VERAMARK TECHNOLOGIES INC
Form 10-Q
May 15, 2006

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q
Quarterly Report Under Section 13 or 15 (d)
of the Securities Exchange Act of 1934
For Quarter Ended March 31, 2006
Commission File Number 0-13898
Veramark Technologies, Inc.

(Exact name of registrant as specified in its charter)

Delaware	16-1192368
(State or other jurisdiction of Incorporation or Organization)	(IRS Employer Identification Number)

3750 Monroe Avenue, Pittsford, NY 14534

(Address of principal executive offices)(Zip Code)
(585) 381-6000

(Registrant s telephone number, including area code)
N/A

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the 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 þ NO o

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. o

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer o Accelerated filer o Non-accelerated filer þ

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

YES o NO þ

The number of shares of Common Stock, $.10 par value, outstanding as of March 31, 2006 was 8,839,365.

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VERAMARK TECHNOLOGIES, INC.
CONDENSED BALANCE SHEETS

	(Unaudited) March 31, 2006	December 31, 2005
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 824,171	$ 911,310
Investments	611,459	600,324
Accounts receivable, trade (net of allowance for doubtful accounts of $43,000 and $32,000, respectively)	1,581,928	1,522,190
Inventories, net	57,176	31,724
Prepaid expenses and other current assets	205,735	161,127
Total Current Assets	3,280,469	3,226,675
PROPERTY AND EQUIPMENT		
Cost	5,835,171	5,796,427
Less accumulated depreciation	(5,078,552)	(5,025,761)
Property and Equipment (Net)	756,619	770,666
OTHER ASSETS:		
Software development costs (net of accumulated amortization of $2,622,409 and $2,373,896, respectively)	2,951,222	2,826,644
Pension assets	2,525,459	2,501,636
Deposits and other assets	797,745	797,745
Total Other Assets	6,274,426	6,126,025
TOTAL ASSETS	$ 10,311,514	$ 10,123,366

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

VERAMARK TECHNOLOGIES, INC.
CONDENSED BALANCE SHEETS

	(Unaudited) March 31, 2006	December 31, 2005
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 224,048	$ 275,756
Accrued compensation and related taxes	428,314	565,096
Deferred revenue	3,230,144	2,936,466
Other accrued liabilities	143,593	135,430
Total Current Liabilities	4,026,099	3,912,748
Pension obligation	4,547,770	4,424,304
Total Liabilities	8,573,869	8,337,052
STOCKHOLDERS EQUITY:		
Common Stock, par value $.10; shares authorized, 40,000,000; shares issued and outstanding 8,919,590 and 8,917,840	891,959	891,784
Additional paid-in capital	21,696,910	21,686,152
Accumulated deficit	(20,470,872)	(20,413,395)
Treasury stock (80,225 shares, at cost)	(385,757)	(385,757)
Accumulated other comprehensive income	5,405	7,530
Total Stockholders Equity	1,737,645	1,786,314
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 10,311,514	$ 10,123,366

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

VERAMARK TECHNOLOGIES, INC.
CONDENSED STATEMENTS OF OPERATIONS (Unaudited)

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005
NET SALES		
Product sales	$ 739,644	$ 954,583
Service sales	1,704,552	1,671,789
Total Net Sales	2,444,196	2,626,372
COSTS AND OPERATING EXPENSES:		
Cost of sales	524,339	440,051
Engineering and software development	152,709	301,792
Selling, general and administrative	1,832,639	1,971,107
Total Costs and Operating Expenses	2,509,687	2,712,950
LOSS FROM OPERATIONS	(65,491)	(86,578)
NET INTEREST INCOME	8,014	1,292
LOSS BEFORE INCOME TAXES	(57,477)	(85,286)
INCOME TAXES		
NET LOSS	$ (57,477)	$ (85,286)
NET LOSS PER SHARE		
Basic	$ (0.01)	$ (0.01)
Diluted	$ (0.01)	$ (0.01)

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

VERAMARK TECHNOLOGIES, INC.
CONDENSED STATEMENTS OF CASH FLOWS (Unaudited)

