

VERAMARK TECHNOLOGIES INC

Form 10-K

April 01, 2013

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

**FORM 10-K**

x **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
**For the Fiscal Year Ended December 31, 2012**

.. **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
**Commission File Number 0-13898**

**Veramark Technologies, Inc.**

(Exact Name of Registrant as specified in its Charter)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**16-1192368**  
(IRS Employer  
Identification Number)

**1565 Jefferson Road, Suite 120, Rochester, NY**  
(Address of principal executive offices)

**14623**  
(Zip Code)

**(585) 381-6000**  
(Registrant's telephone number, including area code)

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

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

**Common Stock, \$.10 par value per share**

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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES  NO

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K 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.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

Large accelerated filer  Accelerated filer   
Non-accelerated filer  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

The aggregate market value of the voting common stock held by non-affiliates of the registrant as of June 29, 2012 was \$3,061,510. The market value calculation was determined using a per share price of \$0.45, the price at which the registrant's common stock was last sold on the Over-the-Counter Bulletin Board System on such date.

The number of shares of Common Stock, \$.10 par value, outstanding on February 28, 2013 was 10,752,406.



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DOCUMENTS INCORPORATED BY REFERENCE\*

PART I	-	None
PART II	-	None
PART III	-	Item 10
		Portions of the Company's Proxy Statement for the Annual Meeting of Shareholders anticipated to be held on or about May 22, 2013, under the headings Election of Directors and Section 16(a) Beneficial Ownership Reporting Compliance.
		Item 11
		Portions of the Company's Proxy Statement for the Annual Meeting of Shareholders anticipated to be held on or about May 22, 2013, under the heading Executive Compensation.
		Item 12
		The tables contained in portions of the information under the headings of Election of Directors and Stock Options of the Company's Proxy Statement for the Annual Meeting of Shareholders anticipated to be held on or about May 22, 2013.
		Item 13
		Portions of the Company's Proxy Statement for the Annual Meeting of Shareholders anticipated to be held on or about May 22, 2013, under the heading Certain Relationships and Related Transactions.
		Item 14
		Portions of the Company's Proxy Statement for the Annual Meeting of Shareholders anticipated to be held on or about May 22, 2013, under the heading Audit Fees and Services.

\* In the event that the Company's Annual Meeting of Shareholders is not held prior to the end of May 2013, the Company will file an amendment to this Annual report on Form 10-K on or before April 30, 2013 to include the information anticipated to be incorporated by reference herein.

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FORWARD-LOOKING STATEMENTS

In addition to historical information, certain sections of this Form 10-K may contain 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 (the Act) that discuss the Company's beliefs, expectations or intentions or those pertaining to the Company's operations, markets, products, services, price and performance. Forward-looking statements use words such as, without limitation, anticipate, believe, estimate, expect, contemplate, project, could, may, might, would. Forward-looking statements and the success of the Company, generally involve numerous risks and uncertainties such as economic trends, interest rates, income tax laws, governmental regulations, legislation and those risk factors discussed elsewhere in this report and the Company's other filings under the Act. The Company cannot guarantee that any forward-looking statements will be accurate, although the Company believes that it has been reasonable in its expectations and assumptions. Forward-looking statements are also subject to the risks identified in Risk Factors and elsewhere in this report. Such risk factors include, without limitation, competitive pressures in our business; cyber security concerns; a decline in the demand for our software and products; risks particular to our marketing and sales efforts; and access to capital. Readers are cautioned not to place undue reliance on our forward-looking statements and are advised to carefully review the risks identified in Risk Factors and elsewhere in this report. The Company does not undertake to update its forward-looking statements, except as required by law.

PART I

**Item 1 Business**

Veramark is a global provider of innovative cost management solutions that help enterprises reduce operational expenses associated with their mobile and fixed communications networks and ensure that these networks are used appropriately. Veramark solutions for Telecom Expense Management (TEM), which include wireline and wireless call accounting solutions, help organizations drive down costs by addressing unused services, identifying billing errors, and optimizing programs for mobile, voice and data communications. Veramark solutions enable enterprises to spend less for the telecom services they need to support their business.

Veramark TEM solutions combine technology and services to meet the specific needs of each customer.

Our TEM Services range from hosting our VeraSMART TEM-enabling technology in support of a customer's internal procure-to-pay process, to the outsourcing to Veramark of a customer's entire telecom expense management program, including invoice and dispute, contracts and sourcing, usage and inventory, ordering and procurement, and help desk.

Our Professional Services experts evaluate telecom environments and design solutions based on industry benchmarks and best practices. They leverage proprietary technology and insight gained through years of experience to help customers negotiate better contracts, audit invoices, evaluate new technology, and improve procure-to-pay processes. Deliverables include recommendations for TEM lifecycle solutions that will enable permanent process improvements and enhance the bottom line.

VeraSMART, our integrated, scalable software platform, enables TEM lifecycle management of wireless and wireline usage (including call accounting), inventory, invoices and disputes, sourcing and contracts, and ordering and provisioning. VeraSMART improves the productivity of the team responsible for the procure-to-pay process and provides visibility to usage, charges, and contracts to maximize services and minimize expenses. VeraSMART powers all our TEM services.

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Veramark solutions are available as on-premise software deployments, hosted Software-as-a-Service (SaaS), and Business Process Outsourcing (BPO), allowing customers to optimally utilize both in-house and Veramark resources to manage the expenses associated with their telecom services and infrastructure.

Veramark market position at a glance:

Managed Services for the entire procure-to-pay lifecycle, as well as help desk services, up to and including full Business Process Outsourcing.

VeraSMART, a highly configurable, full-featured platform for lifecycle management of telecom expenses and related business processes.

Thousands of active customers ranging from small businesses to global enterprises, US national commercial enterprises, educational institutions, and government agencies.

An on-shore (domestic) delivery and support model that delivers responsive, high quality customer service.

A Professional Services team that delivers high-value, one-time engagements including audit, sourcing, benchmarking, operational assessment and network optimization which gain the confidence of customers and create opportunities for multi-year TEM programs.

Continual investment in innovation and R&D has positioned VeraSMART as one of the market-leading platforms for enabling TEM processes.

Extensive training, implementation, and customer support services, to provide comprehensive solutions for every deployment approach.

One of the few public companies in TEM, offering customers internal controls, transparency, and financial stability.

Veramark software and services are developed and delivered by Veramark employees based in our Rochester, NY and Sandy Springs, GA offices. Veramark sells and markets its products and services directly and through distribution channels, and maintains relationships with many top telecommunications service and equipment providers including: AT&T Inc., Avaya® and Cisco®.

## **Services and Products**

### **TEM Services**

Veramark's TEM Services include a range of programs for helping customers reduce expenses and manage procure-to-pay processes. Veramark customers may outsource to Veramark any or all of their TEM processes. Veramark will typically charge a monthly subscription fee and may include success fees for achieving agreed upon levels of savings. Customers gain access to our TEM expertise and the VeraSMART TEM software platform. Our TEM Service customers typically have Web access to their VeraSMART system to monitor performance, control process workflows, and generate reports as desired.



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TEM processes that can be outsourced to Veramark include:

**Invoice loading** Veramark can consolidate the customer's wireless and wireline invoices, convert paper invoices to e-Bills, and load invoices into the VeraSMART system. Compared to manual methods, our invoice loading service can reduce labor costs and processing time.

**Invoice processing** Veramark can manage the invoice processing workflow for the customer utilizing the features of VeraSMART. Wireless and wireline invoices can be validated or reported on as compared to inventory, contracted rates, personnel and cost centers. Veramark can facilitate the coding and approval process to reduce cycle times and mitigate the risk of incurring late payment fees. Veramark TEM experts may be engaged to analyze invoices to help find opportunities to optimize services and reduce expenses for the customer.

**Bill payment** Veramark can pay the customer's approved wireless and wireline invoices on their behalf and present the customer with a single consolidated monthly bill for the total amount. Veramark's bill payment service can provide prompt, accurate payment of approved charges. Labor costs and risks of payment errors (both underpayment and overpayment) and late payment (and resulting penalties) can be minimized.

**Dispute management** Veramark's Managed Services team may work directly with the customer's vendors to settle disputes rapidly. We vigorously pursue the recovery of identified and approved credits on the customer's behalf for potential carrier overcharges. Our dispute management service allows customers to leverage the expertise of our TEM experts, while keeping their staff focused on core capabilities and strategic objectives.

**Ordering and provisioning** Veramark's Ordering and Provision service can help customers reduce off-contract orders and meet their Minimum Annual Revenue Commitment (MARC) contract requirements. TEM Managed Services can manage orders using an automated workflow that optimizes transaction speed and accuracy.

**Managed mobility services** Veramark offers a comprehensive suite of services to help customers manage their mobile devices and reduce wireless expenses. Our in-house managed mobility services team will order, provision, and stage mobile devices; configure applications and set up email accounts; optimize service plans and pools; manage invoices, disputes, usage, and sourcing; and provide advanced help desk services.

**Help desk** Veramark offers help desk services for support of voice, data and wireless networks and equipment. Customers may outsource these services and have Veramark staff handle calls from users. Our U.S. based help desk team is trained to assist callers with a wide range of tasks and repairs associated with wireline and wireless communications. Help desk services can help customers reduce the costs associated with serving internal users.



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### **Professional Services**

Veramark Professional Services offer customers one-time programs for assessing, benchmarking and improving upon inefficiencies in their sourcing and bill processing environments.

Professional Services include one or more of the followings:

Sourcing Assist customers with carrier selection, carrier contracts, and contract negotiations to help reduce contract rates

Benchmarking Utilize proprietary benchmark data to help customers compare their historical costs with market averages to help them negotiate fair rates and terms in carrier contracts

Network optimization Evaluate existing networks and services to identify opportunities to consolidate resources and apply new technology that could help reduce the operational expenses without sacrificing services

Operational assessments Assess the current environment and identify opportunities to improve the overall value received (costs as compared with quality of services)

### **VeraSMART TEM Software**

VeraSMART provides support of transactional processes and creates visibility into telecom usage and spend. VeraSMART enables TEM best practices by automating many functions associated with enterprise telecom contract management, invoice processing and auditing, inventory and asset management, dispute management, call accounting, reporting, and data analytic dashboards. VeraSMART can be deployed as part of an outsourced, hosted or licensed solution. With unlimited scalability, VeraSMART can meet the TEM demands of the largest enterprises.

### **VeraSMART enables a range of capabilities for TEM including the following:**

Usage management captures call records (call accounting), invoice data, organizational structure (employees and cost centers), asset data (inventory) and carrier service data to provide a comprehensive view of your wireline and wireless telecom services and usage.

Invoice analysis and dispute management captures invoice data, produces analytics that help highlight opportunities to reduce expenses and utilizes workflow automation to streamline invoice receipt, reconciliation, processing, approval, and payment.

Inventory management captures asset and service data to help clients manage inventory (wireless devices, laptops, servers, modems), assign inventory charges to personnel and cost centers, and track inventory status.

Sourcing and contract management captures contract data and provides customers reports and analytics creating visibility into contract and vendor performance data that can be applied to assist with contract negotiation and commitments.

Ordering and provisioning management provides capabilities to help customers reduce the effort required to manage, streamline and control the entire ordering and provisioning process.



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Process automation VeraSMART's workflow engine can be configured to support our customers' unique TEM-related business process requirements to help to boost productivity, reduce errors, and reduce operating costs.

Analysis and reporting VeraSMART's management dashboards, reports, and exportable data views let our customers analyze, visualize, understand, and share their TEM data in ways that match their business needs.

### **VeraSMART Call Accounting Software**

VeraSMART Call Accounting is part of the VeraSMART TEM Suite. Many Veramark customers utilize VeraSMART Call Accounting as a standalone solution to manage their telecom usage. Customers can add other VeraSMART components to expand their capabilities as their business needs change and grow.

VeraSMART Call Accounting gives organizations visibility into managing their wireline usage and costs. Compatible with all current telecommunications technologies such as TDM, IP, and hybrid networks, VeraSMART Call Accounting makes it easy to analyze and report on call detail records (CDRs) collected from VOIP/PBX switches and other network sources, perform inbound and outbound traffic analysis, identify toll fraud and abuse, and calculate and assign charges to extensions, personnel, or other user-defined billing numbers. Configurable dashboards and reports enable customers to monitor usage at a glance and deliver information to individuals throughout the organization. VeraSMART Call Accounting scales to serve tens of thousands of extensions at hundreds of sites and offers a variety of optional capabilities to reduce spend and improve productivity.

Veramark has been an OEM provider to Avaya since 1984, and our eCAS brand is widely recognized in the Avaya market. We continue to use the eCAS brand on our Avaya OEM call accounting software to leverage the customer recognition and brand loyalty that we have established in the Avaya channel over the last 28 years. (Other than brand, VeraSMART Call Accounting and VeraSMART eCAS Call Accounting are identical software products.)

Veramark continues to develop complimentary distribution channels including resellers of CISCO and other telecommunications equipment and services. In addition, Veramark will sell direct to the customer if appropriate, particularly if the Call Accounting capabilities are being purchased in a bundle with other VeraSMART TEM capabilities and Veramark TEM services.

### **VeraSMART Wireless Call Accounting**

VeraSMART Wireless Call Accounting can be used as a standalone application or easily added to VeraSMART Call Accounting (or VeraSMART eCAS Call Accounting) to provide a consolidated view of all wireless and wireline usage and spend.

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VeraSMART Wireless Call Accounting features the same user-friendly interface and many of the same capabilities as VeraSMART Call Accounting, and also offers the following:

Savings analysis of every invoice automatically performs 20 checks on each wireless invoice for savings opportunities.

Wireless expense chargeback assign wireless devices to personnel so their monthly charges can be charged back to the appropriate cost center.

Configurable usage and exception reports Includes reports to monitor specific types of calls, manage employee productivity, identify abuse and misuse. In combined wireless/wireline systems, reports can be configured to reflect both PBX and wireless activity.

