

BIO KEY INTERNATIONAL INC  
Form 10-K/A  
April 04, 2017

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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-K/A**

**Annual Report Pursuant to Section 13 or 15(d)**

**of the Securities Exchange Act of 1934**

**For the Fiscal Year Ended December 31, 2016**

**Commission File Number 1-13463**

**BIO-KEY INTERNATIONAL, INC.**

(Exact name of registrant as specified in its charter)

**DELAWARE**                      **41-1741861**  
(State or other jurisdiction of      (IRS Employer

incorporation or organization) Identification Number)  
**3349 HIGHWAY 138, BUILDING A, SUITE E, WALL, NJ 07719**

(Address of principal executive offices) (Zip Code)

**(732) 359-1100**

Registrant's telephone number, including area code.

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

<b>Title of Each Class</b>	<b>Name of Exchange on which Registered</b>
Common Stock, \$0.0001 par value per share	None

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

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

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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 (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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 Exchange Act). Yes No

The aggregate market value of the registrant's voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, as of the last business day of the registrant's most recently completed second fiscal quarter was \$15,629,687.

As of March 28, 2017, the registrant had 6,096,920 shares of common stock outstanding.

Documents Incorporated by Reference: **None**

## **EXPLANATORY NOTE**

This Amendment No. 1 (the “Amendment”) hereby amends our Annual Report on Form 10-K for the year ended December 31, 2016, which was originally filed with the Securities and Exchange Commission on March 31, 2017 (the “Original 10-K”). This Amendment is being filed solely to include the properly dated audit report.

Except as described above, the Company has not modified or updated disclosures presented in this Amendment No. 1. Accordingly, this Amendment No. 1 does not reflect events occurring after the Original 10-K or modify or update those disclosures affected by subsequent events, except as specifically referenced herein. All other information contained in the Original 10-K is unchanged and reflects the disclosures made at the time of filing of the Original 10-K.

This Amendment has been signed as of a current date and all certifications of the Company’s Chief Executive Officer/Principal Executive Officer and Chief Financial Officer/Principal Accounting and Financial Officer are given as of a current date. Accordingly, this Amendment should be read in conjunction with the Company’s filings with the Securities and Exchange Commission subsequent to the filing of the Original 10-K, including any amendments to those filings.

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**ITEM 8—FINANCIAL STATEMENTS**

The following financial statements of BIO-key International, Inc. are included herein at the indicated page numbers:

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**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders

BIO-key International, Inc.

Wall, NJ

We have audited the accompanying consolidated balance sheets of BIO-key International, Inc. and Subsidiaries (the “Company”) as of December 31, 2016 and 2015, and the related consolidated statements of operations, stockholders’ equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated 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 audits 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 consolidated financial statements, assessing the accounting principles used and significant estimates made by management as well as evaluating the overall consolidated financial statement presentation. We believe our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2016 and 2015, and the consolidated results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As disclosed in the consolidated financial statements, the Company has suffered substantial net losses in recent years, has an accumulated deficit at December 31, 2016 and is dependent on debt and equity financing to fund its operations, all of which raise substantial doubt about the Company’s ability to continue as a going concern. Management’s plans regarding these matters are disclosed in Note A. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Rotenberg Meril Solomon Bertiger & Guttilla, P.C.

ROTENBERG MERIL SOLOMON BERTIGER &  
GUTTILLA, P.C.

Saddle Brook, New Jersey

March 31, 2017

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**BIO-key International, Inc. and Subsidiaries****CONSOLIDATED BALANCE SHEETS**

	<b>December 31,</b>	
	<b>2016</b>	<b>2015</b>
<b>ASSETS</b>		
Cash and cash equivalents	\$1,061,307	\$4,321,078
Accounts receivable, net	1,563,246	3,391,405
Due from factor	53,638	37,421
Inventory	465,428	168,645
Software license rights	1,560,000	5,000,000
Prepaid expenses and other	206,677	97,203
Total current assets	4,910,296	13,015,752
Software license rights, net	10,598,411	7,180,000
Accounts receivable, net	1,570,000	-
Equipment and leasehold improvements, net	67,814	63,877
Deposits and other assets	8,712	8,712
Intangible assets, net	134,132	147,738
Total non-current assets	12,379,069	7,400,327
<b>TOTAL ASSETS</b>	<b>\$17,289,365</b>	<b>\$20,416,079</b>
<b>LIABILITIES</b>		
Accounts payable	\$466,842	\$1,158,555
Accrued liabilities	335,323	493,067
Dividends payable	401,250	133,851
Deferred revenue	633,062	376,405
Warrant liabilities	-	104,284
Total current liabilities	1,836,477	2,266,162
<b>TOTAL LIABILITIES</b>	<b>1,836,477</b>	<b>2,266,162</b>
Commitments and Contingencies		
<b>STOCKHOLDERS' EQUITY</b>		
Series A-1 convertible preferred stock: authorized, 100,000 (liquidation preference of \$100 per share); issued and outstanding 90,000 of \$.0001 par value at December 31, 2016 and December 31, 2015	9	9
Series B-1 convertible preferred stock: authorized, 105,000 (liquidation preference of \$100 per share); issued and outstanding 105,000 of \$.0001 par value at December 31, 2016 and December 31, 2015	11	11
Common stock — authorized, 170,000,000 shares; issued and outstanding; 6,093,843 and 5,508,261 of \$.0001 par value at December 31, 2016 and December 31, 2015, respectively	609	551
Additional paid-in capital	78,253,413	76,760,796
Accumulated deficit	(62,801,154)	(58,611,450)
<b>TOTAL STOCKHOLDERS' EQUITY</b>	<b>15,452,888</b>	<b>18,149,917</b>

<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	\$17,289,365	\$20,416,079
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All BIO-key shares issued and outstanding for all periods reflect BIO-key's 1-for-2 reverse stock split, which was effective February 3, 2015, and its 1-for-12 reverse stock split, which was effective December 29, 2016.

The accompanying notes are an integral part of these statements.



**BIO-key International, Inc. and Subsidiaries****CONSOLIDATED STATEMENTS OF OPERATIONS**

	<b>Years ended December</b>	
	<b>31,</b>	
	<b>2016</b>	<b>2015</b>
<b>Revenues</b>		
Services	\$821,178	\$931,394
License fees and other	2,154,578	4,329,831
	2,975,756	5,261,225
<b>Costs and other expenses</b>		
Cost of services	216,465	260,436
Cost of license fees and other	513,218	1,019,085
	729,683	1,279,521
Gross Profit	2,246,073	3,981,704
<b>Operating expenses</b>		
Selling, general and administrative	4,438,950	4,121,942
Research, development and engineering	2,008,942	1,556,025
	6,447,892	5,677,967
<b>Operating loss</b>	<b>(4,201,819)</b>	<b>(1,696,263)</b>
<b>Other income (deductions)</b>		
Interest income	30	14
Interest expense	-	(192,199 )
Gain on derivative liabilities	12,085	31,142
	12,115	(161,043 )
Net loss	\$(4,189,704)	\$(1,857,306)
Convertible preferred stock dividends	(802,500 )	(133,851 )
Net loss available to common stockholders	(4,992,204)	(1,991,157)
<b>Basic and Diluted Loss per Common Share</b>	<b>\$(0.89 )</b>	<b>\$(0.36 )</b>
<b>Weighted Average Shares Outstanding:</b>		
Basic and Diluted	5,587,144	5,502,778

All BIO-key shares issued and outstanding for all periods reflect BIO-key's 1-for-2 reverse stock split, which was effective February 3, 2015, and its 1-for-12 reverse stock split, which was effective December 29, 2016.

The accompanying notes are an integral part of these statements.



## BIO-key International, Inc. and Subsidiaries

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	Series A-1		Series B-1		Common Stock		Additional	Accumulated	
	Preferred Stock Shares	Amount	Preferred Stock Shares	Amount	Shares	Amount	Paid-in Capital	Deficit	Total
<b>Balance as of December 31, 2014</b>	—	\$ —	—	\$ —	5,500,159	\$ 550	\$57,512,655	\$(56,754,144)	\$759,061
Issuance of common stock for directors' fees					8,102	1	16,999		17,000
Issuance of series A-1 and B-1 preferred stock	90,000	9	105,000	11			19,499,980		19,500,000
Dividends declared on preferred stock							(133,851 )		(133,851 )
Issuance of warrants for investment advisor							51,026		51,026
Stock issuance costs							(459,102 )		(459,102 )
Share-based compensation							273,089		273,089
Net loss								(1,857,306 )	(1,857,306 )
<b>Balance as of December 31, 2015</b>	<b>90,000</b>	<b>\$ 9</b>	<b>105,000</b>	<b>\$ 11</b>	<b>5,508,261</b>	<b>\$ 551</b>	<b>\$76,760,796</b>	<b>\$(58,611,450)</b>	<b>\$18,149,917</b>
Issuance of common stock for directors' fees and CEO stock award					27,248	2	61,998		62,000
Issuance of common stock pursuant to securities purchase					516,667	52	1,859,948		1,860,000

agreement									
Dividends declared on preferred stock						(802,500 )		(802,500 )	
Issuance of stock for consultants	41,667		4			104,996		105,000	
Stock issuance costs						(84,866 )		(84,866 )	
Reclassification of derivative liability						92,199		92,199	
Share-based compensation						260,842		260,842	
Net loss							(4,189,704 )	(4,189,704 )	
<b>Balance as of December 31, 2016</b>	<b>90,000</b>	<b>\$ 9</b>	<b>105,000</b>	<b>\$ 11</b>	<b>6,093,843</b>	<b>\$ 609</b>	<b>\$78,253,413</b>	<b>\$(62,801,154)</b>	<b>\$15,452,888</b>

All BIO-key shares issued and outstanding for all periods reflect BIO-key's 1-for-2 reverse stock split, which was effective February 3, 2015, and its 1-for-12 reverse stock split, which was effective December 29, 2016.

The accompanying notes are an integral part of these statements.

