adequately fund our growing working capital needs. In the alternative, we would attempt to refinance the credit facility with another lender. Although management currently believes that our existing lender will agree to a renewal of the facility, there can be no assurance that our bank will in fact do so or that replacement financing could be procured by us on favorable terms or at all. Further, any failure to resolve any future default under or otherwise restructure the subordinated notes, or to maintain the cooperation of the holders of such notes, could negatively impact our ability to renew our existing bank credit facility or procure a replacement. Without such a credit facility, we believe that our ability to fund our business operations, including providing sufficient working capital to fund sales growth, could be adversely affected.

We believe our bank credit facility is currently sufficient to meet our financial needs. However, events could arise which would increase our working capital and other funds requirements beyond the limits of the bank credit facility. Such events might include (i) the need to fund additional acquisitions, (ii) increased working capital needs resulting from additional acquisitions, and (iii) increased working capital requirements resulting from significantly increased sales as a result of increased education funding under the 2009 Recovery Act. Although we believe we have good relations with our bank, we can give no assurances that it would be willing to increase our bank credit line in the future to levels commensurate with our working capital and other funds requirements.

We depend on key management and may not be able to retain those executives or recruit additional qualified personnel.

We believe that our future success will be due, in part, to the continued services of our senior management team. This team historically has been and we anticipate for the foreseeable future will continue to be relatively small. Our company was built by the five former shareholders of CSI – South Carolina who were largely responsible for our growth over the past 15 years. All of these founders of the Company now serve as our executive officers, with the exception of our former interim CFO, Joe G. Black, now retired. Each of the remaining four CSI – South Carolina founders have garnered significant technical expertise in both our products and the requirements of our client base. They have also developed relationships with our clients that we believe are valuable. They have been responsible for the technical development of our products and solutions and the creation of our business strategy. Because we are now a public company, we must also retain a chief financial officer with requisite technical expertise to handle the requirements of public company reporting and compliance. Our ability to implement our business plan is dependent on the retention of these executives who have specific, differentiated skills, as well as key management personnel of businesses we acquire. Losing the services of one or more members of our management team could adversely affect our business and expansion plans.

Our certificate of incorporation limits the liability of our directors, which may bar stockholder actions and recovery against the directors for misconduct.

We have adopted provisions in our Amended and Restated Certificate of Incorporation that eliminate to the fullest extent permissible under Delaware law the liability of our directors for monetary damages for breach of fiduciary of duty as a director. While it may limit stockholder actions against the directors of the Company for various acts of malfeasance, the provision is designed to ensure the ability of our directors to exercise their best business judgment in managing the Company's affairs, subject to their continuing fiduciary duties of loyalty to the Company and its stockholders. Absent such a limitation, their judgment could be unreasonably impeded by exposure to potentially high personal costs or other uncertainties of litigation.

Our certificate of incorporation and bylaws provide for the indemnification of management, which in certain circumstances could serve to circumvent the recovery by stockholders in legal actions.

Our Amended and Restated Certificate of Incorporation and Amended and Restated Bylaws, to the fullest extent permitted by Delaware law, provide, generally, that the Company will indemnify, including the advancement of expenses, any director, officer, employee or agent of the Company who is, or is threatened to be made, a party to any action, suit or proceeding by reason of the fact he was acting as a director, officer, employee or agent of the Company. Any advancement of expenses is subject to the indemnified person undertaking to repay any advanced expenses later deemed to be improper. Such indemnification would cover the cost of attorneys' fees as well as any judgment, fine or amount paid in settlement of such action provided that the indemnified party meets certain standards of conduct necessary for indemnification under applicable law and the provisions of the Amended and Restated Bylaws. Such indemnity may or may not be covered by officer and director liability insurance and could result in expense to the Company even if such person is not successful in the action. This provision is designed to protect such persons against the costs of litigation that may result from his or her actions on our behalf.

Risk Factors Relating to Our Common Stock

Our quarterly financial results fluctuate and may be difficult to forecast. If our future results are below either any guidance we may issue or the expectations of public market analysts and investors, the price of our common stock may decline.

Our quarterly revenue and results of operations are difficult to forecast. We have experienced, and expect to continue to experience, fluctuations in revenue and operating results from quarter to quarter. As a result, we believe that quarter-to-quarter comparisons of our revenue and operating results are not necessarily meaningful and that such comparisons might not be accurate indicators of future performance. The reasons for these fluctuations include but are not limited to:

- the amount and timing of sales of our software, including the relatively long sales cycles associated with many of our large software sales;
- budget and spending decisions by our customers;
- market acceptance of new products we release;
- the amount and timing of operating costs related to the expansion of our business, operations and infrastructure;
- changes in our pricing policies or our competitors' pricing policies;
- seasonality in our revenue;
- general economic conditions; and
- costs related to acquisitions of technologies or businesses.

Certain of our costs and expenses are based on our expectations of future revenue and are, to a large extent, fixed in the short term. These include: our software development costs, certain other overhead costs in costs of sales and the majority of our general and administrative expenses. If revenue falls below our expectations in a quarter and we are not able to quickly reduce our expenses in response, our operating results for that quarter could be adversely affected. It is possible that in some future quarter our operating results may be below either any guidance we may issue or the expectations of public market analysts and investors and, as a result, the price of our common stock may fall.

The market for our common stock is limited. Accordingly, we cannot assure you that an adequate market will develop for our common stock or what the market price of our common stock will be.

Our common stock is currently traded in the over-the-counter market and is quoted on the OTC Bulletin Board. As of March 11, 2009, only approximately 2,835,443 shares were held by non-affiliates and available for trading in the over-the-counter market. As a result, the liquidity of our common stock is limited, not only in the number of shares that are bought and sold, but also through delays in the timing of transactions and the lack of coverage by security analysts and the news media of our company.

In addition, prices per share of our common stock may be lower than might otherwise prevail if it were quoted on the NASDAQ Stock Market or traded on a national securities exchange, such as the New York Stock Exchange or the American Stock Exchange. This lack of liquidity may also make it more difficult to raise capital in the future through the sale of equity securities.

The price of our common stock might be volatile.

Our stock price has been and may continue to be volatile, making an investment in our company risky. In recent years, technology stocks have experienced high levels of volatility and significant declines in value from their historic highs. The trading price of our common stock may fluctuate substantially. The price of the common stock that will prevail in the market might be higher or lower

than the price you pay, depending on many factors, some of which are beyond our control and may not be related to our operating performance. The fluctuations could cause you to lose part or all of your investment in our shares of common stock. Those factors that could cause fluctuations in the trading price of our common stock include the following:

- price and volume fluctuations in the overall stock market from time to time;
- significant volatility in the market price and trading volume of software and technology companies;
- actual or anticipated changes in our earnings or fluctuations in our operating results or in the expectations of securities analysts;
- economic conditions and trends in general and in the software and information technology industries;
- major catastrophic events, including terrorist activities, which could reduce or divert funding from, and technology spending by, our core customer base of municipal governments and educational institutions;
- our common stock continuing to be thinly traded, with the result that relatively small sale transactions have a market impact out of proportion to their magnitude;
- lack of awareness of CSI by a reasonable quantity of investors, coupled with bargain based bidding by a limited number of investors, and conversely increasing awareness of CSI resulting in higher demand;
- changes in our pricing policies or the pricing policies of our customers;
- changes in the estimation of the future size and growth of our market; or
- departures of or changes in key personnel.

In the past, following periods of volatility in the market price of a company's securities, securities class action litigation has often been brought against that company. Due to the potential volatility of our stock price, we might be the target of securities litigation in the future. Securities litigation could result in substantial costs and divert management's attention and resources from our business.

The sale of common stock under our registration statement could encourage short sales by third parties.

If a significant number of shares are sold pursuant to our registration statement, the effect may be downward price pressure on shares of our common stock. Falling share prices may encourage short sales of our common stock, which may exacerbate the downward price pressure.

Holders of the Series A Convertible Preferred Stock have certain rights which are superior to those of the common stockholders. These rights may adversely affect the liquidity and value of your investment.

The superior rights of the preferred stock include:

- If we are liquidated, our preferred stockholders have priority on the distribution of assets up to their original investment value of \$0.6986 per share. If any assets remain after the preferred stockholders receive their entitlement, then the remaining assets will be distributed on a pro rata basis to the common stockholders.
- In the event of a change in control of our company or the occurrence of certain other transactions including, but not limited to, a tender offer, exchange offer or compulsory share exchange, holders of Series A Convertible Preferred Stock are entitled to treat such a transaction as a liquidation and recover their original investment in our company.
- While the preferred stock is outstanding, we are not permitted to pay dividends on our common stock. This restriction means we are unlikely to pay dividends to our common stockholders in the foreseeable future.
- In the future, if we were to offer shares of common stock to the public for cash, the holder of Series A Convertible Preferred Stock and the five former shareholders of CSI – South Carolina would have the right to participate pro rata in such an offering at 80% of the offering price. We do not currently contemplate such an offering.

The Certificate of Designation of Preferences, Rights and Limitations of Series A Convertible Preferred Stock permits the preferred stockholders to demand the return of their original investment under certain circumstances, which could hinder a stock transfer or business combination transaction beneficial to stockholders.

The preferred stockholders have the ability to elect to treat a change in control and certain other fundamental transactions as a liquidation and to be repaid their original investment under these circumstances. These transactions include a tender offer, an exchange offer, or a compulsory share exchange. The ability of the preferred stockholders to elect liquidation treatment could hinder or even prevent an acquisition transaction that might be beneficial to our common stockholders.

The raising of additional capital in the future may dilute your ownership in our company.

We may need to raise additional funds through public or private debt or equity financings in order to:

- take advantage of opportunities, including more rapid expansion;
- acquire complementary businesses or technologies;
- refund our subordinated notes, which totaled \$1,950,400 at December 31, 2008, or other indebtedness;
- provide additional working capital to support revenue growth;
- develop new services and products; or
- respond to competitive pressures.

Any additional capital raised through the sale of equity may dilute your ownership percentage in our company.

We could issue additional shares of common stock, which might dilute the book value of our common stock.

We have a total of 40,000,000 authorized shares of common stock, of which 7,181,204 shares were issued and outstanding as of March 11, 2009. Our board of directors has the authority, without action or vote of our stockholders in most cases, to issue all or a part of any authorized but unissued shares of our common stock. Such stock issuances may be made at a price that reflects a discount from the then-current trading price of our common stock. Of our 40,000,000 authorized shares, we had reserved for issuance as of March 11, 2009, 13,288,875 shares of common stock relating to outstanding warrants, options and convertible preferred stock. An additional 1,037,756 shares of our common stock were reserved for issuance under our 2005 Incentive Compensation Plan as of such date. Also, we anticipate that we may issue common stock in acquisitions we anticipate making pursuant to our business strategy. Any issuances relating to the foregoing would dilute your percentage ownership interests, which would have the effect of reducing your influence on matters on which our stockholders vote. They might also dilute the tangible book value per share of our common stock. In addition, the Series A Convertible Preferred stockholder and the five former shareholders of CSI – South Carolina have the right, so long as any of the Series A Convertible Preferred stock is still outstanding, to participate in any “funding” by the Company (including a sale of common stock) on a pro rata basis at 80% of the offering price, which right if exercised might dilute our net tangible book value per share. Further, Barron has the right under certain circumstances to effect a cashless exercise of the warrants, which would dilute the tangible book value per share of our common stock.

Because we intend to retain any earnings to finance the development of our business, we may never pay cash dividends. Furthermore, the terms of the Series A Convertible Preferred Stock prohibit the payment of cash dividends. Agreements with our bank lender contain significant restrictions on cash dividends.

We have not paid cash dividends, except for the one-time cash dividend paid by CSI – South Carolina, our predecessor, prior to the February 2005 merger and sale of preferred stock. Pursuant to the Preferred Stock Purchase Agreement, no dividends may be paid on our common stock while any Series A Convertible Preferred Stock is outstanding. Also, our agreements with our bank lender prohibit any dividend which would, upon payment, result in a default under our financial covenants. Regardless of these restrictions, we do not anticipate paying cash dividends on our common stock in the foreseeable future, but instead intend to retain any earnings to finance the development of our business.

Availability of significant amounts of common stock for sale in the future, or the perception that such sales could occur, could cause the market price of our common stock to drop.

A substantial number of shares of our common stock may be issued and subsequently sold upon the exercise of the four common stock warrants and the conversion of Series A Convertible Preferred Stock held by Barron. Of the 14,435,472 shares originally issuable under the preferred stock and warrants, 12,903,672 shares remained to be issued as of March 11, 2009. In addition, the five former shareholders of CSI – South Carolina, four of whom are officers of the Company, held on such date 2,526,905 shares of common stock, which have not been registered under the Securities Act of 1933, as amended (the “Securities Act”), and are accordingly subject to the resale restrictions under such Act and Rule 144 thereunder. Outside directors also held 171,094 shares issued pursuant to our 2005 Incentive Compensation Plan, which are registered for sale under the Securities Act pursuant to a Form S-8 registration statement. There were also outstanding non-executive employee options to purchase approximately 360,203 shares of our common stock on March 11, 2009, executive officers held options to purchase 25,000 shares and consultants held 60,000 unregistered restricted shares. Additionally, at March 11, 2009, there remained 1,037,756 shares of common stock which could be issued under our 2005 Incentive Compensation Plan. The sale of any or all of these shares could have an adverse impact on the price of our common stock, as could the sale or issuance of additional shares of common stock in the future in connection with acquisitions or otherwise.

The number of shares which may be sold by Barron is relatively large compared to the number of shares held by our management and our non-affiliated public shareholders. If one or more investors purchased a large number of shares from Barron, they may be able to effect a change of control of the Company.

As of March 11, 2009, our executive officers and directors held 2,192,618 shares of our outstanding common stock, representing approximately 30.5% of the total number of shares outstanding. Barron may sell up to 14,435,472 shares of common stock (of which, as of the date of this report, 12,903,672 shares remain to be sold). Barron is prohibited from beneficially owning greater than 4.9% of our shares (except under limited circumstances involving significant acquisition transactions). However, an investor could acquire a significant number of shares in or subsequent to this offering and effect a change in control of us, including replacing our current management. Such an event might generate uncertainty and a loss of investor confidence.

Insiders currently hold a significant percentage of our stock and could limit your ability to influence the outcome of key transactions, including a change of control, which could adversely affect the market price of our stock.

As of March 11, 2009, approximately 28.2% or 2,021,524 shares of our common stock were held by our executive officers. Outside directors held 171,094 shares. Executive officers held options to purchase 25,000 shares and non-executive officer employees of the Company also held options to purchase approximately 360,203 shares. The former owners of Version3, now employees of the Company, held 2,153,143 shares. All of these shareholdings have the potential of solidifying control of the Company with insiders, and would likely limit the ability of any minority stockholders to influence the outcome of key decisions, including elections of directors.

Item 1B. Unresolved Staff Comments.

Not applicable.

Item 2. Properties.

We have leased the following properties:

- CSI's headquarters and Easley operations are located at 900 East Main St., Ste. T; Easley, SC 29640. CSI occupies approximately 32,163 square feet of the leased premises. The terms of the lease extend from April 2006 until March 2011, and the average cost per square foot increases over the term of the lease from \$4.30/SF to \$4.58/SF. The first extension is available from April 2011 until March 2016 at the rate of \$5.75 per square foot. A second five year extension is available from April 2017 until March 2012 at the rate of \$5.75/SF plus the greater of 5% or shared operating expense.
- A warehouse is located at 903 East Main St., Ste. T; Easley, SC 29640. CSI occupies approximately 18,000 squared feet at this leased premise. The terms of the lease extend from April 2008 until March 2010, and the average cost per square foot is \$2.53.
- The "Alabama Operations Center" is located at 307 W. University Blvd.; USA Research Park Building Three, Suite 1150; Mobile, AL 36688. CSI occupies approximately 11, 110 square feet at this leased premise. The terms of the lease extend from March 2009 until June 2012, and the average cost per square foot at \$12.75/SF. This lease does not include a provision for a lease extension.
- The "NC Operations Center", also known as "CSI-Greensboro", is located at 8518 Triad Drive; Colfax, NC 27235. CSI occupies approximately 7,100 square feet at this leased premise. The terms of this lease extend from April 2008 until March 2011, at the rate of \$11.25/SF.
- The "Version3 Operations" is located at 440 Knox Abbott Drive; Cayce, SC 29033. This is a month-to-month lease which commenced in March 2008, at the rate of \$11,175/month.

All of our properties are in good condition. We do not own or lease any additional facilities. However, we do maintain an address in Georgia through a public image package from Office Suites Plus. The Georgia address is 3235 Satellite Boulevard, Building 400, Suite 300, Duluth, Georgia 30096 and the monthly charge is \$199.

Item 3. Legal Proceedings.

Not applicable.

Item 4. Submission of Matters to a Vote of Security Holders.

Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Our common stock is traded in the over the counter market and is quoted on the OTC Bulletin Board. The high and low bids for each quarter of 2007 and 2008 are set forth in the chart below. The source of this information is the Finance page of www.yahoo.com. The quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission, and may not represent actual transactions.

		Range of Common Stock Prices (\$)	
		High	Low
2007			
	1 st Quarter	\$ 0.96	\$ 0.82
	2nd Quarter	1.20	0.75
	3rd Quarter	1.50	0.75
	4th Quarter	1.70	1.25
2008			
	1st Quarter	\$ 1.40	\$ 0.85
	2nd Quarter	1.19	0.90
	3rd Quarter	1.05	0.70
	4th Quarter	1.00	0.41

Source: <http://finance.yahoo.com>.

As of March 11, 2009, there were 7,181,204 shares of common stock outstanding and approximately 200 stockholders of record, and 6,739,736 shares of Series A Convertible Preferred Stock outstanding with one preferred stockholder of record. Of the total number of shares of common stock outstanding, 2,192,618 shares or 30.5% were held by directors and executive officers.

We have paid no cash dividends during the past three fiscal years, except for the dividends payable by CSI – South Carolina in February 2005 relating to the reverse merger. For a discussion of the merger related dividends, see “Item 1. Business—E. The Merger and Recapitalization.”

No dividends may be paid with respect to the Series A Convertible Preferred Stock and, pursuant to the Preferred Stock Purchase Agreement, no dividends may be paid on our common stock while any Series A Convertible Preferred Stock is outstanding. Also, our agreements with our bank lender prohibit any dividend which would, upon payment, result in a default under our financial covenants. Furthermore, even if these dividend restrictions were to be no longer effective, we have no plans to pay dividends in the foreseeable future. Instead, we intend to retain the earnings of our business for working capital and other investments in order to fund future growth.

The Equity Compensation Plan information as of December 31, 2008 is incorporated by reference to Item 12 of this Annual Report on Form 10-K.

Item 6. Selected Financial Data.

Not applicable.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

A. Introduction

Unless the context requires otherwise, (1) “Computer Software Innovations, Inc.,” “CSI,” “we,” “our,” “us” and “the Company” refer to the consolidated combined business of Computer Software Innovations, Inc., a private Delaware corporation and its subsidiary, CSI Technology Resources, Inc., a South Carolina corporation; (2) “VerticalBuyer” refers to the public Company prior to its merger with CSI—South Carolina on February 11, 2005; and (3) “CSI – South Carolina” refers to Computer Software Innovations, Inc., a South Carolina corporation, prior to the merger, which merged into VerticalBuyer in order for its operations to become publicly reported and its stock publicly traded.

Products and Services

We develop software applications and provide hardware-based technology solutions, focused primarily on the needs of organizations that employ fund accounting. Fund accounting is used by those entities that track expenditures and investments by “fund,” or by source and purpose of the funding (e.g., funds provided by government or grant sources), and is utilized primarily by public sector and not-for-profit entities. Our client base consists principally of K-12 (kindergarten through grade 12) public education and local government organizations including counties and municipalities. Our clients also include public libraries, disabilities boards, higher education and other non-governmental clients. While we have a significant number of non-education focused clients which represent the fastest growing sector based on increases in the number of new clients being added, our education focused customers typically generate more than 75% of our revenues in a given year.

We monitor our business results as two segments; the Software applications segment and the Technology solutions segment.

Through our Software applications segment, we report the results of operations related to our internally developed software, including an allocation of overheads. Our internally developed software consists of fund accounting based financial management software, standards-based lesson planning software and solutions that facilitate single sign-on, application access management, and provisioning based on Microsoft’s Identity Lifecycle Management and Microsoft SharePoint deployments. Our primary software, fund accounting based financial management software, is developed for those entities that track expenditures and investments by “fund,” or by source and purpose of the funding. Our client base for our financial management software consists principally of K-12 public education and local government organizations including counties and municipalities. Our clients also include public libraries, disabilities boards, higher education and other non-governmental clients. Our business was originally founded in South Carolina and in 2007 we acquired a major competitor in Alabama. Accordingly, in the states of South Carolina and Alabama, over 90% of the K-12 education school districts run our proprietary fund accounting software. Our fund accounting software is also present in accounts in six other states in the Southeast. We also provide standards based lesson planning software that allows education professionals to create, monitor and document lesson plans and their compliance with a state’s curriculum standards, including what standards have been met or need to be met. These applications are offered to our education clients. Our solutions for single sign-on application access management provide the ability to eliminate the need for users to sign on to every application separately (thereby allowing “single sign-on”) and provides for other efficiencies related to setting-up and controlling user access. Additionally, we rebrand or resell other software applications and services including application delivery, data recovery, warmsite and other applications focused solutions and report the results through our Software applications segment.

We report the results of operations related to our hardware-based technology solutions, including an allocation of overheads, through our Technology solutions segment. Our hardware-based technology solutions include a wide range of technology services including hardware solutions related design, engineering, project planning, installation, training management and ongoing support and maintenance of hardware solutions and hardware based operating systems and application software. We provide these services for hardware and software for the following: hardware-based operating systems and application software for computers, networking (wireless and wired), firewall (internet and network access security) and email solutions, IP telephony, video conferencing, video surveillance, monitoring and interactive distance and in-classroom teaching tools, including interactive whiteboard solutions and integrated accessories. We have established associations with some of the largest vendors in the industry and others whom we believe offer innovative products. These technology solutions are offered to our primary customer base, users of fund accounting. Some solutions, such as IP telephony and video conferencing, are also offered to for-profit entities as opportunities arise.

Organization

Our business efforts are focused on two key operating segments: internally developed software applications and related service and support (our “Software applications segment”), and other technology solutions and related service and support (our “Technology solutions segment”).

Software Applications Segment

Our Software applications segment develops accounting and administrative software applications that are designed for organizations that employ fund accounting. These organizations are primarily municipalities, school districts and local governments. Specific software modules include:

- General (or “Fund”) Ledger
- Accounts Payable;
- Purchasing;
- Payroll;
- Personnel;
- Employee Absence/Substitutes;
- Inventory;
- Utility Billing; and
- Other specialty modules designed for government markets.

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

As in other competitive software businesses, the sales and support of software products developed for resale, coupled with few related hardware sales, support higher margins in the Software applications segment (also referenced as “software and related services”). The sales of the Technology solutions segment (also referenced as “hardware sales and related services”) are typically at lower margins, due to the amount of hardware, a traditionally low margin product, included in those sales.

Technology Solutions Segment

Our Technology solutions segment has a staff of certified engineers capable of providing a broad range of technology solutions to our client base, including, but not limited to:

- Technology planning (developing plans to purchase or upgrade computers, telephone equipment, cabling and software);
- Hardware/software installations;
- Cabling (installation of wiring and wireless devices to link computer networks and telephones);
- System integration (installation of computers and configuration of software to enable systems to communicate with and understand each other);
- Wide area networking (linking a group of two or more computer systems over a large geographic area, usually by telephone lines or the internet);
- Wireless networking (linking a group of two or more computer systems by radio waves);
- IP telephony and IP surveillance (sending voice calls and surveillance across the internet using internet protocol (“IP”), a standard method for capturing information in packets);
- Project management (overseeing installation of computers, telephone equipment, cabling and software);
- Support and maintenance (using Novell, Microsoft, Cisco and Citrix certified engineers and other personnel to fix problems);
- System monitoring (proactively monitoring computers and software to detect problems);
- Education technologies (distance learning and classroom learning tools such as interactive white boards and integrated accessories, such as hand held voting devices and audio systems).

In addition to our engineers, our Technology solutions segment includes a staff of sales persons, project managers and product specialists. Our Technology solutions segment also purchases and resells products from a variety of manufacturers including but not limited to Hewlett Packard, Cisco, Microsoft, Novell, Promethean and Tandberg, and supports the Software applications segment, as needed.

The combination of traditionally low margin sales of hardware with the sales of services results in a much lower margin for the Technology solutions segment when compared to the Software applications segment. Margins for the Software applications segment were 40.7% for the 2008 fiscal year, while margins for the Technology solutions segment were 16.2% for the same period. Margins for the Software applications segment were 41.6% for the 2007 fiscal year, while margins for our Technology solutions segment were 15.6% for the same period. The significant change in the software applications segment margin from 2007 to 2008 was primarily a result of the addition of the acquired operations with traditionally lower margins than CSI-Easley.

We believe the combined efforts of our Technology solutions segment with that of our Software applications segment provide CSI with a competitive advantage in the education and government markets.

For a discussion of the results of the reported segments, see the section entitled “— F. Financial Performance” below.

Strategy

While we report the business as two segments and use such information for analysis and decision making purposes, we also operate the business collectively, taking advantage of cross-selling opportunities. As a part of our software applications and technology solutions sales efforts we provide systems and software networking and integration services. These services also generate a significant amount of revenue by increasing demand for the computer hardware equipment we sell.

Our marketing strategy is to provide a suite of software products coupled with full service integration of the hardware solutions that support those products and other back-office functions, and to provide ongoing technical support, monitoring and maintenance services to support the clients’ continuing needs. We also market our hardware solutions and ability to provide a wide level of services and support independent from our software solutions, which when marketed to a fund accounting based organization may also lead to

future software sales and integration services. By providing a client the ability to call one solution provider and circumvent the difficulties that often arise when dealing with multiple vendors, we believe we are able to achieve high long-term client satisfaction and a competitive advantage in the marketplace. Repeat business from and increased account penetration through added products and services within our existing customer base has been key to our success and we expect it will continue to play a vital role in our growth. Our focus is on nurturing long-standing relationships with existing customers while establishing relationships with new customers. Over the past ten years we have retained more than 90% of our financial management software customers, and many have become technology solutions customers. Some of our customers who first purchased technology solutions and services have subsequently become financial management software customers.

