

MITEK SYSTEMS INC  
Form 10-Q/A  
May 12, 2005

SECURITIES AND EXCHANGE COMMISSION  
Washington, DC. 20549

**FORM 10-Q/A  
AMENDMENT NO. 2**

(Mark One)

Amended Quarterly Report Pursuant to Section 13 or 15(d)  
of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2004 or

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

Commission file number 0-15235

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*Mitek Systems, Inc.*

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(Exact name of registrant as specified in its charter)

*Delaware*

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(State or other jurisdiction of  
incorporation or organization)

87-0418827

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(I.R.S. Employer  
Identification No.)

*14145 Danielson St, Ste B, Poway, California 92064*

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(Address of principal executive offices)(Zip Code)

Registrant's telephone number, including area code (858) 513-4600

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(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the

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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 .

There were 11,389,481 shares outstanding of the registrant's Common Stock as of December 3, 2004.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2 of the Act)

Yes  No .

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**MITEK SYSTEMS, INC.  
FORM 10-QA**

**For the Quarter Ended June 30, 2004**

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## EXPLANATORY NOTE

Mitek Systems, Inc. (the "Company") is filing this Amendment No. 2 to its Form 10-Q/A for the quarter ended June 30, 2004 to provide additional information regarding our controls and procedures.

The original Form 10-Q for the quarter ended June 30, 2004 (the "10-Q") was filed on August 16, 2004. Amendment No. 1 to the Company's Form 10-Q for the quarter ended June 30, 2004 was filed on January 13, 2005 to reflect the restatement of our financial statements (the "Restatement"). The Restatement reflects adjustments recognized in the quarter, which also affects current and long-term liabilities and stockholders' equity at or for the three and nine months ended June 30, 2004. A discussion of this Restatement and a summary of the effects of the Restatement are presented in Note 10 to the Financial Statements.

For the convenience of the reader, this Amendment No. 2 amends in its entirety the 10-Q and Amendment No.1. This Amendment No. 2 continues to speak as of the date of the 10-Q, and we have not updated the disclosure contained herein to reflect any events that occurred at a later date other than as described in this explanatory note. All information contained in this Amendment No. 2 is subject to updating and supplementing as provided in our periodic reports filed with the Securities and Exchange Commission subsequent to the date of the filing of the 10-Q.

The following section of this Quarterly Report on Form 10-Q/A has been revised from Amendment No. 1:

Item 4 - Controls and Procedures

**PART 1: ITEM 1. FINANCIAL INFORMATION**  
**MITEK SYSTEMS, INC**  
**BALANCE SHEETS**  
**(UNAUDITED)**

	June 30, 2004 As restated	September 30, 2003
<b>ASSETS</b>		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 2,719,226	\$ 1,819,102
Accounts and notes receivable-net of allowances of \$325,697 and \$253,697, respectively	1,439,659	2,900,693
Note receivable - related party	146,245	195,623
Inventories	18,516	43,182
Prepaid expenses and other assets	181,213	84,167
Total current assets	4,504,859	5,042,767
PROPERTY AND EQUIPMENT-net	119,370	321,029
OTHER ASSETS	31,746	279,985
TOTAL ASSETS	\$ 4,655,975	\$ 5,643,781
<b>LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)</b>		
CURRENT LIABILITIES:		
Accounts payable	\$ 477,175	\$ 881,032
Accrued payroll and related taxes	537,581	690,388
Deferred revenue	646,220	884,917
Liabilities in excess of assets held for sale	376,516	0
Other accrued liabilities	272,060	245,818
Warrants-liability	367,887	0
Current portion of Convertible Debt net of unamortized financing costs of \$347,090 (2004)	289,273	0
Total current liabilities	2,966,712	2,702,155
LONG-TERM LIABILITIES:		
Convertible debt - net of unamortized financing costs of \$679,719 (2004)	1,683,918	0
Deferred rent	15,538	16,135
Deferred revenue	0	318,826
Long-term payable	8,539	34,194
Total long-term liabilities	1,707,995	369,155
TOTAL LIABILITIES	4,674,707	3,071,310
STOCKHOLDERS' EQUITY(DEFICIT):		
Common stock - \$.001 par value; 20,000,000		

shares authorized; 11,389,481 and  
11,185,282

issued and outstanding at June 30, 2004		
and September 30, 2003, respectively	11,389	11,185
Additional paid-in capital	10,064,911	9,327,736
Accumulated deficit	(10,095,032)	(6,766,450)
Net stockholders' equity (deficit)	(18,732)	2,572,471
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)</b>	<b>\$ 4,655,975</b>	<b>\$ 5,643,781</b>

See notes to financial statements

**MITEK SYSTEMS, INC**  
**STATEMENTS OF OPERATIONS**  
(Unaudited)

	<b>THREE MONTHS ENDED</b>		<b>NINE MONTHS ENDED</b>	
	<b>June 30, 2004 AS RESTATED</b>	<b>2003</b>	<b>June 30, 2004 AS RESTATED</b>	<b>2003</b>
<b>SALES</b>				
Software	\$ 389,440	\$ 1,479,956	\$ 2,024,455	\$ 6,609,543
Hardware	85,016	1,107,197	858,571	1,960,078
Professional services, education and other	513,012	454,585	1,817,403	1,301,359
<b>NET SALES</b>	<b>987,468</b>	<b>3,041,738</b>	<b>4,700,429</b>	<b>9,870,980</b>
<b>COSTS AND EXPENSES:</b>				
Cost of sales - Software	141,573	218,970	468,947	740,026
Cost of sales - Hardware	71,227	923,462	804,159	2,083,305
Cost of sales - Prof. Services, education and other	158,585	249,742	620,303	675,771
Operations	326,343	431,638	1,065,035	1,291,633
Selling and marketing	449,742	1,101,175	1,571,762	2,908,291
Research and development	644,090	556,245	1,811,606	1,680,478
General and administrative	613,914	517,179	1,673,589	1,355,523
<b>Total costs and expenses</b>	<b>2,405,474</b>	<b>3,998,411</b>	<b>8,015,401</b>	<b>10,735,027</b>
<b>OPERATING LOSS</b>	<b>(1,418,006)</b>	<b>(956,673)</b>	<b>(3,314,972)</b>	<b>(864,047)</b>
Other income (expense) - net	(17,556)	3,645	(10,600)	7,586
<b>LOSS BEFORE INCOME TAXES</b>	<b>(1,435,562)</b>	<b>(953,028)</b>	<b>(3,325,572)</b>	<b>(856,461)</b>
<b>PROVISION FOR INCOME TAXES</b>	<b>457</b>	<b>380</b>	<b>3,007</b>	<b>10,355</b>
<b>NET LOSS</b>	<b>\$ (1,436,019)</b>	<b>\$ (953,408)</b>	<b>\$ (3,328,579)</b>	<b>\$ (866,816)</b>
<b>NET LOSS PER SHARES - BASIC AND DILUTED</b>	<b>\$ (0.13)</b>	<b>\$ (0.09)</b>	<b>\$ (0.29)</b>	<b>\$ (0.08)</b>

WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING - BASIC AND DILUTED	11,389,481	11,156,437	11,340,979	11,144,660
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WEIGHTED AVERAGE NUMBER OF COMMON SHARES AND COMMON SHARE EQUIVALENTS OUTSTANDING - DILUTED	11,389,481	11,156,437	11,340,979	11,144,660
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See notes to financial statements



**MITEK SYSTEMS, INC**  
**STATEMENTS OF CASH FLOWS**  
(Unaudited)

**NINE MONTHS ENDED**

**June 30,**

**2004**

**2003**

**AS RESTATED**

**OPERATING ACTIVITIES**

Net loss	\$ (3,328,579)	\$ (866,816)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	340,996	336,969
Provision for bad debts	72,000	75,000
Loss on disposal of property and equipment	2,113	986
Provision for sales returns & allowances	104,090	153,000
Fair value of stock options granted to non-employees	10,776	2,823
Amortization of debt discount	14,462	0
Changes in operating assets and liabilities:		
Accounts receivable	1,389,034	803,827
Inventory, prepaid expenses, and other assets	79,745	(136,991)
Accounts payable	(403,857)	(222,575)
Accrued payroll and related taxes	(152,807)	324,900
Long-term payable	(25,655)	(25,655)
Deferred revenue	(557,523)	392,214
Liabilities in excess of assets held for sale	376,516	0
Other accrued liabilities	(78,446)	(14,147)
Net cash provided by (used in) operating activities	(2,157,135)	823,535

**INVESTING ACTIVITIES**

Purchases of property and equipment	(45,339)	(180,067)
Proceeds from sale of property and equipment	0	1,203
Payment (advances) on related party note receivable-net	49,378	(8,517)
Net cash provided by (used in) investing activities	4,039	(187,381)

**FINANCING ACTIVITIES**

Proceeds from borrowings	0	360,000
Repayment of borrowings	0	(360,000)
Proceeds from convertible debt	3,000,000	0
Deferred costs related to convertible debt	(151,000)	0
Proceeds from exercise of stock options	204,220	19,201
Net cash provided by financing activities	3,053,220	19,201

**NET INCREASE IN CASH AND CASH EQUIVALENTS**

900,124	655,355
1,819,102	760,416

CASH AND CASH EQUIVALENTS AT  
BEGINNING OF PERIOD

CASH AND CASH EQUIVALENTS AT END OF  
PERIOD

\$	2,719,226	\$	1,415,771
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Supplemental Disclosure of Cash Flow Information

Cash paid for interest	\$	18,510	\$	6,736
Cash paid for income taxes	\$	3,007	\$	10,355

SUPPLEMENTAL DISCLOSURE OF  
NON-CASH FINANCING  
ACTIVITIES

Options issued in exchange for services	\$	10,776	\$	2,823
Warrants issued in connection with financing	\$	367,887	\$	0
Beneficial conversion feature of convertible debt	\$	522,384	\$	0

See notes to financial statements

MITEK SYSTEMS, INC.  
NOTES TO FINANCIAL STATEMENTS-UNAUDITED

1. *Basis of Presentation*

The accompanying unaudited financial statements of Mitek Systems, Inc. (the "Company") have been prepared in accordance with the instructions to Form 10-Q and, therefore, do not include all information and footnote disclosures that are otherwise required by Regulation S-X and that will normally be made in the Company's Annual Report on Form 10-K. The financial statements do, however, reflect all adjustments (solely of a normal recurring nature) which are, in the opinion of management, necessary for a fair statement of the results of the interim periods presented.

Results as of June 30, 2004 and for the three and nine months ended June 30, 2004 are not necessarily indicative of results which may be reported for any other interim period or for the year as a whole.

Accounting Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingencies at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

The operations from Fiscal 2003 and the nine months ended June 30, 2004 have resulted in significant operating losses. The Company has managed its cash requirements for this period principally from cash generated from operations, though the last quarter saw the Company address its cash requirements by issuing Convertible Debt as discussed in Note 6 of the accompanying financial statements. Additionally, the Company reduced its expected future cash needs by entering into the agreement with Harland Financial Solutions whereby certain personnel and overhead expenses were assumed by Harland in the transactions discussed in Note 9 of the accompanying financial statements.

Certain prior year's balances have been reclassified to conform to the 2003 presentation.

2. *New Accounting Pronouncements*

In November 2002, the FASB issued FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees*. This Interpretation elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. This Interpretation does not prescribe a specific approach for subsequently measuring the guarantor's recognized liability over the term of the related guarantee. This Interpretation also incorporates, without change, the guidance in FASB Interpretation No. 34, *Disclosure of Indirect Guarantees of Indebtedness of Others*, which is being superseded. The initial recognition and measurement provisions of this Interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002, irrespective of the guarantor's fiscal year-end. The disclosure requirements in this Interpretation are effective for financial statements of interim or annual periods ending after December 15, 2002. The Company has issued no guarantees that qualify for disclosure in this interim financial statement.

In December 2002, the FASB issued Statement of Financial Accounting Standards ("SFAS") No. 148 *Accounting for Stock-Based Compensation - Transition and Disclosure*. SFAS No. 148 amends SFAS No. 123, *Accounting for*

*Stock-Based Compensation*, to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The amendments to SFAS No. 123 provided for under SFAS No. 148 are effective for financial statements for fiscal years ending after December 15, 2002. The Company has not elected to adopt the fair value accounting provisions of SFAS No. 123 and therefore the adoption of SFAS No. 148 did not have a material effect on our results of operations or financial position.

In January 2003, the FASB issued SFAS No. 150 *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. SFAS 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). This Statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The Company adopted the provisions of this Statement and it had no impact on its financial statements.

In January 2003, the FASB issued Interpretation No. 46 (FIN 46), *Consolidation of Variable Interest Entities*. In general, a variable interest entity is a corporation, partnership, trust, or any other legal structure used for business purposes that either (a) does not have equity investors with voting rights or (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. FIN 46 requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. The consolidation requirements of FIN 46 were initially to apply to variable interest entities created after January 31, 2003. The consolidation requirements were initially to apply to transactions entered into prior to February 1, 2003 in the first fiscal year or interim period beginning after June 15, 2003. The FASB postponed implementation of FIN 46 in December 2003. The Company has no variable interest entities.

