

BIO KEY INTERNATIONAL INC

Form 10-K

March 26, 2010

[Table of Contents](#)

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

Annual Report Pursuant to Section 13 or 15(d)

of the Securities Exchange Act of 1934

For the Fiscal Year Ended December 31, 2009

BIO-KEY INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

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DELAWARE
(State or other jurisdiction of
Incorporation or organization)

41-1741861
(IRS Employer
Identification Number)

3349 HIGHWAY 138, BUILDING D, SUITE B, WALL, NJ 07719

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(Address of Principal Executive Offices) (Zip Code)

(732) 359-1100

Issuer's telephone number, including area code.

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

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

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

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

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

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

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 \$7,410,824.

As of March 24, 2010, the registrant had 77,713,398 shares of common stock outstanding.

Documents Incorporated by Reference: None

Table of Contents

TABLE OF CONTENTS

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	<u>PART I</u>	1
<u>Item 1.</u>	<u>Description of Business</u>	1
<u>Item 1A</u>	<u>Risk Factors</u>	8
<u>Item 2</u>	<u>Description of Property</u>	13
<u>Item 3</u>	<u>Legal Proceedings</u>	13
<u>Item 4</u>	<u>Reserved</u>	13
	 <u>PART II</u>	 14
<u>Item 5</u>	<u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	14
<u>Item 6</u>	<u>Selected Financial Data</u>	16
<u>Item 7</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	16
<u>Item 7A</u>	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	25
<u>Item 8</u>	<u>Financial Statements and Supplementary Data</u>	25
<u>Item 9</u>	<u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	25
<u>Item 9A</u>	<u>Controls and Procedures</u>	25
<u>Item 9B</u>	<u>Other Information</u>	26
	 <u>PART III</u>	 27
<u>Item 10</u>	<u>Directors, Executive Officers and Corporate Governance</u>	27
<u>Item 11</u>	<u>Executive Compensation</u>	30
<u>Item 12</u>	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	36
<u>Item 13</u>	<u>Certain Relationships and Related Transactions, and Director Independence</u>	38
<u>Item 14</u>	<u>Principal Accountant Fees and Services</u>	39
<u>Item 15</u>	<u>Exhibits</u>	40
	<u>Signatures</u>	74

PRIVATE SECURITIES LITIGATION REFORM ACT

All statements other than statements of historical facts contained in this Annual Report on Form 10-K, including statements regarding our future financial position, business strategy and plans and objectives of management for future operations, are forward-looking statements. The words anticipate, believe, estimate, will, may, future, plan, intend and expect and similar expressions generally identify forward-looking statements. Although we believe our plans, intentions and expectations reflected in the forward-looking statements are reasonable, we cannot be sure they will be achieved. Actual results may differ materially from the forward-looking statements contained herein due to a number of factors. Many of these factors are set forth under the caption "Risk Factors" in Item 1A of this Annual Report and other filings with the Securities and Exchange Commission. These factors are not intended to represent a complete list of the general or specific factors that may affect us. It should be recognized that other factors, including general economic factors and business strategies, may be significant, presently or in the future. Except as required by law, we undertake no obligation to update any forward-looking statement, whether as a result of new information, future events or otherwise.

Table of Contents

PART I

ITEM 1. DESCRIPTION OF BUSINESS

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BIO-key International, Inc., a Delaware corporation (the Company, BIO-key, we, or us), was founded in 1993 to develop and market advanced fingerprint biometric technology and software solutions. Biometric technology is the science of analyzing specific human characteristics which are unique to each individual in order to identify a specific person from a broader population. First incorporated as BBG Engineering, the company became SAC Technologies in 1994. The BIO-key name was introduced in 2002.

We develop and market advanced fingerprint identification biometric technology and software solutions. We were among the initial pioneers in developing automated, finger identification technology that can be used without the aid of non-automated methods of identification such as a personal identification, password, token, smart card, ID card, credit card, passport, driver's license or other form of possession or knowledge based identification. This advanced BIO-key identification technology improves both the accuracy and speed of finger-based biometrics.

Since our inception in 1993, we have spent substantial time and effort in completing the development of what we believe is the most discriminating and effective commercially available finger-based biometric technology. During the past five years, our primary focus has shifted to marketing and selling this technology and completing strategic acquisitions that can help us leverage our capability to deliver identification solutions. We have built a direct sales force of professionals with substantial experience in selling technology solutions to government and corporate customers.

In 2004, BIO-key acquired Public Safety Group, Inc. (PSG), a privately held company that was a leader in wireless solutions for law enforcement and public safety markets. PSG's primary technology was PocketCop, a handheld solution that provides mobile officers, such as detectives who are not typically in their vehicles, a hand-held mobile information software solution. Also in, 2004, BIO-key completed a transaction with Aether Systems, Inc. to purchase its Mobile Government Division (Mobile Government or AMG), a leading provider of wireless data solutions for use by public safety organizations, primarily state, local police, fire and rescue and emergency medical services organizations. Their PacketCluster mobile information software is integrated with 50 separate State/NCIC databases, as well as other state, local and federal databases.

In 2007, BIO-key completed a transaction with ZOLL Data Systems, Inc. (ZOLL), a subsidiary of ZOLL Medical Corporation, in which ZOLL acquired substantially all of the assets related to the Company's Fire/EMS Services division. In 2009, BIO-key completed a transaction with InterAct911 Mobile Systems, Inc. (InterAct911), a subsidiary of InterAct911 Corporation, in which InterAct911 acquired substantially all the assets related to the Company's Law Enforcement division.

As a result of these transactions, and as discussed in Note M to the Consolidated Financial Statements included in this report, we have organized the Company into one reporting segment: Biometrics. During the year ended December 31, 2009, the Company continued to focus on its primary objectives of increasing revenue and managing expenses, by developing leadership technology and applications and by providing its customers with high quality support and service.

Table of Contents

Markets

Finger-based Biometric Identification

BIO-key is a leader in finger-based biometric identification. In partnerships with OEMs, integrators, and solution providers, we provide biometric software solutions to private and public sector customers. BIO-key provides the ability to positively identify individuals before granting access to valuable corporate resources, web portals or applications in seconds. Powered by our patented Vector Segment Technology our VST , WEB-key® and BSP development kits are fingerprint biometric solutions that provide true interoperability with all major reader manufacturers, enabling application developers and integrators to seamlessly integrate fingerprint biometrics into virtually any application. BIO-key development tools deliver a tangible return on a security platform investment that can:

- Reduce risk
- Improve user convenience
- Lower operating costs

BIO-key's patented Vector Segment Technology (VST) is the foundation for these solutions. BIO-key's unique solutions provide users with the ability to positively identify themselves to applications with the simple scan of their finger. This capability is a significant improvement in both convenience and security over other alternatives and provides companies with a cost-effective solution to thwart phishing attacks and comply with government regulations and legislation such as FFIEC compliance, HIPAA, HSPD-12, and the Electronic Signatures Act. BIO-key couples these capabilities with device interoperability, system flexibility and scalability.

BIO-key has formed relationships with providers of biometric logon software including Softex, Janus Associates, Indigo, IBM and Computer Associates to provide enterprise-ready SingleSignOn systems to many large companies in the US and abroad. BIO-key has partnership agreements with leading technology companies including Sagem Morpho, McKesson, LexisNexis, and IBM to deliver advanced biometric applications for government, civil and commercial clients. Through its partnership with Oracle, BIO-key has integrated its biometric technology into the entire Fusion Middleware and Identity Management software stack to offer all of Oracle customers a scalable biometric authentication solution. Also, BIO-key has integrated VST to a physical access solution developed and distributed by its partner NextGenID. This solution has been deployed across the US at many leading companies.

- *Growth potential* As the provider of the core technology, BIO-key's greatest growth potential is as a partner with companies that offer applications that address growing concerns related to quickly and accurately identifying individuals for both commercial and civil applications and thwarting the potential for identity theft.