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005
OPERATING ACTIVITIES:		
Net loss	$ (57,477)	$ (85,286)
Adjustments to reconcile net loss to net cash flows provided by operating activities		
Depreciation and amortization	315,707	269,018
Expense (recovery) of bad debts	11,000	(5,512)
Compensation expense-stock options (net of forfeitures)	10,000	4,043
Increase in cash surrender value of company-owned life insurance policies	(23,823)	(23,822)
Realized gain (loss) on sale of investments	(2,125)	1,537
Changes in assets and liabilities		
Accounts receivable	(70,738)	(68,443)
Inventories	(25,452)	(5,668)
Prepaid expenses and other current assets	(44,608)	(35,658)
Accounts payable	(51,708)	(20,004)
Accrued compensation and related taxes	(136,782)	(110,055)
Deferred revenue	293,678	104,471
Other accrued liabilities	8,163	(16,647)
Pension obligation	123,466	160,969
Net cash flows provided by operating activities	349,301	168,943
INVESTING ACTIVITIES:		
Purchase of investments	(11,135)	(6,123)
Capitalized software development costs	(373,091)	(280,454)
Additions to property and equipment	(53,147)	(24,589)
Net cash flows used by investing activities:	(437,373)	(311,166)
FINANCING ACTIVITY:		
Exercise of stock options	933	11,105
Net cash flows provided by financing activities	933	11,105
NET DECREASE IN CASH AND CASH EQUIVALENTS	(87,139)	(131,118)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	911,310	722,020
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 824,171	$ 590,902

	Three Months Ended March 31, 2006	2005
SUPPLEMENTAL CASH FLOW INFORMATION		
Cash Transactions:		
Income taxes paid (received), net	$ 500	$ (3,000)
Interest paid	$ 83	$

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

NOTES TO CONDENSED FINANCIAL STATEMENTS
(Unaudited)
(1) GENERAL

The accompanying unaudited financial statements include all adjustments of a normal and recurring nature which, in the opinion of Company s management, are necessary to present fairly the Company s financial position as of March 31, 2006, the results of its operations for the three months ended March 31, 2006 and 2005, and cash flows for the three months ended March 31, 2006 and 2005.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been omitted pursuant to the rules and regulations of the Securities and Exchange Commission. These condensed financial statements should be read in conjunction with the financial statements and related notes contained in the Company s annual report on Form 10-K to the Securities and Exchange Commission for the year ended December 31, 2005.

The results of operations and cash flows for the three months ended March 31, 2006 are not necessarily indicative of the results to be expected for the full year s operation.

(2) PROPERTY AND EQUIPMENT

The major classifications of property and equipment at March 31, 2006, and December 31, 2005 were:

	March 31, 2006	December 31, 2005
Machinery and equipment	$ 795,606	$ 794,314
Computer hardware and software	2,004,565	1,991,877
Furniture and fixtures	1,652,441	1,627,677
Leasehold improvements	1,382,559	1,382,559
	$ 5,835,171	$ 5,796,427

For the quarter ended March 31, 2006, the Company recorded depreciation expense of $67,194. Depreciation expense for the quarter ended March 31, 2005 was $67,755.

(3) STOCK-BASED COMPENSATION

In December 2004, the FASB issued SFAS No. 123R, Share-Based Payment. SFAS No. 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized as compensation expense in the financial statements based on their fair values. That expense will be recognized over the period during which an employee is required to provide services in exchange for the award, known as the requisite service period (usually the vesting period). We adopted SFAS No. 123R effective beginning January 1, 2006, using the Modified Prospective Application. SFAS No. 123R applies to the new awards modified, repurchased or cancelled after the effective date. The impact of adopting SFAS No. 123R was an increase of $10,000 to operating expenses for three months ended March 31, 2006.

For the three months ended March 31, 2005, the following table includes disclosures required by SFAS No. 123, Accounting for Stock-Based Compensation, as amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, and illustrates the effect on net earnings and net earnings per share as if we had applied the fair value recognition provisions of SFAS No. 123:

			Three Months Ended March 31, 2005
Net loss	As reported	$	(85,286)
Add: total stock-based compensation expense included in net income, net of forfeitures and related tax effects			4,044
Deduct: total stock-based compensation expense determined under fair value, net of forfeitures and related tax effects			(35,546)
	Pro forma	$	(116,788)
Net loss per common share	As reported		
	Basic	$	(0.01)
	Diluted	$	(0.01)
	Pro forma		
	Basic	$	(0.01)
	Diluted	$	(0.01)

Currently, the Company s primary type of share-based compensation consists of stock options, generally vesting over four years. For the quarters ended March 31, 2006 and 2005, the company did not issue any stock options.