### 3. Accounting for Stock-Based Compensation

The Company accounts for stock-based compensation in accordance with Accounting Principles Board Opinion ("APB") No. 25, *Accounting for Stock Issued to Employees*, and FASB Interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation*.

Pro forma information regarding net loss and loss per share is required by SFAS No. 123, *Accounting for Stock-based Compensation*, and has been determined as if the Company had accounted for its employee stock options under the fair value method of that Statement. The fair value for these options was estimated at the dates of grant using the Black-Scholes option valuation model with the following weighted-average assumptions for the three months and nine months ended June 30, 2004 and 2003.

	2004	2003
Risk free interest rates	2.6%	2.0%
Dividend yields	0%	0%
Volatility	77%	76%
Weighted average expected life	3 years	3 years

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. The Company's pro forma information is as follows (in thousands, except for net income/loss per share information):

	Three months ended		Nine months ended	
	June 30		June 30	
	2004	2003	2004	2003
Net loss as reported	\$ (1,436)	\$ (953)	\$ (3,329)	\$ (867)
Net loss pro forma	(1,532)	(968)	(3,617)	(1,507)
Net loss per share as reported	(.13)	(.09)	(.29)	(.08)
Net loss per share pro forma	(.13)	(.09)	(.32)	(.14)

#### 4. Revolving Line of Credit

On February 19, 2003 the Company revised its working capital revolving line of credit with First National Bank. This line required interest to be paid at prime plus 1 percentage point, and was subject to a limit on maximum available borrowings of \$750,000. The Company had no borrowings under the working capital line of credit on September 30, 2003. This credit line was subject to a net worth covenant whereby the Company was required to maintain a tangible net worth of \$2,000,000 in order to use the credit line. The loss sustained during the quarter ended December 31, 2003 caused the Company's net worth to fall to \$1,602,000. Though the Company had no borrowings under the credit line as of December 31, 2003, the Company was no longer in compliance with the aforementioned net worth covenant. In June 2004, the Company entered into a Convertible Note with Laurus Master Fund (Laurus). This Convertible Note is described in Note 6 of the financial statements. The Note is secured by a general lien on all assets of the Company, and as a condition of this transaction, the Company's line of Credit with First National Bank was cancelled.

#### 5. Product Revenues - Below is a summary of the revenues by product lines.

<i>Revenue</i> (000's)	Three Months Ended		Nine Months Ended	
	June 30		June 30	
	2004	2003	2004	2003
Recognition Toolkits	\$ 330	\$ 453	\$ 1,568	\$ 4,071
Check Image Solutions	197	2,298	1,406	4,490
Document and Image Processing Solutions	65	40	420	611
Maintenance and other	395	251	1,306	699
Total Revenue	\$ 987	\$ 3,042	\$ 4,700	\$ 9,871

#### 6. Issuance of Convertible Debt

On June 11, 2004, the Company secured a financing arrangement with Laurus. The financing consists of a \$3 million Secured Note that bears interest at the rate of prime (as published in the Wall Street Journal), plus one percent (6% as of December 2, 2004) and has a term of three years (June 11, 2007). The Secured Note is convertible into shares of the Company's common stock at an initial fixed price of \$0.70 per share, a premium to the 10-day average closing share price as of June 11, 2004. The conversion price of the Secured Note is subject to adjustment upon the occurrence of

certain events. The effective annual interest rate of this Convertible Debt, after considering the total debt issue costs (discussed below), is approximately 17.6%

In connection with the financing, Laurus was also issued warrants to purchase up to 860,000 shares of the Company's common stock. The warrants are exercisable as follows: 230,000 shares at \$0.79 per share; 230,000 shares at \$0.85 per share and the balance at \$0.92 per share. The gross proceeds of the convertible debt were allocated to the debt instrument and the warrants on a relative fair value basis. Then the Company computed the beneficial conversion feature embedded in the debt instrument using the effective conversion price in accordance with EITF 98-5 and 00-27. The Company recorded a debt financing costs of (i) \$367,887 for the valuation of the 860,000 warrants issued with the note (computed using a Black-Scholes model with an interest rate of 2.53%, volatility of 81%, zero dividends and expected term of three years); (ii) \$522,384 for a beneficial conversion feature inherent in the Secured Note and (iii) \$151,000 for debt issue costs paid to affiliates of the lender, for a total discount of \$1,041,271. The \$1,041,271 is being amortized over the term of the Secured Note. On October 4, 2004 the Company filed the registration statement with the Securities and Exchange Commission and the registration statement remains pending as of the date of this report. Amortization of the debt financing costs through June 30, 2004 was \$9,476.

To secure the payment of all obligations, the Company entered into a Master Security Agreement which assigns and grants to Laurus a continuing security interest in all of the following property now owned or at any time upon execution of the agreement, acquired by the Company or subsidiaries, or in which any assignor now have or at any time in the future may acquire any right, title or interest: all cash, cash equivalents, accounts, deposit accounts, inventory, equipment, goods, documents, instruments (including, without limitation, promissory notes), contract rights, general tangibles, chattel paper, supporting obligations, investment property, letter-of-credit rights, trademarks, trademark applications, patents, patent applications, copyrights, copyright applications, tradestyles and any other intellectual property, in each case, in which any Assignor now have or may acquire any right, title or interest, all proceeds and products thereof (including, without limitation, proceeds of insurance) and all additions, accessions and substitutions. In the event any Assignor wishes to finance an acquisition in the ordinary course of business of any hereafter-acquired equipment and have obtained a commitment from a financing source to finance such equipment from an unrelated third party, Laurus agrees to release its security interest on such hereafter-acquired equipment so financed by such third party financing source.

The Secured Notes stipulates that the Secured Note is to be repaid using cash payment along with an equity conversion option; the details of both methods for repayment are as follows: The cash repayments stipulate that beginning on December 1, 2004, or the first amortization date, the Company shall make monthly payments to Laurus on each repayment date until the maturity date, each in the amount of \$90,909.09, together with any accrued and unpaid interest to date. The conversion repayment states that each month by the fifth business day prior to each amortization date, Laurus shall deliver to the Company a written notice converting the monthly amount payable on the next repayment date in either cash or shares of common stock, or a combination of both. If a repayment notice is not delivered by Laurus on or before the applicable notice date for such repayment date, then the Company pays the monthly amount due in cash. Any portion of the monthly amount paid in cash shall be paid to Laurus in an amount equal to 102% of the principal portion of the monthly amount due. If Laurus converts all or a portion of the monthly amount in shares of the Company's common stock, the number of such shares to be issued by the Company will be the number determined by dividing the portion of the monthly amount to be paid in shares of common stock, by the applicable fixed conversion price, which is presently \$0.70 per share.