Interactive analytics Dashboards provide instant access to data such as longest calls, usage trends for voice, data, texting, and wireless invoice costs, allowing users to drill down to the details.

### **Personal Call Identification**

VeraSMART PCI can be added to a VeraSMART Call Accounting (wireless/wireline) system to track business vs. personal usage, classify costs, and help the organization avoid paying for calls that are not business-related. The system tallies the cost of the personal calls as the employee identifies them.

VeraSMART PCI has a streamlined interface and easy-to-use features designed for end-user self-service:

Highlights all new phone numbers wireless and wireline that need to be classified

Links to the date, time and duration of all calls placed to or received from each number

Users can assign nicknames to numbers

Users can search the Web for information on numbers without ever leaving PCI

Includes administration tools for monitoring and reporting

Administrators can identify all outstanding unclassified numbers and email reminder notifications to the responsible employees. They can also generate reports listing cost and duration of personal calls by employee and distribute these reports to specified cost centers.

### **Software Maintenance**

Veramark provides software support and maintenance for an annual fee. Software support and maintenance includes post-warranty support via telephone or modem, as well as new software service pack releases. Initial annual fees for maintenance range from 15% 20% of the original software license fee, depending upon the level of service defined in the customer Service level Agreement.

### **Marketing and Sales**

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Veramark has a multi-faceted distribution strategy that includes direct sales to customers and indirect sales through strategic partners and value-added-resellers (VARs). Products and services are delivered through these complimentary channels based on the complexity of the sale and the complexity of the product and service being sold.

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This multi-channel approach helps create a portfolio of opportunities, extends the reach of our sales efforts, and reduces the total cost of sales as compared with a purely direct sales approach.

Marketing initiatives include a blend of cohesive online and offline programs. Veramark marketing manages new product marketing launch activities, public relations, webinars and seminars, reference programs, customer satisfaction programs, sponsorship of industry and channel conferences, advertising, newsletters, email and Web marketing programs, social marketing, social responsibility programs, channel marketing programs, and other programs. Veramark marketing actively seeks speaking engagements, develops customer case studies, and publishes white papers and by-lined articles.

## **Backlog**

At December 31, 2012, Veramark had a backlog of approximately \$14.0 million of which approximately \$8.8 million is expected to be recognized as revenue during 2013. Backlog as of December 31, 2011 was \$12.6 million. The Company's policy is to accept orders only upon receipt of purchase orders, or the equivalent thereof.

## **Employees**

As of February 28, 2013 Veramark employed 104 full-time personnel. Veramark's employees are not represented by any labor unions.

## **Item 1A Risk Factors**

The following factors, among others discussed herein and in the Company's filings under the Act, could cause actual results and future events to differ materially from those set forth or contemplated in this report: economic, competitive, governmental and technological factors, increased operating costs, failure to obtain necessary financing, risks related to natural disasters and financial market fluctuations. Such factors also include:

**If we cannot continue to enforce the intellectual property rights on which our business depends, or if third parties assert that we violate their intellectual property rights, then our business, financial condition and results of operations could be materially adversely affected.**

Veramark regards its products as proprietary and attempts to protect them with a combination of copyright, trademark and trade secret protections, employee and third-party non-disclosure agreements and other methods of protection. Despite those precautions, it may be possible for unauthorized third parties to copy certain portions of Veramark's products, reverse engineer or obtain and use information that Veramark regards as proprietary. The laws of some foreign countries do not protect Veramark's proprietary rights to the same extent as the laws of the United States. Any misappropriation of Veramark's intellectual property could have a material adverse effect on its business and results of operations. Furthermore, although Veramark takes steps to prevent unlawful infringement of other's intellectual property, there can be no assurance that third parties will not assert infringement claims against Veramark in the future with respect to current or future products. Any such assertion could require Veramark to enter into royalty arrangements or result in costly litigation.

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### **We depend on continued relationships with existing customers and the loss of one or more major customer could have a material adverse effect on our business and results of operations.**

We derive a significant portion of our revenues from multi-year Managed Service contracts with our existing customers. Our customers have no obligation to renew their Managed Service contracts. We expect to continue to depend upon these multi-year contracts with existing customers for a significant portion of our revenues and, as a result, our ability to maintain and grow revenue depends in large part on renewals by existing customers. The loss of a major customer or the delay, reduction or cancellation of a Managed Service contract by one or more major customers could adversely affect our operating results. We cannot provide any assurances that present or future large customers will not terminate, significantly delay, reduce or fail to renew their Managed Service contracts with us, any of which would reduce our revenues and may have a negative impact on our business, financial condition and results of operations.

### **If we cannot develop new products, services and technologies to address the constantly evolving needs of our customers, it could have a material adverse effect on our business and results of operations.**

Due to the competitive nature of the industries and markets in which we compete, we must continually introduce new products, services and technologies, enhance existing products and services, and effectively stimulate customer demand for new and upgraded products. We have made significant investments in research, development and marketing for new products, services and technologies, such as our VeraSMART software offering and its hosted or managed solutions. The success of new product introductions depends on a number of factors including, but not limited to, timely and successful product development, market acceptance, our ability to manage the risks associated with new product production issues, the availability of products and services for appropriate costs to meet anticipated demands and the risk that new products may have quality or other defects in the early stages of introduction. Accordingly, we cannot determine in advance the ultimate effect of new product introductions and transitions. Significant revenue from new products and services may not be achieved for a number of years, if at all, and in the event new products or services are profitable, operating margins may not be as high as the margins we have historically achieved.

The process of developing new products and services is complex, costly, time-consuming and uncertain, and any failure by us to anticipate customers' changing needs and emerging trends accurately could harm our market share and/or results of operations. Additionally, significant delays in new product releases or significant issues in the creation of new products, in particular any delays or significant issues regarding the VeraSMART suite of products and services, could adversely affect our business and results of operations.

### **A sudden decrease in demand for our solutions would likely have a material adverse effect on our business and results of operations.**

If overall market demands for software and computer devices generally, as well as call accounting software or enterprise level products and services specifically, declines, or corporate spending for such products declines, Veramark's revenue could be adversely affected. Additionally, Veramark's revenues could be unfavorably impacted if customers reduce their purchases of new software products or upgrades to existing products.

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### **We operate in highly competitive markets and an inability to compete effectively may have a negative effect on our results of operations.**

Veramark experiences intense competition across all markets for its products and services. Some competing firms have greater name recognition and more financial, marketing and technological resources than Veramark. These competitive pressures may result in decreased sales volumes, price reductions, and/or increased operating costs, such as for marketing and sales incentives, resulting in lower revenues, gross margins and operating income.

### **We rely on pre-existing relationships with companies as part of our marketing and distribution strategy; our business, financial condition and results of operations may be materially adversely affected if we are unable to maintain these relationships.**

Veramark's marketing and distribution strategy is founded on building mutually beneficial relationships with companies that have established distribution networks. Some sell privately labeled, customized products developed and manufactured by Veramark to their specific specifications, while others resell Veramark's products. Any loss of the continued availability of those relationships could have a material adverse effect on Veramark's business and results of operations.

### **Security and privacy breaches in our systems may damage client relations and inhibit our growth**

The uninterrupted operation of our hosted solutions and our ability to preserve the confidentiality of third party information that resides on our systems, are critical to our business. We have what we believe to be sufficient security safeguards in place to prevent major interruptions in service and to prevent unauthorized access. Any failure in our security and privacy measures could have a material adverse impact on our financial position and results of operations.

### **We depend on our key employees and senior management team and the loss of the services of one or more of our key employees or members of our senior management team could harm our business.**

Veramark's delivery of quality products and services requires the experience and knowledge of our staff. The loss of key employees could hinder our ability to deliver services, possibly resulting in loss of customers or loss of revenue. Any loss of key employees could have a material adverse effect on Veramark's business and results of operations.

### **Our inability to raise additional capital on acceptable terms could have a negative impact on our business.**

We may need access to additional capital in the future and may not be able to obtain debt or equity financing on favorable terms, or at all. Furthermore, if we are able to obtain equity financing, it could result in significant dilution of current ownership interests and a decline in the per-share value of our common stock. If we are able to obtain debt financing, it may be under terms that restrict our ability to incur additional indebtedness and/or maintain certain liquidity or other ratios, which could restrict our ability to raise additional capital in the future. If we require additional capital but are unable to raise it on acceptable terms, we may not be able to maintain a competitive software product, hire or retain experienced employees, fund growth in our operations or fund the acquisition of complementary products or businesses, which could have a material adverse effect on our business and results of operations.



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### **A failure of our information technology systems could materially adversely affect our business.**

A failure or prolonged interruption in our information technology systems that compromises our ability to meet our customers' needs, or impairs our ability to record, process and report accurate information to the SEC could have a material adverse effect on our financial condition.

### **If we are unable to continue to access our customers' communications billing and usage data from communications carriers, the value of our solutions could be impaired.**

Some of the features of the solutions that we offer depend on our ability to obtain certain communications billing and usage data from our customers' communications carriers. If one or more communications carriers were to prohibit their customers from providing us with this information, it could impair the functionality of our products and services, which would reduce the value of our solutions. Such impairment could impact our ability to compete, increase our expenses and reduce our sales, any of which would have an adverse effect on our results of operations.

### **Performance problems with our software may harm our reputation and market share, and result in significant costs to us.**

Our solution utilizes complex software products that may contain undetected defects and errors that could cause our software to stop functioning, function improperly or not function at a level that meets our customers' expectations. Such performance problems could damage our reputation among our customers and in the market, which could result in the loss of future sales or the loss of current customers and, accordingly, the loss of market share. Further, our customers use our solution for integral parts of their businesses and any performance problems with our software could therefore damage our customers' businesses. Whether or not we are responsible for such performance problems, we may be required to spend significant resources in defense of any such claims, and could potentially pay significant fees, settlements or damages, which would have an adverse effect on our business and results of operations.

## **Item 2 Properties**

The Company's principal headquarters facility is located in a one-story building in Rochester, New York. Veramark presently leases approximately 24,000 square feet of the building, which was constructed in 2010. The Company began occupancy of this facility in September 2010. The term of the Rochester lease expires on March 31, 2018.

The Company has an office located in Atlanta, Georgia, where it leases approximately 11,000 square feet of the building. The Atlanta lease was entered into in November 2012, and expires August 31, 2018.

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**Item 3 Legal Proceedings**

On June 16, 2011 the Company entered into a Nonexclusive Patent License and settlement agreement relating to an action brought by Asentinel LLC, against Veramark, AnchorPoint a division of MTS, and CASS Information Systems, alleging infringement of two patents held by Asentinel concerning systems and methods for identifying and processing billing exceptions in telecommunications invoices.

Material terms of the agreement included:

Asentinel waived all claims for damages for prior infringement and agreed not to make claims for future infringement of its patents.

The Company agreed to pay Asentinel \$500,000. Of that amount \$250,000 was paid upon execution of the agreement and \$250,000 was paid on June 16, 2012.

The lawsuit was dismissed against the Company.

As of the date of this report, there were no other legal proceedings.

**Item 4 Mine Safety Disclosures**

Not Applicable.

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## PART II

**Item 5 Market for the Registrant's Common Stock and Related Stockholder Matters**

Veramark Common Stock, \$0.10 par value (symbol: VERA), is an Over-The-Counter (OTC) equity security. Effective February 22, 2011, VERA was quoted on the OTCQB market tier. The quotations below reflect inter-dealer prices that do not include retail markups, markdowns or commissions and may not represent actual transactions.

**Quarters Ended**

	31-Mar		30-Jun		30-Sep		31-Dec	
	High	Low	High	Low	High	Low	High	Low
<b>2012</b>	\$ 0.55	\$ 0.35	\$ 0.60	\$ 0.40	\$ 0.60	\$ 0.36	\$ 0.65	\$ 0.40
<b>2011</b>	\$ 0.95	\$ 0.62	\$ 0.98	\$ 0.60	\$ 0.70	\$ 0.41	\$ 0.56	\$ 0.37

As of March 31, 2013, there were approximately 500 holders of record of the Company's Common Stock and approximately 1,200 additional beneficial holders.

**Dividends**

We do not anticipate paying any cash dividends on shares of our common stock in the future.

**Equity Income Plans**

Please see Notes to Financial Statements - Stock Based Compensation, contained in Item 8 of this Report, for information on our equity compensation plans.

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

In addition to historical information, certain sections of this Form 10-K may contain 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 (the "Act") that discuss the Company's beliefs, expectations or intentions or those pertaining to the Company's operations, markets, products, services, price and performance. Forward-looking statements use words such as, without limitation, anticipate, believe, estimate, expect, contemplate, project, could, may, might, would. Forward-looking statements and the success of the Company, generally involve numerous risks and uncertainties such as economic trends, interest rates, income tax laws, governmental regulations, legislation and those risk factors discussed elsewhere in this report and the Company's other filings under the Act. The Company cannot guarantee that any forward-looking statements will be accurate, although the Company believes that it has been reasonable in its expectations and assumptions. Forward-looking statements are also subject to the risks identified in "Risk Factors" and elsewhere in this report. Such risk factors include, without limitation, competitive pressures in our business; cyber security concerns; a decline in the demand for our software and products; risks particular to our marketing and sales efforts; and access to capital. Readers are cautioned not to place undue reliance on our forward-looking statements and are advised to carefully review the risks identified in "Risk Factors" and elsewhere in this report. The Company does not undertake to update its forward-looking statements, except as required by law.

### **2012 Compared with 2011**

#### **Overview**

Revenues of \$3,996,000 for the fourth quarter of 2012 increased 3% from revenues of \$3,876,000 for the fourth quarter of 2011. Revenues for the twelve months ended December 31, 2012 of \$15,318,000 increased 10% from revenues of \$13,938,000 for the year ended December 31, 2011. Net income of \$270,000, or \$0.03 per diluted share for the fourth quarter of 2012 compared with a net loss of \$687,000, or \$0.07 per share for the fourth quarter of 2011. For the year ended December 31, 2012, net income of \$745,000, representing \$0.07 per diluted share, compared with a net loss of \$1,220,000 for the year ended December 31, 2011.