By strategically combining our internally developed software applications with our ability to integrate computer, networking and other hardware solutions, we have been successful in providing software and hardware solutions to over 1,000 clients located primarily in the southeastern states of South Carolina, Alabama, North Carolina, Georgia, Florida, Mississippi, Louisiana and Tennessee. In the states of South Carolina, where CSI was founded, and Alabama where one of our acquired operations was founded, we have account penetration in excess of 90% in the K-12 school district market space.

Our long-term strategy is to pursue a national presence. Our primary, initial focus has been on the southeast region of the United States. As a result of our acquisitions, we have expanded our reach into the southeastern states significantly and are beginning to look at other areas of the United States as well. Additionally, with our latest acquisition we have added a small number of customers outside our main southeast footprint, including a few new customers in Canada and one in the United Kingdom. Not all solutions are marketed to all states. However, we continue to expand the number of solutions offered in each area as resources and expanding vendor relationships permit.

For more information on our strategy, see “Acquisitions” below and “Item 1. Business—H. Strategy.”

Acquisitions

We believe that to remain competitive, we need to take advantage of acquisition opportunities that arise which may help us achieve greater geographic presence and economies of scale. We may also utilize acquisitions to, when appropriate, expand our technological capabilities and product offerings. While we may use a portion of any cash proceeds generated by operations or obtained from capital sources to pay down debt on an interim basis, we intend to use any additional liquidity and/or availability from those sources or related pay-downs to fund acquisitions. We believe our markets contain a number of attractive acquisition candidates. We foresee expanding through acquisitions of one or more of the following types of software and technology organizations:

- Developers and resellers of complementary software, such as time and attendance, workflow management, tax appraisals and assessment, education, court and law enforcement related products.
- Consulting firms providing high level professional services. We believe this type of acquisition would enhance our offering of technology planning and project management.
- Cabling and infrastructure contractors. We currently outsource a substantial portion of our cabling services.

Our business strategy provides that we will examine the potential acquisition of companies and businesses within our industry. In determining a suitable acquisition candidate, we will carefully analyze a target’s potential to add to and complement our product mix, expand our existing revenue base, improve our margins, expand our geographic coverage, strengthen our management team and, above all, improve stockholder returns.

On January 2, 2007, we acquired the business operations of McAleer Computer Associates, Inc (“McAleer”), based in Alabama. We believe the acquisition of this leading provider of fund accounting based financial management software to the K-12 education sector in seven southeastern states fits within our acquisition strategy. We sometimes refer to McAleer as “CSI-Mobile.” In furtherance of our acquisition strategy, on March 31, 2008, we consummated the acquisition, effective April 1, 2008, of substantially all the assets and business operations of ICS Systems, Inc. (“ICS”). ICS, located in Colfax, North Carolina (near Greensboro), was a developer, provider and consultant with respect to fund accounting and billing software for the local government market space in that state. We sometimes refer to the former ICS operations as “CSI-Greensboro.” Also, on August 18, 2008, we consummated the acquisition effective August 14, 2008 of substantially all the assets and business operations of Version3, Inc. (“Version3”). Version3 located in Columbia, South Carolina, was a developer, provider and consultant with respect to solutions that facilitate single sign-on, application access management and provisioning based on Microsoft’s Identity Lifecycle Management, and Microsoft SharePoint deployments. CSI was a reseller of Version3 solutions due to the application of the products to its education market segment. The McAleer, ICS and Version3 transactions are discussed in more detail in Note 3 to our audited consolidated financial statements included in this Form 10-K.

We are unable to predict the nature, size or timing of any acquisition. We can give no assurance that we will reach agreement or procure the financial resources necessary to fund any acquisition, or that we will be able to successfully integrate or improve returns as

a result of any such acquisition. We continue to pursue and enter into preliminary discussions with various acquisition candidates. However, the Company has not entered into agreements or understandings for any acquisitions which management deems material.

Our acquisition strategy is discussed in more detail under “Item 1. Business—H. Strategy—Growth Through Acquisitions.”

B. Recent Developments

Acquisitions

In 2008, we acquired two companies: ICS, a developer of fund accounting systems for the local government market with revenue of approximately \$1 million annually for approximately \$1.3 million cash including capitalized transaction cost and approximately \$0.2 million of our stock issued. We also acquired Version3, a developer of identity life-cycle management products and provider of SharePoint deployments with revenues of approximately \$1.0 million annually. The consideration for Version3 included approximately \$2.2 million of stock, of which approximately \$0.7 million was escrowed pending meeting certain performance targets for both revenues and EBITDA (a non-GAAP measure), and approximately \$0.3 million in cash, including capitalized transaction costs. The acquisitions are described in more detail in Note 3 to our audited consolidated financial statements for the year ended December 31, 2008 in this Form 10-K, and under “A. Introduction – Acquisitions” above.

The Current Economic Crisis, Our Response, the American Recovery and Reinvestment Act of 2009 and Guidance

Impact of Recovery Act

As 2008 progressed, the United States slid into what has been described by economic and financial analysts as a “recession.” Reductions in business and consumer spending impact our primary client base -- education and local government customers -- by reducing their revenues from sales tax. Reductions in property values can impact our clients through reductions in property taxes. Such reductions have the potential to decrease the amount of funds available for the software and technology solutions CSI provides. Some projects, such as new construction, may have funds available through previous bond raising activities, while other projects may not have such funding.

As a result of the impact of the recession on our customers, in recent months we have seen a moderate increase in the amount of projects postponed or changed as a result of customer budget cuts. However, a potential indicator of ongoing business health -- the value of quoting activity and incoming service orders received -- in the first quarter has exceeded modestly that of the prior year. Additionally, due to our acquisition activity we now have a greater geographic region and larger number of potential customers to sell into than at any point in our past history. Our financial results, including revenues and profitability, will hinge significantly on the mix between the actual impact from decreased customer budgets and our ability to acquire new accounts and increase penetration in existing accounts. In light of the current economic climate, we cannot predict what impact this change in mix, if any, will have on our financial results.

On February 17, 2009, President Obama signed into law The American Recovery and Reinvestment Act of 2009 (“Recovery Act”). The Recovery Act was an attempt to jumpstart an economic recovery. It included spending for extension of jobless benefits, relief for state government and education budget shortfalls, and funding of specific initiatives, including improving our nation’s infrastructure, expanding educational opportunities and enhancing energy independence. The initiatives and incentives contained in the Recovery Act which relate to the education and local government market space may have a direct, positive impact on our financial results, or may defray the negative impact of budget shortfalls in our customer markets.

Having performed some initial analysis of the Recovery Act, we still cannot be certain what dollars will be available to fund the types of software and technology projects we provide or when those dollars will begin to flow. However, the picture of the funding is becoming clearer. We have learned school districts are actually going to receive several blocks of money – Stabilization funds, Title I and IDEA (Individuals with Disabilities Education Act), E2T2 (Enhancing Education Through Technology), etc. (South Carolina amounts below are per tables by state available at the US Department of Education’s www.ed.gov website and are for use over the next two school years. They are provided as an example of the amounts that we may be able to tap into our current, primary geographic coverage area):

- The Stabilization funds (estimated \$694 million for South Carolina) will be passed down from states and are really geared to help offset current budget shortfalls. We do not anticipate these dollars being spent with CSI unless a district has a project for which they lost funding and now have the money to proceed.
- Title I (and EFIG Grants – estimated \$143 million for South Carolina) and IDEA (Part B Grants (Section 611) – estimated \$173 million for South Carolina) are both federal programs which districts already participate in. These dollars are to be spent on supplemental programs and some are focused on school innovation. The Title I funds are what we feel will be of greatest significance to us since these funds can be spent for 21st Century Classroom technology. IDEA is geared toward exceptional children. We may be able to tap into some of this fund but Title I is a better option.

- E2T2 (estimated \$9 million for South Carolina) is specifically for technology projects. While E2T2 is a much smaller amount of money than the other blocks, it is still \$650 million nationally.

The funds earmarked for the above are available for projects in many states, not just within the primary geographic region we serve. Additionally, we may be subject to increasing competition to provide projects using these funds. Accordingly, we have the potential to benefit most significantly in those geographic areas within our market, or with those technologies we could easily support remotely. Due to the uncertainties as to when the funds will be distributed; where, and how much might be available; what eligible projects we might be able to propose and win; and whether suppliers are capable of meeting the potential increase in demand, we cannot predict what impact, if any, the Recovery Act will have on our financial results.

Due to the uncertainty created by the current economic environment, we have taken precautionary measures to control costs. We have frozen salaries and have reduced our contribution to our 401(k) plan from a dollar for dollar match up to 3%, to a dollar for dollar match up to 1.5%. If our revenues are significantly impacted negatively we may take further actions to reduce costs. These could include employee furloughs, deferral of replacements for personnel attrition, or if not otherwise avoidable, reducing headcount beyond attrition. While we plan to take such actions based on our monitoring of our ongoing results, we cannot predict those results or the timing, number of or dollar impact of cost reduction efforts we may take or the impact such efforts may have on our financial results. Additionally, if our performance is not impacted significantly by the economy and/or the potential benefits of the Recovery Act are significantly positive to our financial results, we may reinstate raises and increase our 401(k) contributions to prior levels. We may also consider reinstating and funding in future periods, those increases and contributions which were frozen, reduced or otherwise not paid in prior periods.

General Guidance (Forward-Looking Information)

The impact of the current economic conditions on our customers' budgets have, we believe, resulted in an extension of our sales closing cycles. The unknowns related to the timing, issuance of and restrictions which may be placed on Stimulus funds, and uncertainty as to the amount each eligible customer may receive, have pushed out the decision making processes with regard to the funding of technology solutions and services. Due to the lack of knowledge as to what funds will be available for what projects and when, the decision for our customers as to the allocation of their funds to which projects and opportunities for technology improvement and related decisions to execute purchase orders may be clouded in the short-term. As a result of the delays we believe are connected to these challenges to decision making with regard to technology funding and related purchase commitments, we expect our top and bottom line performance for the first quarter of 2009 to be below the same quarter of the prior year and may more closely resemble the fourth quarter of 2008. In addition, the results for our second quarter of 2009 may also be below the prior year as we await the settlement of uncertainties surrounding the Stimulus and as we maintain our operations at a level capable of capitalizing on what we believe is significant potential for upside from the future spending of Stimulus funds.

C. Current Challenges and Opportunities of our Business, and Forward-Looking Information

The Current Economic Crisis, Our Response, the American Recovery and Reinvestment Act of 2009 and Forward Looking Information

Due to the current economic environment in the US and its impact on our customers' budgets and revenues, the opportunity to acquire new customers in an expanded geographic territory following our acquisitions, and the potential impact of the recent American Recovery and Reinvestment Act of 2009, our financial results could be impacted from the combination of these potential risks and opportunities. For a more detailed discussion, see "B. Recent Developments – The Current Economic Crisis, Our Response, the American Recovery and Reinvestment Act of 2009 and Forward Looking Information" above.

Bid and Sales Processes and Procedures

Because of our focus on the public sector, many sales opportunities are subject to our having to comply with government bid requirements and other formal proposal processes. Complying with such requirements and processes can result in a significant investment of time and effort that may not result in a sale. We have been implementing procedures to make the bid and sales process more efficient and believe these types of improvements will aid in our ability to maintain competitiveness in the marketplace.

Sarbanes-Oxley Compliance

As a public company we are required to maintain internal controls and processes related to addressing risks which are inherent in financial reporting, in compliance with the Sarbanes-Oxley Act. These controls must also be executed consistently and reviewed and tested for effectiveness on a periodic basis. The implementation, monitoring, testing and remediation of internal controls are a complex and costly endeavor. In the fourth quarter of 2008 and in the first quarter of 2009, prior to the issuance of this report, we completed our review of our control environment and the testing necessary to assure that our controls for the closing cycle covering the financial reporting period ending December 31, 2008, were operating effectively. We concluded that our controls were effective.

We have incurred costs to implement, and will incur additional costs to support ongoing efforts to comply with the Sarbanes-Oxley Act legislation. In 2008 we budgeted \$289,000 for work to be performed by third party experts related to Sarbanes-Oxley. As of December 31, 2008, we had incurred approximately \$92,000 in expenses with third party experts related to Sarbanes-Oxley work. Internal personnel resources to support Sarbanes-Oxley implementation efforts totaled approximately \$150,000 in salaries and wages expenses. These amounts compare to third party costs of approximately \$170,000, \$10,000 in capitalized costs related to reporting systems implementation efforts, and personnel costs of approximately \$70,000 related to these efforts in 2007.

We have budgeted approximately \$250,000 for this work in 2009, including our efforts in early 2008 to improve our information technology environment and ongoing efforts to automate our financial reporting. This amount excludes the addition to ongoing increased internal personnel costs of approximately \$300,000 in 2008, for positions necessary to support Sarbanes-Oxley. Approximately half of such salaries relate specifically to time spent to support Sarbanes-Oxley, and the remaining portion is necessary to support the ongoing requirements to administratively manage and support a growing business and for improving business processes. Such amounts are included in our budget for internal salaries and wages for 2009.

Due to the ongoing changes in our business, our acquisition strategy and the increasing complexity of reporting requirements and regulations, we can give no assurances that our costs for continuing Sarbanes-Oxley compliance will not increase. Also, we cannot guarantee that we will not in the future identify additional internal control deficiencies, or that we will be able to remediate any such deficiencies in a timely fashion.

Professional Fees

Our professional and legal compliance and litigation related costs (including third party costs related to our Sarbanes-Oxley implementation) totaled approximately \$434,000 for 2008, compared to our 2008 budget of \$800,000 and actual costs of \$562,000 in 2007. The budget and actual increases in 2008 over the prior year were due to additional costs in connection with efforts to automate portions of the Company's financial reporting processes using software purchased in late 2006 and for which final implementation is anticipated in 2008. Work related to securities registrations totaled approximately \$27,000 in 2008 compared to \$118,000 in 2007. This decrease was offset by small increases in a number of compliance related areas and the Sarbanes-Oxley and financial reporting related work. We have budgeted \$550,000 for compliance related professional fees for 2009. This amount does not include any costs which will be incurred to close acquisitions, as we are cannot predict with any degree of certainty the timing and outcome of acquisition efforts.

Software Modifications Required by Geographic Expansion

We have achieved the most significant penetration with our lead products in the tri-state area of South Carolina, North Carolina and Georgia. We are now accelerating our efforts to move into surrounding states. To do so, we may have to modify our existing fund accounting programs to accommodate differences in state laws, regulations and taxation. We anticipate needing to make additional investment in software development to accomplish this. However, we plan to make the changes when we have firm orders in an area in an attempt to maximize return on investment as quickly as possible. We are currently converting our programs to the Microsoft .Net programming and SQL database language, but do not yet have all modules ready for release. As a result, some jurisdictional related changes have been made in 2007 and 2008 may be required to be made in both our current and .Net platforms through 2009 and 2010, when we anticipate the large majority, if not all, modules will be converted. The costs of such changes may offset somewhat the positive impact from expanding our geographic reach significantly begun in early 2007 with the acquisition of McAleer.

Conversion of our Accounting+Plus software to Microsoft .Net Programming and SQL Database Language

We have already completed the conversion of the majority of our core accounting and personnel modules to Microsoft.Net Programming and SQL database language, with the municipal modules still in progress. The completed modules are in formal beta installations. However, the changes resulting from the formal beta use have been limited. We are prepared to install and have installed some of the completed modules in select entities which do not have an immediate need for other integrated modules not yet converted. In addition, the completed modules have the functionality necessary to handle school activity funds, such as student clubs, organizations and athletics. We are beginning to look for additional sales opportunities of the completed modules now. We anticipate completing most if not all of the remaining modules throughout 2009 and 2010.

Maintaining Margins

In 2008, we experienced a significant increase in sales of infrastructure solutions including sales of IP Telephony solutions, as well as increased sales of engineering services related to those solutions. Both infrastructure and interactive whiteboard solutions have become subject to increased competition as more product manufacturers have recognized product potential and have entered these markets. Favorably, we did not see a decline in our margins from the Technology solutions segment in 2008. Our margins improved to 16.2% in 2008 from 15.6% in 2007, primarily from an improvement in product mix. In order to maintain and improve our margins, we need to continue to search for new and innovative, and initially higher margin, products to augment those that become mature, or we need to increase our revenues or our personnel utilization to achieve greater economies of scale. We also intend to continue our focus

on existing higher margin areas such as engineering services and sales of software solutions and related services. While we cannot predict success in achieving these goals, as opportunities arise we take actions to maintain and improve our margins. These include expanding our geographic reach, increasing the size of and reorganizing our sales force to focus on more products backed by product specialists, increasing telemarketing efforts, improving our sales tools, and identifying additional product and service areas. We are focused on increasing margins, but ultimately we are looking to increase profits by leveraging existing and an increasing number of customer relationships by taking advantage of cross-sell opportunities with a variety of products and services. We will work to focus primarily on those customers for whom we can provide ongoing support and higher margin integration and other engineering services.

Additionally in 2008, a considerable percentage of the significant increase in sales of interactive whiteboard solutions related to a select number of large projects, initiated by school districts, involving their implementation of the new technology. Due to the size and nature of these projects, we were able to achieve certain economies of scale that resulted in substantially improved margins and increased gross profits. The challenge in 2009 and future periods will be to secure similar large opportunities or a greater number of smaller implementations. We have therefore developed a strategy focused on both large opportunities and a greater number of smaller opportunities. This strategy includes focusing certain members of our sales team's efforts specifically on the interactive whiteboard solution product line in an effort to increase market penetration and continue the growth of interactive whiteboard sales. We are also making efforts to take advantage of opportunities which may arise to expand our geographic reach with this product line. Prior to 2008, we were authorized to sell interactive whiteboard products by our partner on an exclusive basis in two states, South Carolina and North Carolina. In early 2008, we entered into an affiliate relationship with another vendor whereby we would participate in the opportunity to sell these solutions in certain counties within the state of Alabama. In early 2009, this relationship was changed to be a direct relationship.

Technology and Software Budgets

While federal, state and local funding can vary from year to year, and technology and software budgets have been challenged during the last few years, we have sensed a steady improvement in the discretionary funds that are available to our potential clients. These discretionary funds, coupled with our clients' desire to improve or implement technology and software tools into their individual environments, have provided growth for our business. We recognize that future changes in funding could improve or strain technology budgets. For example, the current recession could result in a decline in spending by our educational and local government client base. However, since such spending is generally based on tax revenues and portions of such revenues do not always correlate immediately or directly with changes in the economy, the impact is generally reduced when compared to the impact on those vendors whose client base consists primarily of private sector businesses. Even so, we cannot predict the impact changes in funding may have on our business.

Creating Synergies with Merger and Acquisition Activity

Part of our strategy to remain competitive and to grow the Company involves taking advantage of acquisition opportunities. While there are many benefits to be gained from a successful acquisition, there are also many financial and operations risks that must be properly addressed in order to create operational synergy and financial benefit. While we may engage outside professionals to assist us with identifying and evaluating potential acquisitions, some members of our management team have limited experience in merger and acquisition activity. Management must be cautious in their evaluation of and expectations from any acquisition target. With any acquisition, we cannot ensure that we are allocating capital to businesses that will increase growth with higher returns and will not require additional capital or strain our capital resources.

We have identified the criteria listed below, by which we evaluate potential acquisition targets in an effort to gain the synergies necessary for successful growth of the Company:

- Access to new customers and new geographic markets
- Protection of our current customer base from competition
- Removal or reduction of market entry barriers
- Opportunity to gain operating leverage and increased profit margins
- Diversification of sales by customer and/or product
- Improved vendor pricing from increased volume and/or existing vendor relationships
- Improvements in product/service offerings
- Protection of and ability to expand mature product lines
- Ability to attract public capital and increased investor interest

By carefully evaluating these factors, we seek to successfully execute our corporate acquisition growth strategy and thereby provide positive operating results and increased return on investment to our stockholders.

Forward-Looking Statements

This report contains “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Among other things, these statements relate to our financial condition, results of operations and future business plans, operations, opportunities and prospects. In addition, we and our representatives may from time to time make written or oral forward-looking statements, including statements contained in other filings with the Securities and Exchange Commission and in our reports to stockholders. These forward-looking statements are generally identified by the words or phrases “may,” “could,” “should,” “expect,” “anticipate,” “plan,” “believe,” “seek,” “estimate,” “predict,” “project” or words of similar import. These forward-looking statements are based upon our current knowledge and assumptions about future events and involve risks and uncertainties that could cause our actual results, performance or achievements to be materially different from any anticipated results, prospects, performance or achievements expressed or implied by such forward-looking statements. These forward-looking statements are not guarantees of future performance. Many factors are beyond our ability to control or predict. You are accordingly cautioned not to place undue reliance on such forward-looking statements, which speak only as of the date that we make them. We do not undertake to update any forward-looking statement that may be made from time to time by or on our behalf.

We have included risk factors and uncertainties that might cause differences between anticipated and actual future results in “Item 1A. Risk Factors.” We have attempted to identify, in context, some of the factors that we currently believe may cause actual future experience and results to differ from our current expectations regarding the relevant matter or subject area. The operations and results of our software and systems integration businesses also may be subject to the effects of other risks and uncertainties, including, but not limited to:

- a reduction in anticipated sales;
- an inability to perform customer contracts at anticipated cost levels;
- our ability to otherwise meet the operating goals established by our business plan;
- market acceptance of our new software, technology and services offerings;
- an economic downturn; and
- changes in the competitive market place and/or customer requirements.

D. Critical Accounting Policies and Estimates

Basis of Presentation

Our consolidated financial statements include CSI Technology Resources, Inc., a wholly-owned subsidiary. We use the accrual basis of accounting.

We employ accounting principles generally accepted in the United States (“generally accepted accounting principles” or “GAAP”). GAAP requires us to make estimates, assumptions and judgments and rely on projections of future results of operations and cash flows. Those estimates, assumptions, judgments and projections are an integral part of the financial statements. We base our estimates and assumptions on historical data and other assumptions, which include knowledge and experience with regard to past and current events and assumptions about future events that we believe are reasonable under the circumstances. These estimates and assumptions affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities in our financial statements. In addition, they affect the reported amounts of revenues and expenses during the reporting period.

Our judgments are based on our assessment as to the effect certain estimates and assumptions of future trends or events may have on the financial condition and results of operations reported in our financial statements. It is important that an investor understand that actual results could differ materially from these estimates, assumptions, projections and judgments.

Certain accounting policies, methods and estimates are particularly sensitive because of their significance to the financial statements and of the possibility that future events affecting them may differ markedly from management’s current judgments. For a description of our significant accounting policies, see Note 1 contained in the notes to our audited consolidated financial statements as of and for the period ended December 31, 2008 included as part of this report. The most critical accounting policies that have a significant impact on the results we report in our consolidated financial statements are discussed below.

Disclosure Regarding Segments

The Company reports its operations under two operating segments: the Software applications segment and the Technology solutions segment. See “A. Introduction – Products and Services” and “– Organization” for more detailed discussions regarding our segments.

Revenue recognition

Software License Revenues

Software revenues consist principally of fees for licenses of our CSI internally-developed software products, services and training. We recognize all software revenue using the residual method in accordance with Statement of Position (“SOP”) 97-2, “Software Revenue Recognition,” as amended by SOP 98-9, “Modification of SOP 97-2, and Software Revenue Recognition with Respect to Certain Transactions.” Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is recognized as revenue. If evidence of the vendor specific fair value of one or more undelivered elements does not exist, revenues are deferred and recognized when delivery of those elements occurs or when fair value can be established. Company-specific objective evidence of fair value of maintenance and other services is based on our customary pricing for such maintenance and/or services when sold separately. At the outset of the arrangement with the customer, we defer revenue for the fair value of its undelivered elements (e.g., maintenance, consulting and training) and recognize revenue for the remainder of the arrangement fee attributable to the elements initially delivered in the arrangement (i.e., software product) when the basic criteria in SOP 97-2 have been met. If such evidence of fair value for each undelivered element of the arrangement does not exist, we defer all revenue from the arrangement until such time that evidence of fair value does exist or until all elements of the arrangement are delivered.

Under SOP 97-2, revenue attributable to an element in a customer arrangement is recognized when (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred, (iii) the fee is fixed or determinable, (iv) collectibility is probable and (v) the arrangement does not require services that are essential to the functionality of the software.

Persuasive evidence of an arrangement exists. We determine that persuasive evidence of an arrangement exists with respect to a customer when we have a written contract, which is signed by both us and the customer, or a purchase order from the customer when the customer has previously executed a standard license arrangement with us.

Delivery has occurred. Our software may be either physically or electronically delivered to the customer. We determine that delivery has occurred upon shipment of the software pursuant to the billing terms of the agreement or when the software is made available to the customer through electronic delivery.

The fee is fixed or determinable. If at the outset of the customer engagement we determine that the fee is not fixed or determinable, we recognize revenue when the fee becomes due and payable.

Collectibility is probable. We determine whether collectibility is probable on a case-by-case basis. When assessing probability of collection, we consider the number of years in business, history of collection, and product acceptance for each customer. We typically sell to customers for whom there is a history of successful collection. However, collection cannot be assured.

We allocate revenue on software arrangements involving multiple elements to each element based on the relative fair value of each element. Our determination of the fair value of each element in multiple-element arrangements is based on vendor-specific objective evidence (“VSOE”). We align our assessment of VSOE for each element to the price charged when the same element is sold separately. We have analyzed all of the elements included in our multiple-element arrangements and determined that we have sufficient VSOE to allocate revenue to the maintenance, support and professional services components of our perpetual license arrangements. We sell our professional services separately, and have established VSOE for professional services on that basis. VSOE for maintenance and support is determined based upon the customer’s annual renewal rates for these elements. Accordingly, assuming that all other revenue recognition criteria are met, we recognize revenue from perpetual licenses upon delivery using the residual method in accordance with SOP 98-9.

Our software products are fully functional upon delivery and implementation and do not require any significant modification or alteration of products for customer use.