A registration rights agreement was executed requiring the Company to register the shares of its common stock underlying the Secured Note and warrants so as to permit the public resale thereof (See Note 8). Liquidated damages of 2% of the Secured Note balance per month accrue if stipulated deadlines are not met. The registration statement was filed with the Securities and Exchange Commission on October 4, 2004.

The following table reflects the Convertible Debt at June 30, 2004:

Convertible Debt	\$ 3,000,000
Deferred financing costs	(1,026,809)
	1,973,191
Less: Current Portion	(289,273)
	\$ 1,683,918

The debt has the following principal amounts due over the remaining life as follows:



Year ended 9/30/05	\$ 909,091
Year ended 9/30/06	1,090,909
Year ended 9/30/07	\$ 1,000,000

## 7. Warrant Liability

In conjunction with raising capital through the issuance of convertible debt, the Company has issued various warrants that have registration rights for the underlying shares. As the contracts must be settled by the delivery of registered shares and the delivery of the registered shares is not controlled by the Company, pursuant to EITF 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock", the net value of the warrants at the date of issuance was recorded as a warrant liability on the balance sheet (\$367,887).

## 8. Subsequent Events

On July 7, 2004, the Company entered into an agreement with Harland Financial Solutions (HFS) wherein HFS acquired certain of the Company's trade assets relating to its Item Processing line of business. In addition, HFS assumed the trade liabilities and hired certain of the Company's personnel relating to this line of business. In connection with this transaction, the Company entered into a reseller agreement wherein HFS will be the exclusive reseller of this line of business. The consideration for this transaction was \$1,425,000, plus the assumption of liabilities. Under the agreement with HFS, the Company may receive additional consideration from HFS should certain contractual issues be resolved, but no assurance can be made this will occur.

Prior to the end of the Fiscal 2004, the Company incurred a penalty to Laurus Funds for failing to register the securities underlying the Debt Instrument described in Note 7. The amount of the penalty was \$208,000. This amount is shown as interest expense in the Financial Statements for the year ended September 30, 2004. On October 4, 2004, the Company settled this penalty with Laurus Master Fund, LLC by agreeing to issue an additional warrant for the purchase of 200,000 shares at a price of \$0.70 per share. The value of this additional warrant was calculated by the Company to be \$77,925, using a Black-Scholes option pricing model.

Subsequent to the end of Fiscal 2004, the Company was approached by the Principal Shareholder of Mitek Systems, Ltd, who offered to repurchase the Company's interest. In exchange for a cash payment of \$150,000 and the cancellation of the stock options granted the principal, the Company agreed to exchange the shares held and the note outstanding, including accrued and unpaid interest. Mitek Systems, Ltd also agreed to cease using the Company's trade name and entered into a reseller agreement on terms similar to other resellers unrelated to the Company.

## 9. Liabilities in Excess of Assets Held for Sale

Certain assets and liabilities of the Company's CheckQuest product line have been classified as held for sale at June 30, 2004. The Components of these liabilities in excess of assets held for sale at June 30, 2004 are as follows:

Accounts Payable	\$ 6,916
Deferred Revenue	940,213
Customer Deposits	40,198
Other Liabilities	688
Accounts Receivable	-453,436
Fixed Assets (Net of Accumulated Depreciation)	-91,187
Prepaid Licenses	-60,938

Other Assets	-5,938
Liabilities in Excess of Assets	\$ 376,516

## 10. Restatement

In December 2004, the Company discovered an error resulting in an adjustment relating to (i) the warrants issued to Laurus in connection with our issuance to Laurus of convertible secured notes were incorrectly accounted for as equity, rather than as a liability; and (ii) the beneficial conversion feature of the convertible secured notes were incorrectly accounted for in our financial statements for the quarter ended June 30, 2004. Our financial statements contained in this Report have been restated to reflect our such changes. A summary of the significant effects of the restatement is as follows:

As restated, our originally stated interest expense of \$12,570 for the quarter ended June 30, 2004 should have been reported as approximately \$5,000 greater, or \$17,556. Our net loss of \$1,431,027 for the quarter ended June 30, 2004 should have been reported as approximately \$5,000 greater or \$1,436,019.

As restated, the liability associated with our warrants issued to Laurus should have been reflected as of June 30, 2004 as approximately \$370,000. The current portion of convertible debt net of unamortized financing costs should have been reflected as of June 30, 2004 as approximately \$289,000. Accordingly, our originally stated current liabilities as of June 30, 2004 of approximately \$2,310,000 should have been reported as approximately \$660,000 greater or approximately \$2,967,000. Our originally stated total liabilities as of June 30, 2004 of approximately \$4,661,000 should have been reported as approximately \$14,000 greater or \$4,675,000. Our originally stated equity of \$(5,000) as of June 30, 2004 should have been reported as approximately \$14,000 less or \$(19,000).

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### *Management's Discussion*

In addition to historical information, this Management's Discussion and Analysis of Financial Condition and Results of Operations (the "MD&A") contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. As contained herein, the words "expects," "anticipates," "believes," "intends," "will," and similar types of expressions identify forward-looking statements, which are based on information that is currently available to the Company, speak only as of the date hereof, and are subject to certain risks and uncertainties. To the extent that the MD&A contains forward-looking statements regarding the financial condition, operating results, business prospects or any other aspect of the Company, please be advised that the Company's actual financial condition, operating results and business performance may differ materially from that projected or estimated by the Company in forward-looking statements. The Company has attempted to identify certain of the factors that it currently believes may cause actual future experiences and results to differ from the Company's current expectations. The difference may be caused by a variety of factors, including, but not limited, to the following: (i) adverse economic conditions; (ii) decreases in demand for Company products and services; (iii) intense competition, including entry of new competitors into the Company's markets; (iv) increased or adverse federal, state and local government regulation; (v) the Company's inability to retain or renew its working capital credit line or otherwise obtain additional capital on terms satisfactory to the Company; (vi) increased or unexpected expenses; (vii) lower revenues and net income than forecast; (viii) price increases for supplies; (ix) inability to raise prices; (x) the risk of additional litigation and/or administrative proceedings involving the Company and its employees; (xi) higher than anticipated labor costs; (xii) adverse publicity or news coverage regarding the Company; (xiii) inability to successfully carry out marketing and sales plans, including the Company's strategic realignment; (xiv) loss of key executives; (xv) changes in interest rates; (xvi) inflationary factors; (xvii) and other specific risks that may be alluded to in this MD&A.