New orders for the year ended December 31, 2012 totaled \$17.1 million, which compared with orders of \$17.3 million for the year ended December 31, 2011. The backlog of recurring revenues at December 31, 2012 of \$14.0 million increased 12% from the December 31, 2011 recurring revenue backlog of \$12.6 million. Of that backlog approximately \$8.8 million is expected to be recognized as revenues in 2013.

#### **Revenues**

Our revenues are earned by providing Telecom Expense Management (TEM) products and services under multi-year managed service contracts in either a hosted or cloud based software- as-a-service environment, or by the deployment of premise-based licensed software. In either case, sales may be made through strategic partners or directly to end users. For the three and twelve months ended December 31, 2012 revenues from multi-year contracts increased 4% and 28% respectively, from the same three and twelve month periods of 2011. Revenues earned from the sale of licensed software, including associated maintenance and related services, increased 4% for both the three months and the twelve months ended December 31, 2012, from the same three and twelve month periods of 2011.

**Table of Contents****Gross Margin**

Gross margin (revenues less cost of revenues) of \$2,403,000, or 60% of revenues for the quarter ended December 31, 2012 increased 1.7% from gross margin of \$2,361,000, or 61% of revenues, for the same quarter of 2011. For the year ended December 31, 2012, gross margin of \$8,997,000 increased 10% from gross margin of \$8,166,000 for the year ended December 31, 2011, representing 59% of revenues for both years.

**Engineering and Software Development Costs**

Engineering and software development expenses, net of the capitalization of software development costs, totaled \$267,000 for the fourth quarter of 2012, a decrease of 17% or \$56,000, from the same quarter of 2011. The decrease in fourth quarter expenses from 2011 included a \$30,000 reduction in facility costs allocated to engineering, and an additional \$26,000 in software development costs capitalized in the quarter versus the same quarter of 2011. For the full year ended December 31, 2012, net engineering and software development expenses of \$1,154,000 were essentially unchanged from net expense of \$1,151,000 for the year ended December 31, 2011. The chart below summarizes gross engineering and software development expenses, development costs capitalized and included in the Company's balance sheet, and the resulting net expense for engineering and software development included in the statements of operations for the years ended December 31, 2012 and 2011.

	<b>2012</b>	<b>2011</b>
Gross expenditures for engineering and software development	\$ 1,867,000	\$ 1,962,000
Less: Software development costs capitalized	(713,000)	(811,000)
Net expenses for engineering and software development	\$ 1,154,000	\$ 1,151,000

**Selling, General and Administrative Expenses**

SG&A expenses of \$1,865,000 for the quarter ended December 31, 2012 and \$7,123,000 for the year ended December 31, 2012 compared with SG&A expenses of \$2,736,000 and \$7,424,000, respectively, for the fourth quarter and year ended December 31, 2011. SG&A expenses for the fourth quarter and year ended December 31, 2011 include \$912,000 of additional expense recognized pursuant to a change in the accounting treatment of pension and other post-retirement benefits adopted by the company in the fourth quarter of 2011. Absent the effects of the change in accounting treatment, SG&A expenses for 2012 increased 9% from 2011 levels. The increase is attributable to a 16% increase in marketing and product management costs, and an expansion of the Company's human resource capabilities.

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**2011 Compared with 2010**

**Overview**

Revenue of \$3,876,000 for the quarter ended December 31, 2011 increased 8% from revenue of \$3,588,000 for the same quarter of 2010 and represented the highest fourth quarter revenues since 1999. Revenues for the full year ended December 31, 2011 totaled \$13,938,000, an increase of 6% from revenues of \$13,165,000 for the year ended December 31, 2010.

The following two separate non-operational events impacted quarterly and annual reported net income for the year ended December 31, 2011.

A second quarter charge against income of \$863,000 for legal and settlement charges associated with a patent infringement lawsuit filed against the Company and two other defendants in 2010 by Asentinel LLC. The lawsuit alleged infringement of two patents dealing with systems and methods for identifying and processing billing exceptions in telecommunications invoices. As part of a settlement agreement reached with Asentinel in June 2011, the lawsuit was dismissed.

A non-cash fourth quarter charge against income of \$912,000 to reflect a change in accounting policy relating to the recognition of gains or losses associated with the Company's Supplemental Executive Retirement Plan. This change in accounting treatment will record the effects of changes in discount rates and actuarial assumptions to our Statement of Operations in the year incurred or realized, rather than deferring portions of those gains or losses to future periods.

As a result of the change in accounting policy, we reported a net loss of \$687,000, or \$0.07 per share, for the fourth quarter of 2011 and a loss of \$1,220,000, or \$0.12 per share, for the year ended December 31, 2011. Absent those charges referenced above, we would have reported net income of \$224,000 for the fourth quarter of 2011 and net income of \$555,000 for the year ended December 31, 2011, or \$0.02 and \$0.05 per share respectively. In 2010, retrospectively applying the effects the change in accounting treatment for pension costs, we incurred a net loss of \$213,000 in the fourth quarter of 2010 and a net income of \$190,000, or \$0.02 per share, for the full year ended December 31, 2010.

Orders received during the fourth quarter of 2011 totaled \$4.4 million, increasing total orders booked for the year ended December 31, 2011 to \$17.3 million, an increase of 25% from orders received of \$13.8 million for the year ended December 31, 2010. As a result, our backlog of future recurring revenues entering 2012 increased 32% from \$9.6 million at December 31, 2010 to approximately \$12.6 million at December 31, 2011.

**Table of Contents****Non-GAAP Financial Measures (UNAUDITED)**

The below chart removes the effect of the non-recurring charges referenced above on reported net income, operating expenses, net income and earnings (loss) per share.

**For the year ended December 31, 2011**

	Q-1 2011	Q-2 2011	Q-3 2011	Q-4 2011	Total 2011
GAAP Net Income (Loss)	53	(671)	86	(688)	(1,220)
Add: Legal Expenses	139	224	0	0	363
Add: Settlement Charges	0	500	0	0	500
Add: Change in Accounting Treatment	0	0	0	912	912
Adjusted Net Income (Non GAAP)	192	53	86	224	555
Fully Diluted EPS (GAAP)	0.01	(0.07)	0.01	(0.07)	(0.12)
Fully Diluted EPS (Non-GAAP)	0.02	0.00	0.01	0.02	0.05

**For the Year ended December 31, 2010**

	Q-1 2010	Q-2 2010	Q-3 2010	Q-4 2010	Total 2010
GAAP Net Income (Loss)	67	122	214	(213)	190
Add: Change in Accounting Treatment	0	0	0	421	421
Adjusted Net Income (Non GAAP)	67	122	214	208	611
Fully Diluted EPS (GAAP)	0.01	0.01	0.02	(0.02)	0.02
Fully Diluted EPS (Non-GAAP)	0.01	0.01	0.02	0.02	0.06

**Revenues**

The Company earns its revenues providing Telecom Expense Management (TEM) products and services, including call accounting, through the direct sale of licensed software, or under multi-year managed service contracts offered by means of Software as a Service (SaaS). For the fourth quarter and full year ended December 31, 2011 revenues from TEM managed service contracts, and related professional services, increased 10% and 24% respectively, from revenues for the fourth quarter and year ended December 31, 2010. Revenues earned from the sale of licensed TEM software and associated services in the fourth quarter increased 6% from the same quarter of 2010, but decreased 4% for the year ended December 31, 2011 from 2010 results.

**Gross Margin**

Gross margin (revenues less cost of revenues) of \$2,361,000 for the quarter ended December 31, 2011 increased 8% from gross margin of \$2,194,000 for the fourth quarter of 2010. For the full year ended December 31, 2011 gross margin of \$8,166,000, or 59% of revenues, decreased less than 1% from gross margin of \$8,181,000, or 62% of revenues, for the year ended December 31, 2010. The decrease in 2011 gross margins from the prior year reflects a higher mix of 2011 revenues being derived from multi-year managed service contracts than 2010. These contracts yield lower margins as a percentage of monthly revenues than those earned from the direct sale of licensed products, but

generally return greater revenues and margin dollars over the life of the contract.



**Table of Contents****Engineering and Software Development Costs**

Engineering and software development costs of \$323,000 for the fourth quarter of 2011, net of the capitalization of software development costs, increased 3% from net expense of \$314,000 the fourth quarter of 2010. For the full year ended December 31, 2011, engineering and software development costs decreased 17% from \$1,394,000 for the year ended December 31, 2010 to \$1,151,000 for the year ended December 31, 2011. The reduction in net expense reflects lower payroll and facility costs in 2011 as compared with 2010. The chart summarizes gross expenses for engineering and software development, development costs capitalized, and the net expense for engineering and software charged to the Company's Statements of Operations for years ended December 31, 2011 and 2010.

	2011	2010
Gross expenditures for engineering & software development	\$ 1,962,000	\$ 2,530,000
Less: Software development costs capitalized	(811,000)	(1,136,000)
<b>Net expense for engineering and software development</b>	<b>\$ 1,151,000</b>	<b>\$ 1,394,000</b>

**Selling, General and Administrative Expenses**

Selling general and administrative (SG&A) expenses totaled \$2,736,000 for the fourth quarter of 2011 and \$7,424,000 for the full year ended December 31, 2011. This represents increases of 31% and 12%, respectively from expenses of \$2,096,000 for the fourth quarter of 2010 and \$6,648,000 for the year ended December 31, 2010. The increase in SG&A expenses for 2011 versus 2010 includes \$427,000 of additional pension expense from the prior year, and an expansion of the Company's direct sales force which increased payroll, commission and travel costs by approximately \$360,000. Expenses for marketing, support and administrative expenses decreased by approximately \$115,000 in total in 2011 as compared with the prior year.

**Litigation Expense and Settlement Costs**

On June 16, 2011 the Company settled a patent litigation complaint brought by Asentinel LLC, which also named CASS Information Systems and AnchorPoint, a division of MTS, as defendants, alleging the infringement of two telecom expense management (TEM) patents held by Asentinel. Under the terms of the settlement, the Company agreed to pay Asentinel \$500,000 in return for a waiver of all known claims for past infringement of the Asentinel patents, an agreement not to make claims for future infringement of those patents and dismissal of the lawsuit. Of the settlement amount, \$250,000 was paid on the date of settlement, with the remaining \$250,000 represented by a non-interest bearing note payable with a maturity date of June 16, 2012. The entire settlement amount of \$500,000 and legal fees of \$224,000 pertaining to this action were charged to the Statement of Operations for the quarter ended June 30, 2011. Additionally the Company expensed \$139,000 of legal fees associated with this action in the first quarter of 2011.

**Liquidity and Capital Resources**

Our total cash position (cash plus cash equivalents and short term investments) totaled \$1,316,000 at December 31, 2012, representing a positive cash flow of \$475,000 from the cash position of \$841,000 at December 31, 2011. During the third quarter of 2012 the Company repaid \$155,000 outstanding on its \$750,000 line of credit arrangement with Manufacturers and Traders Trust Company (M&T Bank), and at December 31, 2012 had no outstanding balance under that arrangement.

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Accounts receivable of \$2,080,000 at December 31, 2012 increased 22% from the December 31, 2011 balance of \$1,711,000 reflecting higher revenues in 2012 versus the prior year. As a result of the increase in accounts receivable, the reserve for bad debts at December 31, 2012 was increased to \$45,000, up from \$35,000 at the end of 2011.

Prepaid expenses increased from \$434,000 at December 31, 2011 to \$480,000 at December 31, 2012 due to an increase in prepaid commissions related to the sale of multi- year TEM service contracts. These commissions will be charged to SG&A expense as the associated revenues are recognized.

For the year ended December 31, 2012 the Company's capital expenditures totaled \$268,000. Capital investments included \$172,000 of additions for technology and infrastructure upgrades, and approximately \$95,000 for furniture and fixtures associated with the relocation of our Atlanta area facility. For the year ended December 31, 2011 capital expenditures totaled \$163,000. Depreciation expense for 2012 of \$200,000 compared with depreciation expense of \$197,000 for 2011.

Software development costs capitalized and included in our balance sheet at December 31, 2012 of \$2,585,000 decreased 6% from the December 31, 2011 balance of \$2,737,000. For the year ended December 31, 2012 software development costs of \$713,000 were capitalized, and \$864,000 of costs capitalized in prior periods were amortized and charged to cost of revenues in the Statement of Operations. For the year ended December 31, 2011, the Company capitalized \$811,000 of software development costs, while amortizing \$1,036,000 of costs capitalized previously.

The intangible asset of \$371,000 at December 31, 2012 represents the remaining unamortized fair market values of assets acquired from Source Loop in 2010. During 2012 we amortized \$192,000 of the remaining fair market values, which have been charged to SG&A expense in the Statement of Operations. See note 9 to the financial statements for a summary of the fair market values assigned at the time of acquisition, amortization expense to date, and future expected amortization expense.

Pension assets of \$3,430,000 at December 31, 2012 compare with a balance of \$3,320,000 at December 31, 2011, and consist of the current cash surrender values of a series of company-owned life insurance contracts designed to reimburse the Company for past, present and future pension obligations. These cash surrender values are also available to the fund current operations at the Company's discretion. Participation and future growth of the Company's supplemental executive retirement program were suspended in 2008. The associated death benefits attached to those policies total \$10.2 million and are not included in the Company's balance sheet.

Current liabilities of \$7,277,000 at December 31, 2012 decreased \$29,000 from \$7,306,000 at December 31, 2011, with reductions in in accounts payable, short term debt, and contingent liabilities largely offset by increases in accrued compensation and deferred revenues. The reduction in short term debt includes the second quarter 2012 payment of a \$250,000 note in final settlement of the patent infringement lawsuit filed against the Company in 2010. The elimination of the contingent liability represented the final consideration paid for the 2010 acquisition of Source Loop.