For example, BIO-key, along with partners, has deployed biometric logical and physical access solutions. These include working with Allscripts and IBM to provide strong network based authentication and with the Pegasus Program to authenticate users accessing a nationwide information-sharing system designed by and for the nation's sheriffs. These represent the kind of partnership-based opportunities BIO-key may

see in the finger-based biometric market.

Products

The Company's biometric identification technology improves both the accuracy and speed of identifying individuals. The Company's proprietary biometric technology extracts unique data from a fingerprint and uses it to positively identify an individual. The technology has been built to be completely scalable to handle databases containing millions of fingerprints. BIO-key achieves the highest levels of discrimination without requiring any other identifying data like a userID, smart card, or token. BIO-key's core technology supports interoperability on over 40 different commercially available readers. This interoperability is a key differentiator for BIO-key in the biometric market. BIO-key has full support for industry standards and received National Institute of Standards and Technology (NIST) certification on its ability to support HSPD-12 supported INCITS-378 templates. We believe we have the largest deployment of ISO standard templates in the world with over 300 million created in Bangladesh. Extending our products to support standards enables BIO-key to participate in large government projects like Transportation Workers Identification Card (TWIC), Registered Traveler projects, PIV initiatives, and FIXS consortium solutions. We believe our fingerprint identification technology has a broad range of information security and access control applications, including:

Table of Contents

- Securing Internet sites and electronic transactions
- Securing access to logical networks and applications
- Securing access to buildings and restricted areas
- Providing fast, accurate member identification services
- Securing mobile devices such as biometric enabled handhelds and PDA's
- Preventing identity theft through positive user identification and false alias validation

BIO-key's finger identification algorithm Vector Segment Technology (VST) is the core intellectual property behind its full suite of biometric products that include:

- **Vector Segment Technology SDK (VST)** BIO-key's biometric development kit that provides developers the ability to take advantage of a highly accurate, device interoperable algorithm. VST is available as a low level SDK for incorporation into any application architecture to increase security while not sacrificing convenience. VST runs on Windows, Linux or Solaris systems.
- **True User Identification®** BIO-key's biometric identification solution that offers large scale one to many user lookup with nothing but a single fingerprint. This solution enables customers to perform false alias checks and manage fraudulent access to systems. True User Identification leverages commercially available databases, like Oracle, to scale the identification capabilities to millions of users. The solution also runs on commercially available hardware making it truly scalable for any size system.
- **WEB-key®** BIO-key's biometric security platform for managing fingerprint authentication across unprotected networks including the Internet. It extends all features and functionalities of the VST algorithm to customers looking to add an enhanced level of security to their thin client and client/server applications. WEB-key currently is supported by both Windows and Linux operating systems.
- **Biometric Service Provider** BIO-key provides support for the BioAPI (a standards based solution meeting worldwide needs) for a compliant interface to applications using biometrics for verification and identification. BIO-key enhances the traditional use of the BioAPI by

adding support for CE devices, supporting identification calls and also providing a single user interface for multiple fingerprint readers.

- **ID Director** BIO-key's solution for single sign on integration with Computer Associates SiteMinder, Oracle's Fusion Middleware SSO, and other solutions, utilizing the power and security of WEB-key. This solution provides a simple to implement, custom authentication scheme for companies looking to enhance authentication. ID Director can easily add a level of security and convenience to the transaction level of any application.

Current Business Plan

BIO-key's current business plan is to:

- **License its core technology VST and True User Identification®** original equipment manufacturers, systems integrators, and application developers who develop products and applications that utilize its biometric finger matching solutions.
- **License WEB-key®**, the Company's security centric web-based biometric authentication solution.
- **Integrate its core technology competencies** to leverage new business opportunities and develop new markets for its innovative products.

Table of Contents

Competition

In addition to companies that provide existing commonplace methods of restricting access to facilities and logical access points such as pass cards, PIN numbers, passwords, locks and keys, there are numerous companies involved in the development, manufacturing and marketing of fingerprint biometrics products to commercial, government, law enforcement and prison markets. These companies include, but are not limited to, Cogent, NEC, L-1 Identity Solutions and Sagem-Morpho.

The majority of sales for automated fingerprint identification products in the market to date have been deployed for government and law enforcement applications. The consumer and commercial markets represent areas of significant growth potential for biometrics. Additionally, the majority of companies competing for commercial opportunities are in the business of selling scanning devices and these companies tie their algorithm to specific hardware. BIO-key has created a device independent algorithm that provides flexibility in choosing the correct device to fit the application served.

BIO-key has found that commercial markets have been slow to widely purchase biometrics as a viable alternative to their current security methods. As a result, the primary competition for biometric technology consists of traditional security methods such as passwords, PINs, cards and tokens.

With respect to competing biometrics technologies, each has its strength and weaknesses and none has emerged as a market leader:

- *Fingerprint identification* is generally viewed as inexpensive and non-intrusive.
- *Iris scanning* is viewed as accurate, but the hardware is significantly more expensive.
- *Facial recognition* can have accuracy limitations and is typically highly dependent on ambient lighting conditions, angle of view and other factors.

The market for biometric technology continues to evolve. Computer breaches, identity theft, phishing and other events in the recent past are driving a large-scale shift to biometric deployments. In addition, companies such as IBM, Dell and HP have all introduced computers with integrated finger scanning devices to complement the conventional username/password technique since it is highly susceptible to hackers and security breaches. BIO-key supports these integrated devices for broader enterprise level security solutions.

BIO-key believes that the next wave of opportunity for finger biometrics is the mobility market where a number of Smartphone and PDA manufacturers are incorporating finger scanners in their devices for more convenient secure access to the handset itself and ultimately for applications. Our secure one to many technology framework can provide a finger only access to any application via the web or a 3G or local

area network.

Marketing and Distribution

BIO-key's marketing and distribution efforts comprise the following major initiatives:

- Over the past few years, BIO-key has strengthened its alliance with Oracle and has been recognized as a Certified Partner in the Oracle Partner Network. BIO-key supports the Oracle e-business suite of applications and provides the biometric enabler for the Oracle Single Sign on product. As an Oracle development partner, BIO-key provides the underlying database used for true user identification and on demand alias checking. As a development partner, BIO-key participates in Oracle Trade Shows such as Oracle Open World and Oracle Apps World.
- BIO-key has strategic alliances with technology leaders including Oracle, Computer Associates, IBM, AT&T, and others.
- BIO-key is also promoting biometric technology and its offerings through industry trade shows, public speaking

Table of Contents

engagements, press activities and partner marketing programs

- BIO-key is directing licensing efforts to original equipment manufacturers, application developers and system integrators.
- BIO-key is continuing to build a reseller, integrator and partner network as well as a direct sales team.

Addressing the Market

Following are the specific marketing/sales programs in place:

- *Direct Selling Efforts* BIO-key's direct sales force focuses on OEMs and large entities in the commercial and Government markets. The sales team has extensive sales experience and expertise in emerging biometric technologies. The BIO-key sales force is rounded out by Inside Sales, which is responsible for maintaining and supporting our existing install base, acting as a front-line support for any inquiries on our product line, and facilitating activities that make the field team more productive.
- *Conferences and Trade Shows* BIO-key attends and actively participates in various product-related conferences and trade shows in the technology and security industries to generate market awareness of biometric and wireless mobile data technology generally and our offerings specifically.
- *Strategic Alliance* BIO-key's strategic alliances and reseller agreements with other vendors play a significant role in our overall sales efforts. In the past year, BIO-key has initiated and bolstered numerous important and promising long-term relationships. Just a few examples include:
 - BIO-key is an active member in CA, IBM and Oracle partner programs, delivering authentication and identification solutions integrated with their Identity Management platform to their customers worldwide.
 - BIO-key is focusing on specific vertical markets including healthcare where it continues to grow on successful integration of its identification technology to provide convenient, accurate and fast user identification in partner solutions including McKesson and Allscripts

Licensing

BIO-key targets both Internet infrastructure companies and large portal providers as possible licensees for its WEB-key® solution. On the Internet infrastructure side, BIO-key seeks to partner with Internet server manufacturers, providers of database and data warehouse engine software, horizontally positioned application engines, firewall solution providers and peripheral equipment manufacturers. On the portal side, BIO-key is targeting financial service providers such as credit and debit card authorization and issuing institutions, Internet retailers, business-to-business application service providers (ASPs) and corporate intranets. In the past five years, BIO-key has undertaken a WEB-key ® and VST direct selling effort, and entered into license agreements with OEMs and system integrators to develop applications for distribution to their respective customers.