The Company's strategy for fiscal 2004 is to grow the identified markets for its new products and enhance the functionality and marketability of the Company's character recognition technology. In particular, Mitek is determined to expand the installed base of its Recognition Toolkits and leverage existing technology by devising recognition-based applications to detect potential fraud and loss at financial institutions. The Company also seeks to penetrate additional markets for its Document and Image Processing Solutions by taking advantage of specific vertical applications which lend themselves to this type of labor-saving technology. The Company has also taken steps to generate working capital, including in June entering into a \$3,000,000 promissory note with Laurus Master Fund, Ltd and in July divesting to Harland Financial Solutions ("HFS") certain assets and liabilities associated with the Company's Item Processing line of business and entering into an exclusive reselling relationship with HFS for the Item Processing line of business. The arrangement with HFS generated working capital, while at the same time reduced ongoing personnel and overhead expenses.

Management presumes that users of these interim financial statements and information have read or have access to the discussion and analysis for the preceding fiscal year. See also Item 3, "Quantitative and Qualitative Disclosures about Market Risk."

### CRITICAL ACCOUNTING POLICIES

#### *Revenue Recognition*

The Company enters into contractual arrangements with end users that may include licensing of the Company's software products, product support and maintenance services, consulting services, resale of third-party hardware, or various combinations thereof, including the sale of such products or services separately. The Company's accounting

policies regarding the recognition of revenue for these contractual arrangements is fully described in Notes to the Audited Financial Statements for the year ended September 30, 2003 included in the Company's Form 10-K.

The Company considers many factors when applying accounting principles generally accepted in the United States of America related to revenue recognition. These factors include, but are not limited to:

- The actual contractual terms, such as payment terms, delivery dates, and pricing of the various product and service elements of a contract
  - Availability of products to be delivered
  - Time period over which services are to be performed
  - Creditworthiness of the customer
- The complexity of customizations to the Company's software required by service contracts
  - The sales channel through which the sale is made (direct, VAR, distributor, etc.)
  - Discounts given for each element of a contract
- Any commitments made as to installation or implementation "go live" dates

Each of the relevant factors is analyzed to determine its impact, individually and collectively with other factors, on the revenue to be recognized for any particular contract with a customer. Management is required to make judgments regarding the significance of each factor in applying the revenue recognition standards, as well as whether or not each factor complies with such standards. Any misjudgment or error by management in its evaluation of the factors and the application of the standards, especially with respect to complex or new types of transactions, could have a material adverse affect on the Company's future revenues and operating results.

#### *Accounts Receivable.*

We evaluate the creditworthiness of our customers prior to order fulfillment and we perform ongoing credit evaluations of our customers to adjust credit limits based on payment history and our assessment of the customer's current creditworthiness. We constantly monitor collections from our customers and maintain a provision for estimated credit losses that is based on historical experience and on specific customer collection issues. While such credit losses have historically been within our expectations and the provisions established, we cannot guarantee that we will continue to experience the same credit loss rates that we have in the past. Since our revenue recognition policy requires customers to be deemed creditworthy, our accounts receivable are based on customers whose payment is reasonably assured. Our accounts receivable are derived from sales to a wide variety of customers. We do not believe a change in liquidity of any one customer or our inability to collect from any one customer would have a material adverse impact on our financial position.

#### *Fair Value of Equity Instruments*

The valuation of certain items, including valuation of warrants, beneficial conversion feature related to convertible debt and compensation expense related to stock options granted, involve significant estimations with underlying assumptions judgmentally determined. The valuation of warrants and stock options are based upon a Black Scholes valuation model, which involve estimates of stock volatility, expected life of the instruments and other assumptions. As the Company's stock is thinly traded, the estimates, which are based partly on historical pricing of the Company's stock, may not represent fair value, but the Company believes it is presently the best form of estimating objective fair value.

#### *Deferred Income Taxes.*

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. We maintain a valuation allowance against the deferred tax asset due to uncertainty regarding the future realization based on historical taxable income, projected future taxable income, and the expected timing of the reversals of existing temporary differences. Until such time as the Company can demonstrate that it will no longer incur losses or if the Company is unable to

generate sufficient future taxable income we could be required to maintain the valuation allowance against our deferred tax assets.

ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS:

Comparison of Three Months and Nine Months Ended June 30, 2004 and 2003

*Net Sales.* Net sales for the three-month period ended June 30, 2004 were \$987,000, compared to \$3,042,000 for the same period in 2003, a decrease of \$2,055,000, or 68%. The decrease was primarily attributable to a 91% decrease in revenue from Check Image Solutions. The Company continued to experience delayed purchasing decisions, which we believe are due to continued customer hesitancy to adopt check imaging solutions. Though image acceptance is mandated by the passage of Check 21, imaging standards required under this legislation are not yet final. The Company also experienced substantial purchasing hesitancy from customers who expressed concern over the Company's recent quarterly losses and the delisting of the Company's stock from NASDAQ. Subsequent to the quarter ended June 30, 2004, the Company substantially exited this line of business, by agreeing to the transaction with Harland Financial Solutions described in Note 7 of the accompanying financial statements. The Company also experienced a 27% decline in revenue associated with our recognition toolkits, the result of continued customer concern over the Company's recent quarterly losses, and enterprise licenses signed during fiscal 2003 which will not renew until later in fiscal 2004. Sales in the Document and Image Processing Solutions increased by 63%, primarily due to orders from two key resellers. Sales of Maintenance rose by 57%, reflecting the Company's efforts to contact current and past customers to encourage the renewal of product support contracts. This has resulted in an increase in the installed base of customers purchasing product support.

Net sales for the nine-month period ended June 30, 2004 were \$4,700,000, compared to \$9,871,000 for the same period in 2003, a decrease of \$5,171,000 or 52%. The decrease was primarily attributable to a 69% decrease in revenue from Check Image Solutions. The Company continued to experience delayed purchasing decisions, which we believe are due to continued customer hesitancy to adopt check imaging solutions. Though image acceptance is mandated by the passage of Check 21, imaging standards required under this legislation are not yet final. The Company also experienced substantial purchasing hesitancy from customers who expressed concern over the Company's recent quarterly losses and the delisting of the Company's stock from NASDAQ. Subsequent to the quarter ended June 30, 2004, the Company substantially exited this line of business, by agreeing to the transaction with Harland Financial Solutions described in Note 7 of the accompanying financial statements. The Company also experienced a 61% decline in revenue associated with our recognition toolkits, the result of continued customer concern over the Company's recent quarterly losses, and enterprise licenses signed during fiscal 2003 which will not renew until later in fiscal 2004. Sales in the Document and Image Processing Solutions decreased by 31%. This is primarily due to the absence of a dedicated sales force for this product line, which the Company intends to put into place later during the 2004 fiscal year. Sales of Maintenance rose by 87%, reflecting the Company's efforts to contact current and past customers to encourage the renewal of product support contracts. This has resulted in an increase in the installed base of customers purchasing product support.