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Deferred revenues of \$4,537,000 at December 31, 2012 which increased 6% from the prior year represent the unrecognized portion of customer orders for a variety of services including maintenance, consulting, training and implementation services that will be performed in future periods and recognized as revenues in the Statement of Operations at that time. Deferred revenues form a component of the backlog of recurring revenues referred to in the overview section of this report.

Long term debt consists of the net present value of future pension obligations and a non-cash prepaid rent liability of \$106,000, related to rent free periods included in our Rochester and Atlanta facility leases.

Stockholder s equity of \$389,000 at December 31, 2012 increased from a negative \$493,000 at December 31, 2011, primarily due to the \$745,000 of net income earned for the year. During 2012 employees of the Company purchased 47,338 shares of Company stock for a total consideration of \$18,000.

It is management s opinion, given current cash and investment balances, its fully available line of credit arrangement, and access to cash surrender values of company- owned life insurance policies, that more than sufficient capital exists to fully fund operational and strategic objectives for the next twelve months and beyond.

**Table of Contents****Off Balance Sheet Arrangements**

**Pension Obligations** The Company sponsors a non-qualified, unfunded, Supplemental Executive Retirement Plan (SERP), which provides certain current and former employees with a defined pension benefit. The SERP is not encumbered by the coverage and benefit restrictions imposed on qualified plans by the IRS. In addition, the Company generally is not required to comply with non-discrimination rules imposed on qualified plans under ERISA. In 2008, the Company suspended any future growth in pension benefits or participation in the plan.

Unfunded means that the Company is not required to set aside any particular assets to satisfy its SERP liabilities. Accordingly any assets the Company may have available to satisfy SERP liabilities are subject to claims by the Company's creditors.

Recovery of 100% of projected SERP costs is designed through a program of Company-owned life insurance (COLI). Recovery for the imputed time value of the money, plus all costs associated with the COLI premium payments, and benefit obligations, are included in this program. The Company currently owns 14 separate life insurance contracts on selected current and former employees, not all of whom will ultimately qualify for participation in the plan. The cumulative death benefit attached to these policies is \$10.2 million and is not included in the Company's Consolidated Balance Sheet as of December 31, 2012.

The cash surrender values of these policies at December 31, 2012 totaled approximately \$3,430,000 and are included in the Company's consolidated balance sheets under the caption of Pension Assets.

The projected future pension benefits expected to be paid under this plan are as follows, assuming retirement at age 65 and life expectations governed by Social Security Administration actuarial tables.

	Year Ending December 31,	
2013		558,660
2014		490,660
2015		449,060
2016		454,340
2017-2021		2,577,612

The net present value of all projected pension obligations at December 31, 2012, totals \$6,018,368, and is included in the current and long-term liability section of the Company's balance sheet.

**Lease Obligations** The Company leases office facilities, at its Rochester, N.Y. location, under a lease which expires March 31, 2018. The Company also carries a lease obligation for its Atlanta, Georgia location, which expires on August 31, 2018. Rent expense under all operating leases (exclusive of real estate taxes and other expenses payable under the leases) was approximately \$319,000, \$305,000, and \$426,000 for the years ended December 31, 2012, 2011 and 2010, respectively.

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As of December 31, 2012, minimum lease payments are as follows:

	Year Ending December 31,	
2013		\$ 278,997
2014		433,669
2015		442,376
2016		450,625
2017		456,715
2018		201,993

ASC 840-20, *Operating Leases* stipulates that rent expense for operating leases with rent-free periods or scheduled increases, be accounted for on a straight-line basis over the lease term, including the related rent-free period. As a result, the Company's financial statements include a lease liability, which at the end of each reporting period, represents the difference between the amount of rent expense recognized, and the amount of rent paid through the reporting period.

**Purchase Commitments** The Company has no purchase commitment contracts in place as of December 31, 2012.

**Critical Accounting Policies**

**Revenue Recognition** The Company's revenue consists of revenues from the licensing of software to resellers and end user customers; fees for services rendered including installation, training, implementation, and customer maintenance contracts; and the outsourcing or hosting of services, commonly referred to as Software as a Service (SaaS).

The Company recognizes software license revenue under ASC 985-605, formerly Statement of Position No 97-2 *Software Revenue Recognition*, Statement of Position No. 98-9, *Software Revenue Recognition With Respect to Certain Transactions*, and under ASC 605-25, formerly Emerging Issues Task Force 00-21, *Revenue Arrangements with Multiple Deliverables*, and related interpretations, as amended.

Licensed software may be sold as a stand-alone element, with other software elements, or in conjunction with supplemental services. When an order consists of more than one element, it is considered to be a multiple element arrangement (MEA). When sold as a stand-alone element, the revenue is recognized upon shipment. When sold as part of a MEA, revenue from the licensed software is recognized when each element is activated at the customer site, via the entry of a software key-code. This typically occurs at the same time that installation occurs. Service revenues such as training, installation and implementation, are recognized when the service is complete, and acknowledged by the customer.

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For either a single element transaction or a MEA, Veramark allocates consideration to all deliverables based on their relative stand-alone selling prices. Amendments to ASC 605-25, which became effective January 1, 2011, establish a hierarchy to determine the stand-alone selling price as follows:

Vendor Specific Objective Evidence of the fair value (VSOE),

Third Party Evidence (TPE)

Best Estimate of the Selling Price (ESP)

Sales which constitute a MEA are accounted for by determining whether the elements can be accounted for as separate accounting units, and if so, by applying values to those units, per the hierarchy above. If VSOE is not available, management estimates the fair selling price using historical pricing for similar items, in conjunction with current pricing and discount policies.

Regardless of the form of sale, no revenue is recognized without persuasive evidence of an arrangement existing. Persuasive evidence is determined to be a signed purchase order received from the customer, or an equivalent form for those customers lacking a formalized purchase order system. Additionally, revenue is only recognized when a selling price is fixed or determinable, and collectability of the receivable is deemed to be probable.

Fees charged to customers for post-contract Technical Support are recognized ratably over the term of the contract. Costs related to maintenance obligations are expensed as incurred.

The Company's revenues generated through hosting solutions are recognized using the proportional performance method. Revenues are recognized in the month services are rendered and earned under service agreements with clients where service fees are fixed or determinable. Contracts can be terminated with 90 days written notice. All services provided by the Company through the date of cancellation are due and payable under the contract terms.

The Company believes its revenue recognition policies are appropriate, in all circumstances, and that its policies are reflective of complexities arising from customer arrangements involving such features as maintenance, warranty agreements, license agreements, and other normal course of business arrangements.

**Capitalization of Software Development** The Company capitalizes software development costs when technological feasibility has been established for the software in accordance with ASC 985-20, "Costs of software to be sold, leased, or marketed". Such capitalized costs are amortized on a product-by-product basis over their economic life or the ratio of current revenues to current and anticipated revenues from such software, whichever provides the greater amortization. The Company periodically reviews the carrying value of capitalized software development costs and impairments are recognized in the results of operations when the expected future undiscounted operating cash flow derived from the capitalized software is less than its carrying value. Should the Company inaccurately determine when a product reaches technological feasibility or the economic life of a product, results could differ materially from those reported. Veramark uses what it believes are reasonable assumptions and where applicable, established valuation techniques in making its estimates.

**Allowance for Doubtful Accounts** The Company maintains allowances for doubtful accounts for estimated losses resulting from the potential inability of its customers to make required payments. Management specifically analyzes accounts receivable, historical bad debts, credit concentrations and customer payment terms when evaluating the adequacy of the allowance for doubtful accounts.

**Pension Liability** The Company sponsors an unfunded Supplemental Executive Retirement Program (SERP), which is a nonqualified plan that provides certain employees a defined pension benefit. In order to properly record the net present value of future pension obligations a number of assumptions are required to be made by Company's management. These assumptions include years of service, life expectancies, and the determination of the proper long-term interest and liability discount rates to be applied to these future obligations.

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Should the Company need to alter any of these assumptions, there is the potential for significant adjustments to projected pension liabilities.

During the fourth quarter of 2011, Veramark retrospectively changed its method of accounting for pension and other postretirement benefits. Historically, Veramark has recognized actuarial gains and losses as a component of equity in its consolidated balance sheets on an annual basis. These gains and losses were amortized into operating results generally over the following year. Veramark elected to immediately recognize actuarial gains and losses in its operating results in the year in which the gains and losses occur. This change is intended to improve the transparency of Veramark's operational performance by recognizing the effects of current economic and interest rate trends on plan assumptions, during the year in which they occur. Accordingly, the financial data for all periods presented has been adjusted to reflect the effect of this accounting change.

**Goodwill and Intangibles** Goodwill represents the excess of the purchase price paid over the fair value of assets acquired. Goodwill is not amortized and as per ASC 350-20, is subject to an impairment test conducted on an annual basis, or more frequently if a change in circumstances or the occurrence of events indicates that potential impairment exists. Through December 2012, there has been no impairment of goodwill associated with the Source Loop acquisition.

In determining whether it is necessary to impair intangible assets other than goodwill, the Company follows the guidance provided under ASC 360-10, *Property, Plant and Equipment*. The Company considers factors such as, but not limited to, estimated useful life, amortization policies, and legal regulations related to the intangible asset. No impairment charges were recorded in 2012, 2011, or 2010.

**Income Taxes** The Company has provided through the date of this report, no provision for deferred income tax assets and liabilities arising from the expected future tax effects of differences between the financial and tax basis of assets and liabilities based on currently enacted tax laws. A valuation allowance is established for deferred tax assets in amounts for which realization is not considered more likely than not to occur. For all periods presented in this Report, management determined that a full valuation of allowance was appropriate primarily given historical cumulative losses. Management also considered estimated future profits, utilization of existing net loss carryforwards and reversal of deferred tax assets in the future to determine if they provided sufficient evidence that would overcome the historical net loss experience. Please see Notes to Financial Statements – Income Taxes, contained in Item 8 of this Report for details of the valuation allowance.

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### Accounting Pronouncements

In May 2011, the FASB issued Accounting Standards Update No. 2011-04, topic 820, *Fair Value Measurement*, to improve the comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with United States GAAP and International Financial Reporting Standards. Some of the amendments clarify the Board's intent about the application of existing fair value measurement requirements. Other amendments change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. Specifically, the guidance requires additional disclosures for fair value measurements that are based on significant unobservable inputs. The updated guidance is to be applied prospectively and became effective for the Company's interim and annual periods beginning January 1, 2012. The adoption of this guidance did not have a material impact on the Company's financial statements.

In June 2011, the FASB issued Accounting Standards Update No. 2011-05, topic 220, *Comprehensive Income*. The objective of this Update is to improve the comparability, consistency, and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. To increase the prominence of items reported in other comprehensive income and to facilitate convergence of U.S. generally accepted accounting principles (GAAP) and International Financial Reporting Standards (IFRS), the FASB decided to eliminate the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity, among other amendments in this Update.

The amendments require that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income, and the total of comprehensive income. The amendments in this update should be applied retrospectively, and became effective for the Company's interim and annual periods beginning after December 15, 2011. The Company chose to present two separate statements.

In September 2011, the FASB issued Accounting Standards Update No. 2011-08, topic 350, *Intangibles - Goodwill and Other*, to simplify how entities test goodwill for impairment. The amendments in the Update permit an entity to first assess qualitative factors to determine whether it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in Topic 350. The amendments in this Update became effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. This update did not have a material effect on the Company's financial statements.

In December 2011, the FASB issued Accounting standards Update No. 2011-12, *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*, which defers the requirement to disclose the effect of items that are reclassified out of accumulated comprehensive income separately in the statement of operations. This requirement is deferred until such time as the FASB can reconsider the relevant paragraphs of that update. The deferral is effective for public companies for fiscal years and interim periods beginning after December 15, 2011.



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In July 2012, the FASB issued Accounting standards Update No. 2012-02, *Testing Indefinite-Lived Intangible Assets for Impairment*, to reduce the complexity of performing an impairment test for indefinite-lived intangible assets by simplifying how an entity tests those assets for impairment and to improve consistency in impairment testing guidance among long-lived asset categories. The amendments permit an entity first to assess qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired as a basis for determining whether it is necessary to perform the quantitative impairment test in accordance with Subtopic 350-30, Intangibles—Goodwill and Other—General Intangibles Other than Goodwill. The amendments of this update are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. The Company does not expect this update to have a material effect on the Company's financial statements.

**Item 7A Quantitative and Qualitative Disclosures About Market Risk**

The Company generally invests its available cash in low risk securities such as bond funds or government issued securities.

At December 31, 2012 and 2011 the carrying value of investments approximated fair market value. Investments at December 31, 2012 and 2011 consisted of the following:

	<b>2012</b>	<b>2011</b>
Bond Funds	\$ 40,120	\$ 40,640
US Government Securities	78,091	121,309
	<b>\$ 118,211</b>	<b>\$ 161,949</b>

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and

Stockholders of Veramark Technologies, Inc

We have audited the accompanying balance sheets of Veramark Technologies, Inc as of December 31, 2012 and 2011, and the related statements of income, stockholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2012. Veramark Technologies, Inc's management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, 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 financial statements referred to above present fairly, in all material respects, the financial position of Veramark Technologies, Inc as of December 31, 2012 and 2011, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2012 in conformity with accounting principles generally accepted in the United States of America.