We expense all manufacturing, packaging and distribution costs associated with software license sales as cost of license revenues.

Computer Hardware Sales Revenues

Revenue related to hardware sales is recognized when: (a) we have a written sales agreement; (b) delivery has occurred; (c) the price is fixed or determinable; (d) collectibility is reasonably assured; (e) the product delivered is standard product with historically demonstrated acceptance; and (f) there is no unique customer acceptance provision or payment tied to acceptance of an undelivered element significant to the functionality of the system. Generally, payment terms are net 30 days from shipment. When sales to a customer involve multiple elements, revenue is recognized on the delivered element provided that (1) the undelivered element is a standard product, (2) there is a history of acceptance on the product with the customer, and (3) the undelivered element is not essential to the customer’s application. Revenue related to spare parts is recognized on shipment. Shipping and handling charges to customers are included in revenues. Shipping and handling costs incurred by the Company are included in cost of sales.

Technology revenues are generated primarily from the sale of hardware. In accordance with Emerging Issues Task Force (“EITF”) 99-19, “Reporting Revenue Gross as a Principal Versus Net as an Agent,” we record revenues as net when we serve as an agent. In these circumstances, our supplier pays a commission to us but acts as the primary obligor in a transaction and we record only the commission in revenues. We record revenues as gross (generally cost of merchandise plus margin) when we serve as a principal whereby we act as the primary obligor in a transaction, have the latitude for establishing pricing and retain all the credit risk associated with such transaction.

Long-term Payment Arrangements

Our primary customer base consists of local government and education entities whose source of funding (local taxes and federal funding) is generally assured; accordingly the risk of uncollectibility is lower than that of businesses selling primarily to non-government entities. The Company has an ongoing practice of providing financing for certain purchases under notes receivable or long term leases typically ranging from 3 to 5 years, subject to review of its exposure under such facilities and cash flow availability or needs at the time of such purchases. Such amounts have not constituted a significant portion of its account balances, and the Company has historically never experienced a default under such arrangements. The Company recognizes revenue under these arrangements when the criteria noted under Software License Revenues and Computer Hardware Sales Revenues above is met, in accordance with SOP 97-2, as amended by SOP 98-9.

Service/Support Revenues

Services revenues consist of professional services and maintenance fees from software and hardware maintenance agreements. Maintenance agreements are typically priced based on a percentage of the product license fee or hardware cost and have a one-year term, renewable annually. Services provided to customers under maintenance agreements may include technical product support and unspecified software upgrades. Revenue related to maintenance and service contracts is recognized ratably over the duration of the contracts. Deferred revenues from advanced payments for maintenance agreements are recognized ratably over the term of the agreement, which is typically one year.

Long-Lived Assets

Expenditures for major renewals or betterments that extend the useful lives of property and equipment are capitalized. Expenditures for maintenance and repairs are charged to expenses as incurred.

We continually evaluate whether events and circumstances have occurred that indicate the remaining estimated useful life of long-lived assets may warrant revision or that the remaining balance of long-lived assets may not be recoverable in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 144, “Accounting for Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of.” When factors indicate that long-lived assets should be evaluated for possible impairment, we use an estimate of the related undiscounted future cash flows over the remaining life of the long-lived assets in measuring whether they are recoverable. If the estimated undiscounted future cash flows exceed the carrying value of the asset, a loss is recorded as the excess of the asset’s carrying value over fair value.

Depreciation

Depreciation of property and equipment is provided using the straight-line method over the estimated useful lives of such property and equipment.

Computer Software Costs and Amortization

Computer software costs consist of internal software production costs and purchased software products capitalized under the provisions of SFAS No. 86, “Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed.”

Costs in the research and development of new software products where the technological feasibility is unknown and enhancements which do not prolong the software life or otherwise increase its value, are expensed as incurred. Capitalized computer software costs are amortized over the economic life of the product, generally three to four years, using the straight-line method. Much of our software development efforts related to our fund accounting and lesson planning products focus on the implementation of known technological capabilities applied to common business processes to enhance our existing products. Historically, to date, through our software solutions segment, we have spent no material efforts on technological innovation for which the feasibility has been unknown. Efforts may increase following the Version3 acquisition as its product focus may result in increasing efforts toward research and development.

Goodwill and Other Intangible Assets

The Company follows SFAS No. 142, "Goodwill and Other Intangible Assets," in our accounting and reporting for goodwill and intangible assets.

SFAS No. 142 eliminates the requirement to amortize intangible assets with an indefinite life, addresses the amortization of intangible assets with a defined life, and addresses impairment testing and recognition of indefinite-lived intangible assets. In accordance with SFAS No. 142, we do not amortize indefinite-lived intangible assets (e.g., corporate trademarks for which planned use is indefinite). As of December 31, 2008, we had approximately \$2.4 million of goodwill. In accordance with SFAS No. 142 we are required to test for the impairment of goodwill and other intangible assets with indefinite lives on at least an annual basis. Our goodwill impairment test involves a comparison of the fair value to its carrying amount. If the fair value is determined to be less than the carrying value, the asset is considered impaired. We tested goodwill for impairment as of December 31, 2008 and will test it annually on December 31 unless changes occur between annual test dates that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Our 2008 impairment test indicated that goodwill was not impaired.

In addition, we evaluate the remaining useful life of other intangible assets that are not being amortized each reporting period to determine whether events and circumstances continue to support an indefinite useful life. If an intangible asset that is not being amortized is subsequently determined to have a finite useful life, we amortize the intangible asset prospectively over its remaining estimated useful life. Amortizable intangible assets (e.g., product trademarks) are amortized on a straight-line basis over six years or the life of the product, whichever is shorter. As of December 31, 2008, the intangible assets classified as indefinite lived totaled \$2.5 million, including goodwill and corporate trademarks.

Other Intangible Assets

In connection with the acquisition of McAleer, ICS, and Version3, we allocated approximately \$3.3 million in value to intangible assets. The estimated fair value of these acquired intangible assets is based upon an independent valuation, and is being amortized over the life of the assets. As of December 31, 2008, the intangible assets had a carrying value of \$3.0 million, net of accumulated amortization of \$0.3 million, and are included in other intangible assets, net on the Consolidated Balance Sheet. See Note 3 to our audited consolidated financial statements dated December 31, 2008 for further detail regarding the intangible assets related to the McAleer, ICS, and Verion3 acquisitions.

Amortization expense was approximately \$217,000 for the year ended December 31, 2008 and \$117,000 for the year ended December 31, 2007. Future estimated amortization expense for the carrying amount of intangible assets as of December 31, 2008 is expected to be as follows (in thousands):

:

Year	Amortization Expense
2009	\$ 348
2010	277
2011	192
2012	175
2013	162
Thereafter	1,789
Total	\$ 2,943

Stock based compensation

The Company has a stock based compensation plan, the 2005 Incentive Compensation Plan. The Company accounts for stock based compensation using the fair value method prescribed in SFAS No. 123R, "Share-Based Payment," and related interpretations, which the Company adopted in 2006 using the modified prospective method. The Company utilizes the Black-Scholes model to estimate the fair value of the shares granted.

Income taxes

The Company uses the asset and liability method of accounting for income taxes. Income taxes are provided for the tax effects of transactions reported in the financial statements and consist of taxes currently due or refundable plus deferred income tax assets and liabilities. Deferred income tax assets and liabilities are recorded to recognize the income tax effect of the temporary differences in the method of reporting various items of income and expenses for financial reporting purposes and income tax purposes. The deferred income tax assets and liabilities at the end of the year are determined using the statutory tax rates expected to be in effect when the taxes are actually due or refundable.

As of the beginning of our 2007 fiscal year, we adopted the provisions of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"), which provides specific guidance on the financial statement recognition, measurement, reporting and disclosure of uncertain tax positions taken or expected to be taken in a tax return. We recognize the impact of our tax positions in our financial statements if those positions will more likely than not be sustained on audit, based on the technical merit of the position.

Related Party Transactions and Off-Balance Sheet Arrangements

We have not entered into any significant transactions with related parties other than the issuance of subordinated debt to certain executive officers and shareholders and payments described in Note 13 to our consolidated audited financial statements for the period ended December 31, 2008 and under "— G. Liquidity and Capital Resources—Credit Arrangements" below. We do not use off-balance-sheet arrangements with unconsolidated related parties, nor do we use other forms of off-balance-sheet arrangements such as research and development arrangements.

E. Recent Accounting Pronouncements

The following is a summary of recent authoritative pronouncements that could impact the accounting, reporting, and/or disclosure of financial information by the Company.

In May 2008, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 162, "The Hierarchy of Generally Accepted Accounting Principles" ("SFAS 162"). SFAS 162 is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with generally accepted accounting principles in the United States for non-governmental entities. SFAS 162 is effective 60 days following approval by the U.S. Securities and Exchange Commission ("SEC") of the Public Company Accounting Oversight Board's amendments to AU Section 411, "The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles." The Company does not expect SFAS 162 to have a material impact on the preparation of its financial statements.

In April 2008, the FASB issued FASB Staff Position (FSP) No. FAS 142-3, "Determination of the Useful Life of Intangible Assets." The final FSP amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS 142, "Goodwill and Other Intangible Assets." The FSP is intended to improve the consistency between the useful life of an intangible asset determined under SFAS 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS 141 (revised 2007), "Business Combinations," and other US generally accepted accounting principles. The FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. We are currently evaluating the impact FSP 142-3 will have on its consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities" (SFAS 161). SFAS 161 is intended to improve financial reporting of derivative instruments and hedging activities by requiring enhanced disclosures to enable financial statement users to better understand the effects of derivatives and hedging on an entity's financial position, financial performance and cash flows. The provisions of SFAS 161 are effective for interim periods and fiscal years beginning after November 15, 2008. We are currently evaluating the effect the adoption of SFAS 161 will have on our Consolidated Financial Statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), "Business Combinations" (SFAS 141R). SFAS 141R establishes principles and requirements for recognizing and measuring assets acquired, liabilities assumed and any non-controlling interests in the acquiree in a business combination. SFAS 141R also provides guidance for recognizing and measuring goodwill acquired in a business combination, requires capitalization of acquired in-process research and development assets at the time of acquisition and requires the acquirer to disclose information that users may need to evaluate and understand the financial effect of the business combination. As SFAS 141R is effective for business combination transactions for which the acquisition date is on or after December 15, 2008. The Company will assess the impact of SFAS 141R if and when a future acquisition occurs.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a material impact on the Company's financial position, results of operations or cash flows.

F. Financial Performance

Overview of Financial Performance – Year Ended December 31, 2008 Compared to the Year Ended December 31, 2007.

Our revenues for the 2008 fiscal year were \$58.7 million, \$3.5 million or 6%, higher than revenues for the 2007 fiscal year. The increase was driven by a \$0.4 million or 1% increase in our Technology solutions segment, and a \$3.1 million or 29% increase in our

Software applications segment. Technology solutions segment sales increased primarily as a result of increased infrastructure solutions sales partially offset by a reduction in instructional hardware solutions (primarily interactive whiteboards) sales. Software applications sales increased along all the major areas of new software, delivery, installation and training related revenues, as well as recurring support agreement revenues primarily from organic growth of \$2.0 million. The addition of sales from the April 2008 acquisition of ICS (“ICS,” or “CSI-Greensboro”) added \$0.7 million and the August 2008 acquisition of Version3 added \$0.3 million.

The gross profit for 2008 was \$12.8 million, \$1.5 million or 13% above the prior year. The Technology solutions segment increased \$0.3 million or 5%, while the Software applications segment increased \$1.2 million or 26%. The addition of CSI-Greensboro added \$0.2 million increase but was substantially offset by a \$0.2 million reduction in gross profit from the acquired Version3 acquisition. The gross margin was 21.8% for 2008 and 20.5% for 2007. The increase in margin for the year was primarily attributable to an increase in margin within the larger contributing Technology solutions segment, reporting 16.2% margin in 2008 versus 15.6% in 2007 from a shift in product mix to higher margin infrastructure solutions. The addition of the CSI-Greensboro operations which has historically had a lower margin (32.2% for 2008) than the ongoing CSI software operations and negative margin from the acquired Version3 operations resulted in a decline in the Software applications segment margin from 41.6% in 2007 to 40.7% in 2008. Version3’s gross margin was -55.2% of which approximately one-half was due to increased depreciation and amortization from the write-up of its assets to fair value in connection with the acquisition, and the remainder from a slow start to revenue expansion efforts in 2008.

Operating income was relatively flat, declining \$119,000, or 4% to \$3.0 million for 2008 compared to operating income of \$3.1 million for the 2007 year. The small decline in operating income resulted from a \$1.5 million increase in gross profit offset by a \$1.6 million increase in operating expenses. Operating expenses increased primarily as a result of increased Technology segment operating costs of \$1.0 million, primarily from increased selling efforts including the expansion of Technology cross-sales efforts into the Alabama region acquired in the 2007 CSI-Mobile software acquisition. The addition of the acquired CSI-Greensboro and Version3 operations each added \$0.6 million and represented the remaining increase in operating expenses driven by the Software segment of \$0.6 million.

Net income decreased \$0.4 million or 23% to \$1.3 million. The decrease was primarily related to the small, \$0.1 million decrease in operating income, net of a loss on the sale of the CSI-Mobile building in order to lease larger space for the expansion of technology sales efforts in Alabama and an increase of \$0.2 million in taxes. In the prior year, the Company began taking Jobs Tax Credits available in the State of South Carolina and was able to pick up some amounts from prior years to carryforward. No such one-time pickup occurred in the current year.

Results of Operations

Year Ended December 31, 2008 Versus Year Ended December 31, 2007

The following table and discussion set forth the change in sales and the major items impacting the change in operating income for the year ended December 31, 2008 compared to the year ended December 31, 2007.

(Amounts in thousands)

	<i>Year Ended</i>		Increase (Decrease)
	December 31, 2008	December 31, 2007	
NET SALES AND SERVICE REVENUE	\$ 58,703	\$ 55,197	\$ 3,506
GROSS PROFIT	12,818	11,321	1,497
OPERATING INCOME	3,027	3,146	(119)
SIGNIFICANT ITEMS THAT INCREASED (DECREASED) OPERATING INCOME			
Gross Profit:			
Sales			3,506
Cost of sales excluding depreciation, amortization, and capitalization			(1,536)
Depreciation and amortization			(334)
Capitalization of software costs			(139)
			<u>1,497</u>
Operating Expenses:			
Selling costs			(1,118)
Marketing costs			(157)
Professional and legal compliance, and litigation related costs			129
Stock based compensation			83
Acquisition expenses			(42)
Depreciation and amortization			(187)
Other general and administrative expenses			(324)
			<u>(119)</u>

Revenue

Our revenues for the 2008 fiscal year were \$58.7 million, \$3.5 million or 6% higher than revenues for the 2007 fiscal year. The increase was driven by increases in both our segments: Technology solutions, with a 1% increase, and Software applications, with a 29% increase. Technology solutions segment product sales of infrastructure solutions increased significantly over the prior year. The increase was partially offset by a decrease in instructional hardware (primarily interactive whiteboards) with an increase in the number of smaller projects not being sufficient to equal the prior year activity including a large districtwide implementation. Software applications sales increased 20% organically, with the remaining increase coming from the additions of CSI-Greensboro (6%) and Version3 (3%). Increases were experienced across all the major areas: new software, delivery, installation and training and recurring support agreement revenues.

Gross Profit

Gross profit for 2008 increased \$1.5 million, or 13%, to \$12.8 million, driven by the increased sales in both the technology and software segments. The gross margin increased from 20.5% in 2007 to 21.8% in 2008. The increase in margin for the year was primarily attributable to an increase in sales of higher margin infrastructure solutions within the larger dollar Technology segment. Technology solutions gross margin increased from 15.6% in 2007 to 16.2% in 2008. This increase was partially offset by a decrease in the software margin from 41.6% in 2007 to 40.7% in 2008. The decrease came from the addition of the CSI-Greensboro operations which has historically had a lower margin (32.2% for 2008) than the ongoing CSI software operations and negative margin from the acquired Version3 operations. Version3's margin was -55.2%, of which approximately one-half was due to increased depreciation and amortization from the recording of its assets at fair value in connection with the acquisition, and the remainder from a slow start to revenue expansion efforts in 2008. The decline in the margin for the ongoing software operations over the prior year came from increased amortization of software efforts capitalized, primarily relating to work for prior modules completed and work related to the remaining modules of the latest version of the Company's fund accounting software written in Microsoft's .Net programming and SQL database languages. Software gross margin was also impacted by decreased development wage costs capitalized with increased wages expensed from more time spent by development staff supporting quality assurance efforts with the new SQL version of the product.

Operating Expenses

Operating expenses were \$9.8 million for the 2008 fiscal year, an increase of \$1.6 million, or 20%, from the same period of the prior year. The increase was primarily from the added selling, general and administrative expenses with the addition of increased selling and marketing expense primarily by the Technology solutions segment, including efforts to capitalize on cross-sell opportunities in the expanded geographic region following the 2007 acquisition of McAleer. Additional selling, general and administrative and acquisition costs from the CSI-Greensboro and Version3 acquisitions also added to the increase in operations costs. Additional salaries and wages, sales consulting fees, marketing expenses, travel and mobile costs connected with the increase in sales also contributed to the increase. Depreciation and amortization increased as a result of the acquisitions, and other general and administrative costs increased due to the delay in increases in insurance and taxes, including franchise and business licenses, which costs are often based on prior year numbers and were driven higher by the large jump in business size which occurred in the prior year. These increases were partially offset by declines in the portion of non-cash stock-based compensation, with a shift to more cash compensation of our outside directors and consultants in 2008 compared to 2007, and decreases in compliance related costs with reduced use of outside consultants in 2008 compared to higher use needed to complete the initial implementation of Sarbanes-Oxley in the prior year.

Operating Income (loss)

We recorded operating income for 2008 of \$3.0 million, a decrease of \$0.1 million, or 4%, compared to the operating income in 2007. This decrease in 2008 compared to 2007 was due primarily to the impact of the substantial increase in gross profit, offset by the increase in Operating Expenses described above.

Segment Information

Software Applications Segment

(Amounts in thousands)

	Year Ended		Increase (Decrease)
	December 31, 2008	December 31, 2007	
NET SALES AND SERVICE REVENUE	\$ 13,559	\$ 10,478	\$ 3,081
GROSS PROFIT	5,514	4,362	1,152
OPERATING INCOME	845	383	462
SIGNIFICANT ITEMS THAT INCREASED (DECREASED) OPERATING INCOME			
Gross Profit:			
Sales			3,081
Cost of sales excluding depreciation, amortization, and capitalization			(1,485)
Depreciation and amortization			(305)
Capitalization of software costs			(139)
			<u>1,152</u>
Operating Expenses:			
Selling costs			(390)
Marketing costs			(12)
Depreciation and amortization			(150)
Other general and administrative expenses			(138)
			<u>462</u>

Software applications segment sales increased from increased sales in all areas: new and third party software, related delivery, training and support services and increased support agreements. The increased sales were due primarily to organic growth (\$2.0 million), but also to the addition of CSI-Greensboro (\$0.7 million) and Version3 (\$0.4 million).

Cost of sales, Selling costs, Marketing costs, Depreciation and amortization and Other general and administrative costs all increased primarily from the addition of CSI-Greensboro and Version3. Cost of sales also increased with increased amortization and depreciation from the recording of the assets at fair value of CSI-Greensboro and Version3 in connection with the acquisitions. Capitalized software costs decreased with continued work on the remaining modules related to the Microsoft .Net and SQL (application programming language and database) conversion effort declining with more efforts spent on quality assurance. Operating expenses also increased in Other general and administrative costs from an increase in costs from the allocation of insurance and taxes driven higher by the large increase in the size of the business in 2007.

Technology Solutions Segment

(Amounts in thousands)

	Year Ended		
	December 31, 2008	December 31, 2007	Increase (Decrease)
NET SALES AND SERVICE REVENUE	\$ 45,144	\$ 44,719	\$ 425
GROSS PROFIT	7,304	6,959	345
OPERATING INCOME	2,686	3,438	(752)
SIGNIFICANT ITEMS THAT INCREASED (DECREASED) OPERATING INCOME			
Gross Profit:			
Sales			425
Cost of sales excluding depreciation, amortization, and capitalization			(51)
Depreciation and amortization			(29)
			<u>345</u>
Operating Expenses:			
Selling costs			(729)
Marketing costs			(144)
Depreciation and amortization			(37)
Other general and administrative expenses			(187)
			<u>(752)</u>

Technology solutions segment sales increased primarily due to sales of new hardware, principally infrastructure solutions, partially offset by decreased sales of instructional (interactive whiteboard based) solutions.

Cost of sales increased but declined modestly as a percent of sales, with technology margins increasing from 15.6% in 2007 to 16.2% in 2008 with the shift to more sales of higher margin infrastructure hardware. Selling and marketing costs increased significantly, primarily driven by efforts to expand the geographic reach of the Technology segment into the expanded geographic territory following the 2007 acquisition of CSI-Mobile. Such efforts began in 2008. Considering our six to twelve month sales cycle and without considering the potential extension of sales cycles which may occur as a result of the late 2008 and current economic environment, we believe the full return on investment will be experienced in the following year. Depreciation and amortization increased, with additional investment in equipment to supply a larger labor force following the significant increase in the business in 2007 and to support expanded sales efforts in 2008. Other general and administrative expenses increased from an increase in costs from the allocation of insurance and taxes driven higher by the large increase in the size of the business in 2007.

The following table summarizes the segment information discussed above and reconciles them to the consolidated amounts reported and previously discussed. The table also presents the segment assets information. Changes in segment assets came primarily from the following:

- Segment assets in the Software applications segment increased primarily from the asset purchase of CSI-Greensboro and Version3. This included an increase in property, plant and equipment, computer software, goodwill and other (intangible) assets, as well as additions to receivables. Receivables also increased for the Technology solutions segment due to increased E-Rate work funded by the Schools and Libraries Division of the Federal government, which typically has long collection cycles.
- Inventory increased in the Technology solutions segment, with increased investment made to take advantage of volume purchase discounts.
- Capitalized software costs for the software applications segment increased from the investment in the conversion of the fund accounting software to the Microsoft .Net and SQL platform and the write up of the purchased CSI-Greensboro and Version3 software to fair value.
- Deferred tax liabilities increased as a result of the tax impact of the carryover of the tax basis of Version3 in that acquisition, due to the acquisition being accomplished as a stock based, tax-free reorganization; and reduced the prior year's reported net deferred asset position.

<i>(Amounts in thousands)</i>	<u>Software Applications</u>	<u>Technology Solutions</u>	<u>Total Company</u>
Year ended December 31, 2008			
Net sales and service revenue	\$ 13,559	\$ 45,144	\$ 58,703
Gross profit	5,514	7,304	12,818
Segment income	845	2,686	(*)
Segment assets	12,200	12,835	25,035
Year ended December 31, 2007			
Net sales and service revenue	\$ 10,478	\$ 44,719	\$ 55,197
Gross profit	4,362	6,959	11,321
Segment income	383	3,438	(*)
Segment assets	7,240	8,946	16,186

***Reconciliation of Segment income (non-GAAP measure) to operating income (loss) per consolidated Statements of Operations (GAAP measure):**

Certain non-recurring items (those items occurring for reasons which have not occurred in the prior two years and are not likely to reoccur in two years), stock-based compensation costs and compliance and acquisition costs are generally excluded from management's analysis of profitability by segment and the Company's segment presentation. The following reconciliation presents separately those costs related to the reverse merger and compliance costs, which have not been included in the analysis of segment income. In addition, due to public reporting requirements, we have incurred significant compliance-related professional and legal costs.

<i>(Amounts in thousands)</i>	<u>December 31, 2008</u>	<u>December 31, 2007</u>
Segment income:		
Software applications segment	\$ 845	\$ 383
Technology solutions segment	2,686	3,438
TOTAL SEGMENT INCOME	<u>3,531</u>	<u>3,821</u>
Less: merger-related and compliance costs		
Stock compensation – non-cash	(19)	(102)
Acquisition costs	(53)	(11)
Professional and legal compliance and litigation related costs	(432)	(562)
OPERATING INCOME Per consolidated Statement of Operations	<u>\$ 3,027</u>	<u>\$ 3,146</u>

Interest and Other Income and Expenses

Interest expense was approximately \$0.6 million in both 2008 and 2007. While average borrowings outstanding increased with additional deals funded by the federal government and having longer collection cycles, and with the cash impact of acquisitions, interest rates declined during the year. Loss on disposal of property and equipment increased approximately \$0.1 million due to the sale of the CSI-Mobile building and land to enable a move to larger leased space in connection with the expansion efforts in Alabama. As of December 31, 2008, we had outstanding draws of \$5,634,000 under our bank credit facility bearing interest at 3.59% (LIBOR plus 2.50%). We also had outstanding long-term bank debt, including current portion, of \$0.9 million bearing interest at 3.59% (LIBOR plus 2.50%) and outstanding subordinated notes payable to Barron Partners LP ("Barron") and the five former CSI-South Carolina shareholders totaling \$1,950,400 and bearing interest at 15.0%.

Income Taxes

Income taxes were recorded as an expense of approximately \$1.0 million in 2008 compared to \$0.9 million in 2007. The increase was due to recognizing fewer South Carolina jobs tax credits in the current year of approximately \$0.1 million. The effective tax rate was driven higher by fewer jobs tax credits and increased non-deductible items such as meals and entertainment due to travel across a broader geographic area.

Net Income (Loss) and Earnings (Loss) Per Share

Net income decreased \$0.4 million or 23% from net income of \$1.7 million in 2007, to net income of \$1.3 million for 2008. The decrease in net income over the prior year was driven by the increase in revenues contributing to increased gross profits, offset by increased operating costs, primarily for technology expansion into Alabama, the loss on the sale of the CSI-Mobile building and increased taxes, as previously discussed.

Basic earnings per share decreased from a basic earnings per share of \$0.46 in 2007 to basic earnings per share of \$0.25 in 2008. The decrease resulted primarily from the decrease in net income, and an increase in the number of weighted average shares outstanding. Weighted average shares increased because of conversions of preferred shares, warrant exercises, and issuance of stock in connection with the 2008 acquisitions. For the same reasons, on a fully diluted basis, earnings per share decreased from \$0.14 per share in 2007 to earnings per share of \$0.11 in 2008.