**BIO-key International, Inc. and Subsidiaries****CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>Years ended December</b>	
	<b>31,</b>	
	<b>2016</b>	<b>2015</b>
<b>CASH FLOW FROM OPERATING ACTIVITIES:</b>		
Net loss	\$(4,189,704)	\$(1,857,306 )
<b>Adjustments to reconcile net loss to cash used for operating activities:</b>		
Allowance for doubtful accounts	500,000	(6,741 )
Depreciation	49,038	42,996
Amortization of:		
Intangible assets	13,606	13,606
Software license rights	21,589	-
Debt discount	-	92,199
Share and warrant-based compensation for employees and consultants	260,842	324,115
Gain on derivative liabilities	(12,085 )	(31,142 )
Stock based fees to Directors and consultants	167,000	17,000
<b>Change in assets and liabilities:</b>		
Accounts receivable	(241,841 )	(2,759,323 )
Due from factor	(16,217 )	39,236
Inventory	(296,783 )	(336,820 )
Software license rights	-	(12,000,000)
Prepaid expenses and other	(109,474 )	139,226
Accounts payable	(691,713 )	811,244
Accrued liabilities	(157,745 )	4,450
Deferred revenue	256,657	(52,828 )
Net cash used for operating activities	(4,446,830)	(15,560,088)
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Capital expenditures	(52,975 )	(3,364 )
Net cash used for investing activities	(52,975 )	(3,364 )
<b>CASH FLOW FROM FINANCING ACTIVITIES:</b>		
Preferred dividends paid	(535,100 )	-
Proceeds from issuances of preferred stock	-	19,500,000
Proceeds from issuances of common stock	1,860,000	-
Proceeds from issuance of note payable	-	250,000
Repayment of note payable	-	(250,000 )
Costs to issue preferred and common stock and note payable	(84,866 )	(459,102 )
Net cash provided by financing activities	1,240,034	19,040,898
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>(3,259,771)</b>	<b>3,477,446</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>	<b>4,321,078</b>	<b>843,632</b>
<b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>	<b>\$1,061,307</b>	<b>\$4,321,078</b>

The accompanying notes are an integral part of these statements.

**SUPPLEMENTARY DISCLOSURES OF CASH FLOW INFORMATION**

	<b>Years ended December 31,</b>	
	<b>2016</b>	<b>2015</b>
<b>Cash paid for:</b>		
Interest	\$-	\$100,000
<b>Noncash investing and financing activities:</b>		
Reclassification of derivative liability to additional paid-in capital	\$92,199	\$-
Issuance of warrants for financing raise	-	92,199
Accrual of dividends	401,250	133,851

The accompanying notes are an integral part of these statements.

**BIO-key International, Inc. and Subsidiaries**

**NOTES TO THE FINANCIAL STATEMENTS**

**December 31, 2016 and 2015**

**NOTE A —THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Nature of Business*

The Company, founded in 1993, develops and markets proprietary fingerprint identification biometric technology and software solutions. We were pioneers in developing automated, finger identification technology that supplements or compliments other methods of identification and verification, such as personal inspection identification, passwords, tokens, smart cards, ID cards, PKI, credit card, passports, driver's licenses, OTP or other form of possession or knowledge-based credentialing. Additionally, advanced BIO-key® technology has been, and is, used to improve both the accuracy and speed of competing finger-based biometrics.

*Basis of Presentation*

The Company has incurred significant losses to date, and at December 31, 2016, it had an accumulated deficit of approximately \$62.8 million. In addition, broad commercial acceptance of the Company's technology is critical to the Company's success and ability to generate future revenues. At December 31, 2016, total cash and cash equivalents were approximately \$1,061,000, as compared to approximately \$4,321,000 at December 31, 2015.

As discussed below, the Company has financed itself in the past through access to the capital markets by issuing secured and convertible debt securities, convertible preferred stock, common stock, and through factoring receivables. The Company currently requires approximately \$592,000 per month to conduct operations and pay dividend obligations, a monthly amount that it has been unable to achieve through revenue generation.

If the Company is unable to generate sufficient revenue to meet our goals, it will need to obtain additional third-party financing to (i) conduct the sales, marketing and technical support necessary to execute its plan to substantially grow operations, increase revenue and serve a significant customer base; and (ii) provide working capital. No assurance can be given that any form of additional financing will be available on terms acceptable to the Company, that adequate financing will be obtained by the Company in order to meet its needs, or that such financing would not be dilutive to



existing shareholders.

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP"), which contemplate continuation of the Company as a going concern, and assumes continuity of operations, realization of assets and the satisfaction of liabilities and commitments in the normal course of business. The matters described in the preceding paragraphs raise substantial doubt about the Company's ability to continue as a going concern. Recoverability of a major portion of the recorded asset amounts shown in the accompanying balance sheet is dependent upon the Company's ability to meet its financing requirements on a continuing basis, and become profitable in its future operations. The accompanying consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded assets or the amounts and classification of liabilities that might be necessary should the Company be unable to continue in existence.

Effective February 3, 2015, the Company implemented a reverse stock split of its outstanding common stock at a ratio of 1 for 2 shares, and effective December 29, 2016, the Company implemented a reverse stock split of its outstanding common stock at a ratio of 1 for 12 shares. All share figures and results are reflected on a post-split basis.

#### *Summary of Significant Accounting Policies*

A summary of the significant accounting policies consistently applied in the preparation of the accompanying consolidated financial statements follows:

##### *1. Basis of Consolidation*

The accompanying consolidated financial statements include the accounts of BIO-key International, Inc. and its wholly-owned subsidiaries (collectively, the "Company"). Intercompany accounts and transactions have been eliminated in consolidation.

## *2. Use of Estimates*

Our consolidated financial statements are prepared in accordance with GAAP as set forth in the Financial Accounting Standards Board's (FASB) Accounting Standards Codification (ASC) and consider the various staff accounting bulletins and other applicable guidance issued by the U.S. Securities and Exchange Commission (SEC). These accounting principles require us to make certain estimates, judgments and assumptions. The Company believes that the estimates, judgments and assumptions upon which it relies are reasonable based upon information available to us at the time that these estimates, judgments and assumptions are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities as of the date of the financial statements as well as the reported amounts of revenues and expenses during the periods presented. To the extent there are material differences between these estimates, judgments or assumptions and actual results, its consolidated financial statements will be affected. In many cases, the accounting treatment of a particular transaction is specifically dictated by GAAP and does not require management's judgment in its application. There are also areas in which management's judgment in selecting among available alternatives would not produce a materially different result.

## *3. Revenue Recognition*

Revenues from software licensing are recognized in accordance with ASC 985-605, "Software Revenue Recognition." Accordingly, revenue from software licensing is recognized when all of the following criteria are met: persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collectability is probable.

The Company intends to enter into arrangements with end users for items which may include software license fees, and services or various combinations thereof. For each arrangement, revenues will be recognized when evidence of an agreement has been documented, the fees are fixed or determinable, collection of fees is probable, delivery of the product has occurred and no other significant obligations remain.

**Multiple-Element Arrangements:** For multiple-element arrangements, the Company applies the residual method in accordance with ASC 985-605. The residual method requires that the portion of the total arrangement fee attributable to the undelivered elements be deferred based on its vendor-specific objective evidence ("VSOE") of fair value and subsequently recognized as the service is delivered. The difference between the total arrangement fee and the amount deferred for the undelivered elements is recognized as revenue related to the delivered elements, which is generally the software license. VSOE of fair value for all elements in an arrangement is based upon the normal pricing for those products and services when sold separately. VSOE of fair value for support services is additionally determined by the renewal rate in customer contracts. The Company has established VSOE of fair value for support as well as consulting services.

License Revenues: Amounts allocated to license revenues are recognized at the time of delivery of the software and all other revenue recognition criteria discussed above have been met.

Revenue from licensing software, which requires significant customization and modification, is recognized using the percentage of completion method, based on the hours of effort incurred by the Company in relation to the total estimated hours to complete. In instances where third party hardware, software or services form a significant portion of a customer's contract, the Company recognizes revenue for the element of software customization by the percentage of completion method described above. Otherwise, third party hardware, software, and services are recognized upon shipment or acceptance as appropriate. If the Company makes different judgments or utilizes different estimates of the total amount of work expected to be required to customize or modify the software, the timing and revenue recognition, from period to period, and the margins on the project in the reporting period, may differ materially from amounts reported. Anticipated contract losses are recognized as soon as they become known and are estimable.

Service Revenues: Revenues from services are comprised of maintenance and consulting and implementation services. Maintenance revenues include providing for unspecified when-and-if available product updates and customer telephone support services, and are recognized ratably over the term of the service period. Consulting services are generally sold on a time-and-materials basis and include a range of services including installation of software and assisting in the design of interfaces to allow the software to operate in customized environments. Services are generally separable from other elements under the arrangement since performance of the services are not essential to the functionality of any other element of the transaction and are described in the contract such that the total price of the arrangement would be expected to vary as the result of the inclusion or exclusion of the services. Revenues from services are generally recognized as the services are performed.

The Company provides customers, free of charge or at a minimal cost, testing kits which potential licensing customers may use to test compatibility/acceptance of the Company's technology with the customer's intended applications.

Costs and other expenses: Includes professional compensation and other direct contract expenses, as well as costs attributable to the support of client service professional staff, depreciation and amortization costs related to assets used in revenue-generating activities, and other costs attributable to serving the Company's client base. Professional compensation consists of payroll costs and related benefits including stock-based compensation and bonuses. Other direct contract expenses include costs directly attributable to client engagements, such as out-of-pocket costs including travel and subsistence for client service professional staff, costs of hardware and software and costs of subcontractors. The allocation of lease and facilities charges for occupied offices is included in costs of service.

The Company accounts for its warranties under the FASB ASC 450, "Contingencies." The Company generally warrants that its products are free from defects in material and workmanship for a period of one year from the date of initial receipt by its customers. The warranty does not cover any losses or damage that occurs as a result of improper installation, misuse or neglect or repair or modification by anyone other than the Company or its authorized repair agent. The Company's policy is to accrue anticipated warranty costs based upon historical percentages of items returned for repair within one year of the initial sale. The Company's repair rate of products under warranty has been minimal, and a historical percentage has not been established. The Company's software license agreements generally include certain provisions for indemnifying customers against liabilities if the Company's software products infringe upon a third party's intellectual property rights. The Company has not provided for any reserves for warranty liabilities as it was determined to be immaterial.

#### 4. *Cash Equivalents*

Cash equivalents consist of liquid investments with original maturities of three months or less. At December 31, 2016 and 2015, cash equivalents consisted of a money market account.

#### 5. *Accounts Receivable*

Accounts receivable are carried at original amount less an estimate made for doubtful receivables based on a review of all outstanding amounts on a monthly basis. Management determines the allowance for doubtful receivables by regularly evaluating individual customer receivables and considering a customer's financial condition, credit history, and current economic conditions. Accounts receivable are written off when deemed uncollectible. During the quarter ended September 30, 2016, the company reclassified a past due receivable to non-current as management concluded that collection may not occur in the near term. As a result of the payment delays at December 31, 2016, the Company has reserved \$500,000 which represents 24% of the remaining balance owed under the contract. Recoveries of accounts receivable previously written off are recorded when received. Accounts receivable at December 31, 2016 and 2015 consisted of the following:

**December 31,**  
**2016            2015**

Accounts receivable - current	\$1,577,031	\$3,405,190
Accounts receivable - non current	2,070,000	-
	3,647,031	3,405,190
Allowance for doubtful accounts - current	(13,785 )	(13,785 )
Allowance for doubtful accounts - non current	(500,000 )	-
Accounts receivable, net of allowances for doubtful accounts	\$3,133,246	\$3,391,405

The allowance for doubtful accounts for the years ended December 31, 2016 and 2015 is as follows:

	Balance at Beginning of Year	Charged to Costs and Expenses	Deductions From Reserves	Balance at End of Year
<i>Year Ended December 31, 2016</i>				
Allowance for Doubtful Accounts	\$ 13,785	\$500,000	\$ -	\$513,785
<i>Year Ended December 31, 2015</i>				
Allowance for Doubtful Accounts	\$ 20,526	\$-	\$ (6,741 )	\$13,785

The bad debt expense is recorded in selling, general, and administrative expense.