BIO-key is also addressing the security needs of application providers in the following vertical markets:

- *Government* Using BIO-key's technology, Northrup Grumman deployed an application within the Department of Defense to cross-credential visitors and contractors to certain military bases. Also BIO-key, in conjunction with MorphoTrak, is providing the finger matching platform for the FBI's Next Generation IAFIS system, which today is one of the world's largest biometric systems.
- *Education* Educational Biometric Technologies and Identimetrics have incorporated BIO-key technology to enable school children to pay for school lunch programs and checkout library books using their fingerprints. VST technology enables schools to enroll these children and reduces the administrative costs of managing passwords and

Table of Contents

collecting payments.

- *Commerce:* LexisNexis has implemented various solutions in thousands of locations in over 70 countries using BIO-key's VST technology to reduce fraud and identity theft.
- *Patient Records and Information Management:* Allscripts has integrated and deployed BIO-key's biometric solution as a standard part of its Enterprise EHR solution. The integrated solution has been deployed at George Washington University, Holzer Clinic, Medisync, and many other Allscripts customers. HBOC, one of the largest healthcare patient records and information management companies, has integrated BIO-key technology into their portal and has deployed their solution in a pilot for the Baptist Hospital System. Also, the Indiana Blood Center is incorporating BIO-key's large scale identity assurance platform to provide a safe, secure and convenient means for donors to confirm their identity. McKesson Provider Services has incorporated BIO-key's one-to-many finger matching software into their Accudose line of medication and supplies dispensing systems solutions and is selling that equipment to clinics and hospitals nationwide.
- *Financial:* BIO-key is working with several companies focusing on financial applications such as point of sale systems and employee trusted identification cards, as well as customer facing applications over the Internet. BIO-key has also begun work with several financial institutions to incorporate its technology for secure access to money transfers for institutional customers.

Intellectual Property Rights

We believe that our intellectual property is important to our biometric operation:

- *Patents* our biometrics segment uses patented technology and trade secrets developed or acquired by us.

In May 2005, the U.S. Patent & Trademark Office issued us a patent for our Vector Segment fingerprint technology (VST), BIO-key's core biometric analysis and identification technology.

On August 29 2006, BIO-key announced that the Company's patent for biometric identification indexing, a core feature of its VST software, has been granted in Europe. In addition, a WEB-key® authentication security patent for Systems and Methods of Secure Biometric Authentication has been issued in South Africa. These patents enhance the worldwide protection of BIO-key's technology. The European patent for VST, which provides BIO-key with protection of its intellectual property in Europe, was issued on March 29, 2006 and covers a similar set of claims for a patent BIO-key was granted in 2005 in the United States.

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On October 3, 2006, BIO-key announced that the Company's patent for a biometric authentication security framework has been granted by the U.S. Patent & Trademark Office. The patent (No. 7,117,356) was issued to BIO-key for a biometric authentication security framework that enhances commercial and civil biometric use. BIO-key's authentication security framework protects privacy and security while also facilitates ease of use of biometric systems. The technology that this patent is based on is the foundation for authentication security as incorporated in BIO-key's WEB-key® product line. WEB-key is a mature enterprise authentication solution that functions in a wide variety of application environments. The solution supports a variety of implementation alternatives including card technologies for two-factor authentication and also supports single-factor authentication. Partners and customers implementing BIO-key's WEB-key software to provide convenient and secure user identity include a number of institutions including the Allscripts Healthcare Solutions, American Association of Medical Colleges, Empresa de Telecomunicaciones de Bogotá (Columbia) and Iomedex Corporation.

On January 11, 2007, BIO-key announced that the U.S. Patent & Trademark Office has issued US patent No. 7,155,040 covering BIO-key's unique image processing technology, which is critical for enhancing information used in the extraction of biometric minutiae. The issued patent protects a critical part of an innovative four-phase image enhancement process developed by BIO-key, and represents the third U.S. patent granted to the company for its biometric technology.

On April 15, 2008, BIO-key announced that the U.S. Patent and Trademark Office has issued US patent No. 7,359,553 covering BIO-key's image enhancement and data extraction core algorithm components. The solution

Table of Contents

protected under this recently issued patent provides the capability to quickly and accurately transform a fingerprint image into a computer image that can be analyzed to determine the critical data elements

On October 15, 2008 BIO-key announced that the U.S. Patent and Trademark Office has issued US patent No. 7,415,605 for the company's Biometric Identification Network Security method. The solution protected under this recently issued patent provides a defense against hackers and system attacks, while leveraging the industry standard Trusted Platform Module (TPM) specification for encryption key management.

On December 3, 2008 BIO-key announced that the U.S. Patent and Trademark Office has issued US patent No. 7,454,624 for the company's Match Template Protection within a Biometric Security System method. The solution protected under this recently issued patent limits the scope of enrollment templates usage and also eliminates the need for revocation or encryption processes, which can be expensive and time consuming.

- *Trademarks* We have registered our trademarks (BIO-key , True User Identification , and WEB-key with the U.S. Patent & Trademark Office.

- *Copyrights and trade secrets* We take measures to ensure copyright and license protection for our software releases prior to distribution. When possible, the software is licensed in an attempt to ensure that only licensed and activated software functions to its full potential. We also take measures to protect the confidentiality of our trade secrets.

Research and Development

Our research and development efforts are concentrated on enhancing the functionality, reliability and integration of our current products as well as developing new and innovative products for biometrics and law enforcement. Although BIO-key believes that its identification technology is one of the most advanced and discriminating fingerprint technologies available today, the markets in which BIO-key compete are characterized by rapid technological change and evolving standards. In order to maintain its position in the market, BIO-key will continue to upgrade and refine its existing technologies. In 2006, BIO-key announced the launch of IdentityMatch, our fingerprint identification system. IdentityMatch offers a tool for agencies to store and search fingerprints and the associated demographic data, the ability to compare new prints with those previously captured as a low-cost AFIS alternative or to be used for a wide variety of routine identification transactions not supported by AFIS.

During the fiscal years ended December 31, 2009 and 2008, BIO-key spent approximately \$927,000 and \$974,000 respectively, on its Biometric segment's research, development and engineering. BIO-key's limited customer base during that time did not directly bear these costs, which were principally funded through outside sources of equity and debt financing.

Government Regulations

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BIO-key is not currently subject to direct regulation by any government agency, other than regulations generally applicable to businesses or related to specific project requirements. In the event of any international sales, the company would be subject to various domestic and foreign laws regulating such exports and export activities.

Environmental Regulations

As of the date of this report, BIO-key has not incurred any material expenses relating to our compliance with federal, state, or local environmental laws and does not expect to incur any material expenses in the foreseeable future.

Employees and Consultants

As of March 11, 2010, BIO-key employed fifteen (15) individuals individuals on a full-time basis five (5) in engineering, customer support, research and development; four (4) in finance and administration; and six (6) in sales and marketing. BIO-

Table of Contents

key also uses the services of two (2) consultants (full-time), who provide engineering and technical services, and one (1) part-time contracts administrator.

ITEM 1A. RISK FACTORS

Set forth below are the risks that we believe are material to our investors. This section contains forward-looking statements. You should refer to the explanation of the qualifications and limitations on forward-looking statements appearing just before our Description of Business section above.

Business and Financial Risks

Based on our lack of significant revenue since inception and recurring losses from operations, our auditors have included an explanatory paragraph in their opinion as to the substantial doubt about our ability to continue as a going concern.

Due to, among other factors, our history of losses (excluding gains from valuation changes in embedded derivatives) and limited revenue, our independent auditors have included an explanatory paragraph in their opinion for the year ended December 31, 2009 as to the substantial doubt about our ability to continue as a going concern. Our financial statements have been prepared in accordance with accounting principals generally accepted in the United States, which contemplate that we will continue to operate as a going concern. Our financial statements do not contain any adjustments that might result if we are unable to continue as a going concern.