/s/ EFP Rotenberg, LLP

EFP Rotenberg, LLP

Rochester, New York

April 1, 2013

**Table of Contents****VERAMARK TECHNOLOGIES, INC.****BALANCE SHEETS****DECEMBER 31, 2012 AND 2011**

	2012	2011
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 1,197,554	\$ 679,405
Investments	118,211	161,949
Accounts receivable, trade (net of allowance for doubtful accounts of \$45,000 and \$35,000)	2,080,475	1,711,171
Prepaid expenses	480,424	434,357
Other current assets	800,001	873,975
Total current assets	4,676,665	3,860,857
<b>PROPERTY AND EQUIPMENT:</b>		
Cost	2,588,081	2,601,535
Less accumulated depreciation	(1,954,057)	(2,033,766)
Property and equipment, net	634,024	567,769
<b>OTHER ASSETS:</b>		
Software development costs (net of accumulated amortization of \$2,222,697 and \$1,892,938)	2,585,230	2,736,572
Pension assets	3,430,020	3,320,073
Intangibles, net	371,000	563,000
Goodwill	336,219	336,219
Deposits and other assets	1,198,317	1,121,738
Total other assets	7,920,786	8,077,602
<b>TOTAL ASSETS</b>	<b>\$ 13,231,475</b>	<b>\$ 12,506,228</b>

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

**Table of Contents****VERAMARK TECHNOLOGIES, INC.****BALANCE SHEETS****DECEMBER 31, 2012 AND 2011**

	2012	2011
<b>LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 244,782	\$ 300,878
Accrued compensation	909,067	740,947
Deferred revenue	4,536,979	4,276,071
Current portion of pension obligation	558,660	538,159
Other contingent liability	0	140,828
Short term debt	55,555	316,667
Other accrued liabilities	972,231	992,052
<b>Total current liabilities</b>	<b>7,277,274</b>	<b>7,305,602</b>
Long-term debt	0	55,555
Long-term portion of pension obligation	5,459,708	5,534,531
Other long-term liabilities	105,917	103,237
<b>Total liabilities</b>	<b>12,842,899</b>	<b>12,998,925</b>
<b>STOCKHOLDERS EQUITY (DEFICIT):</b>		
Common Stock, par value \$.10; shares authorized, 40,000,000; 10,754,334 and 10,696,996 shares issued	1,075,433	1,069,699
Additional paid-in capital	23,029,181	22,906,932
Accumulated deficit	(23,346,304)	(24,091,174)
Treasury stock (80,225 shares at cost)	(385,757)	(385,757)
Accumulated other comprehensive income	16,023	7,603
<b>Total stockholders equity (deficit)</b>	<b>388,576</b>	<b>(492,697)</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)</b>	<b>\$ 13,231,475</b>	<b>\$ 12,506,228</b>

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

**Table of Contents****VERAMARK TECHNOLOGIES, INC.****STATEMENTS OF OPERATIONS****YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010**

	<b>2012</b>	<b>2011</b>	<b>2010</b>
<b>NET REVENUES</b>			
Product revenues	\$ 1,815,162	\$ 1,785,634	\$ 2,214,652
Service revenues	13,503,232	12,152,068	10,950,557
Total net revenues	15,318,394	13,937,702	13,165,209
<b>COSTS AND OPERATING EXPENSES:</b>			
Cost of revenues	6,321,420	5,771,216	4,984,086
Engineering and software development	1,154,165	1,151,031	1,393,716
Selling, general and administrative	7,122,755	7,423,545	6,647,504
Litigation & settlement expenses	0	862,995	0
Total costs and operating expenses	14,598,340	15,208,787	13,025,306
<b>INCOME (LOSS) FROM OPERATIONS</b>	<b>720,054</b>	<b>(1,271,085)</b>	<b>139,903</b>
INTEREST INCOME (NET)	38,816	51,555	50,196
<b>INCOME (LOSS) BEFORE INCOME TAXES</b>	<b>758,870</b>	<b>(1,219,530)</b>	<b>190,099</b>
INCOME TAXES	14,000	0	0
<b>NET INCOME (LOSS)</b>	<b>\$ 744,870</b>	<b>\$ (1,219,530)</b>	<b>\$ 190,099</b>
<b>NET INCOME (LOSS) PER SHARE</b>			
Basic	\$ 0.07	\$ (0.12)	\$ 0.02
Diluted	\$ 0.07	\$ (0.12)	\$ 0.02
<b>WEIGHTED AVERAGE SHARES OUTSTANDING (BASIC)</b>	<b>10,642,752</b>	<b>10,296,727</b>	<b>9,931,399</b>
<b>WEIGHTED AVERAGE SHARES OUTSTANDING (DILUTED)</b>	<b>10,670,471</b>	<b>10,296,727</b>	<b>10,057,844</b>

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

**Table of Contents****VERAMARK TECHNOLOGIES, INC,****CONDENSED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)**

	<b>2012</b>	<b>2011</b>	<b>2010</b>
Net income (loss)	\$ 744,870	\$ (1,219,530)	\$ 190,099
Unrealized Gain PRHB	11,998		
Unrealized gain (loss) on investments	(3,579)	(11,079)	(30,765)
Comprehensive income (loss)	\$ 753,289	\$ (1,230,609)	\$ 159,334

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

**Table of Contents****VERAMARK TECHNOLOGIES, INC.**

## STATEMENTS OF STOCKHOLDERS EQUITY (DEFICIT)

YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010

		Common Stock		Additional	Accumulated	Treasury	Accumulated	Total
		Shares	Par Value	Paid in	Deficit	Stock	Comprehensive	Stockholders
				Capital			Income	Equity (Deficit)
BALANCE	December 31, 2009	9,948,727	\$ 1,002,895	\$ 22,398,110	\$ (23,061,743)	\$ (385,757)	\$ 49,447	\$ 2,952
	Change in other comprehensive income						(30,765)	(30,765)
	Net income				190,099			190,099
	Total comprehensive Income (loss)				190,099		(30,765)	159,334
	Stock issued acquisition	200,000	20,000	101,000				121,000
	Stock purchase plan	42,837	4,283	17,849				22,132
	Cancellation of restricted stock	(81,194)	(8,119)	107,357				99,238
	Compensation expenses stock options			37,089				37,089
BALANCE	December 31, 2010	10,110,370	\$ 1,019,059	\$ 22,661,405	\$ (22,871,644)	\$ (385,757)	\$ 18,682	\$ 441,745
	Change in other comprehensive income						(11,079)	(11,079)
	Net loss				(1,219,530)			(1,219,530)
	Total comprehensive income (loss)				(1,219,530)		(11,079)	(1,230,609)
	Stock issued acquisition	105,000	10,500	33,600				44,100
	Stock purchase plan	56,180	5,618	20,057				25,675
	Exercise of stock options	398,554	39,855	121,404				161,259
	Cancellation of restricted stock	(53,333)	(5,333)	(12,007)				(17,340)
	Compensation expenses stock options			82,473				82,473
BALANCE	December 31, 2011	10,616,771	\$ 1,069,699	\$ 22,906,932	\$ (24,091,174)	\$ (385,757)	\$ 7,603	\$ (492,697)
	Change in other comprehensive income						8,420	8,420
	Net income				744,870			744,870
	Total comprehensive income (loss)				744,870		8,420	753,290
	Stock purchase plan	47,338	4,734	13,373				18,107
	Exercise of stock options	10,000	1,000	1,800				2,800
	Restricted stock grants			15,569				15,569
	Compensation expenses stock options			91,507				91,507
BALANCE	December 31, 2012	10,674,109	\$ 1,075,433	\$ 23,029,181	\$ (23,346,304)	\$ (385,757)	\$ 16,023	\$ 388,576

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



**Table of Contents****VERAMARK TECHNOLOGIES, INC.****STATEMENTS OF CASH FLOWS****YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010**

	2012	2011	2010
<b>OPERATING ACTIVITIES:</b>			
Net Income (Loss)	\$ 744,870	\$ (1,219,530)	\$ 190,099
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	1,255,806	1,474,486	1,472,822
Increase in bad debt reserve	10,000	2,000	9,000
Change in acquisition liabilities	(140,828)	(264,472)	(20,780)
Compensation expense equity grants	107,076	65,133	136,327
Loss on disposal of fixed assets	1,828	316	2,692
Changes in assets and liabilities:			
Accounts receivable	(379,304)	198,522	(605,707)
Prepaid expenses and other current assets	27,907	(723,480)	327,515
Pension assets	(109,947)	(212,121)	(112,295)
Deposits and other assets	(76,579)	(59,586)	(43,563)
Accounts payable	(56,096)	(59,504)	35,178
Accrued compensation	168,120	73,885	209,730
Deferred revenue	260,908	25,138	460,077
Note payable	(250,000)	250,000	0
Other accrued liabilities	(19,821)	576,593	(216,602)
Prepaid rent liability	2,680	50,904	52,333
Pension obligation	(42,323)	655,874	217,863
<b>Net cash provided by operating activities</b>	<b>1,504,297</b>	<b>834,158</b>	<b>2,114,689</b>
<b>INVESTING ACTIVITIES:</b>			
Acquisition cash paid	0	(450,000)	(300,000)
Sale of investments	40,159	92,934	160,793
Additions to property and equipment	(267,788)	(162,980)	(482,435)
Capitalized software development costs	(712,759)	(811,349)	(1,136,074)
<b>Net cash used in by investing activities</b>	<b>(940,388)</b>	<b>(1,331,395)</b>	<b>(1,757,716)</b>
<b>FINANCING ACTIVITIES:</b>			
Bank borrowing (repayment) line of credit	0	(180,000)	180,000
Bank borrowing (repayment) term loan	(66,667)	(66,667)	188,889
Exercise of stock options	2,800	161,259	0
Employee stock purchase plan	18,107	25,675	22,132
<b>Net cash provided (used) by financing activities</b>	<b>(45,760)</b>	<b>(59,733)</b>	<b>391,021</b>
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	<b>518,149</b>	<b>(556,970)</b>	<b>747,994</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>	<b>679,405</b>	<b>1,236,375</b>	<b>488,381</b>
<b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>	<b>\$ 1,197,554</b>	<b>\$ 679,405</b>	<b>\$ 1,236,375</b>

**SUPPLEMENTAL CASH FLOW INFORMATION**

Cash Transactions:

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Income taxes refunded	\$ (11,627)	\$ (8,306)	\$ (6,620)
Interest paid	\$ 7,372	\$ 11,991	\$ 10,946

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

**Table of Contents****VERAMARK TECHNOLOGIES, INC.****NOTES TO FINANCIAL STATEMENTS****YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010****1. DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Description of business** Veramark Technologies, Inc., (the Company) is a leading provider of innovative enterprise solutions for Telecom Expense Management (TEM) and call accounting solutions. Veramark solutions help organizations reduce operational expenses associated with telecommunications and information technology by providing visibility into their usage and telecom spend and enable best practices for managing unified communications networks. The Company operates in one segment.

**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 contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Cash and cash equivalents** The Company considers all highly liquid investments purchased with a maturity of three months or less to be cash equivalents. The fair value of the Company's cash and cash equivalents approximates carrying value, which, due to the relatively short maturities and variable interest rates of the instruments, approximates current market rates.

**Investments** The Company records its investments in accordance with ASC 320-10, Investments- Debt and Equity Securities. As of December 31, 2012 and 2011, the Company has classified its portfolio as available-for-sale securities. These securities are recorded at fair value, based on quoted market prices in an active market, with net unrealized holding gains and losses reported in stockholders' equity as accumulated other comprehensive income. At December 31, 2012 and 2011 the carrying value of investments approximated fair market value, and are classified as Level 1 Assets as defined by ASC 820-10, Fair Value Measurements and Disclosures.

Investments at December 31, 2012 and 2011 consisted of the following:

	2012	2011
Bond Funds	\$ 40,120	\$ 40,640
US Government Securities	78,091	121,309
	\$ 118,211	\$ 161,949

The contractual maturities of the Company's investments as of December 31, 2012 are primarily due within one year.

**Accounts receivable and allowance for doubtful accounts** The Company extends credit to its customers in the normal course of business and collateral is generally not required for trade receivables. Exposure to credit risk is controlled through the use of credit approvals, credit limits and monitoring procedures. Accounts receivable are reported net of an allowance for doubtful accounts. The Company estimates the allowance based on its analysis of specific balances, taking into consideration the age of the past due account and anticipated collections resulting from legal issues. An account is considered past due after thirty (30) days from the invoice date. Based on these factors, there was an allowance for doubtful accounts of \$45,000 at December 31, 2012 and \$35,000 at December 31, 2011. Changes to the allowance for doubtful accounts are charged to expense and reduced by charge-offs, net of recoveries.

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**Concentrations of credit risk** Financial instruments, which potentially subject the Company to concentrations of credit risk, consist principally of investments and accounts receivable. The Company places its cash and investments with quality financial institutions and, by policy, limits the amount of investment exposure to any one financial institution. The Company has not experienced any significant losses to date on its invested cash and investments.

The Company's customers are not concentrated in any specific geographic region, nor in any specific industry. As of December 31, 2012, three customers accounted for approximately \$713,000 of the total accounts receivable balance. As of December 31, 2011, three customers accounted for approximately \$482,000 of the total accounts receivable balance. The Company performs periodic credit evaluations of its customers financial conditions but does not require collateral to support customer receivables. The Company establishes an allowance for doubtful accounts based upon factors surrounding the credit risk of specific customers, historical trends and other information.

The Company maintains cash deposits with major banks, which may from time to time exceed federally insured limits. The Company periodically assesses the financial condition of the institutions and believes that the risk of any loss is minimal.

**Prepaid Expenses** consist of cash outlays made by the Company for economic benefits to be realized in future periods. These benefits typically include the unutilized portions of current business insurances, maintenance contracts on Company-owned equipment, and prepaid commissions. Prepaid expenses are generally expensed on a straight-line basis over the corresponding life of the underlying asset, with the exception of prepaid commissions which are expensed at the time the revenue that gave rise to the commission is recognized.

**Other Current Assets** at December 31, 2012 and 2011 included \$785,994 and \$854,456 of funds held by the Company on behalf of two customers for whom we provide bill payment services as a component of their BPO services agreement. This asset is offset by an identical balance in other accrued liabilities.

**Property and equipment** is recorded at cost and depreciated on a straight-line basis using the following useful lives:

Computer hardware and software	3-5 years
Machinery and equipment	4-7 years
Furniture and fixtures	5-10 years
Leasehold improvements	Term of lease or useful life

All maintenance and repair costs are charged to operations as incurred. The cost and accumulated depreciation for property and equipment sold, retired, or otherwise disposed of are removed from the accounts, and the resulting gains or losses are reflected in earnings.