#### 6. Software License Rights

Software license rights acquired for re-sale to end users are recorded as assets when purchased and are stated at the lower of cost or estimated net realizable value.

The cost of the software license rights has been initially allocated pro-rata to the maximum number of resalable end-user licenses in the rights contract. Licenses are amortized to cost of sales over the greater of the following: 1) an estimate of the economic use of such license rights over a 10 year period with weighting towards the beginning of the term, 2) straight line method over ten years or 3) ratably at cost basis as each end user license is resold to a customer. Management re-evaluates the total sub-licenses it expects to sell during the proceeding twelve months and will adjust the allocation of the current portion vs. non-current portion of software rights.



The rights are also evaluated by management on a periodic basis to determine if estimated future net revenues, on a per sub-license basis, support the recorded basis of each license. If the estimated net revenues are less than the current carrying value of the capitalized software license rights, the Company will reduce the rights to their net realizable value.

*7. Equipment and Leasehold Improvements, Intangible Assets and Depreciation and Amortization*

Equipment and leasehold improvements are stated at cost. Depreciation is provided for in amounts sufficient to relate the cost of depreciable assets to operations over the estimated service lives, principally using straight-line methods. Leasehold improvements are amortized over the shorter of the life of the improvement or the lease term, using the straight-line method.

The estimated useful lives used to compute depreciation and amortization for financial reporting purposes are as follows:

	Years	
<i>Equipment and leasehold improvements</i>		
Equipment (years)	3-	5
Furniture and fixtures (years)	3-	5
Software (years)	3	
Leasehold improvements	life or lease term	

Intangible assets consist of patents. Patent costs are capitalized until patents are awarded. Upon award, such costs are amortized using the straight-line method over their respective economic lives. If a patent is denied, all costs are charged to operations in that year.

*8. Impairment or Disposal of Long Lived Assets, including Intangible Assets*

The Company reviews long-lived assets, including intangible assets subject to amortization, whenever events or changes in circumstances indicate that the carrying amount of such an asset may not be recoverable. Recoverability of these assets is measured by comparison of their carrying amount to the future undiscounted cash flows the assets are expected to generate. If such assets are considered impaired, the impairment to be recognized is equal to the amount by which the carrying value of the assets exceeds their fair value determined by either a quoted market price, if any, or a value determined by utilizing a discounted cash flow technique. In assessing recoverability, the Company must make assumptions regarding estimated future cash flows and discount factors. If these estimates or related

assumptions change in the future, the Company may be required to record impairment charges. Intangible assets with determinable lives are amortized over their estimated useful lives, based upon the pattern in which the expected benefits will be realized, or on a straight-line basis, whichever is greater. The Company did not record any impairment charges in any of the years presented.

#### *9. Advertising Expense*

The Company expenses the costs of advertising as incurred. Advertising expenses for 2016 and 2015 were approximately \$299,000 and \$339,000, respectively.

#### *10. Deferred Revenue*

Deferred revenue includes customer advances and amounts that have been billed per the contractual terms but have not been recognized as revenue. The majority of these amounts are related to maintenance contracts for which the revenue is recognized ratably over the applicable term, which generally is 12 months from the date the customer is delivered the products.

#### *11. Research and Development Expenditures*

Research and development expenses include costs directly attributable to the conduct of research and development programs primarily related to the development of our software products and improving the efficiency and capabilities of our existing software. Such costs include salaries, payroll taxes, employee benefit costs, materials, supplies, depreciation on research equipment, services provided by outside contractors, and the allocable portions of facility costs, such as rent, utilities, insurance, repairs and maintenance, depreciation and general support services. All costs associated with research and development are expensed as incurred.



## 12. *Earnings Per Share of Common Stock (“EPS”)*

The Company’s EPS is calculated by dividing net income (loss) applicable to common stockholders by the weighted-average number of common shares outstanding during the reporting period. Diluted EPS includes the effect from potential issuances of common stock, such as stock issuable pursuant to the conversion of preferred stock, exercise of stock options and warrants, when the effect of their inclusion is dilutive. See Note S - Earnings Per Share “EPS” for additional information.

## 13. *Accounting for Stock-Based Compensation*

The Company accounts for share based compensation in accordance with the provisions of ASC 718-10, “Compensation — Stock Compensation,” which requires measurement of compensation cost for all stock awards at fair value on date of grant and recognition of compensation over the service period for awards expected to vest. The majority of its share-based compensation arrangements vest over either a three or four year vesting schedule. The Company expenses its share-based compensation under the ratable method, which treats each vesting tranche as if it were an individual grant. The fair value of stock options is determined using the Black-Scholes valuation model, and requires the input of highly subjective assumptions. These assumptions include estimating the length of time employees will retain their vested stock options before exercising them (the “expected option term”), the estimated volatility of its common stock price over the option’s expected term, the risk-free interest rate over the option’s expected term, and the Company’s expected annual dividend yield. Changes in these subjective assumptions can materially affect the estimate of fair value of stock-based compensation and consequently, the related amount recognized as an expense in the consolidated statements of operations. As required under the accounting rules, the Company reviews its valuation assumptions at each grant date and, as a result, the Company is likely to change its valuation assumptions used to value employee stock-based awards granted in future periods. The values derived from using the Black-Scholes model are recognized as expense over the service period, net of estimated forfeitures (the number of individuals that will ultimately not complete their vesting requirements). The estimation of stock awards that will ultimately vest requires significant judgment. The Company considers many factors when estimating expected forfeitures, including types of awards, employee class, and historical experience. Actual results, and future changes in estimates, may differ substantially from current estimates.

The following table presents share-based compensation expenses included in the Company’s consolidated statements of operations:

### **Year ended**

**December 31,  
2016      2015**

Selling, general and administrative	\$265,555	\$202,073
Research, development and engineering	74,786	139,042
	\$340,341	\$341,115

#### *Valuation Assumptions for Stock Options*

For 2016 and 2015, 27,087 and 119,000 stock options were granted, respectively. The fair value of each option was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	<b>Year ended</b>	
	<b>December</b>	
	<b>31,</b>	
	<b>2016</b>	<b>2015</b>
Weighted average Risk free interest rate	1.11 %	1.46 %
Expected life of options (in years)	4.5	4.5
Expected dividends	0 %	0 %
Weighted average Volatility of stock price	93 %	117 %

The stock volatility for each grant is determined based on the review of the experience of the weighted average of historical daily price changes of the Company's common stock over the expected option term. The expected term was determined using the simplified method for estimating expected option life, which qualify as "plain-vanilla" options; and the risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant for periods corresponding with the expected life of the option.

#### *14. Derivative Liabilities*

In connection with the issuances of equity instruments or debt, the Company may issue options or warrants to purchase common stock. In certain circumstances, these options or warrants may be classified as liabilities, rather than as equity. In addition, the equity instrument or debt may contain embedded derivative instruments, such as conversion options or listing requirements, which in certain circumstances may be required to be bifurcated from the associated host instrument and accounted for separately as a derivative liability instrument. The Company accounts for derivative liability instruments under the provisions of FASB ASC 815, "Derivatives and Hedging."

### 15. *Deferred Costs*

Costs incurred with obtaining and executing debt arrangements are capitalized and amortized to interest expense using the effective interest method over the term of the related debt.

### 16. *Income Taxes*

The provision for, or benefit from, income taxes includes deferred taxes resulting from the temporary differences in income for financial and tax purposes using the liability method. Such temporary differences result primarily from the differences in the carrying value of assets and liabilities. Future realization of deferred income tax assets requires sufficient taxable income within the carryback, carryforward period available under tax law. The Company evaluates, on a quarterly basis whether, based on all available evidence, if it is probable that the deferred income tax assets are realizable. Valuation allowances are established when it is more likely than not that the tax benefit of the deferred tax asset will not be realized. The evaluation, as prescribed by ASC 740-10, "Income Taxes," includes the consideration of all available evidence, both positive and negative, regarding historical operating results including recent years with reported losses, the estimated timing of future reversals of existing taxable temporary differences, estimated future taxable income exclusive of reversing temporary differences and carryforwards, and potential tax planning strategies which may be employed to prevent an operating loss or tax credit carryforward from expiring unused. Because of the Company's historical performance and estimated future taxable income, a full valuation allowance has been established.

The Company accounts for uncertain tax provisions in accordance with ASC 740-10-05, "Accounting for Uncertainty in Income Taxes." The ASC clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements. The ASC prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The ASC provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

### 17. *Recent Accounting Pronouncements*

In May 2014, ASU No. 2014-09, "Revenue from Contracts with Customers" was issued. The comprehensive new standard will supersede existing revenue recognition guidance and require revenue to be recognized when promised goods or services are transferred to customers in amounts that reflect the consideration to which the Company expects to be entitled in exchange for those goods or services. The guidance will also require that certain contract costs incurred to obtain or fulfill a contract, such as sales commissions, be capitalized as an asset and amortized as revenue is recognized. Adoption of the new rules could affect the timing of both revenue recognition and the incurrence of

contract costs for certain transactions. The guidance permits two implementation approaches, one requiring retrospective application of the new standard with restatement of prior years and one requiring prospective application of the new standard with disclosure of results under old standards. The new standard was scheduled to be effective for reporting periods beginning after December 15, 2017 and early adoption is not permitted. In August 2015, the FASB issued ASU 2015-14, "Revenue from Contracts with Customers (Topic 606): Deferral of Effective Date" ("ASU 2015-14") which defers the effective date of ASU 2014-09 by one year. ASU 2014-09 is now effective for annual reporting periods after December 15, 2017 including interim periods within that reporting period. The Company is currently evaluating the impact of adoption and the implementation approach to be used.

In April 2015, the FASB issued ASU 2015-03, "Interest-Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs." ASU 2015-03 requires debt issuance costs related to a debt liability measured at amortized cost to be reported in the balance sheet as a direct deduction from the face amount of the debt liability. ASU 2015-03 is effective for interim and annual periods beginning January 1, 2016 with early adoption permitted, and is applied on a retrospective basis. The adoption of ASU 2015-03 did not materially impact the Company's consolidated financial statements.