*Cost of Sales.* Cost of sales for the three-month period ended June 30, 2004 was \$371,000, compared to \$1,392,000 for the same period in 2003, a decrease of \$1,021,000 or 73%. Stated as a percentage of net sales, cost of sales decreased to 38% for the three-month period ended June 30, 2004 compared to 46% for the same period in 2003. The dollar decrease in cost of sales is almost entirely due to reduced hardware installations related to the Company's Checkquest product line, which typically carry higher costs, during the quarter, as compared to the same quarter in 2003. The decrease as a percentage of net sales is due to the product mix shifting from hardware installations to the Company's software product lines, which typically carry higher margins.

Cost of sales for the nine-month period ended June 30, 2004 was \$1,893,000, compared to \$3,499,000 for the same period in 2003, a decrease of \$1,606,000 or 46%. Stated as a percentage of net sales, cost of sales increased to 40% for the nine-month period ended June 30, 2004, compared to 35% for the same period in 2003. The dollar decrease in cost of sales is almost entirely due to reduced hardware installations related to the Company's Checkquest product line, which typically carry higher costs. The increase as a percentage of net sales is due to the product mix of software sold



shifting toward the Company's Checkscript and QuickStrokes Premier Banking Edition products, each of which carries a royalty.

*Operations Expenses.* Operations expenses include costs associated with shipping and receiving, quality assurance, customer support, installation and training. As installation, training, maintenance and customer support revenues are recognized, an appropriate amount of these costs are charged to cost of sales, with unabsorbed costs remaining in operations expense. Gross Operations expenses for the three-month period ended June 30, 2004 were \$454,000, compared to \$583,000 for the same period in 2003, a decrease of \$129,000 or 22%. Net Operations expenses for the three-month period ended June 30, 2004 were \$326,000, compared to \$432,000 for the same period in 2003, a decrease of \$106,000 or 25%. Stated as a percentage of net sales, operations expenses were 33% for the three-month period ended June 30, 2004, as compared with 14% for the same period in 2003. The dollar decrease in gross expenses is primarily attributable to reduced amount of salaries and wages, due to a reassignment of personnel into sales functions. The dollar decrease in net expense is attributable to the reduced spending discussed above. The increase in expenses as a percentage of net sales is primarily attributable to lower revenues.

Gross Operations expenses for the nine-month period ended June 30, 2004 were \$1,458,000, compared to \$1,717,000 for the same period in 2003, a decrease of \$259,000 or 15%. Net Operations expenses for the nine-month period ended June 30, 2004 were \$1,065,000, compared to \$1,292,000 for the same period in 2003, a decrease of \$227,000 or 18%. Stated as a percentage of net sales, operations expenses increased to 23% for the nine-month period ended June 30, 2004, compared to 13% for the same period in 2003. The dollar decrease in gross expenses is primarily attributable to reduced amount of salaries and wages, due to a reassignment of personnel into sales functions. The dollar decrease in net expense is attributable to the reduced spending discussed above. The increase in expenses as a percentage of net sales is primarily attributable to lower revenues.

*Selling and Marketing Expenses.* Selling and marketing expenses for the three-month period ended June 30, 2004 were \$450,000, compared to \$1,101,000 for the same period in 2003, a decrease of \$651,000 or 59%. Stated as a percentage of net sales, selling and marketing expenses increased to 46% for the three-month period ended June 30, 2004, as compared with 36% for the same period in 2003. The dollar decrease in expenses is primarily attributable to reduced commissions resulting from lower sales, as well as reduced salaries expense, as the Company reduced its direct sales force in the check image solution product line. The Company believes this product line is better suited to an indirect sales channel, and the Company has signed two resellers to representation agreements to move in this direction.

Selling and marketing expenses for the nine-month period ended June 30, 2004 were \$1,572,000, compared to \$2,908,000 for the same period in 2003, a decrease of \$1,336,000 or 46%. Stated as a percentage of net sales, selling and marketing expenses increased to 33% from 29% for the same period in 2003. The dollar decrease in expenses is primarily attributable to reduced commissions resulting from lower sales, as well as reduced salaries expense, as the Company reduced its direct sales force in the check image solution product line. The Company believes this product is better suited to an indirect sales channel, and the Company has signed two resellers to representation agreements to move in this direction. The increase as a percentage of net sales is primarily attributable to reduced sales.

*Research and Development Expenses.* Research and development expenses are incurred to maintain existing products, develop new products or new product features, technical customer support, and development of custom projects. Research and development expenses for the three-month period ended June 30, 2004 were \$644,000, compared to \$556,000 for the same period in 2003, an increase of \$88,000 or 16%. Stated as a percentage of net sales, research and development expenses increased to 65% for the three-month period ended June 30, 2004, compared to 18% for the same period in 2003. The dollar increase in expenses is the result of consultants engaged to complete two engineering projects. The increase as a percentage of net sales for the three-month period is primarily attributable to the decrease in sales.

Research and development expenses for the nine-month period ended June 30, 2004 were \$1,812,000, compared to \$1,680,000 for the same period in 2003, an increase of \$132,000 or 8%. Stated as a percentage of net sales, research and development expenses increased to 39% for the nine-month period ended June 30, 2004, compared to 17% for the same period in 2003. The dollar increase in expenses is the result of consultants engaged to complete two engineering projects, offset by the prior quarters' reclassification of costs. Such costs, amounting to \$92,000 were reclassified as costs of goods sold, and served to reduce research and development expense during the first quarter. The increase as a percentage of net sales for the three-month period is primarily attributable to the decrease in sales.

*General and Administrative Expenses.* General and administrative expenses for the three-month period ended June 30, 2004 were \$614,000, compared to \$517,000 for the same period in 2003, an increase of \$97,000 or 19%. Stated as a percentage of net sales, general and administrative expenses increased to 62% for the three-month period ended June 30, 2004, compared to 17% for the same period in 2003. The dollar increase in expenses for the three month period is attributable to \$20,000 of additional salaries expense, as the President and Chief Executive Officer was not a separate position in 2003 and \$145,000 in increased legal costs primarily relating to analysis of strategic alternatives, including potential mergers, capital infusions, and other strategic alternatives. The increase in expenses as a percentage of net

sales is primarily attributable to lower revenues.