G. Liquidity and Capital Resources

Our strategic plan includes the expansion of the Company both organically and through acquisitions. Due to the long-term nature of investments in acquisitions and other financial needs to support organic growth, including working capital, we expect our long-term and working capital needs to periodically exceed the short-term fluctuations in cash flow from operations. Accordingly, we use debt and equity vehicles in addition to cash flow from operations to fund our growth and working capital needs. Currently our funds for working capital are provided under our \$7.0 million revolving line of credit (temporarily increased to \$8.0 million in the fall of 2008, then reduced again to \$7.0 million, in the winter of 2008).

Events Impacting Liquidity and Capital Resources

Acquisitions

On March 31, 2008, we consummated the acquisition, effective April 1, 2008, of substantially all the assets and business operations of ICS. The total purchase price was \$1,348,000 in cash, and the issuance by the Company of 209,091 shares of the Company's common stock. We assumed \$50,000 of liabilities of ICS.

Effective August 14, 2008, we acquired substantially all the assets and business operations of Version3. The total purchase price was \$203,000 in cash and the issuance of 2,153,143, shares of the Company's common stock, and we assumed \$88,000 of liabilities of Version3. The cash portion of the purchase prices were paid at closing with a draw on our line of credit facility.

Our utilization of draws under our bank revolver to fund the cash portion of the purchase price of the acquisitions has reduced our availability under the facility. Increased working capital requirements as a result of anticipated sales growth could put pressure on the adequacy of our bank revolving credit facility. Accordingly, we continue to evaluate other funding options, as discussed below under “—Credit Arrangements—Factors Affecting Capital Needs and Resources.”

Sale of Real Estate and Payoff of Real Estate Note

On November 17, 2008, we sold the building and land purchased in the CSI-Mobile acquisition in order to move into a larger leased facility due to growth in connection with our expansion of technology offerings in Alabama. The proceeds from the sale and a small draw on our revolver was used to pay off the related real estate note.

Increase in Equipment Note

As a cash availability conservation measure, we refinanced recent capital expenditures for equipment, which had been initially paid for by a draw on our line, through an increase in our equipment facility of \$665,000. The increase was used to pay down our revolving credit facility, our primary source for working capital to fund day to day business operations. The new note bears interest at Libor plus 2.5%.

Off-Balance Sheet Arrangements

As of December 31, 2008, and for the prior reporting periods, CSI had no off-balance sheet instruments.

Cash Flows

For the years ended December 31, 2008 and 2007 we had no significant increase in cash and cash equivalents with no significant cash on hand. Since the time of the reverse merger in 2005 we have operated in most periods without cash on hand and in reliance on a revolving line of credit facility to fund our day to day working capital needs, as previously noted.

Cash for Operating Activities

Cash used by operating activities totaled \$1.9 million for the year ended December 31, 2008, compared to cash provided by operating activities of \$4.1 million for the year ended December 31, 2007. The decrease was due primarily to slower collections on support agreements, also affecting the cash impact of deferred revenue arrangements, slower collections on hardware sales from payments made following installations of more solutions sold as bundled projects, and slower collections from increased work in connection

with the E-Rate program of the Schools and Libraries Division of the Federal Government (which typically has a longer collection cycle). These items were substantially collected following the year end, as is routine, and not as the result of any significant change in collectability. Increased investment in inventories for volume purchase discounts also resulted in reduced cash flow from operating activities.

The changes in adjustments to net income for 2008 compared to the changes in 2007 netted to a decrease of \$0.4 million. Increases came from depreciation and amortization, primarily from the increases following the current year acquisitions. The remaining portion of the change from the prior year of \$6.2 million were primarily driven by the differences in the changes in inventories and deferred revenues as discussed above.

Significant changes at December 31, 2008 since the prior year end to Balance Sheet items related to operating activities are as follows:

The increase in accounts receivable (\$5.2 million) was a result of a delay in collections on certain support agreements, large technology deals and E-Rate receivables, which were substantially collected after year end. The increase in deferred revenue was primarily from the billing of the majority of CSI-Mobile's support agreements at year end which are recognized over the year as the services are delivered. The CSI-Mobile forward billing was the primary cause for the increase in deferred revenue (\$1.4 million). The increase in inventories (\$1.1 million) is due to additional receipts of inventory at year end 2008 to take advantage of volume purchase discounts, and accounts payable declined by \$0.4 million due to the timing of payments.

Cash for Investing Activities

Cash used for investing activities totaled \$2.8 million for the year ended December 31, 2008, compared to \$5.6 million for the year ended December 31, 2007. The \$2.8 million decrease was a result of the reduction in amount of cash used for the acquisitions made in the current year than that of the prior year. This decrease was partially offset by the net increase in cash used for property and equipment activities, including an increase in cash used for purchases offset by cash received for the sale of the CSI-Mobile facility to enable the movement into a larger space as Alabama operations are expanded to include technology solutions offerings. On the balance sheet, since year end 2007, property and equipment declined due to the sale of the CSI-Mobile facility (as previously noted), partially offset by increases in equipment purchased to support a larger organization (including improvements driven in part by our efforts to maintain compliance with Sarbanes-Oxley legislation). Computer software costs, goodwill and other intangible assets all increased most significantly as a result of the acquisitions of substantially all the assets of ICS and Version3 and related purchase price allocation to the assets and recording of the additions in our financials.

Cash from Financing Activities

Cash provided by financing activities netted to \$4.7 million for the year ended December 31, 2008, compared to cash provided by financing activities of \$1.5 million for the year ended December 31, 2007. The increase of \$3.2 million was primarily due to draws on our revolving line of credit to support increased working capital requirements from increased accounts receivable and investment in inventories (for reasons discussed in Cash from Operating Activities) above, partially offset by a reduction in proceeds from the exercise of stock options and warrants, for which warrant exercises were significant at \$0.7 million in 2007, compared to no warrant exercises in 2008. Borrowings under notes payable resulted from an increase in our equipment note and a corresponding paydown on our revolver to shift funding for capital expenditure purchases from our working capital line to longer-term financing, while repayments of notes payable were a result primarily of the payoff of our real estate loan for the CSI-Mobile facility with proceeds from its sale, regularly scheduled payments on our equipment note and a principal payment on the subordinated notes payable to shareholders.

Non-GAAP Financial Measures: EBITDA and Adjusted EBITDA

Years Ended December 31, 2008 and 2007

EBITDA increased 6.9% or \$0.3 million to \$5.1 million for the year ended December 31, 2008, compared to EBITDA of \$4.8 million reported for the same period in 2007. The EBITDA increase was primarily due to the \$0.4 million decrease in operating income over the prior year being offset by a larger add back for increased depreciation and amortization in connection with the write-up to fair value of assets from the CSI-Mobile and Version3 acquisitions. Adjusted EBITDA for the year ended December 31, 2008 increased by 5.0% or \$0.2 million to \$5.1 million, compared to \$4.8 million for the prior year. The increase was due to the same items as impacted EBITDA. However, the rate of increase in Adjusted EBITDA was lower than that of EBITDA as it excludes the non-cash item stock-based compensation, which declined \$0.1 million in 2008 compared to the amount incurred in the same period of the prior year.

Explanation and Reconciliation of EBITDA and Adjusted EBITDA

EBITDA is a non-GAAP financial measure used by management, lenders and certain investors as a supplemental measure in the evaluation of some aspects of a corporation's financial position and core operating performance. Investors sometimes use EBITDA as

it allows for some level of comparability of profitability trends between those businesses differing as to capital structure and capital intensity by removing the impacts of depreciation and amortization. EBITDA also does not include changes in major working capital items such as receivables, inventory and payables, which can also indicate a significant need for, or source of, cash. Since decisions regarding capital investment and financing and changes in working capital components can have a significant impact on cash flow, EBITDA is not a good indicator of a business's cash flows.

We use EBITDA for evaluating the relative underlying performance of the Company's core operations and for planning purposes, including a review of this indicator and discussion of potential targets in the preparation of annual operating budgets. We calculate EBITDA by adjusting net income or loss to exclude net interest expense, income tax expense or benefit, depreciation and amortization, thus the term "Earnings Before Interest, Taxes, Depreciation and Amortization" and the acronym "EBITDA."

EBITDA is presented as additional information because management believes it to be a useful supplemental analytic measure of financial performance of our core business, and as it is frequently requested by sophisticated investors. However, management recognizes it is no substitute for GAAP measures and should not be relied upon as an indicator of financial performance separate from GAAP measures (as discussed further below).

"Adjusted EBITDA or "Financing EBITDA" is a non-GAAP financial measure used in our calculation and determination of compliance with debt covenants related to our bank credit facilities. Adjusted EBITDA is also used as a representation as to how EBITDA might be adjusted by potential lenders for financing decisions and our ability to service debt. However, such decisions would not exclude those other items impacting cash flow which are excluded from EBITDA, as noted above. Adjusted EBITDA is defined as net income or loss adjusted for net interest expense, income tax expense or benefit, depreciation, amortization, and also certain additional items allowed to be excluded from our debt covenant calculation, including other non-cash items such as operating non-cash compensation expense (such as stock-based compensation), and the Company's initial reorganization or restructuring related costs, unrealized gain or loss on financial instrument (non-cash related) and gain or loss on the disposal of fixed assets. While we evaluate the Company's performance against debt covenants on this basis, investors should not presume the excluded items to be one-time costs. If the Company were to enter into additional capital transactions, for example, in connection with a significant acquisition or merger, similar costs could reoccur. In addition, the ongoing impact of those costs would be considered in, and potential financings based on, projections of future operating performance which would include the impact of financing such costs.

We believe the presentation of Adjusted EBITDA is important as an indicator of our ability to obtain additional financing for the business, not only for working capital purposes, but particularly as acquisitions are anticipated as a part of our growth strategy. Accordingly, a significant part of our success may rely on our ability to finance acquisitions.

When evaluating EBITDA and Adjusted EBITDA, investors should consider, among other things, increasing and decreasing trends in both measures and how they compare to levels of debt and interest expense, ongoing investing activities, other financing activities and changes in working capital needs. Moreover, these measures should not be construed as alternatives to net income (as an indicator of operating performance) or cash flows (as a measure of liquidity) as determined in accordance with GAAP.

While some investors use EBITDA to compare between companies with different investment and capital structures, all companies do not calculate EBITDA or Adjusted EBITDA in the same manner. Accordingly, the EBITDA and Adjusted EBITDA measures presented below may not be comparable to similarly titled measures of other companies.

A reconciliation of Net Income reported under GAAP to EBITDA and Adjusted (Financing) EBITDA is provided below:

(Amounts in thousands)

	Year Ended December 31,	
	2008	2007
Reconciliation of net income per GAAP to EBITDA and Adjusted (Financing) EBITDA:		
Net income per GAAP	\$ 1,342	\$ 1,741
Adjustments:		
Income tax expense	1,036	855
Interest expense, net	574	549
Depreciation and amortization of property and equipment and intangible assets (excluding Software development)	775	525
Amortization of software development costs	1,381	1,109
EBITDA	<u>5,108</u>	<u>4,779</u>
Adjustments to EBITDA to exclude those items excluded in loan covenant calculations:		
Stock based compensation (non-cash portion)	19	102
Adjusted (Financing) EBITDA	<u>\$ 5,127</u>	<u>\$ 4,881</u>

Credit Arrangements

Prior to our going public through the reverse merger, we funded operations through cash flow from operations. In our 2005 reverse merger, which took the CSI operations public, substantially all of our cash was distributed to the founders in exchange for ownership. Due to continued acquisition activity and the recapitalization of the Company in connection with its going public through a reverse merger, the Company frequently has no excess cash and relies on its \$7.0 million line of credit facility with its bank (temporarily increased to \$8.0 million through November 30, or through the collection cycle for the seasonally high business and mid-year) to fund its working capital and other funding needs. Accordingly, we now use primarily our working capital facility and term loans to fund our operations. See Note 8 to our audited consolidated financial statements dated December 31, 2008 for details of recent activity under and terms of these facilities.

Our current credit facilities consist of:

- \$7.0 million revolving line of credit, of which \$5.6 million was drawn and \$1.4 million available December 31, 2008, which bears interest at LIBOR plus 2.5% and matures June 30, 2010;
- \$1,000,000 equipment note, of which approximately \$0.9 million was outstanding at December 31, 2008, which bears interest at LIBOR plus 2.5%, and has a three year amortization maturing in November 2010; and
- \$2.3 million in subordinated notes to Barron Partners and the five founding shareholders, of which \$2.0 million remained outstanding at December 31, 2008. (In order to conserve capital and borrowing capacity, we refrained from repaying the \$2.3 million in subordinated notes upon their maturity in May 2006. We do not anticipate repaying them upon their scheduled maturity on March 31, 2009. We expect to receive, but cannot guarantee an extension of the maturity date. The note holders have cooperated with our deferral of repayment, which, along with the details of subsequent payment activity, is discussed in more detail below under “—Factors Affecting Capital Needs and Resources —Subordinated Promissory Notes.”)

Future Capital Needs

Set forth below are factors which management believes could have a significant impact on our future cash and capital needs and resources.

Ongoing capital resources depend on a variety of factors, including:

- \$1.4 million available to our operations at December 31, 2008, under our \$7.0 million line of credit;
- inventory purchase commitments taken periodically to obtain pricing discounts;
- burden of professional and legal compliance costs;
- the anticipated level of capital expenditures for 2009 of \$800,000;
- software development costs of approximately \$1.0 million;
- our scheduled debt service;
- continued cooperation as to the deferral of payment on our subordinated debt;
- potential future acquisitions; and
- potential capital inflow from warrants exercise and the possibility warrant exercises and related proceeds may not be fully realized.

The above items are described in more detail below.

Factors Affecting Capital Needs and Resources:

Credit Facilities. Absent a significant cash inflow from the cash exercise of the warrants or otherwise, and in light of our growth and acquisition strategy, for the foreseeable future we will rely on a line of credit and borrowing facilities.

While we have drawn on our line significantly and paid it down from time to time, we cannot guarantee that cash flow from operations will be sufficient to repay our line of credit facility at the time it is due and adequately fund our growing working capital needs. In the alternative, we would attempt to refinance the credit facility with another lender. Although management currently believes that our existing lender will agree to a renewal of the facility, there can be no assurance that our bank will in fact do so or that replacement financing could be procured by us on favorable terms or at all. Further, any failure to repay or otherwise restructure the subordinated notes, or to maintain the cooperation of the holders of such notes, could negatively impact our ability to renew our existing bank credit facility or procure a replacement. Without such a credit facility, we believe that our ability to fund our business operations, including providing sufficient working capital to fund sales growth, could be adversely affected.

Expected cash flow from operations. In addition to financing sources, our operating cash flow is a significant source for us to meet our future capital needs. Our ability to generate sufficient operating cash flow is dependent upon, among other things:

- the amount of revenue we are able to generate and collect from our customers;
- the amount of operating expenses required to provide our services;
- the cost of acquiring and retaining customers; and
- our ability to continue to grow our customer base.

In 2007, the Company experienced significant improvement in its cash flow from operations, increasing \$1.1 million to \$4.1 million compared to the prior year's \$3.0 million. Net of needs for other financing activities and scheduled debt retirement, this placed the Company in the position of repaying the short-term portion of borrowings used in connection with the McAleer acquisition, in part or \$1.1 million, from cash provided by operations, while the remaining \$0.7 million was provided from the exercise of warrants. This improvement was also made possible from the acquisition of McAleer which historically bills the largest portion of its annual support agreements in the fourth quarter of each year and receives some additional cash by year end, with the remainder collected in the first quarter. Our projections as to the acquisition of McAleer were that it would be cash flow positive, that is it would fund its own debt service, and in fact it has done so. As a result, we see risk associated with the cost of the McAleer acquisition as substantially behind us and continuing improvements in our cash position long-term. The success of the McAleer acquisition has also mitigated the risks associated with doing and provided capital for the additional acquisitions we consummated in 2008: that of CSI-Greensboro and Verison3. This assessment does not take into account additional capital related to additional acquisitions, and it assumes growth does not significantly outpace our expectations. It also assumes we are able to effectively and timely control our costs if impacted significantly by an economic downturn, and we retain our ongoing ability to secure asset-based financing to fund our growth. Our primary reasons for pursuing other financing and equity capital are to reduce short-term economic risk relating to past and future acquisitions, and to repay our subordinated notes (potentially as part of funding an acquisition).

Purchase Commitments. The majority of our purchase commitments are based on firm purchase orders. However, from time to time we commit to purchase product in advance of customer commitments and as inventory to obtain volume pricing discounts or operational efficiencies. In 2008 we had purchase order commitments to Promethean, one of our major suppliers, for interactive whiteboard inventory purchases of \$12.3 million. We may receive and agree to, but have not yet committed to any amounts for 2009. We have no other significant purchase commitments based on estimates of customer demand that significantly exceed customer commitments. If actual customer demand were to differ significantly either in timing or volume from the purchase commitments, this could strain our available working capital resources. While management anticipates its purchase commitments will not differ significantly from its estimates of customer demand, there can be no assurance that this will in fact be the case.

Burden of Professional and Legal Compliance Costs. For the year ended December 31, 2008, professional and legal compliance and litigation costs, excluding stock-based (non-cash) compensation, totaled \$434,000. These related primarily to compliance costs of operating as a public company, as well as legal and accounting costs for the registration of shares pursuant to the registration rights agreement. Management anticipates that the current level of expenses should continue and could increase somewhat, particularly as the Company grows or acquires other businesses. The Company will continue to incur expenses to test and monitor controls related to the Sarbanes-Oxley Act, and to maintain the registration of shares through 2009 as required by its commitment to Barron. Although the Company is hopeful that costs related to supplementing the registration statement for updated financial and other information will be minimal, there can be no assurances that this will in fact be the case and cost savings realized. Management anticipates that some cost efficiencies may be realized as CSI gains experience as a reporting company and management seeks to manage compliance costs, and believes economies of scale will be achieved particularly with regard to these costs as the Company grows.

Short Term Capital Requirements. We currently anticipate that our capital needs for 2009 will principally consist of \$1.0 million for software development and \$0.7 million for capital expenditures. For the year ended December 31, 2008, we capitalized approximately \$0.9 million of software development costs and \$0.6 million in capital expenditures. We plan to fund 2008 needs for these items through cash flow from operations, our line of credit or other financing options discussed above.

Subordinated Promissory Notes. At December 31, 2008, subordinated promissory notes payable to shareholders totaled approximately \$2.0 million. Although we possessed adequate availability on the May 9, 2006 due date to repay the subordinated notes, management believed that cash flow from operations and remaining availability under the bank facility following such a drawdown would not be sufficient to fund ongoing working capital needs. We also anticipated that such a refunding of the subordinated notes with bank debt would have caused us to fail to comply with equity related covenants with the bank, given that the subordinated notes are treated as equity for such ratios. Accordingly, after consultation with the bank and the holders of the subordinated notes, we determined it was not in the best interest of all stakeholders to pay the notes at maturity, and the subordinated notes remain due and payable. We pay a default interest rate of 15% both on the principal balance and any interest not paid quarterly. From time to time we have deferred the payment of interest to preserve working capital. Specifically, we took this action in the first and second quarters of 2007 as a

precautionary measure considering the cash requirement needed for the acquisition of the McAleer operations. Subsequently we paid this and other interest due and no interest was in arrears as of December 31, 2008.

Looking forward, considering our growth and acquisition strategy, we do not know when we will be able to generate operating cash flow sufficient to repay the subordinated notes, either from cash or with draws under the revolving credit facility. Our ability to utilize our credit facility to repay the subordinated notes would be limited not only by availability under the asset based facility, but also by equity-related financial covenants. Under these covenants in our credit agreement, the subordinated notes are counted as equity. Accordingly, we believe that it is possible that we will not be able to utilize our revolving credit facility to repay the subordinated notes, and that the subordinated notes will need to be restructured or repaid from long-term capital sources. The subordinated notes may, for example, be refinanced as part of the financing of future acquisitions, or repaid from the proceeds of the exercise of warrants by Barron. We expect to receive an extension of the due dates; however, we can give no assurance that we will be able to successfully extend, restructure or repay the subordinated notes, or that the note holders will continue to cooperate. Our bank lender in the past has consented with respect to the subordinated notes and has granted waivers relating to their prior nonpayment. The notes are subordinated to our senior bank debt, and we believe the ability of the note holders to have direct recourse against us is limited. However, if we fail to extend before, or repay the subordinated notes at, the March 31, 2009 maturity date, the holders of the subordinated notes may take actions that could adversely affect the Company, including acting to accelerate the subordinated debt, thereby potentially triggering a default under our credit facility with our bank. Such note holders also might take legal or other adverse collection actions against the Company. We can therefore give no assurances as to what adverse collection actions the subordinated note holders might take, and the impact such actions and default might otherwise have on our other creditors and our financial condition. However, we do not anticipate any of the note holders taking any action detrimental to us. It should be noted that five of the subordinated note holders are currently significant stockholders of the Company, and four of these are executive officers. The ninth note holder, Barron, holds all our preferred stock.

McAleer, ICS, Version3 and Potential Acquisitions. We are examining the potential acquisition of companies and businesses within our industry. We are unable to predict the nature, size or timing of any such acquisition, and accordingly are unable to estimate the capital resources which may be required. Any acquisition would be subject to our utilizing sources in addition to those described above. These alternative sources could include the issuance of our common stock or other securities in an acquisition, seller financing, and bank and other third party financing, among other things. We can give no assurance that, should the opportunity for a suitable acquisition arise, we will be able to procure the financial resources necessary to fund any such acquisition or that we will otherwise be able to conclude and successfully integrate any acquisition.

We acquired McAleer on January 2, 2007. We believe the acquisition of this leading provider of fund accounting based financial management software in Alabama fits within our acquisition strategy. We anticipate that the acquisition of McAleer will provide several benefits as discussed in “—A. Introduction—Strategy.” Also, on March 31, 2008, we consummated the acquisition, effective April 1, 2008, of substantially all of the assets and business operations of ICS and of Version3 on August 14, 2008. We believe that the acquisition of ICS and Version3 will, likewise, provide a number of strategic benefits as discussed in “—A. Introduction—Strategy.” A large portion of the cash consideration for the acquisition was funded by draws under our bank revolving credit facility, thereby reducing our availability under the facility to support working capital needs. Also, the acquisitions of McAleer, ICS and Verison3, like most acquisitions by the Company of other operating businesses, has increased working capital needs of the Company from time to time, primarily due to differences in the timing of collections, typically once a year, and ongoing labor costs for the provision of support services. While our line of credit may be sufficient, its adequacy may be strained by our increased working capital and other needs as a result of acquisition activity. We continue to pursue other opportunities for increasing funds available to us in light of the potentially greater capital needs of a larger organization. A number of options, as discussed above, are under consideration, and could provide longer-term financing to match the longer-term nature of an acquisition related investment.

Potential Capital Inflow from Warrants Exercise. A significant amount of cash and capital for the Company would be generated by the exercise by Barron of its common stock warrants. The exercise of our warrants with an exercise price of \$0.70 would generate approximately \$0.4 million. The exercise of our warrants priced at \$0.85 would generate approximately \$1.3 million. The exercise of our warrants priced at \$1.3972 would generate approximately \$2.8 million. The exercise of our warrants with a price of \$2.0958 would generate approximately \$4.2 million.

In September 2007, Barron exercised warrants priced at \$0.70 per share for 120,000 shares of common stock, for which the Company received proceeds of \$84,000. Additionally, subsequent to September 30, 2007 and through October 25, 2007, Barron exercised additional warrants priced at \$0.70 for 933,800 shares of common stock, the proceeds from which amounted to an additional \$654,000. This leaves warrants for approximately 0.5 million shares of common stock representing proceeds of approximately \$400,000 remaining of those priced at \$0.70 per share. Among other alternatives, we may repay a portion of the subordinated notes with a portion of such proceeds while retaining a portion for working capital or other expansion opportunities.

The exercise of the warrants is in the sole discretion of Barron, subject to the restrictions in the preferred stock and the warrants prohibiting Barron from beneficially holding greater than 4.9% of our outstanding common stock at any time. Although we presume any decision by Barron to further exercise the warrants or any portion would depend upon our stock price, results of operations and the long term outlook for the development of our business, among other things, we cannot predict if and when Barron may exercise

the warrants. Accordingly, there can be no assurance that Barron will exercise additional warrants and that we will receive any resulting capital.

The warrants may be exercised on a cashless basis, in which case the Company would receive no cash proceeds. However, Barron is prohibited from electing a cashless exercise so long as there is an effective registration statement with respect to the shares underlying the warrants. Accordingly, it will be important for us to maintain the effectiveness of the registration statement covering the warrant shares in order to assure the receipt of equity capital from the exercise of the warrants. Our registration statement was declared effective on February 14, 2006 and an updating amendment was likewise declared effective on May 14, 2007, and May 9, 2008. Barron has not invoked the cashless exercise provision.

Adequacy of Liquidity and Capital Resources.

Based on management's assessment giving consideration to the above items, including the availability under our line of credit facility, management anticipates that our cash flow from operations and our existing bank credit facilities will be adequate to fund our short term liquidity and capital needs for operations over the next twelve months. Accordingly, (i) further increased working capital requirements as a result of anticipated sales growth significantly beyond our expectations, (ii) cash flows lower than anticipated without a corresponding decline in working capital requirements and (iii) either of the above in combination with the addition of funding needs and working capital requirements associated with any other acquisition, could put pressure on the adequacy of our bank revolving and other credit facilities.

We continuously consider and pursue other financing options which could include mezzanine financing or other capitalization alternatives. These options are under consideration, and could provide longer-term financing to match our long-term capital needs. Such needs would include providing longer term financing for the recent acquisition of McAleer, potentially supporting additional acquisition activities, and increased working capital. Our evaluation of potential long-term funding sources has also included exercise of the warrants held by Barron. Encouraging the earlier exercise of the warrants, as well as encouraging an earlier increase in the float of our stock, we entered into our decision to reduce the pricing on a portion of the warrants in the fourth quarter 2006. In late 2007 Barron exercised for approximately 1.0 million warrant shares providing capital proceeds of approximately \$0.7 million. There is no guarantee additional warrant exercises will occur or when. Depending on cash flow from current operations or warrant exercises, should we find longer-term funding unnecessary, we may not take advantage of such additional funding options, thereby paying down debt and minimizing any potential for dilution from any additional raise of capital.