Since our formation, we have historically generated minimal revenue and have sustained substantial operating losses.

As of December 31, 2009, we had working capital of approximately \$868,000 and an accumulated deficit of approximately \$50,087,000. Since our inception, we have focused almost exclusively on developing our core technologies and, until the fourth quarter of 2004 had not generated any significant revenue. In 2009 we sold our Law Enforcement division, losing the benefit of significant recurring revenue streams. In order to increase revenue, we have developed a direct sales force and anticipate the need to retain additional sales, marketing and technical support personnel and may need to incur substantial expenses. We cannot assure you that we will be able to secure these necessary resources, that a significant market for our technologies will develop or that we will be able to achieve our targeted revenue.

We have identified material weaknesses in our internal control over financial reporting. If we are unable to successfully address such material weaknesses, we may not be able to accurately report our financial results or prevent fraud. As a result, current and potential stockholders could lose confidence in our financial reporting; this would harm our business and the trading price of our common stock.

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After a review of our 2009 annual operating results, conducted pursuant to Rule 13a-15 under the Securities Exchange Act of 1934, as amended, our Chief Executive Officer and our Chief Financial Officer have determined that, as of such date, our internal control over financial reporting was not effective as of December 31, 2009. Effective internal control over financial reporting are necessary for us to provide reliable financial reports and effectively prevent fraud and to operate successfully as a public company. We have in the past discovered, as described above, and may in the future discover, areas of our internal control over financial reporting that need improvement. We are in the process of addressing these issues to ensure that our internal control over financial reporting are improved. If, however, we cannot provide reliable financial reports or prevent fraud, our reputation and operating results would be harmed. Additionally, if we are unable to adequately establish or improve our internal controls over financial reporting, our external auditors may not be able to issue an unqualified opinion on the effectiveness of our internal controls. Ineffective internal and disclosure controls could also cause investors to lose confidence in our reported financial information, which would likely have a significant negative effect on the trading price of our securities.

Our biometric technology has yet to gain widespread market acceptance and we do not know how large of a market will develop for our technology.

Biometric technology has received only limited market acceptance, particularly in the private sector. Our technology represents a novel security solution and we have not yet generated significant sales. Although recent security concerns relating to identification of individuals has increased interest in biometrics generally, it remains an undeveloped, evolving market. Biometric based solutions compete with more traditional security methods including keys, cards, personal identification numbers and security personnel. Acceptance of biometrics as an alternative to such traditional methods depends upon a number of factors including:

- the reliability of biometric solutions
- public perception regarding privacy concerns
- costs involved in adopting and integrating biometric solutions

For these reasons, we are uncertain whether our biometric technology will gain widespread acceptance in any commercial markets or that demand will be sufficient to create a market large enough to produce significant revenue or earnings. Our future success depends, in part, upon business customers adopting biometrics generally, and our solution

Table of Contents

specifically.

Biometric technology is a new approach to Internet security which must be accepted in order for our WEB-key ® solution to generate significant revenue.

Our WEB-key ® authentication initiative represents a new approach to Internet security which has been adopted on a limited basis by companies which distribute goods, content or software applications over the Internet. The implementation of our WEB-key ® solution requires the distribution and use of a finger scanning device and integration of database and server side software. Although we believe our solutions provide a higher level of security for information transmitted over the Internet than existing traditional methods, unless business and consumer markets embrace the use of a scanning device and believe the benefits of increased accuracy outweigh implementation costs, our solution will not gain market acceptance.

Our software products may contain defects which will make it more difficult for us to establish and maintain customers.

Although we have completed the development of our core biometric technology, it has only been used by a limited number of business customers. Despite extensive testing during development, our software may contain undetected design faults and software errors, or bugs that are discovered only after it has been installed and used by a greater number of customers. Any such defect or error in new or existing software or applications could cause delays in delivering our technology or require design modifications. These could adversely affect our competitive position and cause us to lose potential customers or opportunities. Since our technologies are intended to be utilized to secure physical and electronic access, the effect of any such bugs or delays will likely have a detrimental impact on us. In addition, given that biometric technology generally, and our biometric technology specifically, has yet to gain widespread acceptance in the market, any delays would likely have a more detrimental impact on our business than if we were a more established company.

While we have commenced a significant sales and marketing effort, we have only begun to develop a significant distribution channel and may not have the resources or ability to sustain these efforts or generate any meaningful sales.

In order to generate revenue from our biometric products, we are dependent upon independent original equipment manufacturers, system integrators and application developers, which we do not control. As a result, it may be more difficult to generate sales.

We market our technology through licensing arrangements with:

- Original equipment manufacturers, system integrators and application developers which develop and market products and applications which can then be sold to end users

- Companies which distribute goods, services or software applications over the Internet

As a technology licensing company, our success will depend upon the ability of these manufacturers and developers to effectively integrate our technology into products and services which they market and sell. We have no control over these licensees and can not assure you that they have the financial, marketing or technical resources to successfully develop and distribute products or applications acceptable to end users or generate any meaningful revenue for us. These third parties may also offer the products of our competitors to end users.

We face intense competition and may not have the financial and human resources necessary to keep up with rapid technological changes, which may result in our technology becoming obsolete.

The Internet, facility access control and information security markets are subject to rapid technological change and intense competition. We compete with both established biometric companies and a significant number of startup enterprises as well as providers of more traditional methods of access control. Most of our competitors have substantially greater financial and marketing resources than we do and may independently develop superior technologies, which may result in our technology becoming less competitive or obsolete. We may not be able to keep pace with this change. If we are unable to develop new applications or enhance our existing technology in a timely manner in response to technological changes, we will be unable to compete in our chosen markets. In addition, if one or more other biometric technologies such as voice, face, iris, hand geometry or blood vessel recognition are widely adopted, it would significantly reduce the potential market for our

Table of Contents

fingerprint identification technology.

We depend on key employees and members of our management team, including our Chairman of the Board and Chief Executive Officer, in order to achieve our goals. We cannot assure you that we will be able to retain or attract such persons.

A loss of our current Chairman of the Board of Directors or Chief Executive Officer could severely and negatively impact our operations. Our consulting contract with Thomas J. Colatosti, our Chairman of the Board, expires in December 2011. Mr. Colatosti assists the Company in the areas of strategic planning and corporate finance. In addition, our employment contract with Michael W. DePasquale, our Chief Executive Officer, expires in March 2011. Although the contract does not prevent him from resigning, it does contain confidentiality and non-compete clauses which are intended to prevent him from working for a competitor within one year after leaving our Company. Our success depends on our ability to attract, train and retain employees with expertise in developing, marketing and selling software solutions. In order to successfully market our technology, we will need to retain additional engineering, technical support and marketing personnel. The market for such persons remains highly competitive and our limited financial resources will make it more difficult for us to recruit and retain qualified persons.

We cannot assure you that the intellectual property protection for our core technology provides a sustainable competitive advantage or barrier to entry against our competitors.

Our success and ability to compete is dependent in part upon proprietary rights to our technology. We rely primarily on a combination of patent, copyright and trademark laws, trade secrets and technical measures to protect our propriety rights. We have filed a patent application relating to both the optic technology and biometrics solution components of our technology wherein several claims have been allowed. Over the last few years, the U.S. Patent Office has issued us a series of patents for our Vector Segment fingerprint technology (VST), and our other core biometric analysis and identification technologies. We cannot assure you that any additional patents will be issued or that we will have the resources to protect any patent from infringement. Although we believe our technology does not currently infringe upon patents held by others, we cannot assure you that such infringements do not exist or will not exist in the future.

We may need to obtain additional financing to execute our business plan, which may not be available. If we are unable to raise additional capital or generate significant revenue, we may not be able to continue operations.