General and administrative expenses for the nine-month period ended June 30, 2004 were \$1,674,000, compared to \$1,356,000 for the same period in 2003, an increase of \$318,000 or 23%. Stated as a percentage of net sales, general and administrative expenses increased to 36% for the nine-month period ended June 30, 2004, compared to 14% for the same period in 2003. The dollar increase in expenses for the three month period is attributable to \$120,000 of additional salaries expense, as the President and Chief Executive Officer was not a separate position in 2003 and \$215,000 in increased legal costs primarily relating to analysis of strategic alternatives, including potential mergers, capital infusions, and other strategic alternatives. The increase in expenses as a percentage of net sales is primarily attributable to lower revenues.

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*Interest and Other Income (Expense) - Net.* Interest and other income (expense) for the three-month period ended June 30, 2004 was (\$18,000), compared to \$4,000 for the same period in 2003, a decrease of \$22,000. Interest and other income (expense) for the nine-month period ended June 31, 2004 was (\$10,000), compared to \$8,000 for the same period in 2003, a decrease of \$18,000. The decrease in net interest and other income (expense) for the period ended June 30, 2004 is primarily the result of the Company's share of the net income from the Company's affiliate, Mitek Systems, Ltd.

## LIQUIDITY AND CAPITAL

At June 30, 2004 the Company had \$2,719,000 in cash as compared to \$1,819,000 at September 30, 2003. Accounts receivable totaled \$1,440,000, a decrease of \$1,461,000 over the September 30, 2003, balance of \$2,901,000.

The Company has financed its cash needs during the third quarter of fiscal 2004 primarily from collection of accounts receivable and the proceeds from its convertible debt financing with Laurus. The Company financed its cash needs during fiscal 2003 primarily from collection of accounts receivable.

Net cash used by operating activities during the nine months ended June 30, 2004 was (\$2,157,000). The primary use of cash from operating activities was the operating loss of (\$3,329,000), a decrease in deferred revenue of (\$557,000), a decrease in accounts payable of (\$404,000), and a decrease in the accrued payroll and related taxes of (\$153,000). The primary source of cash from operating activities was a decrease in accounts receivable of \$1,389,000 and an increase in net liabilities held for sale of \$377,000.

The Company used part of the cash provided from operating activities to finance the acquisition of equipment used in its business.

During the nine months ended June 30, 2004, the Company also received cash of approximately \$204,000 from financing activities in the form of proceeds from the exercise of stock options by employees and directors.

The Company's working capital and current ratio were \$1,538,000 and 1.52, respectively, at June 30, 2004, and \$2,341,000 and 1.87, respectively, at September 30, 2003. At June 30, 2004, total liabilities to equity ratio was -249.56 to 1 compared to 1.19 to 1 at September 30, 2003. As of June 30, 2004, total liabilities were increased by \$1,603,000 as compared to September 30, 2003.

In June 2004, the Company entered into a Convertible Note with Laurus Master Fund (Laurus). The principal amount of the note was \$3,000,000. Laurus can convert any portion of the principal outstanding to common stock at a fixed price per share of \$.70 (Conversion Price) any time the market price of the Company's common stock exceeds the Conversion Price by 10%. The note carries an interest rate of prime (as published in the Wall Street Journal) plus 1%, with monthly interest payments to be made by the Company. Principal repayments begin on December 1, 2004, and are ratable over a 36 month term. The Note is secured by a general lien on all assets of the Company, and as a condition of this transaction, the Company's line of Credit with First National Bank was cancelled. See Note 6.

There are no significant capital expenditures planned for the foreseeable future.

The Company evaluates its cash requirements on a quarterly basis. Historically, the Company has managed its cash requirements principally from cash generated from operations, though the last quarter saw the Company address its cash requirements by issuing Convertible Debt. Additionally, the Company reduced its expected future cash needs by entering into the agreement with Harland Financial Solutions whereby certain personnel and overhead expenses were assumed by Harland. Although the Company's strategy for fiscal 2004 is to grow the identified markets for its new products and enhance the functionality and marketability of the Company's character recognition technology, it has not yet observed a significant change in liquidity or future cash requirements as a result of this strategy. Cash requirements over the next twelve months are principally to fund operations, including spending on research and development. The Company believes it has sufficient cash on hand and will generate sufficient cash from operations to meet its requirements for the next 12 months.

#### NEW ACCOUNTING PRONOUNCEMENTS

In November 2002, the FASB issued FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees*. This Interpretation elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. This Interpretation does not prescribe a specific approach for subsequently measuring the guarantor's recognized liability over the term of the related guarantee. This Interpretation also incorporates, without change, the guidance in FASB Interpretation No. 34, *Disclosure of Indirect Guarantees of Indebtedness of Others*, which is being superseded. The initial recognition and measurement provisions of this Interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002, irrespective of the guarantor's fiscal year-end. The disclosure requirements in this Interpretation are effective for financial statements of interim or annual periods ending after December 15, 2002. The Company has issued no guarantees that qualify for disclosure in this interim financial statement.

In December 2002, the FASB issued Statement of Financial Accounting Standards ("SFAS") No. 148 *Accounting for Stock-Based Compensation - Transition and Disclosure*. SFAS No. 148 amends SFAS No. 123, *Accounting for Stock-Based Compensation*, to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The amendments to SFAS No. 123 provided for under SFAS No. 148 are effective for financial statements for fiscal years ending after December 15, 2002. The Company has not elected to adopt the fair value accounting provisions of SFAS No. 123 and therefore the adoption of SFAS No. 148 did not have a material effect on our results of operations or financial position.

In January 2003, the FASB issued SFAS No. 150 *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. SFAS 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). This Statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The Company adopted the provisions of this Statement and it had no impact on its financial statements.

In January 2003, the FASB issued Interpretation No. 46 (FIN 46), *Consolidation of Variable Interest Entities*. In general, a variable interest entity is a corporation, partnership, trust, or any other legal structure used for business purposes that either (a) does not have equity investors with voting rights or (b) has equity investors that do not provide

sufficient financial resources for the entity to support its activities. FIN 46 requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. The consolidation requirements of FIN 46 were initially to apply to variable interest entities created after January 31, 2003. The consolidation requirements were initially to apply to transactions entered into prior to February 1, 2003 in the first fiscal year or interim period beginning after June 15, 2003. The FASB postponed implementation of FIN 46 in December 2003. The Company has no variable interest entities.