**Long-lived assets** In accordance with ASC 360-10, **Property, Plant and Equipment** the Company tests long-lived assets for recoverability whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. No impairment charges were recorded in 2012, 2011, or 2010.

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**Software development costs** meeting recoverability tests are capitalized, under ASC 985-20, Costs of software to be sold, leased, or marketed and amortized on a product-by-product basis over their economic life, ranging from three to five years, or the ratio of current revenues to current and anticipated revenues from such software, whichever provides the greater amortization in a particular period. The Company capitalized \$712,759, \$811,349 and \$1,136,074 of development costs in 2012, 2011 and 2010 respectively. The Company amortized \$864,101, \$1,036,394 and \$1,080,962 of development costs in 2012, 2011 and 2010, respectively. The Company periodically reviews the carrying value of capitalized software development costs and impairments are recognized in the results of operations when the expected future undiscounted operating cash flow derived from the capitalized software is less than its carrying value. No charges for impairment were required in 2012, 2011 or 2010.

**Goodwill** represents the excess of the purchase price paid over the fair value of assets acquired. Goodwill is not amortized and as per ASC 350-20, is subject to an impairment test conducted on an annual basis, or more frequently if a change in circumstances or the occurrence of events indicates that potential impairment exists. Through December 2012, there has been no impairment of goodwill associated with the Source Loop acquisition.

**Intangible Asset Impairment** In determining if it is necessary to impair intangible assets other than goodwill, the Company follows the guidance provided under ASC 360-10, Property, Plant and Equipment. The Company considers factors such as, but not limited to, estimated useful life, amortization policies, and legal regulations related to the intangible asset. No impairment charges were recorded in 2012, 2011, or 2010.

**Fair Value of Financial Instruments** ASC 825-10, Fair Value Option requires entities to disclose the fair value of financial instruments, both assets and liabilities recognized and not recognized on the balance sheet, for which it is practicable to estimate fair value. ASC 825-10, Fair Value Option defines fair value of a financial instrument as the amount at which the instrument could be exchanged in a current transaction between willing parties. At December 31, 2012 and 2011, the carrying value of certain financial instruments (accounts receivable and accounts payable) approximates fair value due to the short-term nature of the instruments or interest rates, which are comparable with current rates.

On January 1, 2008, the Company adopted ASC 820-10, Fair Value Measurements which defines fair value, establishes a framework for measuring fair value, and requires additional disclosures about fair value measurements. The criterion that is set forth in ASC 820-10, Fair Value Measurements is applicable to fair value measurement where it is permitted or required under other accounting pronouncements.

ASC 820-10, Fair Value Measurements defines fair value as the exit price, which is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on inputs of observable and unobservable market data that a market participant would use in pricing the asset or liability. The use of observable inputs is maximized where available and the use of unobservable inputs is minimized for fair value measurement. As a means to illustrate the inputs used, ASC 820-10, Fair Value Measurements establishes a three-tier fair value hierarchy that prioritizes inputs to valuation techniques used for fair value measurement.

Level 1 consists of observable market data in an active market for identical assets or liabilities.

Level 2 consists of observable market data, other than that included in Level 1, that is either directly or indirectly observable.

Level 3 consists of unobservable market data. The input may reflect the assumptions of the Company of what a market participant would use in pricing an asset or liability. If there is little available market data, then the Company's own assumptions are the best available information.

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In the case of multiple inputs being used in a fair value measurement, the lowest level input that is significant to the fair value measurement represents the level in the fair value hierarchy in which the fair value measurement is reported.

**Revenue recognition** The Company's revenue consists of revenues from the licensing of software to resellers and end user customers; fees for services rendered including installation, training, implementation, and customer maintenance contracts; and the outsourcing or hosting of services, commonly referred to as Software as a Service (SaaS).

The Company recognizes software license revenue under ASC 985-605, formerly Statement of Position No 97-2 Software Revenue Recognition, Statement of Position No. 98-9, Software Revenue Recognition With Respect to Certain Transactions, and under ASC 605-25, formerly Emerging Issues Task Force 00-21, Revenue Arrangements with Multiple Deliverables, and related interpretations, as amended.

Licensed software may be sold as a stand-alone element, with other software elements, or in conjunction with supplemental services. When an order consists of more than one element, it is considered to be a multiple element arrangement (MEA). When sold as a stand-alone element, the revenue is recognized upon shipment. When sold as part of a MEA, revenue from the licensed software is recognized when each element is activated at the customer site, via the entry of a software key-code. This typically occurs at the same time that installation occurs. Service revenues such as training, installation and implementation, are recognized when the service is complete, and acknowledged by the customer.

For either a single element transaction or a MEA, the Company allocates consideration to all deliverables based on their relative stand-alone selling prices. Amendments to ASC 605-25, which became effective January 1, 2011, establish a hierarchy to determine the stand-alone selling price as follows:

Vendor Specific Objective Evidence of the fair value (VSOE),

Third Party Evidence (TPE)

Best Estimate of the Selling Price (ESP)

Sales which constitute a MEA are accounted for by determining if the elements can be accounted for as separate accounting units, and if so, by applying values to those units, per the hierarchy above. If VSOE is not available, management estimates the fair selling price using historical pricing for similar items, in conjunction with current pricing and discount policies.

Regardless of the form of sale, no revenue is recognized without persuasive evidence of an arrangement existing. Persuasive evidence is determined to be a signed purchase order received from the customer, or an equivalent form for those customers lacking a formalized purchase order system. Additionally, revenue is only recognized when a selling price is fixed or determinable, and collectability of the receivable is deemed to be probable.

Fees charged to customers for post-contract Technical Support are recognized ratably over the term of the contract. Costs related to maintenance obligations are expensed as incurred.

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The Company's revenues generated through hosting solutions are recognized using the proportional performance method. Revenues are recognized in the month services are rendered and earned under service agreements with clients where service fees are fixed or determinable. Contracts can be terminated with 90 days written notice. All services provided by the Company through the date of cancellation are due and payable under the contract terms.

The Company believes its revenue recognition policies are appropriate, in all circumstances, and that its policies are reflective of complexities arising from customer arrangements involving such features as maintenance, warranty agreements, license agreements, and other normal course of business arrangements.

**Lease Obligations** The Company leases office facilities, at its Rochester, N.Y. location, under a lease which expires March 31, 2018. The Company also carries a lease obligation for its Atlanta, Georgia location, which expires on August 31, 2018. Rent expense under all operating leases (exclusive of real estate taxes and other expenses payable under the leases) was approximately \$319,000, \$305,000, and \$426,000 for the years ended December 31, 2012, 2011 and 2010, respectively.

**Income taxes** are provided on the income earned in the financial statements. In accordance with ASC 740-10, *Income Taxes* the Company applies the liability method of accounting for income taxes, under which deferred income taxes are provided to reflect the impact of temporary differences between the amounts of assets and liabilities for financial reporting purposes and such amounts as measured by tax laws and regulations. A valuation allowance is recorded to reduce the carrying amounts of deferred tax assets unless it is more likely than not, that such assets will be realized.

**Net income (or loss) per common share (EPS)** is computed in accordance with the provisions of ASC 260-10, *Basic EPS* is computed by dividing net income (loss) by weighted average shares outstanding. Diluted EPS includes the dilutive effect of stock options issued. Included in diluted earnings per share in 2012 are 27,719 and in 2010 126,445 shares, representing the dilutive effect of stock options issued. There were no dilutive effects of stock options in 2011 as the effect would have been anti-dilutive, due to the net loss incurred for that year.

**Change in Accounting for Benefit Plans** During the fourth quarter of 2011, Veramark retrospectively changed its method of accounting for pension and other postretirement benefits. Historically, Veramark had recognized actuarial gains and losses as a component of equity in its consolidated balance sheets on an annual basis. These gains and losses were amortized into operating results generally over the following year. Veramark has elected to immediately recognize actuarial gains and losses in its operating results in the year in which the gains and losses occur. This change is intended to improve the transparency of Veramark's operational performance by recognizing the effects of current economic and interest rate trends on plan assumptions, during the year in which they occur. Accordingly, the financial data was adjusted to reflect the effect of these accounting changes. The effects of the change in accounting for pension and other post-retirement benefits on our statements of operations and balance sheets for 2011 were as follows.

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	2011	
	Recognized Under Previous Method	Recognized Under New Method
<b>Income Statement Information</b>		
Selling, General & Administrative Expense	\$ 6,512,078	\$ 7,423,545
Net Income (Loss)	(308,063)	(1,219,530)
Fully Diluted Earnings per Share	\$ (0.03)	\$ (0.12)
<b>Balance Sheet Information</b>		
Other Comprehensive Income	\$ (303,204)	\$ 7,603
Accumulated Deficit	\$ (23,179,707)	\$ (24,091,174)

**Comprehensive Income** Comprehensive income includes all changes in stockholders' equity during the period except those resulting from investments by owners and distribution to owners. The Company's comprehensive income includes net loss or earnings and unrealized gains or losses on available for sale investments.

**Engineering and Software Development Costs** Engineering and development costs, other than certain software development costs previously disclosed in Note 1, are expensed as incurred. For the years ended December 31, 2012, 2011, and 2010, engineering and development costs expensed were \$1,154,165, \$1,151,031, and \$1,393,716, respectively.

**Stock-Based Compensation** The Company's primary type of share-based compensation consists of stock options and restricted stock. For the year ended December 31, 2012 the Company issued 107,500 stock options. During 2012, 10,000 stock options were exercised, and 64,360 stock options were cancelled.

The Company records its stock-based compensation expense in accordance with ASC 718-10, Compensation - Stock Compensation. In estimating the value of stock options issued, the Company uses the Black-Scholes option pricing model. The following table provides the range of assumptions used by the Company, at the time stock options were issued.



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	2012		2011	
	low	high	low	high
Risk Free Rate*	0.6%	0.9%	0.9%	2.2%
Volatility	199%	202%	195%	196%
Dividend Yield	none		none	
Expected Life In Years	5		5	

\* Based on US Treasury 5 Year Constant Maturities

A summary of the status of the Company's stock option plan as of December 31, 2012 is presented below:

	Shares	Weighted Average Exercise Price	Weighted Average Grant-Date Fair Value	Remaining Contractual Term (Yrs)	Intrinsic Value
Outstanding as of December 31, 2011	1,422,443	\$ 0.68	\$ 0.64	6.2	\$ 32,080
Granted	107,500	0.45	0.44		0
Exercised	(10,000)	0.28			(500)
Canceled	(64,360)	0.61			(2,710)
Outstanding as of December 31, 2012	1,455,583	\$ 0.67	\$ 0.63	5.6	\$ 28,870
Options exercisable at December 31, 2012	1,085,801	\$ 0.71	\$ 0.65	4.5	\$ 28,870

As of December 31, 2012, there was \$117,348 of unrecognized compensation cost related to non-vested stock options granted under the Plan. That cost is expected to be recognized over a weighted-average period of 1.5 years. As of December 31, 2012, there was \$4,680 of unrecognized compensation cost related to restricted stock, the cost of which is expected to be recognized over a weighted-average period of 0.4 years.

**Stock Purchase Plans** Under the Company's Employee Stock Purchase Plan (ESPP), employees can purchase Veramark stock at a 15% discount to market price at the ending date of the six-month periods ending approximately June 30<sup>th</sup> and December 31<sup>st</sup>. Employees may elect to make after-tax payroll deductions of 1% to 10% of compensation as defined by the Plan, to the extent that his or her rights to purchase stock under this Plan do not exceed Twenty-Five Thousand Dollars (\$25,000) worth of stock (determined at the full market value of the shares at the time such purchase would occur), and only to the extent that, immediately after the purchase, such employee would not own stock or hold outstanding options to purchase stock, such that his or her combined voting power would exceed 5% of all classes of capital stock of the Company. Employee payroll deductions are for six-month periods beginning approximately each January 1 and July 1. Shares of the Company's common stock are purchased on or about June 30 or December 31, unless the participant has either elected to withdraw from the Plan or was terminated. Purchased shares are restricted for sale or transfer for a six-month period. All participants funds received prior to the ESPP purchase dates are held as Company liabilities without interest or other increment. No dividends are paid on employee contributions until shares are purchased. Plan participants purchased 47,338 shares at an average purchase price of \$0.38 in 2012, 56,180 shares at an average purchase price of \$0.46 in 2011 and 42,837 shares at an average purchase price of \$0.52 in 2010.

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**Reclassifications** Certain prior year amounts have been reclassified to conform to current year presentation.

## **Accounting Pronouncements**

In May 2011, the FASB issued Accounting Standards Update No. 2011-04, topic 820, *Fair Value Measurement*, to improve the comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with United States GAAP and International Financial Reporting Standards. Some of the amendments clarify the Board's intent about the application of existing fair value measurement requirements. Other amendments change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. Specifically, the guidance requires additional disclosures for fair value measurements that are based on significant unobservable inputs. The updated guidance is to be applied prospectively and became effective for the Company's interim and annual periods beginning January 1, 2012. The adoption of this guidance did not have a material impact on the Company's financial statements.

In June 2011, the FASB issued Accounting Standards Update No. 2011-05, topic 220, *Comprehensive Income*. The objective of this update is to improve the comparability, consistency, and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. To increase the prominence of items reported in other comprehensive income and to facilitate convergence of U.S. generally accepted accounting principles (GAAP) and International Financial Reporting Standards (IFRS), the FASB decided to eliminate the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity, among other amendments in this update.

The amendments require that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income, and the total of comprehensive income. The amendments in this update should be applied retrospectively, and became effective for the Company's interim and annual periods beginning after December 15, 2011. The Company chose to present two separate statements.

In September 2011, the FASB issued Accounting Standards Update No. 2011-08, topic 350, *Intangibles - Goodwill and Other*, to simplify how entities test goodwill for impairment. The amendments in the update permit an entity to first assess qualitative factors to determine whether it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in Topic 350. The amendments in this update became effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. This update did not have a material effect on the Company's financial statements.