A summary of the status of the Company s stock option plan as of March 31, 2006 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, 2005	2,865,028	$ 2.37	$ 1.93	4.3	$ 1,198,974
Granted					
Exercised	(1,750)	0.53			(170)
Canceled	(5,100)	2.76			(2,489)
Outstanding as of March 31, 2006	2,858,178	$ 2.37	$ 1.93	4.1	$ 1,196,315

Options exercisable at March 31, 2006	2,718,453	$	2.46	$	2.00	3.9	$ 1,181,442

As of March 31, 2006, there was $53,900 of total unrecognized compensation cost related to non-vested share-based compensation arrangements related to stock options granted under the Plan. That cost is expected to be recognized over a weighted-average period of 1.1 years.

(4) TOTAL COMPREHENSIVE INCOME (LOSS)

Total comprehensive loss for the first quarter of 2006 and 2005 was as follows:

	Three Months Ended March 31,	
	2006	**2005**
Net loss	$ (57,477)	$ (85,286)
Accumulated other comprehensive income (loss)	(2,125)	1,537
Total comprehensive loss	$ (59,602)	$ (83,749)

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

SFAS 128 Earnings Per Share requires the Company to calculate 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 only have a dilutive effect when the average market price of common stock during the period exceeds the exercise price of the options.

Calculations of Earnings (Loss) Per Share

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005
Basic		
Net loss	$ (57,477)	$ (85,286)
Weighted average common shares outstanding	8,838,373	8,673,998
Net loss per common share	$ (0.01)	$ (0.01)
Diluted		
Net loss	$ (57,477)	$ (85,286)
Weighted average common shares outstanding	8,838,373	8,673,998
Additional dilutive effect of stock options and warrants after application of treasury stock method		
Weighted average dilutive shares outstanding	8,838,373	8,673,998
Net loss per common share assuming full obligation	$ (0.01)	$ (0.01)

There were no dilutive effects of stock options in 2006 or 2005, as the effect would be anti-dilutive due to the net losses incurred.

(6) INDEMNIFICATION OF CUSTOMERS

Our agreements with customers generally require us to indemnify the customer against claims that our 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 March 31, 2006 we had not experienced any material losses related to these indemnification obligations and no material claims with respect thereto were outstanding. We do not expect significant claims related to these indemnification obligations, and consequently, we have 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. There were no contributions to the plan for the three months ended March 31, 2006 and 2005.

The Company also sponsors an unfunded Supplemental Executive Retirement Program (SERP), which is a non-qualified plan that provides certain key employees defined pension benefits. Periodic pension expense for the three months ended March 31, 2006 and 2005 consists of the following:

	Three Months Ended March 31,	
	2006	2005
Current Service Cost	$ 69,503	$ 114,248
Amortization of Prior Service Cost	22,123	22,650
Interest Cost	73,374	65,605
Pension Expense	$ 165,000	$ 202,503

The Company paid pension obligations of $41,534 for both the three months ended March 31, 2006 and 2005.
The discount rate used in determining the actuarial present value of the projected benefit obligation was 6% for the three months ended March 31, 2006 and 2005.
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 future pension obligations. The total death benefit associated with these policies is $10.2 million, with an associated accumulated cash surrender value of approximately $2,525,000 at March 31, 2006. The accumulated cash surrender values of these policies at December 31, 2005 was approximately $2,502,000.

Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations

Results of Operations

Management s Discussion and Analysis contains statements that are forward-looking. Such statements are identified by the use of words like plans, expects, intends, believes, will, anticipates, estimates and other w similar meaning in conjunction with, among other things, discussions of future operations, financial performance, the Company s strategy for growth, product development, regulatory approvals, market position and expenditures. Forward-looking statements are based on management s expectations as of the date of this report. The Company cannot guarantee that any forward-looking statement will be accurate, although the Company believes that it has been reasonable in its expectations and assumptions. Forward-looking statements are subject to the risks identified in Issues and Risks and elsewhere in this report. Readers are cautioned not to place undue reliance on forward-looking statements and are advised to review the risks identified in Issues and Risks and elsewhere in this report. The Company has no obligation to update forward-looking statements.