Since our inception, we have not generated significant, recurring revenue (other than revenue from acquired businesses) and have experienced substantial losses. In January 2006 we received approximately \$1,000,000 in a private placement convertible debt offering, and in August 2006 we raised approximately \$2,000,000 in gross proceeds through a private issuance of equity securities, of which \$1,500,000 was received in cash and \$500,000 was paid by an exchange of rights to declared and unpaid dividends. In May 2007 we received approximately \$1,800,000 in net proceeds from the sale of our Fire/EMS Services division. In July and November 2009 we received \$1,000,000 and \$750,000, respectively in gross proceeds through the issuance of unsecured promissory notes. In December 2009 we received approximately \$11,300,000 in net proceeds from the sale of our Law Enforcement division, of which \$7,000,000 was paid in cash, and approximately \$4,000,000 of which is payable in three annual installments.

If we are unable to generate sufficient revenue to meet our goals, we will need to obtain additional third-party financing to (i) conduct the sales, marketing and technical support necessary to execute our plan to substantially grow operations, increase revenue and serve a significant

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customer base; and (ii) provide working capital. Therefore, we may need to obtain additional financing through the issuance of debt or equity securities, or to restructure our financial position through similar transactions to those consummated during 2006, 2007, and 2009.

We cannot assure you that we will ever be able to secure any such financing on terms acceptable to us. If we cannot obtain such financing, we may not be able to execute our business plan or continue operations.

We may not achieve sustainable profitability with respect to the biometric component of our business if we are unable to maintain, improve and develop the wireless data services we offer.

We believe that our future business prospects depend in part on our ability to maintain and improve our current services and to develop new ones on a timely basis. Our services will have to achieve market acceptance, maintain technological

Table of Contents

competitiveness and meet an expanding range of customer requirements. As a result of the complexities inherent in our service offerings, major new wireless data services and service enhancements require long development and testing periods. We may experience difficulties that could delay or prevent the successful development, introduction or marketing of new services and service enhancements. Additionally, our new services and service enhancements may not achieve market acceptance. If we cannot effectively develop and improve services we may not be able to recover our fixed costs or otherwise become profitable.

If we fail to adequately manage our resources, it could have a severe negative impact on our financial results or stock price.

We could be subject to fluctuations in technology spending by existing and potential customers. Accordingly, we will have to actively manage expenses in a rapidly changing economic environment. This could require reducing costs during economic downturns and selectively growing in periods of economic expansion. If we do not properly manage our resources in response to these conditions, our results of operations could be negatively impacted.

Our obligations to the holders of our outstanding preferred stock may adversely affect our ability to enter into potential significant transactions with other parties.

We will need to obtain the consent of the holders of a majority of the then outstanding shares of our convertible preferred stock before we can take certain actions, including the following:

- a sale or other disposition of any material assets;
- an acquisition of a material amount of assets;
- engaging in a merger, reorganization or consolidation; or

Accordingly, unless we obtain such consent, we may not be able to enter into certain transactions.

Risks Related To Our Common Stock

We have issued a substantial number of securities that are convertible into shares of our common stock which will result in substantial dilution to the ownership interests of our existing shareholders.

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As of December 31, 2009, approximately 35,826,000 shares of our common stock were reserved for issuance upon exercise or conversion of the following securities (at conversion prices applicable as at December 31, 2009):

- 20,724,000 shares upon exercise of outstanding stock options and warrants;
- 1,927,000 shares upon exercise of options available for future grant under our existing option plans; and
- 10,714,000 shares or more upon conversion of our outstanding shares of Convertible Preferred Stock and cumulative dividends in arrears.
- 2,461,000 shares or more upon conversion of the outstanding principal of Convertible Promissory Notes and accrued interest payable.

The exercise or conversion of these securities will result in a significant increase in the number of outstanding shares and substantially dilute the ownership interests of our existing shareholders.

A substantial number of our convertible securities are convertible into shares of common stock at a conversion price of \$.30 per share. Most of these shares are eligible for public resale. The trading price of our common stock and

Table of Contents

our ability to raise additional financing may be adversely affected by the influx into the market of such a substantial number of shares.

Our outstanding shares of Series D Convertible Preferred Stock (collectively, the Preferred Stock) and cumulative dividends in arrears are convertible into approximately 10,714,000 shares of common stock as of December 31, 2009, at a per share conversion price of \$.30. In the event that shares issuable upon conversion of our Preferred Stock become eligible for public resale, this significant increase in the number of shares available for public sale may have a negative impact on the trading price of our shares and substantially dilute the ownership interests of our existing shareholders. In the event that our stock trades below \$.30 per share, in order to raise additional financing we would likely be required to issue additional shares of common stock or securities convertible into common stock at a purchase or conversion price, as applicable, of less than \$.30 per share. Any issuance of shares at a purchase price of less than \$.30 per share would reduce the conversion price of our Preferred Stock to such lower price. This would require us to issue additional shares upon conversion of our Preferred Stock and further dilute the ownership interests of our existing shareholders. To the extent these factors are viewed negatively by the market, it may provide an incentive for persons to execute short sales of our common stock that could adversely affect the trading price of our common stock.

Applicable SEC Rules governing the trading of penny stocks limits the trading and liquidity of our common stock, which may affect the trading price of our common stock.

Our common stock currently trades on the OTC Bulletin Board. Since our common stock continues to trade below \$5.00 per share, our common stock is considered a penny stock and is subject to SEC rules and regulations, which impose limitations upon the manner in which our shares can be publicly traded. These regulations require the delivery, prior to any transaction involving a penny stock, of a disclosure schedule explaining the penny stock market and the associated risks. Under these regulations, certain brokers who recommend such securities to persons other than established customers or certain accredited investors must make a special written suitability determination regarding such a purchaser and receive such purchaser's written agreement to a transaction prior to sale. These regulations have the effect of limiting the trading activity of our common stock and reducing the liquidity of an investment in our common stock.

We do not intend to pay dividends in the foreseeable future.

We have never declared or paid a dividend on our common stock. In addition, the terms of our outstanding Preferred Stock preclude us from declaring or paying a dividend on our common stock unless a dividend is also declared or paid, as applicable, on our Preferred Stock. We intend to retain earnings, if any, for use in the operation and expansion of our business and, therefore, do not anticipate paying any dividends on our common stock in the foreseeable future.

The trading price of our common stock may be volatile.

The trading price of our shares has from time to time fluctuated widely and in the future may be subject to similar fluctuations. The trading price may be affected by a number of factors including the risk factors set forth in this Report as well as our operating results, financial condition, announcements of innovations or new products by us or our competitors, general conditions in the biometrics and access control industries, and other events or factors. Although we believe that approximately 15 registered broker dealers currently make a market in our common stock, we can not assure you that any of these firms will continue to serve as market makers or have the financial capability to stabilize or support our common stock. A reduction in the number of market makers or the financial capability of any of these market makers could also result in a

decrease in the trading volume of and price of our shares. In recent years broad stock market indices, in general, and the securities of technology companies, in particular, have experienced substantial price fluctuations. Such broad market fluctuations may adversely affect the future-trading price of our common stock.

Completion of the Asset Sale may result in dilution of future earnings per share to the stockholders of BIO-key.

The completion of the asset sale of BIO-key's Law Enforcement division to InterAct911 Mobile Systems, Inc. in December 2009 may not result in improved earnings per share of BIO-key. The sale could fail to produce the benefits that BIO-key anticipates, or could have other adverse effects that BIO-key currently does not foresee. In this event, the asset sale could result in a reduction of earnings per share of BIO-key as compared to the earnings per share that would have been achieved if the asset sale had not occurred.

Table of Contents

ITEM 2. DESCRIPTION OF PROPERTY

We do not own any real estate. We conduct operations from leased premises in Eagan, Minnesota (6,822 square feet), Wall, New Jersey (4,179 square feet) and Westford, Massachusetts (shared services center). We believe our current facilities are adequate for the foreseeable future.