In July 2015 the FASB issued ASU No. 2015-11, "Inventory (Topic 330): Simplifying the Measurement of Inventory" ("ASU 2015-11"). The amendments in ASU 2015-11 clarifies the measurement of inventory to be the lower of cost or realizable value and would only apply to inventory valued using the FIFO or average costing methods. ASU 2015-11 is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. The reporting entity should apply the amendments prospectively with earlier application permitted as of the beginning of an interim or annual reporting period. The Company does not believe that this will have a material impact on its consolidated financial statements.

In September 2015, FASB issued ASU 2015-16, "Simplifying the Accounting for Measurement-Period Adjustments" ("ASU 2015-16"). This standard requires an acquirer to recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. ASU 2015-16 also requires separate presentation on the face of the income statement, or disclosure in the notes, of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amount had been recognized as of the acquisition date. ASU 2015-16 was effective for the Company beginning January 1, 2016 and did not have a material impact on its consolidated financial statements.

In November 2015, the FASB issued ASU 2015-17, "Balance Sheet Classification of Deferred Taxes" ("ASU 2015-17"). This update requires an entity to classify deferred tax liabilities and assets as noncurrent within a classified statement of financial position. ASU 2015-17 is effective for annual reporting periods, and interim periods therein, beginning after December 15, 2016. This update may be applied either prospectively to all deferred tax liabilities and assets or retrospectively to all periods presented. Early application is permitted as of the beginning of the interim or annual reporting period. In the fourth quarter of 2015, the Company elected to early adopt using the prospective method. Therefore, no prior periods were retrospectively adjusted. The adoption did not have a material impact on the Company's consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, "Financial Instruments – Overall: Recognition and Measurement of Financial Assets and Financial Liabilities" ("ASU 2016-01"). The update addresses certain aspects of recognition, measurement, presentation and disclosure of financial instruments, specifically equity investments and financial instruments measured at amortized cost. ASU 2016-01 is effective for public companies for annual and interim periods beginning after December 15, 2017. Management is currently assessing the impact ASU 2016-01 will have, if any, on the Company's consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, "Leases". The new standard establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The Company is currently evaluating the impact of its pending adoption of the new standard on its consolidated financial statements, but expects that it will increase its assets and liabilities.

In March 2016, the FASB issued Accounting Standards Update 2016-09, "Compensation – Stock Compensation: Improvements to Employee Share-Based Payment Accounting" ("ASU 2016-09"). ASU 2016-09 requires, among other things, that excess tax benefits and tax deficiencies be recognized as income tax expense or benefit in the income statement rather than as additional paid-in capital, changes the classification of excess tax benefits from a financing activity to an operating activity in the statement of cash flows, and allows forfeitures to be accounted for when they occur rather than estimated. ASU 2016-09 is effective for public companies for interim and annual periods beginning after December 15, 2016. The Company does not believe that this will have a material impact on its consolidated financial statements.

Management does not believe that any other recently issued, but not yet effective, accounting standard if currently adopted would have a material effect on the accompanying consolidated financial statements.

## 18. Reclassifications

Reclassifications occurred to certain prior year amounts in order to conform to the current year classifications. The reclassifications have no effect on the reported net loss.

**NOTE B—FACTORING**

Due from factor consisted of the following as of December 31:

	Original Invoice Value	Factored Amount	Factored Balance due
<i>Year Ended December 31, 2016</i>			
Factored accounts receivable	\$214,556	\$160,918	\$53,638
<i>Year Ended December 31, 2015</i>			
Factored accounts receivable	\$149,680	\$112,259	\$37,421

As of December 2011, the Company entered into a 24 month accounts receivable factoring arrangement with a financial institution (the “Factor”) which has been extended to October 31, 2017. Pursuant to the terms of the arrangement, the Company, from time to time, sells to the Factor certain of its accounts receivable balances on a non-recourse basis for credit approved accounts. The Factor remits 35% of the foreign and 75% of the domestic accounts receivable balance to the Company (the “Advance Amount”), with the remaining balance, less fees to be forwarded to the Company once the Factor collects the full accounts receivable balance from the customer. In addition, the Company, from time to time, receives over advances from the factor. Factoring fees range from 2.75% to 21% of the face value of the invoice factored, and are determined by the number of days required for collection of the invoice. The cost of factoring is included in selling, general and administrative expenses. The cost of factoring was as follows:

**Years Ended  
December 31,  
2016      2015**

Factoring fees    \$341,023    \$383,629

**NOTE C—FAIR VALUES OF FINANCIAL INSTRUMENTS**

Cash and cash equivalents, accounts receivable, inventory, due from factor, accounts payable and accrued liabilities are carried at, or approximate, fair value because of their short-term nature.

For the embedded derivatives that were bifurcated from the associated host instruments, the Company utilized the Monte Carlo simulation. The stock volatility for each grant is determined based on the review of the experience of the weighted average of historical daily price changes of the Company's common stock over the expected term and the risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant for periods corresponding with the expected term of the derivative.

The warrant and derivative liabilities are considered Level 3 liabilities on the fair value hierarchy as the determination of fair value includes various assumptions about future activities and the Company's stock prices and historical volatility as inputs.

The table below provides a reconciliation of the beginning and ending balances for the liabilities measured at fair value using significant unobservable inputs (Level 3). There were no assets as of or during the years ended December 31, 2016 and 2015 measured using significant unobservable inputs.

## Fair Value Measurements Using

## Significant Unobservable Inputs (Level 3):

Warrants issued Under October and November 2013 PI SPA (Note O2c)	
Fair value at January 1, 2016	\$7,478
Gain on derivative	(7,478 )
Value at December 31, 2016 (expired)	\$-
Warrant issued under September 2015 SPA (Note I)	
Fair value at January 1, 2016	\$96,806
Gain on derivative	(4,607 )
Transfer grant date fair value to additional paid-in-capital	(92,199)
Value at December 31, 2016	\$-
Total warrant balance, December 31, 2016	\$-

**NOTE D—CONCENTRATION OF RISK**

Financial instruments which potentially subject the Company to risk primarily consist of cash and accounts receivables.

The Company maintains its cash and cash equivalents with various financial institutions, which, at times may exceed the amounts insured by the Federal Deposit Insurance Corporation. The exposure to the Company is solely dependent upon daily bank balances and the respective strength of the financial institutions. The Company has not incurred any losses on these accounts. At December 31, 2016 and 2015, amounts in excess of insured limits were approximately \$811,000 and \$4,073,000, respectively.

The Company extends credit to customers on an unsecured basis in the normal course of business. The Company's policy is to perform an analysis of the recoverability of its receivables at the end of each reporting period and to establish allowances where appropriate. The Company analyzes historical bad debts and contract losses, customer concentrations, and customer credit-worthiness when evaluating the adequacy of the allowances.

The Company had certain customers whose revenue individually represented 10% or more of the Company's total revenue, as follows:

	<b>Years Ended December 31, 2016 2015</b>	
Customer A	34 %	*
Customer B	12 %	*
Customer C	*	37 %

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\* Less than 10% of total revenue





The Company had certain customers whose accounts receivable balances individually represented 10% or more of the Company's total accounts receivable, as follows:

	<b>As of December 31, 2016 2015</b>	
Customer A	35 %	*
Customer C	56 %	62 %
Customer D	*	14 %
Customer E	*	11 %

---

\* Less than 10% of total accounts receivable

Customer C's receivable of \$2,070,000 has been past due per the terms of the invoice for eighteen months as of December 31, 2016. The Company has reserved \$500,000 which represents 24% of the remaining balance owed under the contract.

#### **NOTE E—INVENTORY**

Inventory is stated at the lower of cost, determined on a first in, first out basis, or market, and consists primarily of fabricated assemblies and finished goods. Inventory is comprised of the following as of December 31:

	<b>2016</b>	<b>2015</b>
<i>Current</i>		
Finished goods	381,762	66,475
Fabricated assemblies	83,666	102,170
Total current inventory	\$465,428	\$168,645

The Company reclassified resalable software license rights of \$180,000 from finished goods inventory to software license rights to conform to the current year presentation. See Note F.

#### **NOTE F—SOFTWARE LICENSES AND RIGHTS**

On November 11, 2015, the Company entered into a license agreement for the rights to all software and documentation regarding the technology currently known as or offered under the FingerQ name. The license agreement grants the Company the exclusive right to reproduce, create derivative works and distribute copies of the FingerQ software and documentation, create new FingerQ related products, and grant sub-licenses of the licensed technology to end users. The license rights have been granted to the Company in perpetuity, with a stated number of end-user resale sub-licenses allowed under the contract for a total of \$12,000,000. The cost of sub-license rights expected to be sold to customers in the following 12 months is \$1,560,000 and is classified as a current asset, and the balance as non-current.

The Company has determined the software license rights to be a finite lived intangible asset, and estimated that the software license rights shall be economically used over a 10 year period, with a weighting towards the beginning years of that time-frame. The license rights were acquired during the fourth quarter of 2015, but the usage of such rights in our products was not generally available until January 2017. Accordingly, amortization will begin in the first quarter of 2017. During 2016 we embedded some of the licensed software in our products and expensed the actual per unit cost (actual usage) of such license rights in the amount of \$1,909. There was no amortization expense in 2015. The remaining license rights are to be amortized over the greater of the following: 1) an estimate of the economic use of such license rights, 2) straight line method over ten years or 3) the actual usage of such rights. The Company believes categorizing the amortization expense under Cost of Sales more closely reflects the nature of the license right arrangement and the use of the technology.

On December 31, 2015, the Company purchased third party software licenses in amount of \$180,000 in anticipation of a large pending deployment that has yet to materialize. During 2016 we expensed the actual per unit cost (actual usage) of such license rights in the amount of \$19,680. Therefore, although some of the licenses have been sold during 2016, the Company has classified the balance as non-current until a larger deployment occurs.

	<b>2016</b>	<b>2015</b>
Current software license rights	\$1,560,000	\$5,000,000
Non-current software license rights	10,598,411	7,000,000
Total software license rights	\$12,158,411	\$12,000,000

During the year ended December 31, 2016, there were no events or changes in circumstances that indicated the carrying amount of the software license rights may not be recoverable from their undiscounted cash flows. Consequently, we did not perform an impairment test. The Company did not record an impairment loss related to the software license rights during the years ended December 31, 2016 and 2015.

Estimated amortization expense based on economic use of the software license rights for each of the next five years and thereafter approximates the following:

Years ending December 31

2017	\$ 1,560,000
2018	2,640,000
2019	3,000,000
2020	2,400,000
2021	1,200,000
Thereafter	1,358,411

**NOTE G—EQUIPMENT AND LEASEHOLD IMPROVEMENTS**

Equipment and leasehold improvements consisted of the following as of December 31:

	<b>2016</b>	<b>2015</b>
Equipment	\$403,425	\$398,910
Furniture and fixtures	162,067	139,779
Software	32,045	28,624
Leasehold improvements	23,403	53,948
	620,940	621,261
Less accumulated depreciation and amortization	(553,126)	(557,384)
Total	\$67,814	\$63,877

Depreciation and amortization were \$49,038 and \$42,996 for 2016 and 2015, respectively. Amounts are recorded in Selling, General, and Administrative Expense.