Any of the aforementioned events or circumstances (further detailed below) could involve significant additional funding needs in excess of the identified current available sources, and could require us to raise additional capital to meet these needs. However, our ability to seek additional capital, if necessary, is subject to a variety of additional factors that we cannot presently predict with certainty, including:

- the commercial success of our operations;
- the volatility and demand of the capital markets; and
- the future market prices of our securities.

There is no guarantee CSI could obtain access to additional funding or at reasonable rates. The failure of CSI to meet covenant requirements, raise capital through the exercise of the warrants or find or obtain other funding at reasonable rates, could have a negative impact on our business.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk.

Not applicable.

Item 8. Financial Statements and Supplementary Data.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
Computer Software Innovations, Inc. and Subsidiary
Easley, South Carolina

We have audited the accompanying consolidated balance sheets of Computer Software Innovations, Inc. and Subsidiary as of December 31, 2008 and 2007 and the related consolidated statements of operations, changes in shareholders' equity, and cash flows for each of the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits 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 Computer Software Innovations, Inc. and Subsidiary as of December 31, 2008 and 2007 and the results of their operations and their cash flows for each of the years then ended in conformity with United States generally accepted accounting principles.

We were not engaged to examine management's assertion about the effectiveness of Computer Software Innovations, Inc. and Subsidiary's internal control over financial reporting as of December 31, 2008 and, accordingly, we do not express an opinion thereon.

/s/ Elliott Davis, LLC

Greenville, South Carolina
March 27, 2009

**COMPUTER SOFTWARE INNOVATIONS, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS**

(Amounts in thousands)

	December 31, 2008	December 31, 2007
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ —	\$ —
Accounts receivable, net	13,862	8,697
Inventories	1,552	470
Prepaid expenses	98	43
Taxes receivable	223	177
Total current assets	15,735	9,387
PROPERTY AND EQUIPMENT, net	898	1,317
COMPUTER SOFTWARE COSTS, net	3,001	2,163
DEFERRED TAX ASSET, net	—	263
GOODWILL	2,431	1,481
OTHER INTANGIBLE ASSETS, net	2,970	1,575
Total assets	\$ 25,035	\$ 16,186
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	\$ 3,644	\$ 4,024
Deferred revenue	6,696	5,324
Deferred tax liability	421	469
Current portion of notes payable	447	283
Subordinated notes payable to shareholders	1,950	2,250
Total current liabilities	13,158	12,350
LONG-TERM DEFERRED TAX LIABILITY, net	329	—
NOTES PAYABLE, less current portion	515	764
BANK LINE OF CREDIT	5,634	575
Total liabilities	19,636	13,689
SHAREHOLDERS' EQUITY		
Preferred stock - \$0.001 par value; 15,000 shares authorized; 6,740 and 6,860 shares issued and outstanding, respectively	7	7
Common stock - \$0.001 par value; 40,000 shares authorized; 6,381 and 4,699 shares issued and outstanding, respectively	6	5
Additional paid-in capital	8,884	7,401
Accumulated deficit	(3,443)	(4,785)
Unearned stock compensation	(55)	(131)
Total shareholders' equity	5,399	2,497
Total liabilities and shareholders' equity	\$ 25,035	\$ 16,186

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

**COMPUTER SOFTWARE INNOVATIONS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF OPERATIONS**

(Amounts in thousands, except per share data)

	For the Years Ended December 31,	
	2008	2007
REVENUES		
Software applications segment	\$ 13,559	\$ 10,478
Technology solutions segment	45,144	44,719
Net sales and service revenue	<u>58,703</u>	<u>55,197</u>
COST OF SALES		
<i>Software applications segment</i>		
Cost of sales, excluding depreciation, amortization and capitalization	7,473	5,988
Depreciation	110	77
Amortization of capitalized software costs	1,381	1,109
Capitalization of software costs	(919)	(1,058)
Total Software applications segment cost of sales	<u>8,045</u>	<u>6,116</u>
<i>Technology solutions segment</i>		
Cost of sales, excluding depreciation	37,721	37,670
Depreciation	119	90
Total Technology solutions segment cost of sales	<u>37,840</u>	<u>37,760</u>
Total cost of sales	<u>45,885</u>	<u>43,876</u>
Gross profit	12,818	11,321
OPERATING EXPENSES		
Selling costs	4,304	3,187
Marketing costs	438	281
Stock based compensation	19	102
Acquisition costs	53	11
Professional, legal compliance and litigation costs	434	562
Depreciation and amortization	546	358
Other general and administrative expenses	3,997	3,674
Total operating expenses	<u>9,791</u>	<u>8,175</u>
Operating income	3,027	3,146
OTHER INCOME (EXPENSE)		
Interest income	1	13
Interest expense	(574)	(562)
Loss on disposal of property and equipment	(76)	(1)
Net other expense	<u>(649)</u>	<u>(550)</u>
Income before income taxes	2,378	2,596
INCOME TAX EXPENSE	1,036	855
NET INCOME	<u>\$ 1,342</u>	<u>\$ 1,741</u>
BASIC EARNINGS PER SHARE	<u>\$ 0.25</u>	<u>\$ 0.46</u>
DILUTED EARNINGS PER SHARE	<u>\$ 0.11</u>	<u>\$ 0.14</u>
WEIGHTED AVERAGE SHARES OUTSTANDING:		
– Basic	<u>5,380</u>	<u>3,809</u>
– Diluted	<u>12,661</u>	<u>12,198</u>

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

**COMPUTER SOFTWARE INNOVATIONS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**

(Amounts in Thousands)

	Common Stock	Preferred Stock	Additional Paid-In Capital	Accumulated Deficit	Unearned Stock Compensation	Total
Balances at December 31, 2006	\$ 4	\$ 7	\$ 6,473	\$ (6,526)	\$ (62)	\$ (104)
Barron's conversion of preferred stock into common stock	—	—	—	—	—	—
Barron's exercise of warrants to purchase common stock	1	—	737	—	—	738
Exercise of stock options	—	—	8	—	—	8
Issuance of stock options	—	—	183	—	(183)	—
Stock based compensation	—	—	—	—	114	114
Net income for the year ended December 31, 2007	—	—	—	1,741	—	1,741
Balances at December 31, 2007	5	7	7,401	(4,785)	(131)	2,497
Barron's conversion of preferred stock into common stock	—	—	—	—	—	—
Issuance of common stock, ICS acquisition	—	—	230	—	—	230
Issuance of common stock, Version3 acquisition	1	—	1,243	—	—	1,244
Issuance of stock options	—	—	19	—	(19)	—
Forfeiture of stock options	—	—	(9)	—	9	—
Stock based compensation	—	—	—	—	86	86
Net income for the year ended December 31, 2008	—	—	—	1,342	—	1,342
Balances at December 31, 2008	\$ 6	\$ 7	\$ 8,884	\$ (3,443)	\$ (55)	\$ 5,399

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

**COMPUTER SOFTWARE INNOVATIONS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Amounts in thousands)

	For the years ended December 31,	
	2008	2007
OPERATING ACTIVITIES		
Net income	\$ 1,342	\$ 1,741
Adjustments to reconcile net income to net cash (used for) provided by operating activities		
Depreciation and amortization	2,156	1,634
Stock compensation expense	86	114
Deferred income tax (benefit) expense	(77)	164
Loss on disposal of property and equipment	76	1
Changes in deferred and accrued amounts net of effects from Payments for acquisitions		
Accounts receivable	(5,165)	(4,869)
Inventories	(1,077)	2,099
Prepaid expenses and other assets	(55)	117
Accounts payable	(386)	29
Deferred revenue	1,235	3,245
Income tax receivable	(46)	(134)
Net cash (used for) provided by operating activities	<u>(1,911)</u>	<u>4,141</u>
INVESTING ACTIVITIES		
Purchases of property and equipment	(594)	(338)
Proceeds from disposal of property and equipment	449	—
Capitalization of computer software	(1,067)	(1,058)
Purchase of computer software	—	(98)
Payments for acquisitions	(1,551)	(4,150)
Net cash used for investing activities	<u>(2,763)</u>	<u>(5,644)</u>
FINANCING ACTIVITIES		
Net borrowings under line of credit	5,059	24
Borrowings under notes payable	666	972
Repayments of notes payable	(1,051)	(239)
Proceeds from exercise of stock options and warrants	—	746
Net cash provided by financing activities	<u>4,674</u>	<u>1,503</u>
Net change in cash and cash equivalents	—	—
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	—	—
CASH AND CASH EQUIVALENTS, END OF PERIOD	<u>\$ —</u>	<u>\$ —</u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	\$ 577	\$ 461
Income taxes	\$ 1,159	\$ 824

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

COMPUTER SOFTWARE INNOVATIONS, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in thousands, except where specifically stated as being in millions)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACTIVITIES

Organization

Computer Software Innovations, Inc. (formerly VerticalBuyer, Inc.) (the “Company”, “CSI” or “we”), a Delaware corporation, was incorporated on September 24, 1999. The Company currently trades in the over the counter market and is reported on the OTC Bulletin Board under the symbol “CSWI.OB.”

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

Since the reverse merger, and as a part of our growth strategy we have acquired and will continue to pursue the acquisition of other operations. During the periods covered by this report we acquired three operations. On January 2, 2007, we purchased substantially all of the assets and business operations of McAleer Computer Associates, Inc. (“McAleer”), on April 1, 2008 we purchased substantially all of the assets and business operations of ICS Systems, Inc. (“ICS”), and on August 12, 2008 we purchased substantially all of the assets and business operations of Version3, Inc. (“Version3”). The total prices for the assets acquired in these acquisitions are further discussed in Note 3 – Acquisitions.

Description of business

The Company is engaged in the business of development and sales of internally developed software, sales and distribution of computers, network and communications hardware and accessories, as well as interactive collaborative classroom technologies and other hardware-based solutions.

The Company’s internally developed software consists of fund accounting based financial management software, standards-based lesson planning software, and solutions that facilitate single sign-on application access management provisioning based on Microsoft’s Identity Lifecycle Management and Microsoft SharePoint deployments. The Company’s primary software product, fund accounting based financial management software, is developed for those entities that track expenditures and investments by “fund”, or by source and purpose of the funding. The fund accounting software is used primarily by public sector and not-for-profit entities. The Company’s standards-based lesson planning software is designed to allow teachers to create lesson plans that are tied to a state’s curriculum standards. These lesson plans may be reviewed by administrators and a report generated to determine the standards that have been met or need to be met. The lesson plans can be stored, shared, and retrieved for collaboration, editing and future use. The Company’s solutions for single sign-on application access management provide the ability to eliminate the need for users to sign on to every application separately (thereby allowing “single sign-on”) and provides for other efficiencies related to setting-up and controlling user access.

In connection with its hardware-based solutions, the Company provides a wide range of technology products and services including hardware and design, engineering, installation, training and ongoing support and maintenance. Technology solutions include computers, networking, security, IP telephony, interactive whiteboard solutions and integrated accessories, distance learning and video communication. The Company currently markets its products and services primarily to a wide variety of education and local government agencies, and not-for-profit entities in the southeastern United States. The majority of the Company’s business is with K-12 (kindergarten through grade 12) public education and local government entities.

Basis of presentation

The consolidated financial statements include CSI Technology Resources, Inc., a wholly-owned subsidiary. CSI Technology Resources, Inc. was acquired by CSI on May 1, 2000 and became the technology solutions segment of CSI. This subsidiary no longer has any significant operations or separate accounting, as all activities are now accounted for within CSI, except that certain vendor contracts are still in the name of CSI Technology Resources, Inc. At a future date, the name on these contracts may be converted and the subsidiary deactivated, subject to a review of any tax or legal implications. As the Company files a consolidated tax return and has been accounting for all activities through the parent, there should be no financial or tax implications related to the formal procedures which would be undertaken to deactivate the subsidiary. Intercompany balances and transactions have been eliminated. The Company uses the accrual basis of accounting.

Reclassification

Certain prior period amounts have been reclassified to the current presentation. Such reclassifications had no impact on previously reported Net income or Shareholder's equity.

Use of estimates

The accounting and reporting policies conform to accounting principles generally accepted in the United States of America ("generally accepted accounting principles" or "GAAP"). GAAP requires us to make estimates, assumptions and judgments and to rely on projections of future results of operations and cash flows. Those estimates, assumptions, judgments and projections are an integral part of the financial statements. We base our estimates and assumptions on historical data and other assumptions, which include knowledge and experience with regard to past and current events and assumptions about future events that we believe are reasonable under the circumstances. These estimates and assumptions affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities in our financial statements. In addition, they affect the reported amounts of revenues and expenses during the reporting period.

Our judgments are based on our assessment as to the effect certain estimates, assumptions of future trends or events may have on the financial condition and results of operations reported in our financial statements. Actual results could differ materially from these estimates, assumptions, projections and judgments.

Disclosure regarding segments

The Company reports its operations under two operating segments: the software applications segment and the technology solutions segment.

Cash and cash equivalents

The Company considers all highly liquid investments purchased with original maturities of three months or less to be cash equivalents. At times balances may exceed federally insured amounts. Bank overdrafts of \$698 and \$79 as of December 31, 2008 and 2007, respectively, have been reclassified to accounts payable.

Accounts receivable

The Company generally performs credit evaluations of its customer's financial condition as deemed necessary. The Company sells primarily to local government and education entities whose source of funding (local taxes and federal funding) is generally assured; accordingly the risk of uncollectibility is lower than that of businesses selling primarily to non-government entities. In general, receivables are due 30 days after the issuance of the invoice. The Company provides an allowance for doubtful accounts, based upon a review of outstanding receivables, which can include a review of payment history, credit history and current financial condition. Credit is granted to substantially all customers on an unsecured basis. In addition, the Company provides a sales returns allowance, which is estimated based upon a percentage of sales, derived from historical data of such returns.

Inventories

Inventories consist of finished goods purchased for resell from third party vendors and a small amount of service inventory that can be used to provide support services to customers of the Company. Inventories are valued at the lower of historic cost or net realizable value using the first-in, first-out method. The Company is generally able to limit the amount of inventory it has to carry through direct shipment from its suppliers to its customers. However, at times large shipments of inventory may be in transit or not all parts may have been received sufficient for delivery to be consummated or collectibility assured, in which case a significant amount of inventory may be recorded in the Company's financial statements. Additionally, from time to time the Company takes advantage of bulk purchase opportunities for quantity discounts on high-volume sales items to reduce its costs. Typically such inventories are only carried for a few weeks. As of December 31, 2008 and 2007, the Company had finished goods on hand that amounted to \$1,552 and \$470, respectively.

Revenue recognition

Software License Revenues

Software revenues consist principally of fees for licenses of our CSI Accounting+*Plus* software product, service and training. We recognize all software revenue using the residual method in accordance with Statement of Position ("SOP") 97-2, "Software Revenue Recognition," as amended by SOP 98-9, "Modification of SOP 97-2, and Software Revenue Recognition with Respect to Certain Transactions." Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the

arrangement fee is recognized as revenue. If evidence of the vendor specific fair value of one or more undelivered elements does not exist, revenues are deferred and recognized when delivery of those elements occurs or when fair value can be established. Company-specific objective evidence of fair value of maintenance and other services is based on our customary pricing for such maintenance and/or services when sold separately. At the outset of the arrangement with the customer, we defer revenue for the fair value of its undelivered elements (e.g., maintenance, consulting and training) and recognize revenue for the remainder of the arrangement fee attributable to the elements initially delivered in the arrangement (i.e., software product) when the basic criteria in SOP 97-2 have been met. If such evidence of fair value for each undelivered element of the arrangement does not exist, we defer all revenue from the arrangement until such time that evidence of fair value does exist or until all elements of the arrangement are delivered.

Under SOP 97-2, revenue attributable to an element in a customer arrangement is recognized when (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred, (iii) the fee is fixed or determinable, (iv) collectability is probable and (v) the arrangement does not require services that are essential to the functionality of the software.

Persuasive evidence of an arrangement exists. We determine that persuasive evidence of an arrangement exists with respect to a customer when we have a written contract, which is signed by both us and the customer, or a purchase order from the customer when the customer has previously executed a standard license arrangement with us.

Delivery has occurred. Our software may be either physically or electronically delivered to the customer. We determine that delivery has occurred upon shipment of the software pursuant to the billing terms of the agreement or when the software is made available to the customer through electronic delivery.

The fee is fixed or determinable. If at the outset of the customer engagement we determine that the fee is not fixed or determinable, we recognize revenue when the fee becomes due and payable.

Collectability is probable. We determine whether collectability is probable on a case-by-case basis. When assessing probability of collection, we consider the number of years in business, history of collection, and product acceptance for each customer. We typically sell to customers for whom there is a history of successful collection. However, collection cannot be assured.

We allocate revenue on software arrangements involving multiple elements to each element based on the relative fair value of each element. Our determination of the fair value of each element in multiple-element arrangements is based on vendor-specific objective evidence (“VSOE”). We align our assessment of VSOE for each element to the price charged when the same element is sold separately. We have analyzed all of the elements included in our multiple-element arrangements and determined that we have sufficient VSOE to allocate revenue to the maintenance, support and professional services components of our perpetual license arrangements. We sell our professional services separately, and have established VSOE for professional services on that basis. VSOE for maintenance and support is determined based upon the customer’s annual renewal rates for these elements. Accordingly, assuming that all other revenue recognition criteria are met, we recognize revenue from perpetual licenses upon delivery using the residual method in accordance with SOP 98-9.

Our software products are fully functional upon delivery and implementation and do not require any significant modification or alteration of products for customer use.

We expense all manufacturing, packaging and distribution costs associated with software license sales as cost of license revenues.

Computer Hardware Sales Revenues

Revenue related to hardware sales is recognized when: (a) we have a written sales agreement; (b) delivery has occurred; (c) the price is fixed or determinable; (d) collectability is reasonably assured; (e) the product delivered is standard product with historically demonstrated acceptance; and (f) there is no unique customer acceptance provision or payment tied to acceptance or an undelivered element significant to the functionality of the system. Generally, payment terms are net 30 days from shipment. When sales to a customer involve multiple elements, revenue is recognized on the delivered element provided that (1) the undelivered element is a standard product, (2) there is a history of acceptance on the product with the customer, and (3) the undelivered element is not essential to the customer’s application. Revenue related to spare parts is recognized on shipment. Shipping and handling charges to customers are included in revenues. Shipping and handling costs incurred by the Company are included in cost of sales.

Technology revenues are generated primarily from the sale of hardware. In accordance with Emerging Issues Task Force (“EITF”) 99-19, “Reporting Revenue Gross as a Principal Versus Net as an Agent,” we record revenues as net when we serve as an agent. In these circumstances, our supplier pays a commission to us but acts as the primary obligor in a transaction and we record only the commission in revenues. We record revenues as gross (generally cost of merchandise plus margin) when we serve as a principal whereby we act as the primary obligor in a transaction, have the latitude for establishing pricing and retain all the credit risk associated with such transaction.

Long-term Payment Arrangements

Our primary customer base consists of local government and education entities whose source of funding (local taxes and federal funding) is generally assured; accordingly the risk of uncollectibility is lower than that of businesses selling primarily to non-government entities. The Company has an ongoing practice of providing financing for certain purchases under notes receivable or long term leases typically ranging from 3 to 5 years, subject to review of its exposure under such facilities and cash flow availability or needs at the time of such purchases. Such amounts have not constituted a significant portion of account balances, and the Company has historically never experienced a default under such arrangements. The Company recognizes revenue under these arrangements when the criteria noted under Software License Revenues and Computer Hardware Sales Revenues above is met, in accordance with SOP 97-2, as amended by SOP 98-9.

Service/Support Revenues

Services revenues consist of professional services and maintenance fees from software and hardware maintenance agreements. Maintenance agreements are typically priced based on a percentage of the product license fee or hardware cost and have a one-year term, renewable annually. Services provided to customers under maintenance agreements may include technical product support and unspecified software upgrades. Revenue related to maintenance and service contracts is recognized ratably over the duration of the contracts. Deferred revenues from advanced payments for maintenance agreements are recognized ratably over the term of the agreement, which is typically one year.

Warranties

The Company's suppliers generally warrant the products distributed by the Company and allow returns of defective products, including those that have been returned to the Company by its customers. The Company does not independently warrant the products it distributes; however, the Company does warrant its services with regard to products that it configures for its customers and products that it builds from components purchased from other sources. Warranty expense is not material to the Company's consolidated financial statements.

Vendor programs

The Company receives volume incentives and rebates from certain manufacturers related to sales of certain products, which are recorded as a reduction of cost of sales when earned. The Company also receives manufacturer reimbursement for certain promotional and marketing activities that offset expenses incurred by the Company.

Long-Lived Assets

Expenditures for major renewals or betterments that extend the useful lives of property and equipment are capitalized. Expenditures for maintenance and repairs are charged to expenses as incurred.

We continually evaluate whether events and circumstances have occurred that indicate the remaining estimated useful life of long-lived assets may warrant revision or that the remaining balance of long-lived assets may not be recoverable in accordance with Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of." When factors indicate that long-lived assets should be evaluated for possible impairment, we use an estimate of the related undiscounted future cash flows over the remaining life of the long-lived assets in measuring whether they are recoverable. If the estimated undiscounted future cash flows exceed the carrying value of the asset, a loss is recorded as the excess of the asset's carrying value over fair value.

Depreciation

Depreciation of property and equipment is provided using the straight-line method over the following estimated useful lives:

<u>Classification</u>	<u>Useful life (years)</u>
Furniture.....	7
Computer equipment.....	3
Office equipment	3
Leasehold improvements	3

Computer Software Costs and Amortization

Computer software costs consist of internal software production costs and purchased software products capitalized under the provisions of SFAS No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed." Costs in the

research and development of new software products where the technological feasibility is unknown, and enhancements which do not prolong the software life or otherwise increase its value, are expensed as incurred. Capitalized computer software costs are amortized over the economic life of the product, generally three to four years, using the straight-line method. Our software development efforts focus on the implementation of known technological capabilities applied to common business processes to enhance our existing products. Historically, to date, through our software solutions segment, we have spent no material efforts on technological innovation for which the feasibility has been unknown.

Goodwill

The Company follows SFAS No. 142, "Goodwill and Other Intangible Assets," in our accounting and reporting for goodwill and intangible assets.

SFAS No. 142 eliminates the requirement to amortize intangible assets with an indefinite life, addresses the amortization of intangible assets with a defined life, and addresses impairment testing and recognition of indefinite-lived intangible assets. In accordance with SFAS No. 142, we do not amortize indefinite-lived intangible assets (e.g., corporate trademarks for which planned use is indefinite). As of December 31, 2008, we had \$2,431 of goodwill. In accordance with SFAS No. 142 we are required to test for the impairment of goodwill and other intangible assets with indefinite lives on at least an annual basis. Our goodwill impairment test involves a comparison of the fair value to its carrying amount. If the fair value is determined to be less than the carrying value, the asset is considered impaired. We tested goodwill for impairment as of December 31, 2008 and will test it annually on December 31 unless changes occur between annual test dates that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Our 2008 impairment test indicated that goodwill was not impaired.

In addition, we evaluate the remaining useful life of other intangible assets that are not being amortized each reporting period to determine whether events and circumstances continue to support an indefinite useful life. If an intangible asset that is not being amortized is subsequently determined to have a finite useful life, we amortize the intangible asset prospectively over its remaining estimated useful life. Amortizable intangible assets (e.g., product trademarks) are amortized on a straight-line basis over six years or the life of the product, whichever is shorter. As of December 31, 2008, the intangible assets classified as indefinite lived assets total \$2,458, including goodwill (\$2,431) and corporate trademarks (\$27 included in Other intangible assets).

Other Intangible Assets

In connection with the acquisition of McAleer, ICS, and Version3, we allocated \$3,258 in value to intangible assets. The estimated fair value of these acquired intangible assets is based upon an independent valuation, and is being amortized over the life of the assets. Intangible assets also include previously capitalized intangibles of \$49.

As of December 31, 2008, intangible assets had a carrying value of \$2,970, net of accumulated amortization of \$337, and are included in other intangible assets, net on the consolidated balance sheet. See Note 3 to our audited consolidated financial statements dated December 31, 2008 for further detail regarding the intangible assets related to the McAleer, ICS, and Version3 acquisitions.

Amortization expense was \$217 for the year ended December 31, 2008 and \$117 for the year ended December 31, 2007. Future estimated amortization expense for the carrying amount of intangible assets as of December 31, 2008 is expected to be as follows:

Year	Amortization Expense
2009	\$ 348
2010	277
2011	192
2012	175
2013	162
Thereafter	1,789
Total	\$ 2,943

Income taxes

The Company uses the asset and liability method of accounting for income taxes. Income taxes are provided for the tax effects of transactions reported in the financial statements and consist of taxes currently due or refundable plus deferred income tax assets and liabilities. Deferred income tax assets and liabilities are recorded to recognize the income tax effect of the temporary differences in the method of reporting various items of income and expenses for financial reporting purposes and income tax purposes.

The deferred income tax assets and liabilities at the end of the year are determined using the statutory tax rates expected to be in effect when the taxes are actually due or refundable.

Effective January 1, 2007, we adopted Financial Accounting Standards Board (FASB) Interpretation No. 48 (FIN 48), "Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109" which requires that a position taken or expected to be taken in a tax return be recognized in the financial statements when it is more likely than not (i.e., a likelihood of more than fifty percent) that the position would be sustained upon examination by tax authorities. A recognized tax position is then measured at the largest amount of benefit that is greater than fifty percent likely of being realized upon settlement. Upon adoption, we found there to be no impact.

Fair value of financial instruments

The Company's financial instruments include cash equivalents, accounts receivable, accounts payable, short-term debt and notes payable. The carrying values of cash equivalents, accounts receivable and accounts payable approximate their fair value because of the short maturity of these instruments. The fair value of the Company's bank line of credit is assumed to be approximately equal to the carrying value since the interest rate on the on the line of credit obligation is adjustable based on the LIBOR rate. The fair value of the Company's long-term notes payable depends primarily on current market interest rates for debt issued with similar maturities by companies with risk profiles similar to the Company.