### **ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK**

The Company is exposed to certain market risks arising from adverse changes in interest rates, primarily due to the potential effect of such changes on the Company's variable rate Convertible Note, as described under "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital." The Company does not use interest rate derivative instruments to manage exposure to interest rate changes.

### **ITEM 4. CONTROLS AND PROCEDURES**

Under the supervision and with the participation of the Company's management, including the Chief Executive Officer and Chief Financial Officer, the Company has evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-15 as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures were effective as of the end of the fiscal quarter ended June 30, 2004. During the fiscal quarter ended June 30, 2004, the Company did not change its internal control over financial reporting in a manner that materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

In connection with the audit of the Company's financial statements for the year ended September 30, 2004, the Company identified that it had incorrectly accounted for (i) the beneficial conversion feature of the convertible promissory note issued to Laurus in the third quarter of fiscal 2004 and (ii) the categorization and recording of the warrants that were issued to Laurus in connection with the convertible promissory note issued to Laurus in the third quarter of fiscal 2004. The Company determined that the incorrect accounting resulted from a significant deficiency in its internal controls over application of existing accounting principles to new transactions and financial reporting.

The Company took various steps subsequent to the quarter ended December 31, 2004, to enhance its internal controls and now believes that the significant deficiency has been remediated. Specifically, the Company's internal control improvements were to implement the following procedure when the Company is faced with an accounting issue which the Company perceives to be particularly complex: (i) the issue will be researched, including analysis of the transaction and how the appropriate authoritative literature mandates accounting treatment; (ii) the Company will conduct additional communication with its independent auditor as to the appropriateness of the authoritative literature considered; (iii) the Company will generate a memorandum regarding the basis for the Company's accounting treatment; (iv) the memorandum will be retained in the Company's files as documented evidence of its findings; and (v) the memorandum will be presented to the Company's independent auditors for review.

While the Company believes its significant deficiency has been remediated, it also has undertaken a search for a full-time Chief Financial Officer with deeper understanding of the current accounting literature as it relates to the Company's business, which the Company anticipates will be completed during the fiscal year ending September 30, 2005. The Company believes such a Chief Financial Officer will result in further improvements to its internal control and to its disclosure controls and procedures.

## **PART II - OTHER INFORMATION**

### **ITEM 2. - CHANGES IN SECURITIES AND USE OF PROCEEDS**

In June 2004, we issued to Laurus Master Fund, Ltd. a \$3.0 million secured convertible promissory note with a term of three years, along with a warrant which is exercisable at any time through June 11, 2011, to purchase up to 860,000 shares of common stock at an exercise price of (i) \$0.79 for the first 230,000 shares acquired thereunder; (ii) \$0.85 for the next 230,000 shares acquired thereunder; and (iii) \$0.92 for the remaining shares acquired thereunder. The note is convertible into approximately 4,285,714 shares of our common stock at an initial conversion price of \$.70 per share,

without taking into account additional shares which may be issuable upon conversion of interest paid on the note. The conversion price is subject to certain anti-dilution adjustments, including if we issue convertible or equity securities (subject to certain exceptions) at a price less than the conversion price. The proceeds from the promissory note will be used for working capital.



As part of the issuance of the convertible promissory note, we granted to Laurus a blanket security interest in all of our assets. In the event we default in payment on the debt, or any other event of default occurs under the investment documents, 130% of the outstanding principal amount of the note and accrued interest will accelerate and be due and payable in full.

We have agreed to register with the SEC for resale the shares of common stock that are issuable upon conversion of the note and upon exercise of the warrant, prior to September 9, 2004. The note and warrant were offered and sold in reliance on the exemption from registration provided by Rule 506 of Regulation D under the Securities Act. At closing, we paid a closing payment of \$121,000 to Laurus Capital Management, LLC, manager of Laurus Master Fund, Ltd. and additional fees of approximately \$30,000.

**ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K**

a. Exhibits:

The following exhibits are filed herewith:

Exhibit Number	Exhibit Title
10.1	Securities Purchase Agreement dated June 11, 2004 between Mitek Systems, Inc. and Laurus Master Fund, Ltd.
10.2	Warrant Certificate issued in connection with receipt of proceeds from issuance of Promissory Note dated June 11, 2004
10.3	Security Agreement dated June 11, 2004 issued to Laurus Master Fund, Ltd.
10.4	Registration Rights Agreement dated June 11, 2004 between Mitek Systems, Inc. and Laurus Master Fund, Ltd.
10.5	10% Secured Convertible Term Note, dated June 11, 2004 issued to Laurus Master Fund, Ltd.
31.1	Rule 13a-14(a) Certification of the Chief Executive Officer
31.2	Rule 13a-14(a) Certification of the Chief Financial Officer
32.1	Section 1350 Certification of the Chief Executive Officer
32.2	Section 1350 Certification of the Chief Financial Officer

b. Reports on Form 8-K: No report on Form 8-K was filed by the Company during the three months ended June 30, 2004.

Form 8-K filed with the Securities and Exchange Commission on April 5, 2004, under Item 5 and Item 7 announced that the NASDAQ had scheduled a hearing date to consider the delisting of the common stock of Mitek Systems, Inc. from the NASDAQ SmallCap Market.

Form 8-K filed with the Securities and Exchange Commission on May 4 2004, under Item 7 and Item 12 announced Mitek Systems, Inc.'s financial results for the second fiscal quarter ended March 31, 2004.

Form 8-K filed with the Securities and Exchange Commission on May 24, 2004, under Item 5 and Item 7 announced that the NASDAQ had determined to delist the common stock of Mitek Systems, Inc. from the NASDAQ SmallCap Market.



Form 8-K filed with the Securities and Exchange Commission on June 14, 2004, under Item 5 and Item 7 announced that Mitek Systems, Inc. had issued a \$3,000,000 convertible secured promissory note and certain warrants to Laurus Master Fund, Ltd.

There were no other reports filed on Form 8-K in the quarter ended June 30, 2004.

SIGNATURES

Pursuant to the requirements 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.

**MITEK SYSTEMS, INC.**

Date: May 12, 2005

By: /s/ James B. DeBello

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James B. DeBello, President and  
Chief Executive Officer  
(Authorized Officer and Principal Executive Officer)

Date: May 12, 2005

By: /s/ John M. Thornton

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John M. Thornton, Chairman and  
Chief Financial Officer  
(Principal Financial Officer)