ITEM 3. LEGAL PROCEEDINGS

Effective as of July 2, 2009, the Company entered into a Settlement and Mutual Release Agreement (the "Settlement Agreement") with Longview Special Finance, Inc. and Longview Fund, L.P. (collectively, the "Longview Entities") in order to resolve all matters relating to the litigation initiated by the Longview Entities earlier in 2009, in which they were seeking \$2,886,563 in damages and an unspecified amount of interest and attorney's fees from the Company as a result of the Company's alleged improper failure to redeem their outstanding shares of the Company's Convertible Preferred Stock (collectively, the "Shares") in accordance with the terms and conditions of such preferred stock. Pursuant to the Settlement Agreement, without admission of any liability or fault, the parties agreed to a payment schedule under which the Company was required to pay a total cash settlement amount of \$2,164,922, fifty percent (50%) of which was paid on July 7, 2009. The remaining portion of the settlement amount accrued interest at seventeen percent (17%) per annum and was required to be paid in full on or before October 30, 2009. In return, the Longview Entities agreed to a full and complete release of the Company from all claims that were or could have been alleged in the lawsuit and agreed to relinquish all of the Shares upon receiving final payment of the settlement amount. From October 30, 2009 until November 12, 2009, interest on the remaining portion of the settlement amount accrued at twenty percent (20%) per annum. On November 12, 2009, the Company paid in full the entire outstanding portion of the settlement amount, together with all accrued and unpaid interest, and satisfied all of its obligations to the Longview Entities under the Settlement Agreement.

ITEM 4. RESERVED

Table of Contents**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

Our common stock currently trades on the OTC Bulletin Board under the symbol BKYI. The following table sets forth the range of high and low bid prices per share of our common stock for each of the calendar quarters identified below as reported by the OTC Bulletin Board. These quotations represent inter-dealer prices, without retail mark-up, markdown or commission, and may not represent actual transactions.

2009:	High	Low
Quarter ended December 31, 2009	\$ 0.30	\$ 0.15
Quarter ended September 30, 2009	0.26	0.10
Quarter ended June 30, 2009	0.17	0.07
Quarter ended March 31, 2009	0.11	0.05

2008:	High	Low
Quarter ended December 31, 2008	\$ 0.11	\$ 0.04
Quarter ended September 30, 2008	0.20	0.09
Quarter ended June 30, 2008	0.18	0.10
Quarter ended March 31, 2008	0.13	0.10

 Holders

As of March 24, 2010, the number of stockholders of record of our common stock was 170.

 Dividends

We have not paid any cash dividends on our common stock to date, and have no intention of paying any cash dividends on our common stock in the foreseeable future. The terms of our outstanding Convertible Preferred Stock preclude us from declaring or paying a dividend on our common stock unless a dividend is also declared or paid, as applicable, on our Convertible Preferred Stock. The declaration and payment of dividends on our common stock is also subject to the discretion of our Board of Directors and certain limitations imposed under the Delaware General Corporation Law. The timing, amount and form of dividends, if any, will depend on, among other things, our results of operations, financial condition, cash requirements and other factors deemed relevant by our Board of Directors.

 Equity Compensation Plan Information

For information regarding our equity compensation plans, see Item 12 included in this Annual Report on Form 10-K.

Recent Sales of Unregistered Securities; use of Proceeds from Registered Securities

(a) On July 7, 2009, the Company issued an unsecured promissory note in the aggregate principal amount of \$1,000,000 to The Shaar Fund Ltd. These securities were issued in a private placement transaction exempt from the registration requirements of the Securities Act pursuant to Section 4(2) thereof directly by the Company without engaging in any advertising or general solicitation of any kind and without payment of underwriting discounts or commissions to any person.

(b) On November 12, 2009, the Company issued an unsecured promissory note in the aggregate principal amount of \$750,000 to The Shaar Fund Ltd. These securities were issued in a private placement transaction exempt from the registration requirements of the Securities Act pursuant to Section 4(2) thereof directly by the Company without engaging in any advertising or general solicitation of any kind and without payment of underwriting discounts or commissions to any person.

Table of Contents

(c) On November 12, 2009, the Company entered into a Securities Exchange Agreement with The Shaar Fund Ltd. and Mr. Thomas J. Colatosti (the Holders), pursuant to which these investors agreed to exchange 27,932 shares of the Company s Series A Convertible Preferred Stock owned by the respective Holders, for 27,932 shares of the Company s Series D Convertible Preferred Stock at an initial fixed conversion price of \$0.30 per share. In addition, the Company issued convertible promissory notes in the aggregate principal amount of \$737,957 to the Holders in exchange for all dividends accrued and unpaid on their Series A Convertible Preferred Stock. Also, the Company issued warrants to the Holders to purchase 5,000,000 shares of common stock at an initial exercise price of \$0.30. These securities were issued in a private placement transaction exempt from the registration requirements of the Securities Act pursuant to Section 4(2) thereof directly by the Company without engaging in any advertising or general solicitation of any kind and without payment of underwriting discounts or commissions to any person.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

None.

Table of Contents

ITEM 6. SELECTED FINANCIAL DATA

N/A

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Management's Discussion And Analysis Of Financial Condition And Results Of Operations and other parts of this Report contain forward-looking statements that involve risks and uncertainties. All forward-looking statements included in this Report are based on information available to us on the date hereof, and we assume no obligation to update any such forward-looking statements. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of a number of factors, including those set forth in the section captioned **RISK FACTORS** in Item 1A and elsewhere in this Report. The following should be read in conjunction with our audited financial statements included elsewhere herein.

The following Management's Discussion And Analysis Of Financial Condition And Results Of Operations (**MD&A**) is intended to help you understand BIO-key International (the **Company** , **we** , **us** or **our**). MD&A is provided as a supplement to and should be read in conjunction with our financial statements and the accompanying notes. Our MD&A includes the following sections:

OVERVIEW provides a description of our business, the major items that affected our business, and how we analyze our business. It then provides an analysis of our overall 2009 performance and a description of the significant events impacting 2009 and thereafter.

RESULTS OF OPERATIONS provides an analysis of the consolidated results of operations for 2009 compared to 2008.

LIQUIDITY AND CAPITAL RESOURCES provides an overview of our cash flows, financing, contractual obligations, and liquidity outlook.

CRITICAL ACCOUNTING POLICIES provides a discussion of our accounting policies that require critical judgment, assumptions and estimates.

RECENT ACCOUNTING STANDARDS by reference to Note 1 to the Consolidated Financial Statements provides a description of accounting standards which we have not yet been required to implement and may be applicable to our operations, as well as those significant accounting standards which were adopted during 2009.

OVERVIEW

Our Business

BIO-key develops and markets advanced fingerprint identification biometric technology and software solutions.

We were among the initial pioneers in developing automated, finger identification technology that can be used without the aid of non-automated methods of identification such as a personal identification, password, token, smart card, ID card, credit card, passport, driver's license or other form of possession or knowledge based identification. This advanced BIO-key identification technology improves both the accuracy and speed of finger-based biometrics.

In 2004, BIO-key acquired Public Safety Group, Inc. (PSG), a privately held company that was a leader in wireless solutions for law enforcement and public safety markets. PSG's primary technology was PocketCop, a handheld solution that provides mobile officers, such as detectives who are not typically in their vehicles, a hand-held mobile information software solution. Also in, 2004, BIO-key completed a transaction with Aether Systems, Inc. to purchase its Mobile Government Division (Mobile Government or AMG), a leading provider of wireless data solutions for use by public safety organizations, primarily state, local police, fire and rescue and emergency medical services organizations. Their

Table of Contents

PacketCluster mobile information software is integrated with 50 separate State/NCIC databases, as well as other state, local and federal databases.

In 2007, BIO-key completed a transaction with ZOLL Data Systems, Inc. (ZOLL), a subsidiary of ZOLL Medical Corporation, in which ZOLL acquired substantially all of the assets related to the Company's Fire/EMS Services division.

In 2009, BIO-key completed a transaction with InterAct911 Mobile Systems, Inc. (InterAct911), a subsidiary of InterAct911 Corporation, in which InterAct911 acquired substantially all the assets related to the Company's Law Enforcement division.