Overview

Sales for Veramark s first quarter ended March 31, 2006 were $2,444,000 which compared with sales of $2,626,000 for the first quarter ended March 31, 2005. The net loss of $57,000, or $0.01 per share, incurred for the quarter ended March 31, 2006 represents a slight improvement from the loss of $85,000, also $0.01 per share, for the same quarter of 2005.

Significant progress was made in terms of filling key sales and marketing positions. During the first quarter we added four new employees to our sales team, two of whom will be focused on channel sales of telemanagement products, primarily eCAS, and two chartered with increasing direct sales of VeraSMART. In addition, our marketing capabilities have been strengthened with the addition of a Director of Business Development and Marketing, and a Director of International Business Development. We will continue our efforts to recruit additional sales and marketing personnel during the remainder of 2006.

Orders booked for the quarter ended March 31, 2006 were $2,643,000, an increase of 14% from orders booked of $2,319,000 for the first quarter of 2005. We are pleased with that increase as the first quarter has traditionally been the weakest quarter in terms of orders for the Company.

For the first quarter of 2006 we did experience a net cash and investment outflow of $76,000. The decrease was primarily the result of a $60,000 increase in accounts receivable combined with an $188,000 decrease in accounts payable and accrued compensation from December 31, 2005 balances.

Sales

For the quarter ended March 31, 2006 sales of VeraSMART, the Company s enterprise level product increased 20% from sales achieved for the first quarter of 2005. New VeraSMART customers included the Federal Emergency and Management Agency (FEMA), Hearst Corporation, KPMG Peat Marwick LLP, ING Reliastar, and Comcast Cable Communications.

Sales revenues generated from existing maintenance contracts for Quantum, VeraSMART s predecessor product, declined 17% for the first quarter of 2006 from the prior year. This decrease was anticipated as we continue to phase out support for the discontinued Quantum product line, and encourage the transition of existing Quantum customers to the VeraSMART platform.

Sales of eCAS, our core telemangement product which is sold primarily on a direct basis to Avaya, Inc. or through Avaya s master distribution channels, declined 29% for the first quarter of 2006 as compared with the first quarter of 2005. We feel that the decreased sales activity in this heavily competitive market segment can be addressed by strengthening our sales and marketing resources from the level that existed during the fourth quarter of 2005 and continuing into the earlier stages of the first quarter of 2006. Subsequent to the end of the first quarter we announced the renewal of our OEM Resellers Agreement with Avaya. Pursuant to the agreement Veramark and Avaya will continue their long established relationship of providing Avaya customers with Veramark s eCAS call accounting software under the Avaya brand name.

Sales derived from the Company s Outsourced Solution Group decreased 3% in the first quarter of 2006 from the same quarter of 2005, though increased 6% from the fourth quarter of 2005. The comparison to last years first quarter is inclusive of the loss of a major client at the end of the first quarter of 2005 as a result of a merger/consolidation. Major clients currently served by Veramark s Outsourced Solutions Group include St.Paul /Travelers Insurance, Sony Corporation, Bank of America/Fleet Bank, and a division of Lockheed Martin.

Cost of Sales

For the quarter ended March 31, 2006 gross margin (defined as sales minus cost of sales) was $1,920,000, or 79% of sales. This compares with a gross margin of $2,186,000, or 83% of sales for the quarter ended March 31, 2005. The reduction in gross margin results from a combination of the lower sales volume in the first quarter of 2006 as compared with the prior year, and an increase in amortization and direct overhead costs charged to cost of sales for those respective periods.

Operating Expenses

Engineering and software development expenses, net of the capitalization of development costs, decreased 49% from $302,000 for first quarter of 2005 to $153,000 for the first quarter of 2006. The below table summarizes for the three months ended March 31, 2006 and 2005 gross engineering costs, development costs capitalized, costs amortized, and the resulting impact on the Company s Statements of Operations for those respective periods.