Marketing, Business Promotion and Advertising

Marketing, business promotion and advertising costs are expensed as incurred. Such costs amounted to \$438 and \$281 for the years ended December 31, 2008 and 2007, respectively.

NOTE 2 – EARNINGS PER SHARE

Basic earnings per share are computed by dividing net income by the weighted average number of common stock shares outstanding during the period. Diluted earnings per share is computed by dividing net income by the weighted average number of common and potential common shares outstanding, including common shares held in escrow, during the period following application of the treasury stock method. The table below presents the weighted average shares outstanding for the year ended December 31, 2008 and 2007, both prior to and after application of the treasury stock method.

	For the Years Ended December 31,	
	2008	2007
Weighted Average Shares Outstanding Prior to Application of the Treasury Stock Method		
Common stock (excluding shares held in escrow)	5,380	3,809
Common stock held in escrow	297	—
Preferred stock	6,839	6,926
Warrants	6,164	6,971
Options	383	303
Total Weighted Average Shares Outstanding	19,063	18,009
Weighted Average Shares Outstanding After Application of the Treasury Stock Method		
Common stock (excluding shares held in escrow)	5,380	3,809
Common stock held in escrow	297	—
Preferred stock	6,839	6,926
Warrants	—	1,239
Options	145	224
Total Weighted Average Shares Outstanding – Treasury Stock Method	12,661	12,198

Stock related activity for the year ended December 31, 2007

	Common stock (excluding shares held in escrow)	Common stock held in escrow	Preferred Stock	Warrants*	Options*
Outstanding at December 31, 2006	3,429	—	7,013	7,218	268
Issues in 2007	—	—	—	—	170
Conversions and exercises in 2007	1,270	—	(153)	(1,054)	(63)
Outstanding at December 31, 2007	4,699	—	6,860	6,164	375

Stock related activity for the year ended December 31, 2008

	Common stock (excluding shares held in escrow)	Common stock held in escrow	Preferred Stock	Warrants*	Options*
Outstanding at December 31, 2007	4,699	—	6,860	6,164	375
Issues in 2008 – related to acquisitions	1,562	800	—	—	—
Other issues, net of forfeitures in 2008	—	—	—	—	10
Conversions and exercises in 2008	120	—	(120)	—	—
Outstanding at December 31, 2008	6,381	800	6,740	6,164	385

*For details of Warrant related activity, see Note 9. Preferred Stock and Related Warrants, and for details of Option related activity see Note 11. Stock-based Compensation.

The potential common shares, including common stock held in escrow, were used in the calculation of diluted earnings per share for the years ended December 31, 2008 and 2007.

NOTE 3 – ACQUISITIONS**Acquisition of McAleer**

On January 2, 2007, the Company consummated its acquisition of the business operations of McAleer. The transaction was structured as a purchase of substantially all of the assets of McAleer.

The total price for the purchased assets was \$4,050, of which \$3,525 was paid in cash at closing. The balance of \$525 was to be paid pursuant to a promissory note to the owner, William McAleer, in twenty quarterly installments of principal in the amount of \$26, plus interest in arrears at the LIBOR rate, beginning March 31, 2007. The note was secured by a first mortgage on the real property of McAleer conveyed in the acquisition, consisting of the office building located in Mobile, Alabama from which the Mobile personnel operate. The Company assumed no liabilities of McAleer, other than certain operating leases and obligations under ongoing customer contracts. On February 8, 2007, the Company repaid the note to William McAleer by financing the real estate through a mortgage note with its bank in the amount of \$486 (the terms of which are discussed below under Note 8 – Long-term and Short-term Debt, and Off-Balance Sheet Instruments), and a draw against its revolving credit facility for the remaining balance. Expenses for the acquisition, in the amount of \$267, consisted of legal and professional fees, travel costs, stock compensation costs and various other expenses related to the acquisition transaction. These expenses have been capitalized and allocated to goodwill. The Company engaged an independent party to provide assistance with customary valuations, analysis and allocation of the purchase price, which resulted in an allocation to goodwill. For the purposes of recording assets by segment, the acquired assets, including goodwill, are reported under the Software applications segment. The Company expects all goodwill will be deductible for tax purposes, and has an indefinite life for book purposes. The deferred tax liability arises from a difference in the agreed to price for the building asset (tax basis) and the purchase price allocation (book basis included in property and equipment and based on appraisal). Research and development assets acquired in the purchase were not material.

On November 17, 2008, the Company sold the land and the building acquired in the acquisition of McAleer. The sales price was \$485. Cash proceeds after selling expenses were \$449. The Company recorded a loss on the sale of the building of \$72. Proceeds from the sale and a \$6 draw on our line of credit were used to pay off the mortgage loan relating to the Property with RBC Bank (USA) in the amount of \$455. In conjunction with the sale of the Alabama Property, the Company and the Buyer also entered into a short term lease. Pursuant to such lease, the Company leased the Property from the Buyer until February 15, 2009, at a monthly rate of \$5,000. On December 8, 2008 the Company entered into a lease for other facilities and moved into the newly leased facility on or about the expiration date of the short term lease-back of the sold property. See Note 10 – “Commitments and Contingencies.”

Acquisition of ICS Systems, Inc.

On March 31, 2008, CSI consummated the acquisition, effective April 1, 2008, of substantially all the assets and business operations of ICS. The total purchase price was \$1,370 in cash offset by \$50 of liabilities, and the issuance by the Company of 209 shares of the Company’s common stock. We did not assume any material liabilities of ICS. We operate ICS as a separate office from which we continue to support the existing product and expand opportunities and sales into surrounding areas. We also integrate the unique features of ICS software into our products over time, and plan to use ICS personnel to assist with these efforts and future product development needs.

The acquisition was effectuated pursuant to an Asset Purchase Agreement with ICS and Michael Byers, its sole shareholder. The assets acquired included: certain account receivables; work in progress; all furniture, fixtures, machinery, equipment and supplies; and all software and intellectual property rights. The cash portion of the consideration was substantially funded by draw under the Company’s revolving credit facility with RBC Bank (USA).

In connection with the asset purchase transaction described in the Asset Purchase Agreement, the Company entered into a Lease with Byers Properties, L.L.C. for the lease by the Company of the former facilities of ICS. Byers Properties is controlled by Michael Byers, who is the sole shareholder of ICS. The term of the Lease begins April 1, 2008 and runs for a period of three years through March 2011. The Lease calls for annual rent of \$80, payable monthly. The leased property consists of a single-story brick building located on 2.57 acres in Triangle Industrial Park at 8518 Triad Drive, Colfax, North Carolina. The building comprises 7,207 square feet, with approximately 300 square feet being warehouse space.

ICS, located in Colfax, North Carolina (near Greensboro) is a developer, provider and consultant with respect to fund accounting and billing software. Its primary focus is municipalities located in North Carolina. ICS provides CSI with an immediate customer base geographically contiguous with that of CSI, and its North Carolina office provides a launching point for continued expansion into areas north along the eastern seaboard. The acquisition also provides CSI strategic advantages, including valuable market experience and deeper penetration into the local government market.

Acquisition of Version3, Inc.

On August 12, 2008, CSI consummated the acquisition, effective August 14, 2008, of substantially all the assets and business operations of Version3. Version3, based out of Columbia, South Carolina, is a developer, provider and consultant with respect to solutions that facilitate single sign-on application access management provisioning based on Microsoft's Identity Lifecycle Management and Microsoft SharePoint deployments. While Version3 solutions are not solely designed for the education market segment, many recent projects have been directed to K-12 and higher education. Prior to the acquisition, CSI was a reseller of Version3 solutions. We anticipate, by joining forces with Version3, that synergies will be achieved to expand sales efforts, enhance delivery efficiencies, and allow increased focus on new product development and enhancements to existing solutions. We believe Version3's solutions are more easily scalable to a national level than the Software applications segment's other major proprietary applications, fund accounting solutions, with many solutions having reduced or no integration requirements, depending on the venue, with local or state reporting. Version3 has provided solutions both within and outside our eight-state footprint prior to the acquisition.

In the purchase, we issued 2,153 shares of common stock, paid down a note of approximately \$233, and received \$89 for assumed liabilities for deferred revenue. Of the 2,153 shares issued, 800 shares were placed in escrow for release in the event Version3 achieves certain revenue and EBITDA targets over the next three years following the closing and subject to forfeiture if such targets are not achieved. The calculated purchase price, including share values based on the latest closing price on the date of acquisition, liabilities assumed and capitalized expenses aggregated approximately \$1.5 million. If performance targets are reached the total value paid will include an addition \$0.7 million related to the 800 shares held in escrow. The share amount was negotiated with a goal of eliminating dilution within the first year following the acquisition based on projected earnings performance before the impact of non-cash items (such as the amortization of values allocated to amortizable intangible assets) and also considered equalizing the basis for valuations of both CSI and Version3 using multiples of revenues and EBITDA (or Earnings (Net Income), Before Interest, Taxes, Depreciation and Amortization) for acquisition transactions occurring within the past 12 months based on third party data. In the fiscal years 2009, 2010 and 2011, upon the achievement of revenue targets of \$2.5 million, \$5.0 million and \$7.0 million and EBITDA targets of \$0.7 million, \$1.5 million and \$2.1 million, 300, 300, and 200 shares would be released from escrow, respectively.

We will run Version3 as a separate office of the Company from its Columbia location. We will continue to support the existing product and expand opportunities and sales through this office.

The acquisition was effectuated pursuant to an Agreement and Plan of Reorganization with Version3 and its shareholders, including key employees, who have entered into employment agreements and will continue in management, product development and selling roles following the acquisition. The assets acquired included: certain account receivables; work in progress; all furniture, fixtures, machinery, equipment and supplies; and all software and intellectual property rights. The cash portion of costs related to the acquisition was substantially funded by draws under the Company's revolving credit facility with RBC Bank (USA).

Allocation of Purchase Price

The allocation of the purchase prices for the McAleer, ICS, and Version3 acquisitions, including capitalized acquisition expenses, are as follows (liabilities other than deferred taxes assumed as part of the purchase price were not deemed material):

	<u>McAleer</u>	<u>ICS</u>	<u>Version3</u>
Property and equipment	\$ 615	\$ 50	\$ 20
Computer Software	610	164	989
Goodwill	1,481	950	—
Other intangible assets	1,645	464	1,149
Deferred tax liability	(34)	—	(622)
Total assets purchase price	<u>\$ 4,317</u>	<u>\$ 1,628</u>	<u>\$ 1,536</u>

Source of Funds for Acquisition

Sources of funds used in the transactions (net of subsequent refinancing activities) are as follows:

	<u>McAleer</u>	<u>ICS</u>	<u>Version3</u>
Proceeds from increase in long-term not payable secured by property and equipment (at time of purchase)	\$ 486	\$ —	\$ —
Proceeds from long-term note payable secured by real estate (for refinance of McAleer note)	486	—	—
Receipts on billings for McAleer 2007 support agreements earmarked for CSI	1,280	—	—
Funds from revolving credit facility			
Draw on revolving credit facility (escrow payment at time of signing of definitive agreement)	100	—	—
Draw on revolving credit facility (at time of purchase (including \$12 for acquisition related expenses)	1,671	1,321	153
Draw on revolving credit facility (for refinance of McAleer note)	39	—	—
Payments of acquisition related expenses (funded from revolving credit facility)	255	27	50
Subtotal of funds from revolving credit facility	<u>2,065</u>	<u>1,348</u>	<u>203</u>
Issuance of 209 shares of CSI's common stock valued at \$1.10 per share	—	230	—
Issuance of 1,353 shares of CSI's common stock valued at \$0.92 per share ¹	—	—	1,244
Assumed liabilities	—	50	89
Total purchase price	<u>\$ 4,317</u>	<u>\$ 1,628</u>	<u>\$ 1,536</u>

¹ Excludes 800 shares held in escrow subject to achieving performance requirements previously discussed.

Computer Software, Other Intangible Assets, Goodwill, and Useful Lives of Acquired Assets

The detail of computer software, other intangible assets and goodwill and their useful lives are as follows:

Asset	<u>McAleer</u>		<u>ICS</u>		<u>Version3</u>	
	<u>Value</u>	<u>Effective Useful Life</u>	<u>Value</u>	<u>Effective Useful Life</u>	<u>Value</u>	<u>Effective Useful Life</u>
Computer software	\$ 610	4 years	\$ 164	4 years	\$ 989	4 years
Trade name	70	3 years	19	3 years	857	15 years
Covenants not-to-compete	75	5 years	70	5 years	37	5 years
Customer contracts and related relationships	1,500	20 years	375	20 years	255	2 years
Other intangible assets	\$ 1,645		\$ 464		\$ 1,149	
Total computer software and other intangible assets	<u>\$ 2,255</u>	13.3years ²	<u>\$ 628</u>	13.3 years ²	<u>\$ 2,138</u>	14.7 years ²
Goodwill	<u>\$ 1,481</u>	indefinite	<u>\$ 950</u>	indefinite	<u>—</u>	—

² Weighted average

NOTE 4 – ACCOUNTS RECEIVABLE

	<u>December 31,</u>	
	<u>2008</u>	<u>2007</u>
Billed receivables	\$ 12,560	\$ 5,742
Unbilled receivables	1,218	2,851
Commission receivable and other	158	194
Allowance for sales returns	(40)	(18)
Allowance for doubtful accounts	(34)	(72)
Total accounts receivable, net	<u>\$ 13,862</u>	<u>\$ 8,697</u>

NOTE 5 – CONCENTRATION OF CREDIT RISK

For the years ended December 31, 2008 and 2007 our top ten clients constituted approximately 37% and 46%, respectively, of our annual revenue. At December 31, 2008 and 2007, approximately 28% and 8%, respectively, of the Company's net accounts receivable were due from the top ten customers. Potential losses from concentrations of credit risk with respect to trade accounts receivable are considered to be limited due to the number of the customers comprising the customer base, including significant amounts to be paid through government funding, and the Company's ongoing credit evaluations of its customers.

For the years ended December 31, 2008 and 2007, approximately 55% and 57%, respectively, of the Company's purchases were from three vendors. At December 31, 2008 and 2007, approximately 11% and 50%, respectively, of the Company's accounts payable were due to these three vendors.

NOTE 6 – PROPERTY AND EQUIPMENT

	December 31,	
	2008	2007
Land	\$ ---	\$ 117
Buildings	—	423
Furniture	321	255
Computer equipment	234	234
Office equipment	1,494	929
Leasehold improvements	198	179
Total	2,247	2,137
Accumulated Depreciation	(1,349)	(820)
Property and equipment, net	\$ 898	\$ 1,317

Depreciation expense charged to operations was \$558 and \$408 for the years ended December 31, 2008 and 2007, respectively.

On November 17, 2008, the Company sold the building and the land that was acquired in the acquisition of McAleer. The sales price was \$485, and the Company recorded a loss on the sale of \$72. (See note 3 – Acquisitions)

NOTE 7 – COMPUTER SOFTWARE COSTS

	December 31,	
	2008	2007
Capitalized computer software costs	\$ 6,125	\$ 5,816
Capitalized computer software from acquisitions	1,762	—
Purchase of computer software for resale	363	215
Accumulated amortization	(5,249)	(3,868)
Computer software costs, net	\$ 3,001	\$ 2,163

Amortization expense charged to cost of sales for the software applications segment was \$1,381 and \$1,109 for the years ended December 31, 2008 and 2007, respectively.

NOTE 8 – LONG-TERM AND SHORT-TERM DEBT AND OFF-BALANCE SHEET INSTRUMENTS

In 2005, in order to support the activities of the reverse acquisition and provide for future borrowing needs, the Company entered into a line of credit facility with a bank. This facility has been increased from time to time to support the growing needs of an expanding company. The Company could borrow up to 80% of accounts receivable balance and up to 50% of inventory, not to exceed facility limits.

On September 14, 2007, the Company entered into agreements with the bank renewing the line of credit facility. The terms of the agreements previously entered into were amended as follows:

- the principal amount of the facility was increased from \$5.5 million to \$7.0 million;
- the maturity date was extended from September 15, 2007 until June 30, 2009;
- permissible purposes of the funds borrowed under the revolving facility were expanded to include funding short-term working capital and general corporate purposes of the Company; and
- the definition of the borrowing base was expanded to include 50% of eligible inventory (with a maximum borrowing ability against eligible inventory of \$1.0 million), in addition to 80% of eligible accounts receivable.

On June 30, 2008, the Company entered into agreements to once again extend the maturity date of the line of credit facility from June 30, 2009 to June 30, 2010. On September 11, 2008, the Company entered into a modification of the line of credit facility. The modification temporarily increased the credit facility from \$7.0 million to \$8.0 million until November 30, 2008 to support the collection cycle for increased receivables generated during the summer, the seasonally high point of CSI's business. The modification increased availability by increasing the amount of inventory includable in the Credit Facility's borrowing base from \$1.0 million to \$2.0 million.

Other than the amendments noted above, the material obligations and provisions of the facility remain unchanged. The modifications also memorialized certain previously granted waivers to the restrictive covenants and requirements contained in the agreements with the bank. The bank granted waivers permitting us to enter into the acquisition of McAleer, including the use of bank credit facility advances to fund such acquisition, and incurring mortgage indebtedness to McAleer as a part of the purchase of McAleer's real estate. Subsequently, on November 17, 2008, the Company sold the land and the building for \$485, and recorded a loss of \$72. Proceeds from the sale were used to pay off the mortgage loan relating to the property in the amount of \$455. (See note 3 – Acquisitions) The bank also waived any cross-default relating to the subordinated notes payable to certain stockholders, which the Company did not repay at their May 2006 maturity.

Under our bank facility, eligible accounts receivable balances essentially include all of our trade accounts receivable except, in most cases, those accounts which are more than 90 days past due. Certain other accounts are excluded from eligibility for borrowing including: (i) accounts due from affiliates; (ii) accounts which we have determined to be of doubtful collectibility; and (iii) accounts due from any one of our customers if such accounts constitute more than 20% of the total eligible accounts. The loans bore interest at LIBOR plus 2.50% (3.59%) at December 31, 2008, and LIBOR plus 2.50% (7.73%) at December 31, 2007, payable monthly.

On February 14, 2006 the Company entered into an agreement with a bank for a 42 month equipment term loan of \$400 at a fixed interest rate of 7.5% per year. The facility is collateralized by substantially all of the assets of the Company. The purpose of the term loan was to finance 2005 capital expenditures and improve its availability under its bank credit facility for working capital purposes. On January 2, 2007, the Company entered into a modification of the equipment loan. Pursuant to the modification, the equipment loan was increased to \$800, and bears interest at 7.85% per annum. Principal and interest is payable in 36 consecutive monthly payments of principal and interest of \$25 continuing until January 1, 2010.

The loans under the revolving credit facility and the equipment facility, as well as all other obligations owed by the Company to the bank, are secured by a first priority security interest in substantially all of the Company's assets. Also, the Company is required to comply with certain covenants, including: providing periodic financial statements to the bank, compliance with SEC reporting requirements, allowing the bank to inspect its secured assets, and the Company maintaining its assets in good operating condition and maintaining sufficient insurance. Also, the Company is required to comply with certain financial covenants. The first financial covenant is a "Debt Service Coverage Ratio," which is measured at the end of each year beginning December 31, 2007. This ratio is calculated by adding certain nonrecurring special items to EBITDA ("Adjusted EBITDA"), and then dividing by current maturities of long term debt plus interest expense. For the purposes of the amended loan agreement, "EBITDA" means the total of (i) net income from continuing operations (excluding extraordinary gains or losses), and to the extent deducted in determining net income (ii) interest expense, (iii) income taxes, and (iv) depreciation, depletion and amortization expenses. The Company is required to maintain a Debt Service Coverage Ratio of not less than 1.2 to 1.0. The second financial ratio is Funded Debt to EBITDA, which is also measured annually beginning December 31, 2007. A ratio of not greater than 2.5 to 1.0 is required. For the purposes of the ratio, "Funded Debt" generally means all obligations for borrowed money or for the deferred purchase price of property, and all capitalized lease obligations. Management believes the Company complied with these current covenants at December 31, 2008, and complied at December 31, 2007 with the previous, now expired agreements.

The amended loan agreement also contains certain restrictive covenants. These include general prohibitions on: (i) disposing of property other than in the ordinary course of business; the Company changing its business; a change in control of the Company; mergers, acquisitions and the creation of new subsidiaries; the incurring of new indebtedness; the creation of new encumbrances or liens; investments, other than certain permitted investments in liquid investment grade paper; and the Company making loans, including loans to officers. Also, the amended loan agreement prohibits the Company from making any distributions (including any dividends on its common stock), or making any repurchases or redemptions of its capital stock, except to the extent there is no event of default either before or after any such distribution, repurchase or redemption. The bank may accelerate the Company's obligations under the amended loan agreement and the related promissory notes upon an event of default under the amended loan agreement. Events of default generally include the Company failing to make payments of principal or interest when due; defaults under loan covenants, subject to periods during which the Company may cure in certain cases; the Company becoming insolvent or being subject to certain bankruptcy proceedings, subject to certain time periods; and the occurrence of a material adverse change in the Company's business or financial condition. Upon an acceleration of the bank's loans to the Company, the bank, among other remedies, would have recourse to substantially all of the Company's assets through its security interest. There was \$5,634 and \$575 of outstanding draws under the facility as of December 31, 2008 and 2007, respectively.

The Company has subordinated notes payable to shareholders with amounts outstanding totaling \$1,950 at December 31, 2008 and \$2,250 at December 31, 2007, respectively. Although the Company possessed adequate availability on the May 9, 2006 due date to repay the subordinated notes, management believed that cash flow from operations and remaining availability under the bank facility following such a draw would not be sufficient to fund ongoing working capital needs. The Company also anticipated that such a refunding of the subordinated notes with bank debt would have caused the Company to fail to comply with equity related covenants with the bank, given that the subordinated notes are treated as equity for such ratios. Accordingly, after consultation with the bank and the holders of the subordinated notes, the Company determined it was not in the best interest of all stakeholders to pay the notes at maturity, and the subordinated notes remain due and payable.

Since the Company failed to pay the subordinated notes at maturity, such notes are in default. Interest not paid quarterly and any principal not paid by the due date accrue interest at 15% until paid. Any potential cross-default under our bank credit facilities relating to the nonpayment of the subordinated notes has been waived by our bank lender. Pursuant to the terms of our bank credit facilities, we have also agreed to obtain the consent of the bank to any modification of the terms of the subordinated notes.

On April 23, 2008, we and each of the holders of the subordinated notes entered into a letter agreement which extended the maturity date of such notes until March 31, 2009. Each note holder also waived existing and past payment defaults and the notes will continue to bear interest at the default rate of 15%. In exchange for the extension and waiver, the Company made principal payments on the subordinated notes totaling \$300, paid pro-rata among the note holders.

The Company's subordinated noteholders have cooperated with us in the deferral of payment on the subordinated notes. The Company has paid interest at a default rate of 15%, and as of December 31, 2008 was current with such payments. The Company anticipates the continued cooperation of the noteholders and the ultimate successful negotiation of a maturity date extension or other restructuring of its subordinated debt with the holders. The subordinated notes may, for example, be refinanced as part of the financing of future acquisitions, or repaid from the proceeds of the exercise of warrants by Barron. However, the Company can give no assurance that it will be able to successfully restructure, extend or refund the subordinated notes, and that the noteholders will continue to cooperate. The notes are subordinated to the Company's senior bank debt, and management believes the ability of the noteholders to have direct recourse against us is limited. However, the Company can give no assurances as to what adverse collection actions the subordinated noteholders might take, and the impact such actions and default might otherwise have on its other creditors and its financial condition. The Company does not anticipate any of the noteholders taking any action which would be detrimental. It should be noted that five of the subordinated noteholders are currently significant stockholders of the Company, and four of these are executive officers. The sixth noteholder, Barron, holds all of the Company's preferred stock.

The amount outstanding on the notes payable to the bank was \$962 at December 31, 2008 and \$1,047 at December 31, 2007.

The principal payments for subsequent years under the Company's notes payable are presented below:

2009	\$	447
2010		515
Total Principal Payments	<u>\$</u>	<u>962</u>

As of December 31, 2008, and for the prior reporting periods, and through the filing date, CSI had no off-balance sheet instruments except for certain operating leases discussed in Note 10.

NOTE 9 – PREFERRED STOCK AND RELATED WARRANTS

Registration Rights Agreement

In conjunction with the Preferred Stock Purchase Agreement, the Company entered into a Registration Rights Agreement with Barron on February 10, 2005, whereby the Company agreed to register the shares of common stock underlying the preferred stock and warrants to be sold to Barron. Barron may also demand the registration of all or part of such shares on a one-time basis and, pursuant to "piggy-back rights," may require the Company (subject to carve back by a managing underwriter) to include such shares in certain registration statements it may file. The Company is obligated to pay all expenses in connection with the registration of the shares and, prior to February 11, 2007, was liable for liquidated damages in the event the registration of shares did not remain effective pursuant to the Registration Rights Agreement.

On December 29, 2006, the Registration Rights Agreement was amended to, among other things, eliminate liquidated damages. The Company's obligation to maintain an effective registration statement was also extended by one year until February 11, 2009 plus that number of days during which the registration has not been effective during that term of the agreement.

Warrants

On February 11, 2005, pursuant to the terms of a Preferred Stock Purchase Agreement with Barron, we issued to Barron common stock purchase warrants to purchase a total of 7,218 shares of our common stock.

Warrant exercises may be accomplished in one or a series of transactions, subject to a 4.9% beneficial ownership restriction. The terms and conditions of the warrants are identical except with respect to the exercise price.

The warrants may be exercised on a cashless basis. In such event, the Company would receive no proceeds from their exercise. So long as the Company maintains an effective registration statement for the shares underlying the warrants, a warrant holder is prohibited from utilizing a cashless exercise. The Company's registration statement was declared effective on February 14, 2006 and an updating amendment was declared effective on May 9, 2008.