INTRODUCTION

As a result of these transactions, and as discussed in Note M to the Consolidated Financial Statements included in this report, we have organized the Company into one reporting segment: Biometrics. During the year ended December 31, 2009, the Company continued to focus on its primary objectives of increasing revenue and managing expenses, by developing leadership technology and applications and by providing its customers with high quality support and service.

A detailed analysis of operations can be found below.

RESULTS OF OPERATIONS

Consolidated Results of Operations

Two Year % trend

	Years ended December 31,	
	2009	2008
Revenues		
Services	20%	6%
License fees and other	80%	94%
	100%	100%
Costs and other expenses		
Cost of services	4%	2%
Cost of license fees and other	17%	8%
	21%	10%

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Gross Profit	79%	90%
Operating expenses		
Selling, general and administrative	144%	111%
Research, development and engineering	39%	29%
Operating loss	-104%	-50%
Other income (deductions)		
Total other deductions	-9%	6%
Net loss from continuing operations	-113%	-43%
Net income from discontinued operations	122%	49%
Gain (loss) on disposal of discontinued operations	190%	-2%
Net income	199%	4%

Table of Contents***Revenues and Costs of goods sold***

	2009	2008	2009 - 2008	
			\$ Chg	% Chg
<i>Revenues</i>				
Service	482,900	191,515	291,385	152%
License & other	1,874,382	3,188,027	(1,313,645)	-41%
<i>Total Revenue</i>	\$ 2,357,282	\$ 3,379,542	\$ (1,022,260)	-30%
<i>Cost of goods sold</i>				
Service	82,594	63,569	19,025	30%
License & other	421,641	268,589	153,052	57%
<i>Total COGS</i>	\$ 504,235	\$ 332,158	\$ 172,077	52%

Revenues

For the year ended December 31, 2009, service revenue increased as the Company continued to bundle maintenance agreements to its expanding customer license base during the period, as well as renewed existing maintenance agreements from its legacy customers during the period. The percentage of service revenue as a proportion of total Biometric revenue increased from approximately 6% to 20% across the two periods reported.

For the year ended December 31, 2009, license and other revenue decreased primarily as a result of non-recurring sales generated from an OEM customer in 2008, however the decrease was offset by additional license revenue from existing customers.

Costs of goods sold

For the year ended December 31, 2009, cost of services increased from the 2008 period due to increased customer support, as needed for the expanding customer base, however the relative percent of service revenue decreased from 33% in 2008 to 17% in 2009. The Company expects these costs will increase in future periods as additional Biometric customers are added.

For the year ended December 31, 2009, cost of license and other increased from the 2008 period, due to an increase in costs for temporary outside services required to support specific customer orders, hardware costs for an increase in hardware orders and third party software costs, driven by a larger customer base.

Selling, general and administrative

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	2009	2008	2009 - 2008	
			\$ Chg	% Chg
Total	\$ 3,382,613	\$ 3,758,888	\$ (376,275)	-10%

The overall decline in the total SG&A costs for the year ended December 31, 2009 as compared to 2008 was attributable to a reduction in intangible amortization by approximately \$295,000, payroll expense by \$128,000 and a decrease of approximately \$69,000 in non-cash compensation charges. The reduction in expenses were offset by increases in legal fees related to the Settlement Agreement by \$30,000, and commission expenses of approximately \$72,000.

Table of Contents**Research, development and engineering**

	2009	2008	2009 - 2008	
			\$ Chg	% Chg
Total	\$ 927,241	\$ 974,182	\$ (46,941)	-5%

For the year ended December 31, 2009, R & D costs decreased as compared to 2008, primarily due to lower consultant expenses, offset by an increase in non-cash compensation charges.

Other income and expense

	2009	2008	2009 - 2008	
			\$ Chg	% Chg
Interest income (expense)	\$ 89,804	\$ (2,552)	\$ 92,356	-3619%
Derivative and warrant fair value adjustments	(286,492)	93,059	(379,551)	-408%
Gain on sale of investments		119,348	(119,348)	-100%
Other expense	(9,393)		(9,393)	N/A
	\$ (206,081)	\$ 209,855	\$ (415,936)	-198%

For the year ended December 31, 2009, the increase in interest income was a result of the Company releasing unclaimed penalty reserves from prior years. Interest expense includes actual cash paid for interest as well as non-cash interest charges for the amortization of debt discounts, deferred charges, and deferred rent. The majority of interest expense for 2009 and 2008 was associated with Notes Payable (Note L).

For the year ended December 31, 2009, derivative and warrant fair value adjustments decreased, when compared to the 2008 period, due to changes in the fair market value of embedded derivatives and detachable warrants issued with convertible debt in 2004, 2005, and 2009, as well as with additional derivatives recorded as a result of financings in 2006 and 2009. The fair value of the instruments will fluctuate based on; our stock price on the valuation date, the debt conversion price, the volatility of our stock price over a period of time, changes in the value of the risk free interest rate, and the time to maturity of the outstanding debt at different points in time. Stock price is the major driver behind the movement in the Company's balances. As our stock price increased during 2009, the value of these instruments also increased, leading to an adjustment to other expenses; the opposite effect occurred during the 2008 period, as our stock price decreased, leading to a reduction in the value of these instruments, and an adjustment to other income.

For the year ended December 31, 2008, gain on sale of investments related to the realization of available-for-sale securities sold at its market value.

DISCONTINUED OPERATIONS

On December 8, 2009, we completed the sale of our Law Enforcement division for approximately \$11.3 million, amounting to a net gain to the Company of approximately \$4.5 million. This business had previously been reported as a separate segment in our financial statements. For the fiscal years ended 2009 and 2008, \$2.9 million, and \$1.7 million of operating income, respectively, net of tax, were reflected as discontinued operations in the accompanying consolidated statements of operations. Net sales associated with the discontinued operations were \$8.6 million, and \$9.5 million for 2009 and 2008, respectively. See Note B Discontinued Operations for further discussion.

Table of Contents

LIQUIDITY AND CAPITAL RESOURCES

OPERATING ACTIVITIES OVERVIEW

Net cash used for operations during the year ended December 31, 2009 was approximately \$1,655,000. The cash used by operating activities of continuing operations was primarily due to the following items:

- Negative cash flows related to a decrease in accounts receivable, and deferred revenue of approximately \$757,000, and \$468,000, respectively (net outflow of \$1,225,000),
- Negative cash flows from payments with respect to the note payable, and a decrease in accrued liabilities of approximately \$268,000,

The following non-cash items reflected in the Company's statement of operations are used to reconcile the net loss to the net cash used in operating activities during the year ended December 31, 2009:

- The Company issued notes in 2005, 2006, and 2009 and preferred stock in 2009, all of which contained embedded derivatives, and associated warrants. In 2009, the Company recognized losses of approximately \$286,000 related to the decrease in value of the derivatives and associated warrants. The decrease in value is driven mainly by the decline in value of the underlying BIO-key stock,
- The Company recorded approximately \$222,000 of charges in 2009 for the expense of issuing options to employees for services.

INVESTING ACTIVITIES OVERVIEW

Net cash provided by investing activities for the year ended December 31, 2009 was approximately \$6,941,000. The cash provided by investing activities for continuing operations was primarily driven by the net cash proceeds from the sale of the Law Enforcement division of approximately \$7,000,000.

FINANCING ACTIVITIES OVERVIEW

Net cash used by financing activities for the year ended December 31, 2009 was approximately \$6,206,000. The cash provided by financing activities of continuing operations was primarily due to the following items:

- Negative cash flows related to payment of short term obligations of approximately \$3,915,000, partially offset by proceeds from the issuance of short term obligations of \$1,750,000 (net outflow of \$2,165,000),

- Negative cash flows from the redemption of redeemable preferred stock of approximately \$4,004,000.

Net working capital of continuing operations at December 31, 2009 was approximately \$868,000 as compared to approximately \$283,000 at December 31, 2008, the improvement of which was driven mainly by the Company's restructuring of its balance sheet following the sale of the Law Enforcement division.

Since January 7, 1993 (date of inception), our capital needs have been principally met through proceeds from the sale of equity and debt securities.