	Three Months Ended March 31,	
	2006	**2005**
Gross expenditures for engineering and software development	$ 526,000	$ 582,000
Less: Software development costs capitalized	(373,000)	(280,000)
Net expenses for engineering and software development included in the Company s statement of operations	153,000	302,000
Plus: Software development costs amortized and charged to cost of sales	249,000	201,000
Total Expense Recognized	$ 402,000	$ 503,000

Engineering and software development efforts throughout the first quarter of 2006 continued to be focused on further expansion of the VeraSMART product, and the continued strengthening of eCAS functionality. In early March of this year we announced the general availability of Release 4.0 of eCAS. This latest release of eCAS includes expanded reporting and graphics packages, improved alerting, more robust data import functionality, and greater auditing capabilities. Development also continues on the next release of VeraSMART which will be a fully integrated Assets/Inventory module, currently scheduled for a fourth quarter 2006 release.

Selling, general and administrative expenses of $1,833,000 for the quarter ended March 31, 2006 decreased 7% or $138,000 from expenses of $1,971,000 for the quarter ended March 31, 2005. Expenses for 2006 versus 2005 declined in all functional areas encompassing Marketing ($60,000), Sales ($26,000), Support and Service ($19,000) and Administration ($34,000). Significant expense reductions were realized in legal and professional costs, trade show expenses incurred and facility costs. It is expected that selling, general, and administrative costs will increase throughout the balance of 2006 due to the additional staffing added during the first quarter of the year, and the anticipated hiring of additional staff contemplated for the remainder of 2006.

Liquidity and Capital Resources

Veramark s total cash and investment position, consisting of cash in the bank and the value of short term investments, was $1,436,000 at March 31, 2006 which compares with $1,512,000 at December 31, 2005 and $978,000 at March 31, 2005. The decrease in the cash and investment balance from December 31, 2005 was attributable to an increase of $60,000 in accounts receivable and a $188,000 reduction in accounts payable and accrued compensation.

As noted above, accounts receivable increased $60,000 during the first quarter from $1,522,000 at December 31, 2005 to $1,582,000 March 31, 2006. The increase in accounts receivable results from a balance due from a single customer that is over 90 days past due. The company does not expect the ultimate collection of this invoice to be problematic and payment is expected in May. Merely as a precaution and acknowledgement of the higher accounts receivable balance we have increased our reserve for bad debts from $32,000 at December 31, 2005 to $43,000 at March 31, 2006.

Inventories increased from $32,000 at December 31, 2005 to $57,000 at March 31, 2006 due to the purchase of pollable storage devices utilized in the collection and storage of customer call records required of larger customer installations with multi-site locations. It is not expected that inventories will increase by a significant amount over the remainder of 2006.

Prepaid expenses and other current asset total $206,000 at December 31, 2006 increased from $161,000 at December 31, 2005. The increase reflects first quarter premium payments associated with the renewal of a series of business insurance policies, the economic benefit of which will extend through December 31, 2006.

Capital equipment additions for the quarter ended March 31, 2006 totaled $53,000. Capital equipment additions for the first quarter of 2005 totaled $25,000. During the quarter we disposed of $14,000 of outdated equipment, all of which had been fully depreciated.

Software development costs capitalized and carried on the Company s balance sheet at March 31, 2006 are $2,951,000 versus $2,827,000 at December 31, 2005. During the first quarter of 2006 we capitalized $373,000 of software development costs and amortized $249,000 of previously capitalized development costs. All of the development costs capitalized in the first quarter of 2006 relate to additional functionality being applied to the VeraSMART product suite.

Pension assets of $2,525,000 at March 31, 2006 and $2,502,000 at December 31, 2005 consists of the cash surrender values of company owned life insurance policies, the death benefit and accumulated cash surrender values of which are designed to fund future pension obligations. These cash surrender values are also available to fund current operations of the Company in the event that was deemed appropriate. Management has no current plans, nor does it anticipate the need in the near future to access these funds to meet operating requirements.

Current liabilities total $4,026,000 at March 31, 2006 as compared with $3,913,000 at December 31, 2005. While liabilities for accounts payable and accrued compensation were reduced by a combined total of $188,000 during the first quarter, total current liabilities rose as a result of an increase in deferred revenues of $294,000. Deferred revenues represent services for which we have billed customers but for which we have not yet performed the contracted service, and therefore have not recognized the associated revenue. These services typically include maintenance and support contracts, training and installation. The vast majority of the currently deferred revenues will be recognized as revenue over the next twelve months as those services are provided.