**NOTE H—INTANGIBLE ASSETS**

Intangible assets consisted of the following as of December 31:

	<b>2016</b>		<b>Net</b>	<b>2015</b>		<b>Net</b>
	<b>Gross</b>	<b>Accumulated</b>	<b>Carrying</b>	<b>Gross</b>	<b>Accumulated</b>	<b>Carrying</b>
	<b>Carrying</b>	<b>Amortization</b>	<b>Amount</b>	<b>Carrying</b>	<b>Amortization</b>	<b>Amount</b>
	<b>Amount</b>	<b>Amount</b>	<b>Amount</b>	<b>Amount</b>	<b>Amount</b>	<b>Amount</b>
Patents and patents pending	\$287,248	\$ (153,116 )	\$ 134,132	\$287,248	\$ (139,510 )	\$ 147,738
Total	\$287,248	\$ (153,116 )	\$ 134,132	\$287,248	\$ (139,510 )	\$ 147,738

Aggregate amortization expense for both 2016 and 2015 was \$13,606. Amounts are recorded in Research, Development and engineering expense. The estimated aggregate amortization expense of intangible assets for the years following December 31, 2016 is approximately \$13,000 per year for 2017 through 2021, and approximately \$35,000 thereafter.

## **NOTE I—NOTE PAYABLE**

### Securities Purchase Agreement dated September 23, 2015

On September 23, 2015 the Company issued a promissory note due seven months from the date of issuance and a warrant to purchase 69,445 shares of common stock in net consideration, after the original issue discount, of \$250,000. The principal sum due under the note is the aggregate purchase price of \$250,000 plus an original issue discount of approximately 20% of the purchase price and a one-time interest charge of 12% of the purchase price. The principal sum and all other amounts owing under the note were fully paid by the Company following the initial closing of the October 2015 Series A-1 Convertible Preferred Stock offering. The warrants are immediately exercisable at an exercise price of \$3.60 per share and have a term of five years.

The warrants have customary anti-dilution protections including a "full ratchet" anti-dilution adjustment provision which are triggered in the event the Company sells or grants any additional shares of common stock, options, warrants or other securities that are convertible into common stock at a price lower than \$3.60 per share. The anti-dilution adjustment provision is not triggered by certain "exempt issuances" which among other issuances, includes the issuance of shares of common stock, options or other securities to officers, employees, directors, consultants or service providers.

Based on an evaluation as discussed in FASB ASC 815-15, "Embedded Derivatives" and FASB ASC 815-40-15, "Contracts in Entity's Own Equity - Scope and Scope Exceptions," the Company determined that the full ratchet anti-dilution feature in the common stock issued was not considered indexed to its own stock because neither the occurrence of a sale of equity securities by the issuer at market nor the issuance of another equity contract with a lower strike price is an input to the fair value of a fixed-for-fixed option or forward on equity shares. As such, the full ratchet anti-dilution feature should be bifurcated from the common stock and accounted for as a derivative liability.

The Company did not value the derivative liability. One of the key determinants of the Company's decision to not value the derivative liability was the high likelihood that a future financing would not occur that would trigger the down round feature. Whether a future equity financing would occur would be determined by the cash needs of the Company and management's willingness to trigger the down round feature. The Company's reasons were based on the issuance of Series A-1 and Series B-1 preferred stock in October and November of 2015, issued at a conversion price of \$3.60.



The cashless exercise features contained in the warrants were initially considered to be derivatives and the Company recorded a warrant liability of \$92,199 on the consolidated balance sheet. The warrants issued by the Company were valued using an option-pricing model. The Company marked-to-market the warrant liabilities at the end of each reporting period. During the 2016 year, the Company determined the cashless exercise features did not meet the criteria for recording a warrant liability. Accordingly, the grant date fair value of the warrant liability was transferred to additional paid-in capital and the cumulative loss due to change in the recorded fair value of the liability was reversed during the period. For the year ended December 31, 2016 the Company recorded income of \$4,607 in order to reverse the net cumulative loss on the warrant liability that had been previously recorded. The warrant liability was \$96,806 as of December 31, 2015.

The fair value of the warrants was initially estimated on the date of grant at \$92,199 using the Black-Scholes option-pricing model with the following assumptions: risk free interest rate: 1.47%, expected remaining life of options in years: 5, expected dividends: 0, volatility of stock price: 115.7%.

#### **NOTE J—ACCRUED LIABILITIES**

Accrued liabilities consisted of the following as of December 31:

	<b>2016</b>	<b>2015</b>
Compensation	\$66,152	\$78,016
Compensated absences	154,368	113,996
Accrued legal and accounting fees	79,633	141,000
Sales tax payable	26,988	48,255
Other	8,182	111,800
Total	\$335,323	\$493,067

#### **NOTE K—RELATED PARTY**

##### **Licensing Agreement with Subsidiaries of China Goldjoy Group Limited.**



On November 11, 2015 our subsidiary BIO-key Hong Kong Limited entered into a license purchase agreement with certain subsidiaries of China Goldjoy Group Limited (“CGG”). The license agreement provides for the grant of a perpetual, irrevocable, exclusive, worldwide, fully-paid license to all software and documentation regarding the software code, toolkit, electronic libraries and related technology currently known as or offered under the Finger Q name, together with perpetual license under all related patents held by the licensors and any other intellectual property rights owned by the licensors related to the forgoing software. We made a one-time payment of \$12,000,000 to the licensors. Mr. Yao Jianhu is the chairman and chief executive officer of CGG and a director of the Company. Mr. Wong Kwok Fong served as the chief technology officer of CGG through October 2016 and is the beneficial owner of 17.2% of our common stock, and a director and executive officer of the Company.

#### **Securities Purchase Agreement with Wong Kwok Fong**

On November 18, 2016, we issued to Wong Kwok Fong, a director and executive officer of the Company 516,667 shares of common stock at a purchase price of \$3.60 per share for gross cash proceeds of \$1,860,000.

#### **NOTE L—DEFERRED REVENUE**

Deferred revenue represents unearned revenue on maintenance contracts. Maintenance contracts include provisions for unspecified when-and-if available product updates and customer telephone support services, and are recognized ratably over the term of the service period. At December 31, 2016 and 2015, amounts in deferred revenue were approximately \$633,000 and \$376,000, respectively.

#### **NOTE M—SEGMENT INFORMATION**

The Company has determined that its continuing operations are one discrete segment consisting of Biometric products. Geographically, North American sales accounted for approximately 78% and 51% of the Company’s total revenues for 2016 and 2015, respectively.

**NOTE N—COMMITMENTS AND CONTINGENCIES**

*Operating Leases*

The Company does not own any real estate but conducts operations from three leased premises. These non-cancelable operating leases expire at various dates through 2018. In addition to base rent, the Company pays for property taxes, maintenance, insurance and other occupancy expenses according to the terms of the individual leases.

Future minimum rental commitments of non-cancelable operating leases are approximately as follows:

<b>Years ending December 31,</b>	
2017	165,111
2018	103,829
	\$268,940

Rental expense was approximately \$193,000 and \$170,000 during 2016 and 2015, respectively. Amounts are recorded in Selling, General, and administrative expenses.

*Contingency*

On or about March 13, 2014, LifeSouth Community Blood Centers, Inc. (“LifeSouth”), filed a lawsuit against the Company in the Superior Court of Monmouth County, New Jersey (MON-L-1042-14) alleging a breach of a license agreement and seeking return of all amounts paid under the license in the amount of \$718,500. On August 21, 2015, the Company and LifeSouth entered into a settlement agreement to discontinue and end litigation.

**NOTE O— EQUITY**

1. Preferred Stock

Within the limits and restrictions provided in the Company's Certificate of Incorporation, the Board of Directors has the authority, without further action by the shareholders, to issue up to 5,000,000 shares of preferred stock, \$.0001 par value per share, in one or more series, and to fix, as to any such series, any dividend rate, redemption price, preference on liquidation or dissolution, sinking fund terms, conversion rights, voting rights, and any other preference or special rights and qualifications. As of December 31, 2016, 100,000 shares of preferred stock have been designated as Series A-1 Convertible Preferred Stock, of which 90,000 shares are issued and outstanding, and 105,000 shares of preferred stock have been designated as Series B-1 Convertible Preferred Stock, all of which are outstanding.

Series A-1 Convertible Preferred Stock

On October 22 and 29, 2015, the Company issued 84,500 shares of Series A-1 Convertible Preferred Stock at a purchase price of \$100.00 per share, for aggregate gross proceeds of \$8,450,000. On November 11, 2015, 5,500 additional shares of Series A-1 Convertible Preferred Stock were issued at a purchase price of \$100.00 per share, for gross cash proceeds of \$550,000. Shares of the Series A-1 Convertible Preferred Stock are convertible at any time at the option of the holder into shares of common stock by dividing the Series A-1 Original Issue Price by the conversion price of \$3.60 per share, subject to adjustment for stock dividends, stock splits, combinations, and reclassifications of the Company's capital stock, and subject to a "blocker provision" which prohibits conversion if such conversion would result in the holder being the beneficial owner of in excess of 9.99% of the Company's common stock. The Series A-1 Shares accrue dividends at the rate of 6% per annum payable quarterly on April 1, July 1, October 1, and January 1 of each year. Until October 1, 2017, the dividends are payable in cash provided that if payment in cash would be prohibited under applicable Delaware corporation law or cause the Company to breach any agreement for borrowed money, such dividends are payable in kind through the issuance of additional shares of common stock having a value equal to the volume weighted average trading price of the Company's common stock for the ten (10) days preceding the applicable dividend payment date. Commencing January 1, 2018, dividends are payable at the option of the Company in cash or kind through the issuance of additional shares of common valued as described above.

The holders of the Series A-1 shares are entitled to designate one person to serve on the Board of Directors of the Company. The holders of the Series A-1 Shares are entitled to vote on an as converted to common stock basis together with the holders of common stock on all matters presented to the Company's stockholders. Upon any liquidation or dissolution of the Company, any merger or consolidation involving the Company or any subsidiary of the Company in which the shares of capital stock of the Company outstanding immediately prior to such merger or consolidation do not represent immediately following such merger or consolidation at least a majority of the voting power of the capital stock of the resulting or surviving corporation, or the sale of all or substantially all assets in a single transaction or a series of related transactions, unless the holders of at least a majority of the outstanding Series A-1 Shares elect otherwise, holders of Series A-1 Shares shall be entitled to receive prior to any payment to any holders of the Company's common stock an amount per share equal to \$100.00 per share plus any declared and unpaid dividends (pari-passu with the Series B-1 holders). As at December 31, 2016, \$270,000 of dividends were accrued for the holders of the Series A-1 shares which remain unpaid as of the date of this filing for October 1, 2016 and January 1, 2017 dividends.