Activity related to the common stock purchase warrants for the years ended December 31, 2008 and 2007 and outstanding balances is as follows:

Common Stock Purchase Warrants

	Warrant A1	Warrant A2	Warrant B1	Warrant B2
Exercise Price	\$ 1.3972	\$ 0.70	\$ 2.0958	\$ 0.85
Expiration Date	2/10/2010	2/10/2010	2/10/2010	2/10/2010

Warrant related activity for the year ended December 31, 2007

	Warrant A1	Warrant A2	Warrant B1	Warrant B2
Outstanding at December 31, 2006	2,000	1,609	2,000	1,609
Exercised in 2007	—	(1,054)	—	—
Outstanding at December 31, 2007	2,000	555	2,000	1,609

Warrant related activity for the year ended December 31, 2008

	Warrant A1	Warrant A2	Warrant B1	Warrant B2
Outstanding at December 31, 2007	2,000	555	2,000	1,609
Exercised in 2008	—	—	—	—
Outstanding at December 31, 2008	2,000	555	2,000	1,609

NOTE 10 – COMMITMENTS AND CONTINGENCIES

Operating leases

The Company leases certain facilities and equipment under various operating leases. At December 31, 2008, future minimum lease payments under non-cancelable leases are:

2009	\$ 958
2010	974
2011	683
2012	72
Total Principal Payments	<u>\$ 2,687</u>

Rent expense for the years ended December 31, 2008 and 2007 was \$486 and \$182, respectively.

The Company entered into an operating lease on November 30, 2005 related to the lease of its office facility. The term of this lease is five years, beginning on April 1, 2006 and ending on March 31, 2011. The original commitment under this lease totaled \$701, due on the first of each month in escalating monthly payments. The commitments under this lease are included in the future payments in the table above. If at any time the Company terminates the lease, the lessor may recover from the Company all damages approximately resulting from the termination, including the cost of recovering the premises and the worth of the balance of the lease over the reasonable rental value of the premises for the remainder of the lease term, which shall be due immediately. The Company does not anticipate terminating the lease at any time prior to its expiration.

On June 20, 2007, the Company and Chuck Yeager Real Estate amended the operating lease agreement, originally entered into on November 30, 2005, to include an additional 12,544 square feet of warehouse space. The lease of the additional warehouse space was the result of carrying additional inventory and increased monthly rent by approximately \$2. While the lease on the additional space was scheduled to expire on August 31, 2007, the Company extended the lease until December 31, 2007. On April 1, 2008 the

Company terminated the lease of this additional warehouse space, and entered into a one year lease with Edge Developments, LLC for 18,000 square feet of warehouse space located at 903B East Main Street, Easley, SC. The terms of this lease require monthly payments of \$4, which are included in the schedule above, and are scheduled to expire on March 31, 2009, at which time the Company may choose to extend the lease.

On April 1, 2008, in connection with the acquisition of ICS (Note 3), the Company entered into a lease with Byers Properties, LLC for the lease by the Company of the former facilities of ICS. Byers Properties is controlled by Michael Byers, who is the sole shareholder of ICS. The term of the Lease begins April 1, 2008 and runs for a period of three years through March 2011. The lease calls for annual rent of \$80, payable monthly. The leased property consists of a single-story brick building located on 2.57 acres in Triangle Industrial Park at 8518 Triad Drive, Colfax, North Carolina. The building comprises 7,207 square feet, with approximately 300 square feet being warehouse space. The future minimum lease payments under this lease are included in the schedule above.

In August 2008, the Company entered into a corporate fleet lease program with Enterprise Fleet Services, for which individual vehicle leases are signed that may amount to a total commitment of \$2.0 million over a weighted-average lease term of approximately three years. The future minimum lease payment for leases executed under the program as of September 30, 2008 is included in the schedule above.

Purchase Commitments

The majority of our purchase commitments are based on firm purchase orders. However, from time to time we commit to purchase product in advance of customer commitments and as inventory to obtain volume pricing discounts or operational efficiencies. We have entered into purchase order commitments from time to time with Promethean, one of our major suppliers, for interactive whiteboard inventory. These purchase order commitments were \$12.3 million in 2008. We expect to incur similar commitments in 2009. We have no other significant purchase commitments based on estimates of customer demand that significantly exceed customer commitments. If actual customer demand were to differ significantly either in timing or volume from the purchase commitments, this could strain our available working capital resources. While management anticipates its purchase commitments will not differ significantly from its estimates of customer demand, there can be no assurance that this will in fact be the case.

Executive Officer Employment Agreements

The Company entered into separate employment agreements with each of the four most highly compensated executive officers on March 1, 2009. The term of all the employment agreements is three years, expiring on February 28, 2012. The agreements renew for a one year term automatically upon the expiration of the initial or any renewal periods unless sooner terminated by any one of the parties. Such agreements provide for minimum salary levels adjusted for performance based on review by the Board of Directors. The aggregate commitment for future salaries at December 31, 2008, excluding bonuses, was approximately \$2.7 million.

NOTE 11 – STOCK-BASED COMPENSATION

The Company has a stock based compensation plan, the 2005 Incentive Compensation Plan. The Company accounts for stock based compensation using the fair value method prescribed in SFAS No. 123R, “Share-Based Payment,” and related interpretations, which the Company adopted in 2006 using the modified prospective method. The Company utilizes the Black-Scholes model to estimate the fair value of the shares granted.

In 2005, the Company assumed the stock based employee compensation plan of CSI- South Carolina as a result of the reverse merger. In addition, the Company granted options to purchase 70 shares of common stock under the 2005 Incentive Compensation Plan in the first quarter of 2007 at an exercise price of \$0.85 per share, as a result of the McAleer acquisition which closed on January 2, 2007, and in November 2007 granted options to purchase an additional 100 shares to key employees. The fair value of stock-based compensation was estimated at the grant date for each issuance using the Black-Scholes option-pricing model with the following weighted-average assumptions. The assumptions in 2008 relate to the options issued in 2008, reflected in the tables below. The assumptions in 2007 relate to the non-employee compensation issued in 2007, which is discussed under “Non-employee Compensation” below.

Assumptions used in calculation of fair value

	<u>For the Years Ended December 31,</u>	
	<u>2008</u>	<u>2007</u>
Expected term (in years)	7	10
Expected volatility	123%	153%
Expected dividend yield	0.0%	0.0%
Risk-free interest rate	3.6%	4.7%

Stock options

Detail	Number of Options	Weighted Average Exercise Price	Expiration
Options assumed in reverse merger	268	\$ 0.12	November 1, 2012
Options granted in McAleer acquisition	70	\$ 0.85	January 2, 2017
Options granted to key employees	100	\$ 1.42	November 9, 2017
Options granted to other employees	10	\$ 1.09	May 28, 2018

The following table summarizes option activity under the plans for the year of 2007:

Stock Options	Number of Shares	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at December 31, 2006	268	\$ 0.12		
Granted	170	1.19		
Cancelled	-	-		
Exercised	(63)	0.13		
Forfeited/expired	-	-		
Outstanding at December 31, 2007	375	\$ 0.60	7.21	\$ 280
Exercisable at December 31, 2007	205	\$ 0.12	5.09	\$ 252

The aggregate intrinsic value represents the difference between the Company's closing stock price of \$1.34 as of December 31, 2007 and the exercise price multiplied by the number of options outstanding as of that date.

As of December 31, 2007 there remained \$131 of unrecognized compensation cost related to non-vested stock options which is expected to be recognized over a weighted-average period of approximately three years.

The following table summarizes option activity under the plans for the year of 2008:

Stock Options	Number of Shares	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at December 31, 2007	375	\$ 0.60		
Granted	20	1.09		
Cancelled	—	—		
Exercised	—	—		
Forfeited/expired	(10)	(1.09)		
Outstanding at December 31, 2008	385	\$ 0.62	5.80	\$ (79)
Exercisable at December 31, 2008	285	\$ 0.39	5.11	\$ 5

The aggregate intrinsic value represents the difference between the Company's closing stock price of \$0.41 as of December 31, 2008 and the exercise price multiplied by the number of options outstanding as of that date.

As of December 31, 2008 there remained \$55 of unrecognized compensation cost related to non-vested stock options which is expected to be recognized over a weighted-average period of approximately two years.

Non-employee Compensation

On February 21, 2006, the Compensation Committee of the Board of Directors and the full Board of Directors approved awards of Company common stock for the Company's outside directors under the Company's 2005 Incentive Compensation Plan (the "Plan"). Directors receiving awards under the Plan were Anthony H. Sobel, Chairman; Shaya Phillips; and Thomas V. Butta. Mr. Sobel was granted 98 shares, while Messrs. Phillips and Butta were granted 49 shares each. One-third of the awards vested immediately upon approval. An additional one-third vested on February 28, 2006, with the final one-third vesting on February 28, 2007. Except in the event of a change in control of the Company, the directors could not sell any shares awarded to them prior to March 1, 2007. If a director's service terminated prior to a vesting date, all unvested shares would have been forfeited, subject to exception in the discretion of the Board. As a result of his subsequent resignation as a director discussed below, Mr. Butta forfeited 32 shares.

Thomas V. Butta resigned from the Company's Board of Directors effective February 22, 2006. His resignation was not the result of any disagreement relating to the Company's operations, policies or practices. Rather, Mr. Butta resigned in order to devote his full attention to his responsibilities with an unaffiliated company of which he is the Chief Executive Officer. Mr. Butta served on the Board's Audit and Compensation Committees.

On March 2, 2006, the Company entered into a Letter of Engagement dated February 27, 2006 and individual restricted stock agreements with Robert F. Steel and Kenneth A. Steel, Jr. (the "Consultants"). The purpose of the agreements was to formally set forth the terms and conditions under which the Consultants had been providing and would continue to provide consulting services to the Company through February 10, 2008. Under the terms of the Letter of Engagement, the Consultants were to advise the Company on the development and implementation of strategic business plans, assist management in developing marketing and growth strategies, and assist management in seeking out and analyzing potential acquisition opportunities. The agreement required the Consultants to provide such consulting services until February 10, 2008. In return, the Company agreed to issue 172 shares of its common stock to each of the Consultants. The stock awards were granted pursuant to the Company's 2005 Incentive Compensation Plan. The Company was also required to reimburse the Consultants for reasonable travel and other expenses incurred by the Consultants in furtherance of the objectives of the agreements. The agreements contained customary confidentiality and non-competition provisions. The agreements also required the Consultants, if they were terminated for cause prior to the earlier to occur of February 28, 2007 or a change in control of the Company, to return one-third of the Stock Awards at the time of termination.

On June 20, 2006, the Board elected Jeffery A. Bryson to fill the vacancy on the Board created by the February 22, 2006 resignation of Mr. Butta. Mr. Bryson serves on the Company's Audit and Compensation Committees and he is Chairman of the Audit Committee. In connection with his election to the Board of Directors on June 20, 2006, the Board approved the award to Mr. Bryson of 23 shares of common stock under the Company's 2005 Incentive Compensation Plan. Under the terms of the award, 12 shares vested immediately upon Mr. Bryson's election to the Board and the remaining shares vested at the conclusion of the 2007 Annual Meeting of Stockholders of the Company upon Mr. Bryson's reelection to the Board.

On July 10, 2006, the Company entered into an Investor Relations Consulting Agreement (the "Agreement") with Alliance Advisors, LLC ("Alliance"). The purpose of the Agreement is for Alliance to assist the Company in the development of the Company's investor relations and corporate communications program. Under the terms of the Agreement, Alliance assisted the Company for a term of twelve months in developing and implementing an investor relations and corporate communications strategy. In exchange for Alliance's services, the Company paid Alliance \$7 per month for the first six months of the Agreement. At the end of six months, either party to the Agreement had the option of terminating the Agreement. The Agreement continues on a monthly basis, with a monthly payment of \$7. In addition to the cash compensation just described, the Company issued to Alliance sixty 60 shares of restricted common stock in the third quarter of 2006. If Alliance had not completed the full one-year term of the Agreement, a pro rata portion of 54 shares would have been required to be returned to the Company.

No additional non-employee based stock awards were granted in 2008.

Total stock based compensation for 2008 was \$86, of which \$19 related to the stock options granted as a result of the McAleer acquisition and \$67 related to employee stock compensation and are included in Cost of sales and Selling costs and Other general and administration expenses. Total stock based compensation for 2007 was \$114, of which \$40 related to the stock options granted as a result of the McAleer acquisition and \$62 related to non-employee stock compensation, with the remaining \$12 classified as costs of sales as they are related to the options issued in November 2007 to key employees.

NOTE 12 – DEFINED CONTRIBUTION PLAN

In 2007, the Company established a 401(k) defined contribution plan for the benefit of its employees, and terminated the Simple IRA savings plan maintained in previous years. Employees of the Company may participate in the 401(k) plan, whereby the employees may elect to make contributions pursuant to a salary reduction agreement. The Company's contributions to the plan, as determined by management, are discretionary and are allocated among the participants based on the participants' contributions. Contributions to the 401(k) plan were \$288 for the year ended December 31, 2008, and \$224 for the year ended December 31, 2007, respectively.

NOTE 13 – RELATED PARTY TRANSACTIONS

During the year ended December 31, 2008, the Company made interest payments to the five former shareholders of CSI – South Carolina, all of whom are significant shareholders of the Company, and four of which are executive officers, and Barron Partners LP, who owns all of the Company's preferred shares. These interest payments were made on the subordinated notes payable associated with the reverse merger transaction which occurred in 2005, and represented an annual interest rate of 15% as of December 31, 2008. In 2008, interest payments to the five original shareholders of CSI-South Carolina totaled \$160 and interest payments to Barron Partners LP totaled \$160. In 2007, interest payments to the five original shareholders of CSI-South Carolina totaled \$134 and interest payments to Barron Partners LP totaled \$134.

NOTE 14 – INCOME TAXES

Income tax expense (benefit) for the years ended December 31, 2008 and 2007 is summarized as follows:

	December 31,	
	2008	2007
Current income tax expense (benefit):		
Federal	\$ 1,008	\$ 633
State	105	58
Total current	<u>1,113</u>	<u>691</u>
Change in deferred income taxes:		
Federal	32	198
Other	(109)	(34)
Total deferred	<u>(77)</u>	<u>164</u>
Income tax expense	<u>\$ 1,036</u>	<u>\$ 855</u>

The gross amounts of deferred tax assets (liabilities) as of December 31, 2008 and 2007 are as follows:

	December 31,	
	2008	2007
Deferred tax assets:		
Allowance for doubtful accounts	\$ 13	\$ 26
Allowance for sales returns	15	6
Trademarks	15	7
Computer software costs	92	40
Other intangible	1	—
Vacation accrual	173	107
Net operating loss carryforwards	305	121
Acquisition related expenses	34	16
Deferred stock compensation	75	41
SC Jobs Tax Credit	112	130
Gross deferred tax assets	<u>835</u>	<u>494</u>
Deferred tax liabilities:		
Goodwill	(70)	(13)
Depreciation	(108)	(56)
Trademarks	(314)	(1)
Other intangibles	(102)	(5)
Prepaid expenses	(30)	(11)
Computer software costs	(961)	(614)
Gross deferred tax liabilities	<u>(1,585)</u>	<u>(700)</u>
Net deferred tax liability	<u>\$ (750)</u>	<u>\$ (206)</u>

The net deferred tax asset (liability) is classified in the accompanying consolidated Balance Sheets as follows:

	December 31,	
	2008	2007
Current portion	\$ (421)	\$ (469)
Long-term portion	(329)	263
Total	<u>\$ (750)</u>	<u>\$ (206)</u>

As of December 31, 2008 the Company had net loss carry-forwards of approximately \$0.7 million, with various expiration dates through 2024. The net loss carry-forwards relate to the operating losses of VerticalBuyer, prior to the reverse merger with CSI-South Carolina and the Version3 acquisition.

Reconciliation between income tax expense (benefit) and the amount computed by applying the federal statutory rate of 34 percent to income (loss) before income taxes for the years ended December 31, 2008 and 2007 is as follows:

	2008		2007	
Tax expenses at statutory rate	\$ 808	34.0%	\$ 883	34.0%
State income tax, net of federal income tax benefit	69	2.9%	58	2.2%
South Carolina jobs tax credit, net of federal tax effect	—	0.0%	(130)	-5.0%
Nondeductible portion of meals and entertainment costs	50	2.1%	40	1.5%
Nondeductible registration costs	9	0.4%	25	1.0%
Late fees & penalties	52	2.2%	—	0.0%
Other miscellaneous items	48	2.0%	(21)	-0.8%
	\$ 1,036	43.6%	\$ 855	32.9%

The Company, after consulting with tax experts, recorded South Carolina Jobs Tax Credits earned in fiscal years 2005, 2006 and 2007 of \$35, \$74 and \$133, respectively, or a total of \$242 (\$159, net of applicable federal income tax effect). Of this amount, approximately \$29 was taken in 2007, and approximately \$43 will be utilized in 2008, with \$169 deferred tax benefit (\$112, net of applicable federal income tax effect) remaining. We recorded no significant benefit for 2008.

According to SFAS No. 109, "Accounting for Income Taxes," such tax credits are to be recorded as assets and reductions of tax expense to the extent it is more likely than not that the taxable income in future periods will be sufficient to utilize the credits earned and employment levels will not decrease, causing a loss of credits recorded in prior years. SFAS No. 109 also requires that, on an ongoing basis, management assess any changes in conditions which may affect the likelihood of realizing these tax credits and that a valuation allowance be established should a degree of uncertainty about the likelihood of realizing these credits become apparent. A valuation allowance would be established with a charge against income. Based on management's review of the Company's historical and current performance and its plans for future growth including acquisitions, the introduction of new products, the expansion of existing products and expansion into new markets, management believes it is more likely than not that the Company will be able to fully utilize these tax credits and no valuation allowance is considered necessary at this time. The company applies the principles for recording its South Carolina Jobs Tax Credits established in Emerging Issues Task Force ("EITF") 94-1, whereby the accounting task force reached consensus that it is not appropriate to record the entire future years' benefits for increases based on the current year's events which give rise to the potential but not guarantee the benefits in future years (that is the credits should not be recognized in the financial statements prior to their inclusion in the company's tax returns. Specifically we record only the amount of Jobs Tax Credit Carryforwards which have been reported in calculations within the company's tax returns, as required by the state for recognition of the amount of carryforward benefits.)

The Company is uncertain as to the amount and net income effect of credits, if any, which may be earned in future years, because future credits are contingent upon regionally specific increases in employment, sustained increases in future periods of employment gains in prior periods, and the net income effect is contingent upon additional future South Carolina taxable income sufficient to fully utilize such credits as may become available in the future.

NOTE 15 – SEGMENT INFORMATION

CSI is organized into the two reportable segments: software applications and technology solutions. Below is a description of the types of products and services from which each reportable segment derives its revenues.

Software applications segment

Through our Software applications segment, we report the results of the development, sales, and deployment and provision of ongoing support of our software applications, fund accounting based financial management software, standards based lesson planning software, solutions that facilitate single sign-on application access management provisioning based on Microsoft's Identity Lifecycle Management and Microsoft SharePoint deployments. Through this segment we also report the results of operations related to complimentary third-party applications and services we resell.

Technology solutions segment

Through our technology solutions segment, we report the results of the technology solutions products through the sales and distribution of computers and accessories and the wide range of technology consulting services, including network and systems integration and computer support and maintenance services, that we provide.

Factors management used to identify our segments:

CSI's reportable segments are analyzed separately because of the differences in margin routinely generated by the major products within each group, and the differences in which sales and investment decisions may be made to evaluate existing or potential new products. Through its software applications segment, the Company develops, sells, deploys and provides ongoing support of software applications. Through its technology solutions segment, the Company provides technology solutions through the sale and distribution of computers and accessories and offers a wide range of technology consulting services, including network and systems integration and computer support and maintenance services.

There are no significant transactions between reportable segments. The total of Segment net sales and service revenue from all segments is equal to Net sales as reported in our Consolidated Statements of Operations. Sales and Cost of sales are included in each segment's income as reported in our Consolidated Statements of Operations. Accordingly, the total of the segments' Gross profit is equal to Gross profit in our Consolidated Statements of Operations. Operating expenses are allocated to segment income based on estimate of sales and administrative time spent on each segment. None of the income or loss items following Operating income (loss) in our Consolidated Statements of Operations are allocated to our segments, since they are reviewed separately by management. Certain non-recurring items (those items occurring for reasons which have not occurred in the prior 2 years and are not likely to reoccur in 2 years) and compliance costs are generally excluded from management's analysis of profitability by segment and the Company's segment presentation. Accordingly, the total of Segment income from all segments, less non-recurring and compliance items, if any, is equal to Operating income (loss) as reported in our Consolidated Statements of Operations.

The total of Segment assets for all segments is equal to Total Assets as reported in our Consolidated Balance Sheets. The Company allocates shared assets related to liquidity (e.g., cash, accounts receivable and inventory) based on each segment's percent of revenues to total consolidated revenues. Capitalized computer software costs are allocated to the software segment. Fixed assets, net, are allocated on the same basis as operating expenses (or by time spent on each segment as discussed above), since support equipment usage is generally tied to time utilized. All other assets are generally allocated on the same basis.

The following tables summarize information about segment income for the years ended December 31, 2008 and 2007 and assets allocated to segments as of December 31, 2008 and 2007.

	<u>Software Applications</u>	<u>Technology Solutions</u>	<u>Total Company</u>
Year ended December 31, 2008			
Net sales and service revenue	\$ 13,559	\$ 45,144	\$ 58,703
Gross profit	5,514	7,304	12,818
Segment income	845	2,686	(*)
Segment assets	12,200	12,835	25,035
Year ended December 31, 2007			
Net sales and service revenue	\$ 10,478	\$ 44,719	\$ 55,197
Gross profit	4,362	6,959	11,321
Segment income	383	3,438	(*)
Segment assets	7,240	8,946	16,186

* See reconciliation below

Reconciliation of Segment income (non-GAAP measure) to operating income (loss) per consolidated Statements of Operations (GAAP measure):

	<u>For the Years Ended December 31,</u>	
	<u>2008</u>	<u>2007</u>
Segment income:		
Software applications segment	\$ 845	\$ 383
Technology solutions segment	2,686	3,438
TOTAL SEGMENT INCOME	<u>3,531</u>	<u>3,821</u>
Less: merger-related and compliance costs		
Stock compensation – non-cash	(19)	(102)
Acquisition costs	(53)	(11)
Professional and legal compliance and litigation related costs	(432)	(562)
OPERATING INCOME Per Consolidated Statement of Operations	<u>\$ 3,027</u>	<u>\$ 3,146</u>

NOTE 16—RECENTLY ISSUED ACCOUNTING STANDARDS

The following is a summary of recent authoritative pronouncements that could impact the accounting, reporting, and/or disclosure of financial information by the Company.

In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles." SFAS No. 162 is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with generally accepted accounting principles in the United States for non-governmental entities. SFAS No. 162 is effective 60 days following approval by the U.S. Securities and Exchange Commission ("SEC") of the Public Company Accounting Oversight Board's amendments to AU Section 411, "The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles." The Company does not expect SFAS No. 162 to have a material impact on the preparation of its financial statements.

In April 2008, the FASB issued FASB Staff Position (FSP) No. FAS 142-3, "Determination of the Useful Life of Intangible Assets." The final FSP amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, "Goodwill and Other Intangible Assets." The FSP is intended to improve the consistency between the useful life of an intangible asset determined under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141 (revised 2007), "Business Combinations," and other US generally accepted accounting principles. The FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. We are currently evaluating the impact FSP 142-3 will have on its consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities." SFAS No. 161 is intended to improve financial reporting of derivative instruments and hedging activities by requiring enhanced disclosures to enable financial statement users to better understand the effects of derivatives and hedging on an entity's financial position, financial performance and cash flows. The provisions of SFAS No. 161 are effective for interim periods and fiscal years beginning after November 15, 2008. We are currently evaluating the effect the adoption of SFAS No. 161 will have on our Consolidated Financial Statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), "Business Combinations." SFAS No. 141R establishes principles and requirements for recognizing and measuring assets acquired, liabilities assumed and any non-controlling interests in the acquiree in a business combination. SFAS No. 141R also provides guidance for recognizing and measuring goodwill acquired in a business combination, requires capitalization of acquired in-process research and development assets at the time of acquisition and requires the acquirer to disclose information that users may need to evaluate and understand the financial effect of the business combination. As SFAS No. 141R is effective for business combination transactions for which the acquisition date is on or after December 15, 2008. The Company will assess the impact of SFAS No. 141R if and when a future acquisition occurs.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a material impact on the Company's financial position, results of operations or cash flows.

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.

Not applicable.

Item 9A(T). Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods required by the Securities and Exchange Commission, including, without limitation, those controls and procedures designed to ensure that such information is accumulated and communicated to our management to allow timely decisions regarding required disclosures.

Our management, under the direction of our chief executive officer and chief financial officer, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as such terms are defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of December 31, 2008. Based upon this evaluation our management, including our chief executive officer and chief financial officer, has concluded that our disclosure controls were effective as of December 31, 2008.

Management's Report on Internal Control Over Financial Reporting

Management's Latest Assessment of Internal Control over Financial Reporting (as of the end of the period covered by this report)

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act). Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of published financial statements in accordance with generally accepted accounting principles.

However, because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or the degree of compliance with policies may deteriorate.

Management conducted its evaluation of the effectiveness of our internal control over financial reporting based on the framework in "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") for the controls covering the financial reporting cycle for the year ending as of December 31, 2008.

Based on our assessment, we believe that as of December 31, 2008, our internal control over financial reporting was effective based on criteria set forth by COSO in "Internal Control-Integrated Framework."

No Attestation of Registered Public Accounting Firm

This annual report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the Company to provide only management's report in this annual report.

Update for Changes In Internal Control over Financial Reporting (since our last quarterly report).