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In December 2011, the FASB issued Accounting standards Update No. 2011-12, *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*, which defers the requirement to disclose the effect of items that are reclassified out of accumulated comprehensive income separately in the statement of operations. This requirement is deferred until such time as the FASB can reconsider the relevant paragraphs of that update. The deferral is effective for public companies for fiscal years and interim periods beginning after December 15, 2011.

In July 2012, the FASB issued Accounting standards Update No. 2012-02, *Testing Indefinite-Lived Intangible Assets for Impairment*, to reduce the complexity of performing an impairment test for indefinite-lived intangible assets by simplifying how an entity tests those assets for impairment and to improve consistency in impairment testing guidance among long-lived asset categories. The amendments permit an entity first to assess qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired as a basis for determining whether it is necessary to perform the quantitative impairment test in accordance with Subtopic 350-30, Intangibles - Goodwill and Other - General Intangibles Other than Goodwill. The amendments of this update are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. The Company does not expect this update to have a material effect on the Company's financial statements.

**2. PROPERTY AND EQUIPMENT**

The major classifications of property and equipment as of December 31, 2012 and 2011 are:

	2012	2011
Machinery and equipment	\$ 186,204	\$ 116,385
Computer hardware and software	1,434,636	1,301,043
Furniture and fixtures	967,241	1,184,107
	\$ 2,588,081	\$ 2,601,535

Depreciation expense was approximately \$200,000, \$197,000 and \$203,000 for the years ended December 31, 2012, 2011 and 2010, respectively.

**Table of Contents****3. ENGINEERING AND SOFTWARE DEVELOPMENT EXPENDITURES**

Engineering and software development costs incurred during the years ended December 31, 2012, 2011 and 2010 were recorded as follows:

	2012	2011	2010
Engineering and software development expenses included in the statements of operations	\$ 1,154,165	\$ 1,151,031	\$ 1,393,716
Amounts capitalized and included in the balance sheets	712,759	811,349	1,136,074
<b>Total costs for engineering and software development</b>	<b>\$ 1,866,924</b>	<b>\$ 1,962,380</b>	<b>\$ 2,529,790</b>

Additionally, the Company recorded amortization of capitalized software development costs of approximately \$864,101, \$1,036,394 and \$1,080,962 for the years ended December 31, 2012, 2011 and 2010, respectively. Such amortization is included in cost of revenues in the statements of operations. Estimated aggregate minimum amortization expenses for each of the next five years is:

2013	824,002
2014	706,012
2015	392,942
2016	170,718
2017	43,484

**4. COMPREHENSIVE INCOME (LOSS)**

Comprehensive income (loss) for years ended December 31, 2012, 2011 and 2010 was as follows:

	2012	2011	2010
Net income (loss)	\$ 744,870	\$ (1,219,530)	\$ 190,099
Unrealized Gain PRHB	11,998		
Unrealized gain (loss) on investments	(3,579)	(11,079)	(30,765)
<b>Comprehensive income (loss)</b>	<b>\$ 753,289</b>	<b>\$ (1,230,609)</b>	<b>\$ 159,334</b>

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Accumulated comprehensive income (loss) consisted of the following as of December 31, 2012, 2011 and 2010:

	2012	2011	2010
Unrealized Gain PRHB	\$ 11,998	\$ 0	\$ 0
Unrealized gain on investments	4,025	7,603	18,682
<b>Total Comprehensive Income</b>	<b>\$ 16,023</b>	<b>\$ 7,603</b>	<b>\$ 18,682</b>

**5. NET INCOME (LOSS) PER SHARE (EPS)**

ASC 260-10 Earnings Per Share requires the Company to calculate its net income (loss) per share based on basic and diluted net income (loss) per share, as defined. Basic EPS excludes dilution and is computed by dividing net income (loss) by the weighted average number of shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. The dilutive effect of outstanding options issued by the Company, are reflected in diluted EPS using the treasury stock method. Under the treasury stock method, options will generally have a dilutive effect when the average market price of common stock during the period exceeds the exercise price of the options.

	Year Ended December 31,		
	2012	2011	2010
<b>Basic</b>			
Net income (loss)	\$ 744,870	\$ (1,219,530)	\$ 190,099
Weighted average common shares outstanding	10,642,752	10,296,727	9,931,399
Net income (loss) per common share	\$ 0.07	\$ (0.12)	\$ 0.02
<b>Diluted</b>			
Net income (loss)	\$ 744,870	\$ (1,219,530)	\$ 190,099
Weighted average common shares outstanding	10,642,752	10,296,727	9,931,399
Additional dilutive effect of stock options and warrants after application of treasury stock method	27,719	0	126,445
Weighted average dilutive shares outstanding	10,670,471	10,296,727	10,057,844
Net income (loss) per common share assuming dilution	\$ 0.07	\$ (0.12)	\$ 0.02

There were no dilutive effects of stock options in 2011, as the effect would have been anti-dilutive due to the net loss incurred.

**Table of Contents****6. INDEMNIFICATION OF CUSTOMERS**

The Company's agreements with customers generally require us to indemnify the customer against claims that its software infringes third party patent, copyright, trademark or other proprietary rights. Such indemnification obligations are generally limited in a variety of industry-standard respects, including our right to replace an infringing product. As of December 31, 2012, the Company had not experienced any material losses related to these indemnification obligations and no material claims with respect thereto were outstanding. The Company does not expect significant claims related to these indemnification obligations, and consequently, the Company has not established any related reserves.

**7. BENEFIT PLANS**

The Company sponsors an employee incentive savings plan under section 401(k) for all eligible employees. The Company's contributions to the plan are discretionary. The Company expects to contribute approximately \$49,000 to employee's 401(k) plans in 2013. The Company's contribution to employee's 401(k) plans was \$0 in 2012 and \$27,000 in 2011.

The Company also sponsors an unfunded Supplemental Executive Retirement Program (SERP), which is a nonqualified plan that provides certain key employees defined pension benefits. For the years ended December 31, 2012 and 2011 changes to the benefit obligation consisted of the following:

	2012	2011
Benefit obligation-beginning of year	\$ 6,072,690	\$ 5,416,816
Interest cost on projected benefit obligation	477,577	443,534
Actuarial loss	0	705,300
Benefits paid	(531,899)	(492,690)
<b>Benefit obligation-end of year</b>	<b>\$ 6,018,368</b>	<b>\$ 6,072,960</b>

A reconciliation of the SERP plan's funded status with amounts recognized in the Company's balance sheets is as follows:

	2012	2011
Actuarial present value of projected benefit obligation	\$ 6,018,368	\$ 6,072,690
Plan assets	0	0
<b>Projected benefit obligation in excess of plan assets</b>	<b>\$ 6,018,368</b>	<b>\$ 6,072,690</b>

The discount rate used in determining the actuarial present value of the projected benefit obligation was 4.0% in 2012, 4.5% in 2011 and 5.0% in 2010.

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Pension expense for the years ended December 31, 2012, 2011 and 2010 consisted of the following.

	2012	2011	2010
Interest costs	477,577	443,534	300,625
Actuarial costs	0	705,300	420,798
	477,577	1,148,834	721,423

The Company maintains life insurance covering certain key employees under its Supplemental Executive Retirement Program with the Company named as beneficiary. The Company intends to use the death benefits of these policies, as well as loans against the accumulating cash surrender value of the policies, to fund the pension obligation. The total death benefit associated with these policies is \$10.2 million, with an associated accumulated cash surrender value of approximately \$3,430,000 at December 31, 2012. The accumulated cash surrender values of these policies at December 31, 2011, was approximately \$3,320,000. All of the current accumulated cash surrender values are available to meet current pension obligations, or to fund current general operations of the Company in the event that should become necessary.

The projected future pension benefits under this plan are as follows, assuming a retirement age of 65 and life expectancies based on Social Security Administration actuarial tables.

	Year Ending December 31,
2013	558,660
2014	490,660
2015	449,060
2016	454,340
2017-2021	2,577,612

**8. ACQUISITION**

On June 18, 2010 we acquired the enterprise telecom expense management (TEM) consulting business of privately held Source Loop, LLC, based in Alpharetta, Georgia. The aggregate purchase price paid for those assets was up to \$1.5 million, plus the issuance of up to 500,000 shares of Veramark's common stock. At closing, \$300,000 in cash was paid and 100,000 shares of Veramark common stock issued to the principals of Source Loop. In addition, Source Loop retained \$300,000 in accounts receivable and cash on hand prior to the acquisition date, leaving potential contingent consideration of \$900,000 and 400,000 shares of Veramark common stock that could be earned, subject to attaining certain revenue and employee retention parameters through December 31, 2011.

Based on actual performance against the revenue and employee retention targets contained in the asset purchase agreement, of the potential contingent consideration, the Principals of Source Loop earned approximately \$591,000 in cash and an additional 205,000 shares of Veramark Common Stock. All of the common stock earned has been included in the Company's Balance Sheet at December 31, 2011. A final cash payment of approximately \$141,000 was made during the first quarter of 2012.

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The unaudited financial information in the table below summarizes the combined results of operations on a pro-forma basis, as if we had acquired Source Loop on January 1, 2009.

Unaudited (In 000s)	2012	2011	2010
Revenue	\$ 15,318	\$ 13,938	\$ 14,133
Income (Loss)	\$ 745	(\$ 1,220)	\$ 130
Earnings Per Share	\$ 0.07	(\$ 0.12)	\$ 0.01

**9. INTANGIBLE ASSETS AND GOODWILL**

Under the purchase method of accounting, we allocated the fair value of the total consideration expected to be transferred, to the tangible and identifiable intangible assets acquired from Source Loop based on their estimated fair values on the date of acquisition. The fair values assigned to the identifiable intangible assets were based on estimates and assumptions determined by management. See the table below.



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## Amortization of Intangible Assets Acquired in Source Loop Acquisition

(In 000s except for years)

Intangible Asset Class	Weighted Avg Life Years	FMV at Acquisition Date	Current Year Amortization	Accumulated Amortization at 12/31/12	Net Value by Asset Class at 12/31/12
Customer Contracts	3.1	526	103	293	233
Customer Relationships	2.6	260	42	165	95
Key Employee Agreements	1.4	177	42	138	39
Other	0.7	30	5	26	4
Sub-Total Intangibles Subject to Amortization	2.6	993	192	622	371
Goodwill		336			
Total Intangible Assets Acquired		1,329			

## Expected Future Amortization

Intangible Asset Class	2013	2014	2015	2016	2017
Customer Contracts	62	55	47	41	28
Customer Relationships	31	25	19	15	5
Key Employee Agreements	39	0	0	0	0
Other	3	1	0	0	0
Sub-Total Intangibles Subject to Amortization	135	81	66	56	33

Goodwill represents the excess of the purchase price paid over the fair value of assets acquired. Goodwill is not amortized and is subject to an impairment test conducted on an annual basis, or more frequently if a change in circumstances or the occurrence of events indicates that potential impairment exists. Through December 31, 2012, there has been no impairment of goodwill associated with the Source Loop acquisition.

**10. STOCKHOLDERS EQUITY**

The Company has reserved 4,500,000 shares of its common stock for issuance under its 1998 Stock Option Plan. As of December 31, 2012, 1,117,486 shares of common stock were available for future grants. The plan provides for options, which may be issued as nonqualified stock options. All options granted are generally exercisable in increments of 20 100% per year beginning one year from the date of grant. All options granted to employees and directors have a ten year term.

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A summary of stock option transactions for the years ended December 31, 2012, 2011 and 2010 is shown below:

	2012		2011		2010	
	WEIGHTED AVERAGE		WEIGHTED AVERAGE		WEIGHTED AVERAGE	
	EXERCISE		EXERCISE		EXERCISE	
	SHARES	PRICE	SHARES	PRICE	SHARES	PRICE
Shares under option, beginning of year	1,422,443	\$ 0.68	1,557,768	\$ 0.62	1,740,793	\$ .94
Options granted	107,500	0.45	425,375	0.63	106,500	0.48
Options exercised	(10,000)	0.28	(398,554)	0.43		
Options canceled	(64,360)	0.61	(162,146)	0.61	(289,525)	2.45
Shares under option, end of year	1,455,583	\$ 0.67	1,422,443	\$ 0.68	1,557,768	\$ 0.62
Shares exercisable	1,085,801	\$ 0.71	943,818	\$ 0.71	1,431,893	\$ 0.63
Weighted average fair market value of options granted	\$ 0.44		\$ 0.61		\$ 0.32	
Exercise price of options outstanding	\$ 0.20-\$1.53		\$ 0.28-\$1.53		\$ 0.20-\$1.54	

The following table summarizes information relating to currently outstanding and exercisable stock options as of December 31, 2012:

Range of Exercise Prices	Weighted Average Remaining Contractual Life (in years)	Options Outstanding	Weighted Average Exercise Price	Options Exercisable	Weighted Average Exercise Price
\$0.28 - \$0.99	6	1,405,583	\$ 0.64	1,035,801	\$ 0.67
\$1.00 - \$1.53	1	50,000	1.45	50,000	1.45
	6	1,455,583	\$ 0.67	1,085,801	\$ 0.71

**11. SALES INFORMATION**

Sales to five customers were approximately \$4,349,025 or 28% of the Company's total sales in 2012. Sales to five customers were approximately \$3,798,198 or 27% of the Company's total sales in 2011.