The Series A-1 Preferred Stock contains options that based on an evaluation of FASB ASC 815-15, “Embedded Derivatives” and FASB ASC 815-40-15, “Contracts in Entity’s Own Equity - Scope and Scope Exceptions,” are considered embedded features: Preferred Stock’s conversion option: The Series A-1 Preferred Stock is convertible at the holder’s option at any time at the fixed conversion price of \$3.60 per share; Quarterly Dividend Conversion Option: From issuance until December 31, 2017, the holders of a majority of the outstanding Series A-1 Shares may elect to have the quarterly dividend payment made in shares of Common Stock, having a value equal to the volume weighted average trading price of the Common Stock during the ten (10) trading day period preceding the applicable dividend payment date. These features were analyzed by the Company and determined that they were not required to be bifurcated from the preferred stock and recorded as derivatives as they are clearly and closely related to an equity host.

### Series B-1 Convertible Preferred Stock

On November 11, 2015, the Company issued 105,000 shares of Series B-1 Convertible Preferred Stock at a purchase price of \$100.00 per share, for gross proceeds of \$10,500,000. Shares of the Series B-1 Convertible Preferred Stock are convertible at any time at the option of the holder into shares of common stock by dividing the Series B-1 Original Issue Price by the conversion price of \$3.60 per share, subject to adjustment for stock dividends, stock splits, combinations, and reclassifications of the Company’s capital stock, and subject to a “blocker provision” which prohibits conversion if such conversion would result in the holder being the beneficial owner of in excess of 9.99% of the Company’s common stock. The Series B-1 Shares accrue dividends at the rate of 2.5% per annum payable quarterly on April 1, July 1, October 1, and January 1 of each year payable in cash provided that if payment in cash would be prohibited under applicable Delaware corporation law or cause the Company to breach any agreement for borrowed money, or if the holders of a majority of the outstanding shares of the Series B-1 Shares elect otherwise, such dividends are payable in kind through the issuance of additional shares of common stock having a value equal to the volume weighted average trading price of the Company’s common stock for the ten (10) days preceding the applicable dividend payment date.

The holders of the Series B-1 Shares are entitled to designate one person to serve on the Board of Directors of the Company. The holders of the Series B-1 Shares are entitled to vote on an as converted to common stock basis together with the holders of our common stock on all matters presented to the Company’s stockholders. Upon any liquidation or dissolution of the Company, any merger or consolidation involving the Company or any subsidiary of the Company in which the shares of capital stock of the Company outstanding immediately prior to such merger or consolidation do not represent immediately following such merger or consolidation at least a majority of the voting power of the capital stock of the resulting or surviving corporation, or the sale of all or substantially all assets in a single transaction or a series of related transactions, unless the holders of at least a majority of the outstanding Series B-1 Shares elect otherwise, holders of Series B-1 Shares shall be entitled to receive prior to any payment to any holders of the Company’s common stock an amount per share equal to \$100.00 per share plus any declared and unpaid dividends (pari-passu with the Series A-1 holders). As at December 31, 2016 \$131,250 of dividends were accrued for the holders of the Series B-1 shares which remain unpaid as of the date of this filing for October 1, 2016 and January 1, 2017 dividends.

The Series B-1 Preferred Stock contains options that based on an evaluation of FASB ASC 815-15, "Embedded Derivatives" and FASB ASC 815-40-15, "Contracts in Entity's Own Equity - Scope and Scope Exceptions," are considered embedded features: Preferred Stock's conversion option: The Series B-1 Preferred Stock is convertible at the holder's option at any time at the fixed conversion price of \$3.60 per share; Quarterly Dividend Conversion Option: The holders of the majority of the outstanding Series B-1 shares may elect to have the Stock's Quarterly dividend payment made in shares of Common Stock, having a value equal to the volume weighted average trading price of the Common Stock during the ten (10) trading day period preceding the applicable dividend payment date. These features were analyzed by the Company and determined that they were not required to be bifurcated from the preferred stock and recorded as derivatives as they are clearly and closely related to an equity host.

### Stock Issuance Costs

Costs of approximately \$85,000 were incurred during 2016 in relation to the issuance of common and preferred stock.

## 2. Common Stock

Effective February 3, 2015, the Company implemented a reverse stock split of its outstanding common stock at a ratio of 1-for-2. The number of authorized shares and the par value of the Company's common stock and preferred stock were not affected by the reverse stock split. Stockholders who otherwise would be entitled to receive fractional shares were rounded up to the nearest whole share. The reverse stock split became effective on the OTCQB at the opening of trading on February 6, 2015.

Effective December 29, 2016, the Company implemented a reverse stock split of its outstanding common stock at a ratio of 1-for-12. The number of authorized shares and the par value of the Company's common stock and preferred stock were not affected by the reverse stock split. Stockholders who otherwise would be entitled to receive fractional shares were rounded up to the nearest whole share. The reverse stock split became effective on the OTCQB at the opening of trading on December 29, 2016.

Holders of common stock have equal rights to receive dividends when, as and if declared by the Board of Directors, out of funds legally available therefor. Holders of common stock have one vote for each share held of record and do not have cumulative voting rights.

Holders of common stock are entitled, upon liquidation of the Company, to share ratably in the net assets available for distribution, subject to the rights, if any, of holders of any preferred stock then outstanding. Shares of common stock are not redeemable and have no preemptive or similar rights. All outstanding shares of common stock are fully paid and nonassessable.

#### Issuances of Common Stock

- a) Securities Purchase Agreement dated November 11, 2016

Pursuant to a Securities Purchase Agreement, dated November 11, 2016, by and between the Company and Wong Kwok Fong the Company issued 516,667 shares of common stock for aggregate gross proceeds of \$1,860,000.

- b) Securities Purchase Agreement dated November 13, 2014

Pursuant to a Securities Purchase Agreement, dated November 13, 2014, by and between the Company and a number of private and institutional investors (the "November 2014 Private Investor SPA"), the Company issued to certain private investors 664,584 shares of common stock and warrants to purchase an additional 996,877 shares of common stock for aggregate gross proceeds of \$1,595,000.

The common stock has a purchase price reset feature. If at any time prior to the two year anniversary of the effective date of the registration statement covering the public resale of such shares (January 29, 2015), the Company sells or issues shares of common stock or securities that are convertible into common stock at a price lower than \$2.40 per

share, the Company will be required to issue additional shares of common stock for no additional consideration.

The Company valued the purchase price reset feature using a Monte Carlo simulation at the date of issuance, and at quarterly reporting intervals until the expiration of the feature in January 2017, and determined that the purchase price reset feature had no value as the Company issued Series A-1 and Series B-1 preferred stock in October and November of 2015, at a conversion price of \$3.60, and issued common stock in November 2016 also at a price of \$3.60.

The warrants have a term of five years and an exercise price of \$3.60 per share, and have been fully exercisable since February 2015. The warrants have customary anti-dilution protections including a “full ratchet” anti-dilution adjustment provision which are triggered in the event the Company sells or grants any additional shares of common stock, options, warrants or other securities that are convertible into common stock at a price lower than \$3.60 per share. The anti-dilution adjustment provision is not triggered by certain “exempt issuances” which among other issuances, includes the issuance of shares of common stock, options or other securities to officers, employees, directors, consultants or service providers.

Based on an evaluation as discussed in FASB ASC 815-15, “Embedded Derivatives” and FASB ASC 815-40-15, “Contracts in Entity’s Own Equity - Scope and Scope Exceptions,” the Company determined that the purchase price reset feature on the common stock and the full ratchet anti-dilution feature in the warrants issued were not considered indexed to its own stock because neither the occurrence of a sale of equity securities by the issuer at market nor the issuance of another equity contract with a lower strike price is an input to the fair value of a fixed-for-fixed option or forward on equity shares. As such, the purchase price reset feature and the full ratchet anti-dilution feature should be bifurcated from the common stock and warrants and accounted for as derivative liabilities.

The Company did not value the derivative liabilities. One of the key determinants of the Company’s decision to not value the derivative liability was the high likelihood that a future financing would not occur that would trigger the down round feature or the purchase price reset feature. Whether a future equity financing would occur would be determined by the cash needs of the Company and management’s willingness to trigger the down round feature or purchase price reset feature. The Company’s reason was based on the issuance of Series A-1 and Series B-1 preferred stock in October and November of 2015, issued at a conversion price of \$3.60, and the issuance of common stock in November 2016, at a price of \$3.60.



Under GAAP, the Company is required to mark-to-market the derivative liabilities at the end of each reporting period. The Company did not value the derivative liabilities at the date of issuance, December 31, 2016 or December 31, 2015. At such dates, the Company determined that it was highly unlikely that an equity financing would occur that would trigger the down round feature or purchase price reset feature. Such conclusion was based upon the discussion noted above.

c) Derivative Liabilities: Securities Purchase Agreements dated October 25, 2013 and November 8, 2013

Pursuant to a series of Private Investors Securities Purchase Agreements (the "PI SPA"), on October 25, 2013 and November 8, 2013, the Company issued to certain private investors an aggregate of 1,026,972 units consisting of 1,026,972 post-split shares of common stock (the "Shares") and warrants to purchase an additional 1,026,972 post-split shares of common stock (the "Warrants") for an aggregate purchase price of \$3,697,100. The warrants were immediately exercisable at an exercise price of \$6.00 per post-split share, and had a term of three years which expired in 2016.

In connection with the share issuances described above, and pursuant to a placement agency letter agreement, the Company paid the placement agent cash commissions equal to 8% of the gross proceeds of the offering, reimbursed the placement agent for its reasonable out of pocket expenses, and issued to the placement agent warrants (the "Placement Agent Warrants") to purchase an aggregate of 82,158 post-split shares of common stock. The Placement Agent Warrants have substantially the same terms as the warrants issued to the investors, except the Placement Agent Warrants were immediately exercisable on a cashless basis.

The cashless exercise features contained in the warrants were considered to be derivatives and the Company recorded warrant liabilities on the consolidated balance sheet. The Company initially recorded the warrant liabilities equal to their estimated fair value of \$325,891. Such amount was also recorded as a reduction of additional paid-in capital. The Company is required to mark-to-market the warrant liabilities at the end of each reporting period. For the year ended December 31, 2016, the Company recorded a gain on the change in fair value of the cashless exercise features of \$7,478. As of December 31, 2016, the fair value of the cashless exercise features was \$0 as the underlying warrants expired during the fourth quarter of 2016. The fair value of the cashless exercise features was \$7,478 as at December 31, 2015.