Stockholders Equity of $1,738,000 at March 31, 2006 compares with total stockholders equity of $1,786,000 at December 31, 2005, primarily reflecting the net loss incurred for the quarter of $57,000

It is management s opinion, that given our current cash and investment position, the access to cash surrender values of company-owned insurance policies if necessary and the absence of debt, that the Company has sufficient resources to fully fund operations and support product development schedules for the next twelve month and beyond.

Accounting Pronouncements

1) In December 2003, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition, which updates the guidance in SAB No. 101, integrates the related set of Frequently Asked Questions, and recognizes the role of EITF 00-21. The adoption of SAB No. 104 did not have a material effect on the Company s financial statements.

2) In November 2002, the Emerging Issues Task Force reached a consensus on Issue No. 00-21, Revenue Arrangements with Multiple Deliverables. Issue 00-21 provides guidance on how to account for arrangements that involve the delivery or performance of multiple products, services and/or rights to use assets. The provisions of Issue 00-21 applied to revenue arrangements entered into in periods beginning after June 15, 2003. The adoption of Issue 00-21 did not have a material effect on the Company s financial position or results of operations.

3) In December 2004, the FASB issued SFAS 123(R), Share-Based Payment , which establishes standards for transactions in which an entity exchanges its equity instruments for goods or services. This standard requires an issuer to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award and the recording of such expense in the consolidated financial statements. This eliminates the exception to account for such awards using the intrinsic value method previously allowable under Accounting Principles Board (APB) Opinion No. 25. Pro forma disclosure of fair value recognition will no longer be an alternative. In addition, the adoption of SFAS No. 123(R) will require additional accounting related to the income tax effects and disclosure regarding the cash flow effects resulting from share-based payment arrangements.

SFAS 123(R) permits public companies to adopt its requirements using one of two methods:

Modified prospective method: Compensation cost is recognized beginning with the effective date of adoption (a) based on the requirements of SFAS No. 123(R) for all share-based payments granted after the effective date of adoption and (b) based on the requirements of SFAS 123 for all awards granted to employees prior to the effective date of adoption that remain unvested on the date of adoption.

Modified retrospective method: Includes the requirements of the modified prospective method described above, but also permits restatement using amounts previously disclosed under the pro forma provisions of SFAS No. 123 either for (a) all periods presented or (b) prior interim periods of the year of adoption. In March 2005, the SEC released Staff Accounting Bulletin (SAB) 107, Share-Based Payment , which expresses views of the SEC Staff about the application of SFAS No. 123(R). In April 2005, the SEC issued a rule that SFAS No. 123(R) will be effective for annual reporting periods beginning on or after June 15, 2005.

SFAS 123(R) was effective for our first quarter of fiscal 2006 and we utilized the modified prospective method. We have selected the Black-Scholes option-pricing model as the most appropriate fair-value method for our awards and will recognize compensation cost on a straight-line basis over our awards vesting periods. Although the adoption of SFAS No. 123(R) had no adverse impact on our balance sheet or total cash flows, it is expected to negatively impact our net income and earnings per share for 2006 by approximately $50,000. The actual effects of adopting SFAS No. 123(R) will depend on numerous factors including the amounts of share-based payments granted in the future, our stock price volatility, estimated forfeiture rates and employee stock option exercise behavior.

4) In December 2004, FASB issued SFAS 153, Exchanges of Nonmonetary Assets an amendment to APB Opinion No. 29. This statement amends APB 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. Adoption of this statement is not expected to have a material impact on our results of operations or financial condition.

5) In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections a replacement of APB Opinion No. 20 and FASB Statement No. 3 (SFAS 154). SFAS 154 changes the requirements for the accounting for and reporting of a change in accounting principle. These requirements apply to all voluntary changes and changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. SFAS 154 is effective for fiscal years beginning after December 15, 2005. As such, the Company is required to adopt these provisions at the beginning of the fiscal year ended December 31, 2006. Adoption of SFAS 154 is not expected to have a significant impact on the Company s financial statements.

Critical Accounting Policies

The preparation of financial statements requires management to make estimates and assumptions that affect amounts reported therein. The most significant of these involving difficult or complex judgments in 2005 include:

Revenue recognition

Capitalization of software development costs

Allowance for Doubtful Accounts

Pension liability

In each situation, management is required to make estimates about the effects of matters or future events that are inherently uncertain.