**Table of Contents****12. INCOME TAXES**

The income tax provision includes the following:

	2012	2011	2010
<b>Current income tax expense:</b>			
Federal	\$ 14,000	\$ 0	\$ 0
State	0	0	0
	\$ 14,000	\$ 0	\$ 0
<b>Deferred income tax provision (benefit):</b>			
Federal	\$ 234,921	\$ (612,258)	\$ 116,247
State	23,700	(38,995)	18,797
Change in valuation allowance	(258,621)	651,253	(135,044)
	\$ 0	\$ 0	\$ 0

The income tax provision differs from those computed using the statutory federal tax rate of 34%, due to the following:

	2012	2011	2010
Tax expense (benefit) at statutory federal rate	\$ 258,016	\$ (414,640)	\$ 196,504
State taxes, net of federal tax benefit	23,700	(38,995)	22,757
Increase (decrease) in valuation allowance	(258,621)	651,253	(135,044)
Other	329	0	400
Nondeductible expenses	10,576	(27,299)	7,370
Deferred tax adjustment-net operating loss	0	0	0
Deferred tax adjustment-general business credits	(20,000)	(170,319)	(91,987)
	\$ 14,000	\$ 0	\$ 0

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Deferred income taxes recorded in the balance sheets results from differences between financial statement and tax reporting of income and deductions. A summary of the composition of the deferred income tax assets (liabilities) follows:

	2012	2011
General business credits	\$ 1,761,565	\$ 1,741,565
Net operating losses	3,533,981	3,941,340
Deferred compensation	2,630,596	2,651,740
Stock options	352,066	312,448
Alternative minimum tax credits	346,492	332,822
Inventory	263	263
Accounts receivable	16,650	12,950
Capitalized software	(307,130)	(363,126)
Fixed assets	107,158	127,431
Other	220,006	162,835
New York State ITC	92,855	92,855
	8,754,502	9,013,123
Valuation allowance	(8,754,502)	(9,013,123)
New deferred asset (liability)	\$ 0	\$ 0

The Company has \$9,551,299 of net operating loss carryforwards available as of December 31, 2012. Of that total, \$682,000 is limited to a utilization of approximately \$100,000 annually. The carryforwards expire in varying amounts in 2020 through 2032. The valuation allowance decreased by \$258,621 during the year ended December 31, 2012.

The Company's tax credit carry forwards as of December 31, 2012 are as follows:

Description	Amount	Expiration Dates
General business credits	1,761,565	2013 2032
New York State investment tax credits	92,855	2013 2025
Alternative minimum tax credits	346,492	No expiration date

Cash received for income taxes during the years ended December 31, 2012, 2011 and 2010 totaled \$11,627, \$8,306, and \$6,620, respectively.

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### **13. COMMITMENTS AND CONTINGENCIES**

On June 16, 2011 the Company entered into a Nonexclusive Patent License and settlement agreement relating to an action brought by Asentinel LLC, against Veramark, AnchorPoint a division of MTS, and CASS Information Systems, alleging infringement of two patents held by Asentinel concerning systems and methods for identifying and processing billing exceptions in telecommunications invoices.

Material terms of the agreement included:

Asentinel waived all claims for damages for prior infringement and agreed not to make claims for future infringement of its patents.

The Company agreed to pay Asentinel \$500,000. Of that amount \$250,000 was paid upon execution of the agreement and \$250,000 was paid, without interest on June 16, 2012.

The lawsuit was dismissed against the Company.

### **14. REVOLVING DEMAND NOTE AGREEMENT**

On October 31, 2008, Veramark Technologies, Inc. entered into a Revolving Demand Note Agreement (the Line of Credit ), effective as of October 31, 2008, with Manufacturers and Traders Trust Company (the Bank ) to provide working capital in the ordinary course of business. This Line of Credit was amended in October 2010 increasing the amount available under the agreement from \$400,000 to \$750,000. At December 31, 2012, the Company had no outstanding balance under this Line of Credit.

The material terms of the Line of Credit include:

The maximum outstanding principal balance under the Line of Credit is \$750,000.

Veramark may borrow under the Agreement, from time to time, an amount less than or equal to, but not greater than the available balance.

The outstanding principal balance will bear interest at a per annum rate equal to LIBOR rate plus 3.5% with a minimum rate of 4.0%.

The Bank may demand payment of the outstanding principal balance at any time.

### **15. TERM NOTE AGREEMENT**

On October 29, 2010 the Company entered into an agreement with Manufacturers and Traders Trust Company to provide a three year term note in the amount of \$200,000, the proceeds of which were used to purchase furnishings and fixtures for the Company's headquarters facility. The loan bears an interest rate of LIBOR plus 4.0%, with a minimum interest rate of 4.5%. At December 31, 2012 the remaining balance of the term loan was \$55,555.

**Table of Contents****16. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)**

Summarized quarterly financial information for the years ended December 31, 2012 and 2011 is as follows:

	<b>Three Months Ended</b>			
	<b>March 31</b>	<b>June 30</b>	<b>September 30</b>	<b>December 31</b>
<b>2012</b>				
Net sales	\$ 3,605,289	\$ 3,856,535	\$ 3,859,933	\$ 3,996,637
Gross profit	\$ 2,059,067	\$ 2,242,814	\$ 2,291,687	\$ 2,403,406
Net income	\$ 80,432	\$ 147,298	\$ 247,147	\$ 269,993
Net income per common share				
- Basic	\$ 0.01	\$ 0.01	\$ 0.02	\$ 0.03
- Diluted	\$ 0.01	\$ 0.01	\$ 0.02	\$ 0.03
<b>2011</b>				
Net sales	\$ 3,386,323	\$ 3,246,643	\$ 3,429,339	\$ 3,875,397
Gross profit	\$ 2,018,218	\$ 1,842,402	\$ 1,943,281	\$ 2,362,585
Net income (loss)	\$ 52,962	\$ (670,852)	\$ 85,541	\$ (687,181)
Net income (loss) per common share				
- Basic	\$ 0.01	\$ (0.07)	\$ 0.01	\$ (0.07)
- Diluted	\$ 0.01	\$ (0.07)	\$ 0.01	\$ (0.07)

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### **Item 9A. Controls and Procedures**

#### **Evaluation of Disclosure Controls and Procedures**

Based upon an evaluation as of the end of the period covered by this report, the Company's President and Chief Executive Officer and Vice President of Finance (principal financial officer) concluded that the Company's disclosure controls and procedures are effective to provide reasonable assurance that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934 is (i) recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms and (ii) accumulated and communicated to the Company's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. There have been no changes in the Company's internal controls over financial reporting, that occurred during the period covered by this report, that have materially affected, or are reasonably likely to materially affect the Company's internal controls over financial reporting.

The Company's disclosure controls and procedures and internal controls over financial reporting provide reasonable, but not absolute, assurance that all deficiencies in design or operation of those control systems, or all instances of errors or fraud, will be prevented or detected. Those control systems are designed to provide reasonable assurance of achieving the goals of those systems in light of the Company's resources and nature of the Company's business operations. The Company's disclosure controls and procedures and internal control over financial reporting remain subject to risks of human error and the risk that controls can be circumvented for wrongful purposes by one or more individuals in management or non-management positions.

#### **Management's Report on Internal Control Over Financial Reporting**

The management of Veramark Technologies, Inc. is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) of the Securities Exchange Act of 1934, as amended. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. These internal controls include policies and procedures that:

Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of assets;

Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles;

Provide reasonable assurance that receipts and expenditures are being made only in accordance with the authorization of our management and directors; and

Provide reasonable assurance that unauthorized acquisition, use or disposition of company assets that would have a material impact on financial statements will be prevented or detected on a timely basis.

Because of its inherent limitations, internal control over financial reporting is not intended to provide absolute assurance that a misstatement of our financial statements would be prevented or detected.

Management conducted an evaluation of the effectiveness of 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). Based on this evaluation, management concluded that internal control over financial reporting was effective as of December 31, 2012.

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## PART III

In the event that the Company's Annual Meeting of Shareholders is not held prior to the end of May 2013, the Company will file an amendment to this Annual report on Form 10-K on or before April 30, 2013 to include the information anticipated to be incorporated by reference into this Part III.

**Item 10 Directors and Executive Officers of the Registrant**

Information relating to the officers and directors of the Company and the Committees of the Company's Board of Directors is incorporated herein by reference to portions of the Company's Proxy Statement for the Annual Meeting of Shareholders anticipated to be held on or about May 22, 2013 under the headings "Election of Directors" and "Section 16(a) Beneficial Ownership Reporting Compliance."

The following lists the names and ages of all executive officers and Directors of the Company as of the date of this report, all persons chosen to become executive officers, and all persons nominated or chosen to become directors.

## MANAGEMENT

Directors and Executive Officers of the Registrant

Name	Age	Position
Ronald J. Casciano	59	Director
Seth J. Collins	46	Director
Charles A. Constantino	73	Director
Steve M. Dubnik	50	Director
John E. Gould	68	Director
Anthony C. Mazzullo	55	President and Chief Executive Officer, Chairman of the Board
Ronald C. Lundy	61	Senior Vice President of Finance and Chief Financial Officer

All Directors hold office until the next annual meeting of stockholders and until their successors are duly elected and qualified. Officers are elected annually by the Board of Directors and serve at the discretion of the Board.

The Company has adopted a Code of Business Conduct and Ethics for all principal executive officers, directors, and employees of the Company. A copy of this code is incorporated by reference to portions of the Company's Proxy Statement for the Annual Meeting of Shareholders anticipated to be held on or about May 22, 2013. A copy of the Code of Business Conduct and Ethics is available, without charge, upon written request to the Company's Senior Vice President of Finance and Chief Financial Officer at the Company's corporate offices.



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**Item 11 Executive Compensation**

Information relating to executive compensation is incorporated by reference to portions of to the Company's Proxy Statement for the Annual Meeting of Shareholders anticipated to be held on or about May 22, 2013, under the heading Executive Compensation.

**Item 12 Security Ownership of Certain Beneficial Owners and Management**

Information relating to the security holdings of more than five percent holders and directors and officers of the Company is incorporated herein by reference to portions of the Company's Proxy Statement for the Annual Meeting of Shareholders anticipated to be held on or about May 22, 2013, under the headings Executive Compensation and Stock Options.

**Item 13 Certain Relationships and Related Transactions**

Information related to certain relationships and related transactions of the Company are incorporated herein by reference to portions of the Company's Proxy Statement, for the Annual Meeting of Shareholders anticipated to be held on or about May 22, 2013, under the heading Certain Relationships and Related Transactions.

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PART IV

**Item 14 Principal Accounting Fees and Services**

Information relating to accounting fees and services incurred by and provided to the Company are incorporated herein by reference to portions of the Company's Proxy Statement for the Annual Meeting of Shareholders anticipated to be held on or about May 22, 2013, under the heading Audit Fees and Services.

**Item 15 Exhibits, Consolidated Financial Statement Schedule and Reports on Form 8-K**

(a) Financial Statements as set forth under Item 8 of this report on Form 10-K

(b) Exhibits required to be filed by Item 601 of Regulation S-K

- 3.1 Restated Certificate of Incorporation (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-18 (File No. 2-96787) filed on March 22, 1985)
- 3.2 Bylaws (incorporated by reference to Exhibit 3 to the Company's Registration Statement on Form S-8 filed on October 5, 1992)
- 10.1\* 2007 Management Bonus Plan (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on March 8, 2007)
- 10.2 Letter Agreement dated as of March 29, 2007 by and between the Company and David G. Mazzella (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on April 3, 2007)
- 10.3 Letter Agreement dated as of July 30, 2007 by and between the Company and Martin LoBiondo (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on August 3, 2007)
- 10.4\* Amended and Restated Board of Directors Deferred Compensation Plan (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on November 26, 2007)
- 10.5 Consulting Agreement dated as of December 12, 2007 by and between the Company and David G. Mazzella (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on December 13, 2007)
- 10.6\* Employment Agreement dated as of December 17, 2007 by and between the Company and Anthony C. Mazzullo (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on December 19, 2007)
- 10.7\* Letter Agreement dated as of February 4, 2008 by and between the Company and Douglas F. Smith (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on February 4, 2008)
- 10.8\* Restricted Stock Award Agreement dated as of January 1, 2008 by and between the Company and Anthony C. Mazzullo (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on March 25, 2008)

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10.9*	2008 Incentive Plan for Management and Key Employees (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on April 2, 2008)
10.10*	2008 Employee Stock Purchase Plan (incorporated by reference to Exhibit F to the Company's Proxy Statement for its 2008 Annual Meeting of Shareholders filed on April 29, 2008)
10.11*	Description of non-employee director compensation (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on August 18, 2008)
10.12*	Amended Salary Continuation Agreement dated as of October 10, 2008 by and between the Company and Ronald C. Lundy (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on October 17, 2008)
10.13*	Form of 2008 Employee Stock Purchase Plan Enrollment Agreement (incorporated by reference to Exhibit 4.2 to the Company's Registration Statement on Form S-8 (File No. 333-155286) filed on November 12, 2008)
14	Code of Business Conduct and Ethics (incorporated by reference to Exhibit E to the Company's Proxy Statement for its 2008 Annual Meeting of Shareholders filed on April 29, 2008)
23.1	Consent of Independent Registered Public Accounting Firm regarding Registration Statements on Form S-8 (No. 333-155286, 333-48144, and 333-55663)
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

\* Management contract or compensatory plan or arrangement

(c) Schedules required to be filed by Regulation S-X

(99) Valuation and Qualifying Accounts

All other schedules are omitted because they are not applicable or the required information is shown in the financial statements or notes thereto.

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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.

VERAMARK TECHNOLOGIES, INC., Registrant

/s/ Anthony C. Mazzullo

Anthony C. Mazzullo, President and CEO

Dated: April 1, 2013

/s/ Ronald C. Lundy

Ronald C. Lundy, Senior Vice President of Finance and CFO

Dated: April 1, 2013

Pursuant to the requirements of the Securities Exchange Act of 1934, that this report be signed by the Company's principal executive officer(s), principal financial officer(s), controller or principal accounting officer and at least a majority of the members of the Company's Board of Directors, this report has been signed below, by the following persons, on behalf of the registrant, and in the capacities and on the dates indicated.

Signature	Capacity	Date
/s/ Ronald J. Casciano Ronald J. Casciano	Director	April 1, 2013
/s/ Seth J. Collins Seth J. Collins	Director	April 1, 2013
/s/ Charles A. Constantino Charles A. Constantino	Director	April 1, 2013
/s/ Steve M. Dubnik Steve M. Dubnik	Director	April 1, 2013
/s/ John E. Gould John E. Gould	Director	April 1, 2013