(d) Issuances to Directors, Executive Officers and Consultants

During the year ended December 31, 2016, the Company issued 18,914 shares of common stock to its directors in lieu of payment of board fees, valued at \$45,000, and issued 8,334 shares of common stock to the Chief Executive Officer as compensation, valued at \$17,000.

On December 13, 2016, the Company issued 41,667 shares of common stock to a consultancy firm in lieu of payment for services. The fair value at issuance was calculated at \$2.52 per share, with the total amount of \$105,000 to be expensed over the period of the services.

e) Employees' exercise options

No stock options were exercised during the years ended December 31, 2016 and 2015.

### 3. Warrants

The Company has issued warrants to certain creditors, investors, investment bankers and consultants. A summary of warrant activity is as follows:

	<b>Total Warrants</b>	<b>Weighted average exercise price</b>	<b>Weighted average remaining life (in years)</b>	<b>Aggregate intrinsic value</b>
Outstanding, as of January 1, 2015	1,587,266	4.44	3.91	
Granted	117,362	3.16		
Exercised	—	—		
Forfeited	—	—		
Expired	—	—		
Outstanding, as of December 31, 2015	1,704,628	4.40	3.02	—
Granted	—	—		
Exercised	—	—		
Forfeited	—	—		
Expired	(444,548 )	6.00		
Outstanding, as of December 31, 2016	1,260,080	3.84	2.78	—
Vested or expected to vest at December 31, 2016	1,260,080	3.84	2.78	—
Exercisable at December 31, 2016	1,260,080	3.84	2.78	—



On March 9, 2015, the Company issued a warrant to purchase 47,917 shares of common stock to a consultant which vested in equal quarterly installments over one year and is exercisable at \$2.52 per share through March 8, 2020.

The fair value of the warrants was initially estimated on the date of grant at \$98,065 using the Black-Scholes option-pricing model with the following assumptions: risk free interest rate: 1.66%, expected remaining life of options in years: 5, expected dividends: 0, volatility of stock price: 115.7%.

Share based expense related to the value of the stock warrants is recorded over the requisite service period, which is generally the vesting period for each tranche. For the years ended December 31, 2016 and December 31, 2015, the Company recorded an expense of \$11,625 and \$51,026 respectively, related to the stock warrants. The expense in 2016 completed the service period.

On September 23, 2015, the Company issued a warrant to purchase 69,445 shares of common stock in connection with the issuance of a promissory note. Refer to Note I for details.

## **NOTE P—STOCK OPTIONS**

### *1999 Stock Option Plan*

During 1999, the Board of Directors of the Company adopted the 1999 Stock Option Plan (the 1999 Plan). The 1999 Plan was not presented to stockholders for approval and thus incentive stock options are not available under the plan. Under the 1999 Plan, 83,334 shares of common stock were reserved for issuance to employees, officers, directors, and consultants of the Company at exercise prices which may not be below 85% of fair market value. The term of nonstatutory stock options granted may not exceed ten years. Options issued under the 1999 Plan vest pursuant to the terms of stock option agreements with the recipients. In the event of a change in control, as defined, all options outstanding vest immediately. The 1999 Plan expired in August 2009.

### *2004 Stock Option Plan*

On October 12, 2004, the Board of Directors of the Company approved the 2004 Stock Option Plan (the 2004 Plan). The 2004 Plan was not presented to stockholders for approval and thus incentive stock options are not available under this plan. Under the terms of this plan, 166,667 shares of common stock are reserved for issuance to employees, officers, directors, and consultants of the Company at exercise prices which may not be below 85% of fair market value. The term of stock options granted may not exceed ten years. Options issued under the 2004 Plan vest pursuant to the terms of stock option agreements with the recipients. In the event of a change in control, as defined, all options outstanding vest immediately. The 2004 Plan expired in October 2014.

#### *2015 Stock Option Plan*

On January 27, 2016, the shareholders approved the 2015 Equity Incentive Plan (the 2015 Plan). Under the terms of this plan, 666,667 shares of common stock are reserved for issuance to employees, officers, directors, and consultants of the Company at exercise prices which may not be below 100-110% of fair market value. The term of stock options granted may not exceed ten years. Options issued under the 2015 Plan vest pursuant to the terms of stock option agreements with the recipients. In the event of a change in control, certain stock awards issued under this plan may be subject to additional acceleration of vesting as may be provided in the participants' written agreement. The 2015 Plan expires in December 2025.

*Non-Plan Stock Options*

Periodically, the Company has granted options outside of the 1999, 2004 and 2015 Plans to various employees and consultants. In the event of change in control, as defined, certain of the non-plan options outstanding vest immediately.

*Stock Option Activity*

Information summarizing option activity is as follows:

	Number of Options					Total	Weighted average exercise price	Weighted average remaining life (in years)	Aggregate intrinsic value
	1999 Plan	2004 Plan	2015 Plan	Non Plan					
Outstanding, as of December 31, 2014	20,834	136,276	—	184,167	341,277	\$ 4.32			
Granted	—	—	—	119,000	119,000	2.16			
Exercised	—	—	—	—	—				
Forfeited	—	(3,473 )	—	(38,531 )	(42,004 )	3.72			
Expired	—	(47,795 )	—	(5,548 )	(53,343 )	3.00			
<b>Outstanding, as of December 31, 2015</b>	<b>20,834</b>	<b>85,008</b>	<b>—</b>	<b>259,088</b>	<b>364,930</b>	<b>\$ 3.87</b>	<b>4.57</b>	<b>\$ 240</b>	
Granted	—	—	27,087	—	27,087	2.74			
Exercised	—	—	—	—	—				
Forfeited	—	—	(2,084 )	(8,335 )	(10,419 )	2.16			
Expired	(20,834)	(15,628 )	—	(3,473 )	(39,935 )	2.50			
<b>Outstanding, as of December 31, 2016</b>	<b>—</b>	<b>69,380</b>	<b>25,003</b>	<b>247,280</b>	<b>341,663</b>	<b>\$ 3.99</b>	<b>4.23</b>	<b>\$ 53,936</b>	
<b>Vested or expected to vest at December 31, 2016</b>					<b>307,164</b>	<b>\$ 4.16</b>	<b>4.04</b>	<b>\$ 41,816</b>	

<b>Exercisable at December 31, 2016</b>	<b>216,566</b>	<b>\$ 4.56</b>	<b>3.51</b>	<b>\$ 17,367</b>
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The options outstanding and exercisable at December 31, 2016 were in the following exercise price ranges:

Range of exercise prices	Options Outstanding			Options Exercisable	
	Number of shares	Weighted average exercise price	Weighted average remaining life (in years)	Number exercisable	Weighted average exercise price
\$1.90-3.00	122,485	\$ 2.24	5.81	34,815	\$ 2.15
3.01-5.00	197,927	4.47	3.66	160,500	4.41
5.01-11.04	21,251	9.67	0.72	21,251	9.67
\$1.90-11.04	341,663			216,566	

The aggregate intrinsic value in the table above represents the total intrinsic value, based on the Company's closing stock price of \$2.65 as of December 31, 2016, which would have been received by the option holders had all option holders exercised their options as of that date. The total number of in-the-money options exercisable as of December 31, 2016 was 34,815.

The weighted average fair value of options granted during the years ended December 31, 2016 and 2015 was \$1.86 and \$1.68 per share, respectively. The total intrinsic value of options exercised during the years ended December 31, 2016 and 2015 was \$0 and \$0, respectively. The total fair value of shares vested during the years ended December 31, 2016 and 2015 was \$285,430 and \$265,247 respectively.

As of December 31, 2016, future compensation cost related to nonvested stock options is \$166,146 and will be recognized over an estimated weighted average period of 1.18 years.

**NOTE Q—INCOME TAXES**

There was no provision for federal or state taxes as at December 31, 2016 and 2015.

The Company has deferred taxes due to income tax credits, net operating loss carryforwards, and the effect of temporary differences between the carrying values of certain assets and liabilities for financial reporting and income tax purposes. Significant components of deferred taxes are as follows at December 31:

	<b>2016</b>	<b>2015</b>
<b>Current asset:</b>		
Accrued compensation	\$67,000	\$75,000
Accounts receivable allowance	202,000	5,000
<b>Non-current asset (liability):</b>		
Stock-based compensation	360,000	258,000
Basis differences in fixed assets	(8,000 )	(16,000 )
Basis differences in intangible assets	60,000	55,000
Net operating loss and credit carryforwards	18,597,000	17,994,000
Valuation allowances	(19,278,000)	(18,371,000)
	\$—	\$—

The Company has a valuation allowance against the full amount of its net deferred taxes due to the uncertainty of realization of the deferred tax assets due to operating loss history of the Company. The Company currently provides a valuation allowance against deferred taxes when it is more likely than not that some portion, or all of its deferred tax assets will not be realized. The valuation allowance could be reduced or eliminated based on future earnings and future estimates of taxable income. Similarly, income tax benefits related to stock options exercised have not been recognized in the financial statements.

As of December 31, 2016, the Company has federal net operating loss carryforwards of approximately \$54,300,000 subject to expiration between 2020 and 2036. These net operating loss carryforwards are subject to the limitations under Section 382 of the Internal Revenue Code due to changes in the equity ownership of the Company.



A reconciliation of the effective income tax rate on operations reflected in the Statements of Operations to the US Federal statutory income tax rate is presented below.

	<b>2016</b>	<b>2015</b>
Federal statutory income tax rate	34 %	34 %
Permanent differences	—	— )
Effect of net operating loss	(34 )	(34 )
Effective tax rate	— %	— %

The Company has not been audited by the Internal Revenue Service (“IRS”) or any states in connection with income taxes. The Company files income tax returns in the U.S. federal jurisdiction and various state jurisdictions. The periods from 2013 through 2016 remain open to examination by the IRS and state jurisdictions. The Company believes it is not subject to any tax audit risk beyond those periods. The Company’s policy is to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. The Company does not have any accrued interest or penalties associated with any unrecognized tax benefits, nor was any significant interest expense recognized during the years ended December 31, 2016 and 2015.

**NOTE R—PROFIT SHARING PLAN**

The Company has established a savings plan under section 401(k) of the Internal Revenue Code. All employees of the Company, after completing one day of service, are eligible to enroll in the 401(k) plan. Participating employees may elect to defer a portion of their salary on a pre-tax basis up to the limits as provided by the IRS Code. The Company is not required to match employee contributions but may do so at its discretion. The Company made no contributions during the years ended December 31, 2016 and 2015.

**NOTE S—EARNINGS PER SHARE (EPS)**

The Company's basic EPS is calculated using net income (loss) available to common shareholders and the weighted-average number of shares outstanding during the reporting period. Diluted EPS includes the effect from potential issuance of common stock, such as stock issuable pursuant to the exercise of stock options and warrants and the assumed conversion of preferred stock.