The Company s revenue consists of revenues from the licensing of software to resellers and end user customers; fees for services rendered to include installation, training, implementation, and customer maintenance contracts; and the outsourcing or hosting of services.

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

Sales of licensed software sold directly to an end user customer are recognized as revenue upon delivery and installation of the software at the customer site. Sales of licensed software to a reseller are recognized as revenue when delivery is made to the reseller. 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. In the case of VeraSMART sales, a software license agreement signed by both parties is often required in addition to a purchase order or equivalent. Additionally, revenue is only recognized when a selling price is fixed or determinable and collectibility of the receivable is deemed to be probable.

Service revenues such as training, installation and implementation are recognized when the service is complete and acknowledged by the customer, regardless as to whether the sale is on a direct basis or through a reseller arrangement.

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

Sales which constitute a multiple-element arrangement 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 for which there is vendor specific objective evidence of their fair value. We use the residual method to apply any remaining balance to the remaining elements of the arrangement. More specifically, this methodology applies when there is embedded maintenance (post-contract customer support) involved in the sale of a software license, or when the sale of a software license is made in conjunction with installation services. In the latter case, the recognition of the software license is deferred until installation is completed.

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 us 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.

The Company capitalizes software development costs when technological feasibility has been established for the software in accordance with SFAS No. 86, Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise 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.

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.

The Company sponsors an unfunded Supplemental Executive Retirement Program (SERP), which is a nonqualified plan that provides certain key 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 projected future salary increases for each participant. In addition, management must make assumptions with regard to the proper long-term interest and liability discount rates to be applied to these future obligations.

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

Issues and Risks

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 the forward-looking statements: economic, competitive, governmental and technological factors, increased operating costs, failure to obtain necessary outside financing, risks related to natural disasters and financial market fluctuations. Such factors also include:

Intellectual Property Rights

Veramark regards its software as proprietary and attempts to protect it 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 take 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.

New Products and Services

Veramark has made significant investments in research, development and marketing for new products, services and technologies, including the VeraSMART® software offering and its service bureau outsourced solutions. Significant revenue from new product and service investments may not be achieved for a number of years, if at all. Moreover, if such products or services are profitable, operating margins may not be as high as the margins historically experienced by Veramark.

Declines in Demand for Software

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

Product Development Schedule

The development of software products is a complex and time-consuming process. New products and enhancements to existing products can require long development and testing periods. Significant delays in new product releases or significant problems in creating new products, particularly any delays in future releases of the VeraSMART® suite of products, could adversely affect Veramark revenues.

Competition

Veramark experiences intensive 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.

Marketing and Sales

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.

Item 3 Quantitative and Qualitative Disclosures About Market Risk

The Company has no long-term bank debt obligations. The Company has no foreign currency exchange risk and has no foreign currency exchange contracts.

Item 4 Controls and Procedures

Based upon an evaluation as of the end of the period covered by this report, the Company s Chief Executive Officer and Treasurer (Chief Accounting 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.

PART II OTHER INFORMATION

Item 5: Certification of Chief Executive Officer and Chief Accounting Officer

The Company s Chief Executive Officer and the Company s Chief Accounting Officer have provided the certifications with respect to this Form 10-Q that are required by Sections 302 and 906 of the Sarbanes-Oxley Act of 2002. These certifications have been filed as Exhibits 31.1 and 31.2 and Exhibits 32.1 and 32.2, respectively.

Item 6: Exhibits and Reports on Form 8-K

(a) Exhibits required by Item 601 of Regulation S-K

(I) Registrant s Condensed Financial Statements for the three months ended March 31, 2006 and 2005 are set forth in Part I, Item 1 of this Quarterly Report on Form 10-Q.

(31.1) CEO Certification Pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

(31.2) Treasurer Certification Pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

(32.1) CEO Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(32.2) Treasurer Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

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

VERAMARK TECHNOLOGIES, INC.
REGISTRANT

Date: May 12, 2006

/s/ David G. Mazzella

David G. Mazzella
President and CEO

Date: May 12, 2006

/s/ Ronald C. Lundy

Ronald C. Lundy
Treasurer (Chief Accounting Officer)