There were no changes in our internal control over financial reporting during the fourth quarter of fiscal 2008 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Remediation of Material Weaknesses or Significant Deficiencies

In August 2007, the Security and Exchange Commission ("SEC") amended Rule 1-02 of Regulation S-X [17 CFR 210.1-02(a)(4)] by adding a new paragraph to define both the terms "material weakness" and "significant deficiency." Under the new guidance, a material weakness was defined as, "a deficiency, or combination of deficiencies, in internal control over financial reporting ("ICFR") such that there is a reasonable possibility that a material misstatement of the registrant's annual or interim financial statements will not be prevented or detected on a timely basis." The new guidance further defined significant deficiency as, "a deficiency or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those responsible for oversight of the registrant's financial reporting." As defined in this new standard, if our management identifies significant deficiencies in our internal controls over financial reporting in our reviews of our internal control environment, management takes action to remediate those deficiencies by changing processes and controls to the extent considered necessary by management to eliminate the significant deficiency. In addition, from time to time management identifies deficiencies which are not considered significant deficiencies or material weaknesses as defined. It is generally management's practice to remediate these deficiencies as well.

Due to the increasing number and complexity of pronouncements, emerging issues and releases, and reporting requirements and regulations, we expect there will continue to be some risk related to financial disclosures. We believe that such risks have been reasonably mitigated following our implementation of the Sarbanes-Oxley Act requirements in late 2007. However, the process of identifying risk areas and implementing financial disclosure controls and internal controls over financial reporting required under the Sarbanes-Oxley Act continues to be complex and subject to significant judgment and may result in the identification in the future of areas where we may need additional resources. Additionally, due to the complexity and judgment involved in this process, we cannot guarantee we may not find or have pointed out to us either by internal or external resources, or by our auditors following the implementation of the external auditor requirement for their independent assessment of our controls, additional areas needing improvement or resulting in a future assessment that our controls are or have become ineffective as a result of overlooked or newly created significant deficiencies or unmitigated risks.

Item 9B. Other Information.**Creation of a Direct Financial Obligation or an Obligation Under an Off-Balance Sheet Arrangement of a Registrant**

Our revolving credit arrangement with RBC Centura Bank is a facility under which we may borrow, repay and then re-borrow. Advances and repayments under the credit facility occur daily, reflecting cash receipts and the Company's working capital needs. Set forth below is the outstanding balance as of specific dates through March 17, 2009. The balances presented reflect aggregate advances and pay downs which the Company deems material, or significant. Such information through November 4, 2008 was previously disclosed in our Form 10-Q dated September 30, 2008.

Date	Loan Balance
November 7, 2008	\$ 5,455,000
November 18, 2008	4,737,000
November 24, 2008	5,526,000
November 28, 2008	3,976,000
December 5, 2008	4,470,000
December 15, 2008	4,723,000
December 22, 2008	6,158,000
December 31, 2008	5,634,000
January 5, 2009	6,255,000
January 9, 2009	6,690,000
January 20, 2009	5,804,000
January 26, 2009	5,398,000
January 30, 2009	4,239,000
February 6, 2009	4,165,000
February 12, 2009	1,571,000
February 17, 2009	1,988,000
February 25, 2009	1,551,000
February 27, 2009	1,878,000
March 4, 2009	2,211,000
March 9, 2009	2,371,000
March 17, 2009	1,984,000

PART III**Item 10. Directors, Executive Officers and Corporate Governance.**

In response to this Item, the information contained under the headings "Election of Directors," "Governance of the Company," and "Securities Ownership" in the Company's Proxy Statement for the Annual Meeting of Shareholders to be held on May 7, 2009 is incorporated herein by reference.

Item 11. Executive Compensation.

In response to this Item, the information contained under the headings "Governance of the Company – Director Compensation" and "Executive Compensation" in the Company's Proxy Statement for the Annual Meeting of Shareholders to be held on May 7, 2009 is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

In response to this Item, the information contained under the heading "Securities Ownership" in the Company's Proxy Statement for the Annual Meeting of Shareholders to be held on May 7, 2009 is incorporated herein by reference.

Equity Compensation Plans

The following table sets forth certain equity compensation plan information for the Company as of December 31, 2008.

EQUITY COMPENSATION PLAN INFORMATION

	Number of Securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	385,203 ⁽¹⁾	\$ 0.62	1,037,756 ⁽²⁾
Equity compensation plans not approved by security holder	N/A	N/A	N/A

(1) Includes 205,203 shares underlying options held by non-executive officers of the Company pursuant to the former incentive plan of CSI – South Carolina, which options were assumed by the Company in its February 2005 merger with CSI – South Carolina. No more options may be granted under the former CSI – South Carolina plan. Also includes 180,000 shares underlying options granted to employees under our 2005 Incentive Compensation Plan.

(2) Reflects shares available for award under our 2005 Incentive Compensation Plan.

Item 13. Certain Relationships and Related Transactions, and Director Independence.

In response to this Item, the information contained under the headings “Certain Relationships and Related Transactions” and “Governance of the Company” in the Company’s Proxy Statement for the Annual Meeting of Shareholders to be held on May 7, 2009 is incorporated herein by reference.

Item 14. Principal Accounting Fees and Services.

In response to this Item, the information contained under the heading “Audit Information” in the Company’s Proxy Statement for the Annual Meeting of Shareholders to be held on May 7, 2009 is incorporated herein by reference (except for the Report of the Audit Committee of the Board of Directors).

Item 15. Exhibits, Financial Statement Schedules.

(a)(1) Financial Statements. Financial statements and report of independent registered public accounting firm filed as a part of this report are listed below:

	<u>Page</u>
Report of Independent Registered Public Account Firm	62
Consolidated Balance Sheets – As of December 31, 2008 and 2007	63
Consolidated Statements of Operations – For the Years Ended December 31, 2008 and 2007	64
Consolidated Statements of Changes in Shareholders’ Equity - For the Years Ended December 31, 2008 and 2007	65
Consolidated Statements of Cash Flows - For the Years Ended December 31, 2008 and 2007	66
Notes to Consolidated Financial Statements	67-86

(2) Financial Statement Schedule. None.

(3) List of Exhibits. The exhibits filed as part of this report are listed in the Exhibit Index, which is incorporated in this item by reference.

(b) Exhibits. See Item 15(a)(3) above.

(c) Financial Statement Schedule. See Item 15(a)(2) above.

SIGNATURES

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

COMPUTER SOFTWARE INNOVATIONS, INC.

By: /s/ Nancy K. Hedrick

Nancy K. Hedrick
President and Chief Executive Officer

Date: March 31, 2009

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ Nancy K. Hedrick</u> Nancy K. Hedrick	President and Chief Executive Officer and Director (Principal Executive Officer)	March 31, 2009
<u>/s/ David B. Dechant</u> David B. Dechant	Chief Financial Officer (Principal Financial and Accounting Officer)	March 31, 2009
<u>/s/ Anthony H. Sobel</u> Anthony H. Sobel	Chairman, Director	March 31, 2009
<u>/s/ Shaya Phillips</u> Shaya Phillips	Director	March 31, 2009
<u>/s/ Jeffrey A. Bryson</u> Jeffrey A. Bryson	Director	March 31, 2009
<u>/s/ Thomas P. Clinton</u> Thomas P. Clinton	Senior Vice President of Strategic Relations and Director	March 31, 2009

INDEX TO EXHIBITS

<u>Exhibit Number</u>	<u>Document</u>
2.1	Agreement and Plan of Merger dated as of February 10, 2005, between the Company and Computer Software Innovations, Inc. (incorporated by reference to Exhibit 2.1 to the Company's Form 8-K, filed February 16, 2005).
3.1.1	Amended and Restated Certificate of Incorporation of the Company (incorporated by reference to Exhibit 3.1 to the Company's Form 8-K, filed February 16, 2005).
3.1.2	Certificate of Amendment to the Amended and Restated Certificate of Incorporation of the Company (incorporated by reference to Exhibit 4.1 to the Company's Form 8-K, filed November 14, 2005).
3.1.3	Certificate of Amendment of the Amended and Restated Certificate of Incorporation of Computer Software Innovations, Inc. filed with the Delaware Secretary of State on March 28, 2006 (incorporated by reference to Exhibit 3.1 to the Company's Form 8-K, filed March 29, 2006).
3.2	Amended and Restated Bylaws of the Company (incorporated by reference to Exhibit 3.2 to the Company's Form 8-K, filed March 29, 2006).
4.1	Amended and Restated Certificate of Designation of Preferences, Rights and Limitations of Series A Convertible Preferred Stock of the Company (incorporated by reference to Exhibit 4.2 to the Company's Form 8-K, filed November 14, 2005).
10.1	Preferred Stock Purchase Agreement dated as of February 10, 2005, between the Company and Barron Partners LP (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K, filed February 16, 2005).
10.2	First Amendment to the Preferred Stock Purchase Agreement dated November 7, 2005 between the Company and Barron Partners LP (incorporated by reference to Exhibit 10.4 to the Company's Form 8-K, filed November 14, 2005).
10.3	Registration Rights Agreement dated as of February 10, 2005, between the Company and Barron Partners LP (incorporated by reference to Exhibit 10.5 to the Company's Form 8-K, filed February 16, 2005).
10.4	First Amendment to the Registration Rights Agreement dated November 7, 2005 (incorporated by reference to Exhibit 10.3 to the Company's Form 8-K, filed November 14, 2005).
10.5	Warrant Amendment and Exchange Agreement between Computer Software Innovations, Inc. and Barron Partners LP dated December 29, 2006 (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K, filed January 5, 2007).
10.6	Computer Software Innovations, Inc. Common Stock Purchase Warrant "A-1" between Computer Software Innovations, Inc. and Barron Partners LP, with an original issue date of February 11, 2005 and a reissue date of December 29, 2006 (incorporated by reference to Exhibit 10.2 to the Company's Form 8-K, filed January 5, 2007).
10.7	Computer Software Innovations, Inc. Common Stock Purchase Warrant "A-2" between Computer Software Innovations, Inc. and Barron Partners LP, with an original issue date of February 11, 2005 and a reissue date of December 29, 2006 (incorporated by reference to Exhibit 10.3 to the Company's Form 8-K, filed January 5, 2007).
10.8	Computer Software Innovations, Inc. Common Stock Purchase Warrant "B-1" between Computer Software Innovations, Inc. and Barron Partners LP, with an original issue date of February 11, 2005 and a reissue date of December 29, 2006 (incorporated by reference to Exhibit 10.4 to the Company's Form 8-K, filed January 5, 2007).
10.9	Computer Software Innovations, Inc. Common Stock Purchase Warrant "B-2" between Computer Software Innovations, Inc. and Barron Partners LP, with an original issue date of February 11, 2005 and a reissue date of December 29, 2006 (incorporated by reference to Exhibit 10.5 to the Company's Form 8-K, filed January 5, 2007).
10.10	Subordinated Promissory Note payable to Barron Partners LP by the Company dated February 11, 2005 (incorporated by reference to Exhibit 10.6 to the Company's Form 8-K, filed February 16, 2005).

- 10.11 Form of Subordinated Promissory Notes payable by the Company to each of Nancy K. Hedrick, Thomas P. Clinton, Joe G. Black, Beverly N. Hawkins and William J. Buchanan, respectively, dated February 11, 2005 (incorporated by reference to Exhibit 10.7 to the Company's Form 8-K, filed February 16, 2005).
- 10.12 Agreement for the Extension of Subordinated Notes and Waiver between the Company and Barron Partners LP, Nancy K. Hedrick, Beverly N. Hawkins, Thomas P. Clinton, William J. Buchanan and Joe G. Black dated April 23, 2008 (incorporated by reference to Exhibit 10.01 to the Company's Form 8-K, filed April 29, 2008).
- 10.13 Stock Purchase Agreement by and between Maximum Ventures, Inc., a New York corporation, Computer Software Innovations, Inc., a South Carolina corporation and Leatherwood Walker Todd & Mann, P.C. dated January 31, 2005 (incorporated by reference to Exhibit 10.22 to the Company's Form 8-K, filed March 28, 2005).
- 10.14* Employment Agreement dated as of March 1, 2009 between the Company and Nancy K. Hedrick (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K, filed March 5, 2009).
- 10.15* Employment Agreement dated as of March 1, 2009, between the Company and Thomas P. Clinton (incorporated by reference to Exhibit 10.2 to the Company's Form 8-K, filed March 5, 2009).
- 10.16* Employment Agreement dated as of March 1, 2009, between the Company and William J. Buchanan (incorporated by reference to Exhibit 10.3 to the Company's Form 8-K, filed March 5, 2009).
- 10.17* Employment Agreement dated as of March 1, 2009, between the Company and Beverly N. Hawkins (incorporated by reference to Exhibit 10.4 to the Company's Form 8-K, filed March 5, 2009).
- 10.18* Employment Agreement dated as of May 6, 2005, between the Company and David B. Dechant (incorporated by reference to Exhibit 10.3 to the Company's Form 8-K, filed May 9, 2005).
- 10.19 Lease Agreement between Office Suites PLUS and CSI-South Carolina dated September 16, 2003 (incorporated by reference to Exhibit 10.14 to the Company's Form 8-K, filed March 28, 2005).
- 10.20 Lease Agreement between Office Suites PLUS and CSI-South Carolina dated July 15, 2002 (incorporated by reference to Exhibit 10.15 to the Company's Form 8-K, filed March 28, 2005).
- 10.21 Form of CSI-South Carolina Equity Incentive Plan as adopted and approved by the stockholders on August 1, 2000 (incorporated by reference to Exhibit 10.16 to the Company's Form 8-K, filed March 28, 2005).
- 10.22 Form of Non-qualified Stock Option Agreement between CSI-South Carolina and certain non-executive personnel pursuant to the CSI Equity Incentive Plan (incorporated by reference to Exhibit 10.17 to the Company's Form 8-K, filed March 28, 2005).
- 10.23 Form of Option Repurchase Agreement between CSI-South Carolina and certain non-executive personnel effective February 7, 2005 (incorporated by reference to Exhibit 10.18 to the Company's Form 8-K, filed March 28, 2005).
- 10.24 Indirect Channel Partner Agreement between the Company and Cisco Systems, Inc. dated January 9, 2006 (incorporated by reference to Exhibit 10.2 to the Company's Form 8-K, filed January 9, 2006).
- 10.25 Notification of March 2, 2007 renewal of Indirect Channel Partner Agreement between the Company and Cisco Systems, Inc. dated January 9, 2006 (incorporated by reference to Exhibit 10.4 to the Company's Form 10-QSB, filed November 13, 2007).
- 10.26 H.P. Business Development Partner Agreement between the Company and Hewlett-Packard, Inc. effective through May 31, 2005 (incorporated by reference to Exhibit 10.21 to the Company's Form 8-K, filed March 28, 2005).
- 10.27 Notification of November 8, 2007 of Renewal of H.P. Business Development Partner Agreement between the Company and Hewlett-Packard, Inc. (incorporated by reference to Exhibit 10.5 to the Company's Form 10-QSB, filed November 13, 2007).
- 10.28 Amended and Restated Loan and Security Agreement between RBC Centura Bank and Computer Software Innovations, Inc. dated September 14, 2007 (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K, filed September 14, 2007).
- 10.29 Amended and Restated Commercial Promissory Note in the Amount of \$7,000,000 payable by Computer Software Innovations, Inc. to RBC Centura Bank dated September 14, 2007 (incorporated by reference to Exhibit 10.2 to the Company's Form 8-K, filed September 14, 2007).

- 10.30 Commitment Letter between Computer Software Innovations, Inc. and RBC Centura Bank dated September 10, 2007 (incorporated by reference to Exhibit 10.3 to the Company's Form 8-K, filed September 14, 2007).
- 10.31 Commercial Promissory Note in the Amount of \$800,000 payable by Computer Software Innovations, Inc. to RBC Centura Bank dated January 2, 2007 (incorporated by reference to Exhibit 10.8 to the Company's Form 8-K, filed January 5, 2007).
- 10.32 Waiver Agreement regarding Payment on Subordinated Notes between the Company and RBC Centura Bank dated April 23, 2008 (incorporated by reference to Exhibit 10.02 to the Company's Form 8-K filed April 29, 2008).
- 10.33 Modification to Revolving Facility between the Company and RBC Bank (USA) dated June 30, 2008 (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K/A, filed July 16, 2008).
- 10.34 Waiver Letter between the Company and RBC Bank (USA) dated August 8, 2008, relating to the Company engaging in certain operating leases (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K, filed August 14, 2008).
- 10.35 Waiver Letter between the Company and RBC Bank (USA) dated August 18, 2008, relating to the acquisition by the Company of Version3, Inc. (incorporated by reference to Exhibit 10.2 to the Company's Form 8-K, filed August 20, 2008).
- 10.36 Modification Agreement between the Company and RBC Bank (USA) dated September 11, 2008 (incorporated by reference to the Company's Form 8-K, filed September 17, 2008).
- 10.37 Modification Agreement between the Company and RBC Bank (USA) dated November 14, 2008 (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K, filed November 20, 2008).
- 10.38* Computer Software Innovations, Inc. 2005 Incentive Compensation Plan (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K, filed on May 9, 2005).
- 10.39* Amendment to the Company's 2005 Incentive Compensation Plan approved by the stockholders at the Company's annual meeting held on May 7, 2008 (incorporated by reference to Exhibit 10.6 to the Company's Form 10-Q, filed May 13, 2008).
- 10.40* Form of Restricted Stock Agreement entered into by and between the Company and Anthony H. Sobel, Shaya Phillips and Thomas V. Butta dated February 21, 2006 (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K, filed February 27, 2006).
- 10.41* Restricted Stock Agreement by and between the Company and Jeffrey A. Bryson dated June 20, 2006 (incorporated by reference to Exhibit 10.2 to the Company's Form 10-QSB, filed August 14, 2006).
- 10.42* Nonqualified Stock Option Agreement between the Company and David B. Dechant dated November 30, 2007 (incorporated by reference to Exhibit 99.1 to the Company's Form 8-K filed December 3, 2007).
- 10.43* Computer Software Innovations, Inc. 2005 Incentive Bonus Plan (incorporated by reference to Exhibit 10.2 to the Company's Form 8-K, filed on May 9, 2005).
- 10.44 Reseller Agreement by and between the Company and Promethean, Inc. dated April 18, 2006 (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K, filed April 24, 2006).
- 10.45 Description of Oral Reseller Agreement Between the Company and Promethean, Inc. (May 2007) (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K, filed May 15, 2007).
- 10.46 IDS Branded Reseller Agreement by and between the Company and Information Delivery Systems, LLC dated April 18, 2006 (incorporated by reference to Exhibit 10.2 to the Company's Form 8-K, filed April 24, 2006).
- 10.47 Investor Relations Consulting Agreement by and between the Company and Alliance Advisors, LLC dated July 10, 2006 (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K, filed July 14, 2006).
- 10.48 Asset Purchase Agreement for the Acquisition of Assets of McAleer Computer Associates, Inc. by Computer Software Innovations, Inc. dated November 27, 2006 among Computer Software Innovations, Inc., McAleer Computer Associates, Inc. and William J. McAleer (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K, filed December 1, 2006).

- 10.49 Bill of Sale by McAleer Computer Associates, Inc. in favor of Computer Software Innovations, Inc. dated January 2, 2007 (incorporated by reference to Exhibit 10.11 to the Company's Form 8-K, filed January 5, 2007).
- 10.50 Assignment and Assumption Agreement between McAleer Computer Associates, Inc. and Computer Software Innovations, Inc. (executed January 2, 2007) (incorporated by reference to Exhibit 10.12 to the Company's Form 8-K, filed January 5, 2007).
- 10.51 Warranty Deed from McAleer Computer Associates, Inc. to Computer Software Innovations, Inc. dated January 2, 2007 (incorporated by reference to Exhibit 10.13 to the Company's Form 8-K, filed January 5, 2007).
- 10.52 Consulting Agreement between Computer Software Innovations, Inc. and William J. McAleer dated December 2, 2006 (incorporated by reference to Exhibit 10.9 to the Company's Form 8-K, filed January 5, 2007).
- 10.53 Confidentiality, Noncompetition and Nonsolicitation Agreement by and among Computer Software Innovations, Inc.; McAleer Computer Associates, Inc.; and William J. McAleer dated January 2, 2007 (incorporated by reference to Exhibit 10.10 to the Company's Form 8-K, filed January 5, 2007).
- 10.54 Asset Purchase Agreement executed March 31, 2008, to be effective April 1, 2008, by and among Computer Software Innovations, Inc., ICS Systems, Inc. and Michael Byers (incorporated by reference to Exhibit 10.01 to the Company's Form 8-K, filed April 4, 2008).
- 10.55 Lease by and between Byers Property, L.L.C. and Computer Software Innovations, Inc. made April 1, 2008 (incorporated by reference to Exhibit 10.02 to the Company's Form 8-K, filed April 4, 2008).
- 10.56 Contract of Purchase and Sale between the Company and Employee Liability Management, Inc. dated August 8, 2008 (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K, filed August 18, 2008).
- 10.57 Agreement and Plan of Reorganization dated August 18, 2008 by and among Computer Software Innovations, Inc., Version3, Inc. and the shareholders of Version3, Inc. (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K, filed August 20, 2008).
- 10.58 Statutory Warranty Deed from the Company to Middle Bay Land, LLC dated November 17, 2008 (incorporated by reference to Exhibit 10.1 of the Company's Form 8-K filed on November 21, 2008).
- 10.59* Company's 2008 Executive Bonus Plan (incorporated by reference to Exhibit 99.1 to the Company's Form 8-K, filed July 17, 2008).
- 14 Computer Software Innovations, Inc. Code of Business Conduct and Ethics (incorporated by reference to Exhibit 14 to the Company's Form 10-KSB filed April 2, 2007).
- 21** List of Subsidiaries.
- 23** Consent of Elliott Davis, LLC.
- 31.1** Certification Pursuant to Rule 13a-14 of the Securities Exchange Act of 1934 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2** Certification Pursuant to Rule 13a-14 of the Securities Exchange Act of 1934 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32** Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 99.1 Acknowledgement between the Company and The Geneva Companies, Inc. dated December 28, 2005 (incorporated by reference to Exhibit 99.1 of the Company's Current Report on 8-K filed on January 3, 2006).
- 99.2 Letter Agreement by and between Computer Software Innovations, Inc., a South Carolina corporation, and The Geneva Companies, Inc. dated February 6, 2003 (incorporated by reference to Exhibit 99.2 of the Company's Current Report on 8-K filed on January 3, 2006).
- 99.3 Compensation Committee Charter (incorporated by reference to Exhibit 99.1 to the Company's Form 8-K filed August 14, 2007).

* Denotes management contract or compensatory plan or arrangement.
** Filed herewith.

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Shareholder Information

Annual Meeting

Computer Software Innovations, Inc.'s annual meeting of shareholders will be held on Thursday, May 7, 2009 at 9:00 a.m., at the CSI Corporate Office, Easley, SC.

Stock

Computer Software Innovations, Inc.'s common stock is traded in the over-the-counter market and quoted on the OTC Bulletin Board under the symbol "CSWI.OB."

Investor Information / Financial Reporting

Investor inquiries about Computer Software Innovations should be directed to the attention of the CFO at Computer Software Innovations, Inc. corporate headquarters.

10-K Report

Computer Software Innovations, Inc. files an Annual Report on Form 10-K with the Securities and Exchange Commission, a copy of which is included without exhibits in this Annual Report to Shareholders. An additional free copy may be obtained by writing to the CFO at Computer Software Innovations, Inc. corporate headquarters. The Company's SEC filings, Annual Report to Shareholders, news releases and other investor relations information may be accessed through its website – www.csioutfitters.com

Independent Registered Public Accounting Firm

Elliott Davis, LLC
200 East Broad Street
Greenville, SC 29601

Policy Regarding Dividends

Computer Software Innovations, Inc. has no plans to pay cash dividends in the foreseeable future in order to retain earnings to fund our future growth. The payment of dividends is also currently restricted and effectively prohibited under the Company's agreements with its bank lender and the holder of preferred stock.

Common Stock Registrar and Transfer Agents

Continental Stock and Trust Company, Inc.
17 Battery Place, 8th Floor
New York City, NY 10004
(P) 212.509.4000
(F) 212.509.5150
Email: cstmail@continentalstock.com

Common Stock Prices

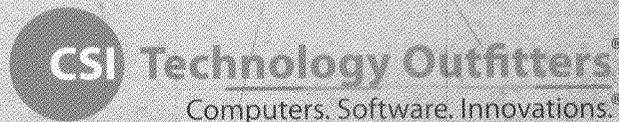
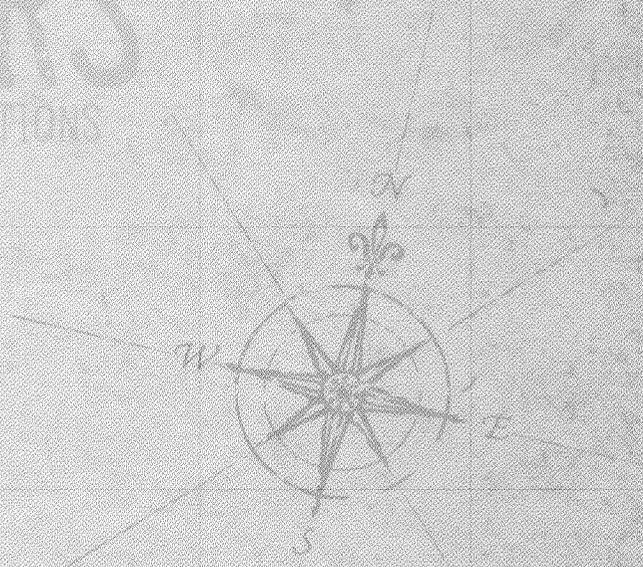
Price ranges of Computer Software Innovations, Inc. common stock during 2007 and 2008 as reported on the OTC Bulletin Board were:

	2007	
	High	Low
First Quarter	\$0.96	\$0.82
Second Quarter	\$1.20	\$0.75
Third Quarter	\$1.50	\$0.75
Fourth Quarter	\$1.70	\$1.25

	2008	
	High	Low
First Quarter	\$1.40	\$0.85
Second Quarter	\$1.19	\$0.90
Third Quarter	\$1.05	\$0.70
Fourth Quarter	\$1.00	\$0.41

TECHNOLOGY OUTFITTERS

COMPUTERS. SOFTWARE. INNOVATIONS.



Computer Software Innovations, Inc.

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Easley, South Carolina 29640
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Statements in this annual report that are not reported financial results or other historical information are forward-looking statements. Please refer to page 45 of the enclosed Form 10-K for important information relating to these forward-looking statements.

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