The reconciliation of the numerator of the basic and diluted EPS calculations, due to the inclusion of preferred stock dividends was as follows for the following fiscal years ended December 31:

	<b>2016</b>	<b>2015</b>
<b>Basic Numerator:</b>		
Loss from continuing operations	\$(4,189,704)	\$(1,857,306)
Convertible preferred stock dividends	(802,500 )	(133,851 )
Net loss available to common stockholders (basic and diluted EPS)	\$(4,992,204)	\$(1,991,157)

The following table summarizes the weighted average securities that were excluded from the diluted per share calculation because the effect of including these potential shares was antidilutive.

	<b>Years ended December 31,</b>	
	<b>2016</b>	<b>2015</b>
Preferred stock	5,416,667	859,095
Stock options	17,657	4,639
Warrants	1,018	-
Potentially dilutive securities	5,435,342	863,734

Items excluded from the diluted per share calculation because the exercise price was greater than the average market price of the common shares:

	<b>Years ended December 31,</b>	
	<b>2016</b>	<b>2015</b>

Stock options	235,845	236,528
Warrants	1,212,163	1,704,618
Total	1,448,008	1,941,146

#### **NOTE T—SUBSEQUENT EVENTS**

On March 15, 2017, the Company issued 1,895 shares of common stock to its directors in payment of board fees.

On March 15, 2017, the Company issued options to purchase 40,000 shares of the Company's common stock to four non-employee members of the Board of Directors. The options have a three year vesting period, seven year term and with an exercise price of \$2.64.

On March 16, 2017, the Board of Directors issued options to purchase 1,120,000 shares of the Company's common stock to certain officers, employees, and contractors. The options have a three year vesting period, seven year term, and exercise price of \$2.65.

The Company has reviewed subsequent events through the date of this filing.

**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.

BIO-KEY INTERNATIONAL, INC.

Date: April 4, 2017 By: /s/ MICHAEL W. DEPASQUALE

Michael W. DePasquale  
CHIEF EXECUTIVE OFFICER

(Principal Executive Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities on the dates indicated.

<b>Signature</b>	<b>Title</b>	<b>Date</b>
/s/ MICHAEL W. DEPASQUALE Michael W. DePasquale	Chairman of the Board of Directors, Chief Executive Officer and Director (Principal Executive Officer)	April 4, 2017
/s/ CECILIA WELCH Cecilia Welch	Chief Financial Officer (Principal Financial and Accounting Officer)	April 4, 2017
/s/ JOHN SCHOENHERR John Schoenherr	Director	April 4, 2017
/s/ THOMAS E. BUSH III Thomas E. Bush	Director	April 4, 2017
/s/ THOMAS GILLEY Thomas Gilley	Director	April 4, 2017
/s/ WONG KWOK FONG Wong Kwok Fong	Director	April 4, 2017

/s/ YAO JIANHUI                      Director  
Yao Jianhui

April 4,  
2017

/s/ PIETER KNOOK                      Director  
Pieter Knook

April 4,  
2017

## EXHIBIT INDEX

### ExhibitExhibit

### No.

- 3.1 Certificate of Incorporation of BIO-key International, Inc., a Delaware corporation (incorporated by reference to Exhibit 3.1 to the current report on Form 8-K, filed with the SEC on January 5, 2005)
- 3.2 Bylaws (incorporated by reference to Exhibit 3.3 to the current report on Form 8-K, filed with the SEC on January 5, 2005)
- 3.3 Certificate of Amendment to Certificate of Incorporation (incorporated by reference to Appendix A to the definitive proxy statement, filed with the SEC on January 18, 2006)
- 3.4 Certificate of Amendment of Certificate of Incorporation of Bio-key International, Inc., a Delaware corporation (incorporated by reference to Exhibit 3.4 to the annual report on Form 10-K, filed with the SEC on March 31, 2015)
- 3.5 Certificate of Elimination of BIO-key International, Inc. filed October 6, 2015 (incorporated by reference to Exhibit 3.5 to the registration statement on Form S-1 File No. 333-208747 filed with the SEC on December 23, 2015)
- 3.6 Certificate of Designation of Preferences, Rights and Limitations of Series A-1 Convertible Preferred Stock (incorporated by reference to Exhibit 3.1 to the current report on Form 8-K, filed with the SEC on November 2, 2015)
- 3.7 Certificate of Designation of Preferences, Rights and Limitations of Series B-1 Convertible Preferred Stock (incorporated by reference to Exhibit 3.1 to the quarterly report on Form 10-Q, filed with the SEC on November 16, 2015)
- 3.8 Certificate of Amendment of Certificate of Incorporation of Bio-key International, Inc., a Delaware corporation (incorporated by reference to Exhibit 3.1 to the current report on Form 8-K, filed with the SEC on December 28, 2016)
- 4.1 Specimen Stock Certificate (incorporated by reference to Exhibit 4.1 to the registration statement on Form SB-2, File No. 333-16451)
- 10.1 Employment Agreement by and between BIO-key International, Inc. and Mira LaCous dated November 20, 2001 (incorporated by reference to Exhibit 10.39 to the current report on Form 8-K, filed with the SEC on January 22, 2002)
- 10.2 BIO-key International, Inc. 2004 Stock Incentive Plan (incorporated by reference to Exhibit 10.48 to amendment no. 1 the registrant's registration statement on Form SB-2, File No. 33-120104, filed with the SEC on December 14, 2004)
- 10.3

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Employment Agreement, effective March 25, 2010, by and between the Company and Michael W. DePasquale (incorporated by reference to Exhibit 10.93 to the annual report on Form 10-K, filed with the SEC on March 26, 2010)

10.4 Form of Securities Purchase Agreement, dated February 26, 2013, by and between the Company and certain investors (incorporated by reference to Exhibit 10.4 to the quarterly report on Form 10-Q, filed with the SEC on May 15, 2013)

10.5 Form of Securities Purchase Agreement, dated July 23, 2013, by and between the Company and certain investors (incorporated by reference to Exhibit 10.29 to the registration statement on Form S-1, filed with the SEC on July 26, 2013)

10.6 Form of Warrant (incorporated by reference to Exhibit 10.30 to the registration statement on Form S-1, filed with the SEC on July 26, 2013)

10.7 Form of Securities Purchase Agreement by and between the Company and certain investors dated October 25, 2013 and November 8, 2013 (incorporated by reference to Exhibit 10.1 to the quarterly report on Form 10-Q, filed with the SEC on November 14, 2013)

10.8 Form of Investor Warrant by and between the Company and certain investors dated October 25, 2013 and November 8, 2013 (incorporated by reference to Exhibit 10.2 to the quarterly report on Form 10-Q, filed with the SEC on November 14, 2013)

10.9 Form of Registration Rights Agreement by and between the Company and certain investors dated October 25, 2013 and November 8, 2013 (incorporated by reference to Exhibit 10.3 to the quarterly report on Form 10-Q, filed with the SEC on November 14, 2013)

- 10.10 Form of Supplement to Securities Purchase Agreement by and between the Company and certain investors dated November 8, 2013 (incorporated by reference to Exhibit 10.4 to the quarterly report on Form 10-Q, filed with the SEC on November 14, 2013)
- 10.11 Employment Agreement by and between BIO-key International, Inc. and Cecilia Welch dated May 15, 2013 (incorporated by reference to Exhibit 10.42 to the annual report on Form 10-K, filed with the SEC on March 31, 2014)
- 10.12 Third Amendment to Lease Agreement by and between BIO-key International, Inc. and Victor AOP, Inc. dated June 30, 2013 (incorporated by reference to Exhibit 10.43 to the annual report on Form 10-K, filed with the SEC on March 31, 2014)
- 10.13 First Amendment to Lease Agreement by and between BIO-key International, Inc. and BRE/DP MN LLC dated September 12, 2013 (incorporated by reference to Exhibit 10.44 to the annual report on Form 10-K, filed with the SEC on March 31, 2014)
- 10.14 Form of Securities Purchase Agreement by and between the Company and certain investors dated November 13, 2014 (incorporated by reference to Exhibit 10.1 to the quarterly report on Form 10-Q, filed with the SEC on November 14, 2014)
- 10.15 Form of Investor Warrant, by and between the Company and certain investors dated November 13, 2014 (incorporated by reference to Exhibit 10.2 to the quarterly report on Form 10-Q, filed with the SEC on November 14, 2014)
- 10.16 Form of Registration Rights Agreement by and between the Company and certain investors dated November 13, 2014 (incorporated by reference to Exhibit 10.3 to the quarterly report on Form 10-Q, filed with the SEC on November 14, 2014)
- 10.17 Form of Convertible Preferred Stock Purchase Agreement (incorporated by reference to Exhibit 10.1 to the current report on Form 8-K, filed with the SEC on November 2, 2015)
- 10.18 Form of Registration Rights Agreement (incorporated by reference to Exhibit 10.2 to the current report on Form 8-K, filed with the SEC on November 2, 2015)
- 10.19 Form of Securities Purchase Agreement (incorporated by reference to Exhibit 10.1 to the quarterly report on Form 10-Q, filed with the SEC on November 16, 2015)
- 10.20 Form of Registration Rights Agreement (incorporated by reference to Exhibit 10.2 to the quarterly report on Form 10-Q, filed with the SEC on November 16, 2015)
- 10.21 BIO-key International, Inc. 2015 Equity Incentive Plan (incorporated by reference to Appendix A to the definitive proxy statement filed with the SEC on December 15, 2015)
- 10.22 Software License Purchase Agreement Dated November 11, 2015 by and among BIO-key Hong Kong Limited, Shining Union Limited, WWTT Technology China, Golden Vast Macao Commercial Offshore Limited, Giant Leap International Limited (incorporated by reference to Exhibit 10.36 to the registration statement on Form S-1 File No. 333-208747 filed with the SEC on December 23, 2015)\*\*



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10.23 Securities Purchase Agreement dated November 11, 2016 by and between Registrant and Wong Kwok Fong (Kelvin) (incorporated by reference to Exhibit 10.1 to the quarterly report on Form 10-Q, filed with the SEC on November 14, 2016)

21.1 List of subsidiaries of BIO-key International, Inc. (incorporated by reference to Exhibit 21.1 to the annual report on Form 10-K, filed with the SEC on March 30, 2016)

23.1\* Consent of RMSBG

31.1\* Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2\* Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.1\* Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.2\* Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

101.INS\* XBRL Instance

101.SCH\* XBRL Taxonomy Extension Schema

101.CAL\* XBRL Taxonomy Extension Calculation

101.DEF\* XBRL Taxonomy Extension Definition

101.LAB\* XBRL Taxonomy Extension Labels

101.PRE\* XBRL Taxonomy Extension Presentation

\* filed herewith

\*\* Confidential treatment has been requested with respect to certain portions of this exhibit. Omitted sections have been filed separately with the Securities and Exchange Commission