We do not expect any material capital expenditures during the next twelve months.

Table of Contents

We do not currently maintain a line of credit or term loan with any commercial bank or other financial institution.

Liquidity outlook

At December 31, 2009, our total of cash and cash equivalents was approximately \$792,000, as compared to approximately \$1,713,000 at December 31, 2008.

As discussed above, the Company has financed itself in the past through access to the capital markets by issuing convertible debt securities, convertible preferred stock and common stock. We currently require approximately \$400,000 per month to conduct our operations. During 2009, we generated approximately \$2,400,000 of revenue. While the Company expects to increase revenue in 2010, there can be no assurance that we will achieve that goal.

The Company expects to receive \$4 million from the maker of its Note Receivable in three equal annual instalments commencing December 2010. These cash inflows shall be partially offset by approximately \$3.1 million due to the anticipated redemption of the outstanding balance of the Company's redeemable preferred stock.

If we are unable to generate sufficient revenue to meet our goals, we will need to obtain additional third-party financing to (i) conduct the sales, marketing and technical support necessary to execute our plan to substantially grow operations, increase revenue and serve a significant customer base; and (ii) provide working capital. Therefore, we may need to obtain additional financing through the issuance of debt or equity securities, or to restructure our financial position through similar transactions to those consummated during 2006, 2007, and 2009.

Due to several factors, including our history of losses and limited revenue, our independent auditors have included an explanatory paragraph in opinions they have previously issued related to our annual financial statements as to the substantial doubt about our ability to continue as a going concern. Our long-term viability and growth will depend upon the successful commercialization of our technologies and our ability to obtain adequate financing. To the extent that we require such additional financing, no assurance can be given that any form of additional financing will be available on terms acceptable to us, that adequate financing will be obtained to meet our needs, or that such financing would not be dilutive to existing stockholders. If available financing is insufficient or unavailable or we fail to continue to generate meaningful revenue, we may be required to further reduce operating expenses, delay the expansion of operations, be unable to pursue merger or acquisition candidates, or continue as a going concern.

OFF-BALANCE SHEET ARRANGEMENTS

We do not have any off-balance sheet arrangements that have, or are in the opinion of management reasonably likely to have, a current or future effect on our financial condition or results of operations. In 2008 the Company extended its property lease at its Marlborough, MA location. Pursuant to the agreement BIO-key was to maintain a security deposit in the form of an irrevocable letter of credit in the amount of \$40,500. However, BIO-key and the landlord for the property subsequently agreed to have BIO-key place the funds in a third party escrow account, to be returned at the conclusion of the lease term, in August 2011. Pursuant to the sale of the Company's Law Enforcement to InterAct911 in

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December 2009 (see Note B Discontinued Operations), the Company is no longer situated at this location, and expects to fully assign the obligations of the Marlborough premises in early 2010. Accordingly, the balance is recorded as the current asset, Restricted cash as at December 31, 2009.

CRITICAL ACCOUNTING POLICIES

Our financial statements are prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires that we make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting periods. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. We evaluate our estimates and

Table of Contents

assumptions on an ongoing basis. Our actual results may differ significantly from these estimates under different assumptions or conditions. There have been no material changes to these estimates for the periods presented in this Annual Report on Form 10-K.

We believe that of our significant accounting policies, which are described in Note A of the notes to our consolidated financial statements included in this Annual Report on Form 10-K, the following accounting policies involve a greater degree of judgment and complexity. Accordingly, these are the policies we believe are the most critical to aid in fully understanding and evaluating our financial condition and results of operations.

1. 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, each element of the arrangement will be analyzed and the Company will allocate a portion of the total fee under the arrangement to the elements using vendor specific objective evidence of fair value of the element, regardless of any separate prices stated within the contract for each element. Vendor specific objective evidence is based on the price the customer is required to pay when the element is sold separately (i.e., software license fees charged when consulting or other services are not provided, hourly rates charged for consulting services when sold separately from a software license). If vendor specific objective evidence of fair value does not exist for any undelivered elements, all revenue is deferred and recognized ratably over the service period if the undelivered element is services, or until sufficient objective evidence of fair value exists or all elements have been delivered.

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. 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.

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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.

Table of Contents

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 are included in costs of service.

2. Derivative and Warrant financial instruments

In connection with the sale of debt or equity instruments, we may sell options or warrants to purchase our common stock. In certain circumstances, these options or warrants may be classified as derivative liabilities, rather than as equity. Additionally, the debt or equity instruments may contain embedded derivative instruments, such as conversion options, which in certain circumstances may be required to be bifurcated from the associated host instrument and accounted for separately as a derivative instrument asset or liability.

Our derivative instrument liability is re-valued at the end of each reporting period, with changes in the fair value of the derivative liability recorded as charges or credits to income, in the period in which the changes occur. For options, warrants and bifurcated conversion options that are accounted for as derivative instrument liabilities, we determine the fair value of these instruments using the Black-Scholes or Binomial option pricing model. That model requires assumptions related to the remaining term of the instruments and risk-free rates of return, our current common stock price and expected dividend yield, and the expected volatility of our common stock price over the life of the option. The identification of, and accounting for, derivative instruments and the assumptions used to value them can significantly affect our financial statements.

3. Impairment or Disposal of Long Lived Assets, including Intangible Assets

We review our 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, we must make assumptions regarding estimated future cash flows and discount factors. If these estimates or related assumptions change in the future, we 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. We did not record any impairment charges in any of the years presented.

4. 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

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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.

5. 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

Table of Contents

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 Companies historical performance and estimated future taxable income a full valuation allowance has been established.

6. 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 our 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 our 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, we review our valuation assumptions at each grant date and, as a result, are likely to change our 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. We consider 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 our current estimates.

RECENT ACCOUNTING STANDARDS

In September 2009, the FASB issued ASU 2009-13, *Multiple Element Arrangements*. ASU 2009-13 addresses the determination of when the individual deliverables included in a multiple arrangement may be treated as separate units of accounting. ASU 2009-13 also modifies the manner in which the transaction consideration is allocated across separately identified deliverables and establishes definitions for determining fair value of elements in an arrangement. This standard must be adopted by the Company no later than January 1, 2011 with earlier adoption permitted. The Company is currently evaluating the impact, if any, that this standard update will have on its consolidated financial statements.

In June 2009, the FASB issued ASC 105-10, *Generally Accepted Accounting Principles* (the Codification). The Codification will be the single source of authoritative nongovernmental U.S. generally accepted accounting principles. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. All existing accounting standards are superseded as described in ASC 105-10. All other accounting literature not included in the Codification is non-authoritative. ASC 105-10 is effective for interim and annual periods ending after September 15, 2009. The adoption of ASC 105-10 did not have a material impact on the Company's financial condition or results of operations.

In May 2009, the FASB issued ASC 855-10, *Subsequent Events*. ASC 855-10 sets forth the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. ASC 855-10

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will be effective for interim or annual period ending after June 15, 2009 and will be applied prospectively. The adoption of ASC 855-10 had no impact on the Company's financial condition or results of operations.

In April 2009, the FASB issued FSP No. FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments*, which is now part of ASC 825. This FSP essentially expands the disclosure about fair value of

Table of Contents

financial instruments that were previously required only annually to also be required for interim period reporting. In addition, the FSP requires certain additional disclosures regarding the methods and significant assumptions used to estimate the fair value of financial instruments. These additional disclosures were required beginning with the quarter ended June 30, 2009. The adoption had no impact on the Company's financial condition or results of operations.

In February 2009, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 141(R)-a, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination that Arise from Contingencies* (SFAS No. 141(R)-a), now part of ASC 805, which simplifies how entities will be required to account for contingencies arising in business combinations under SFAS 141(R) *Accounting for Business Combinations*. FASB decided to amend the guidance SFAS 141(R) to require assets acquired and liabilities assumed in a business combination that arise from contingencies be recognized at fair value, if fair value can be reasonably estimated. If fair value of such an asset or liability cannot be reasonably estimated, the asset or liability would be accounted for in accordance with FASB Statement No. 5 *Accounting for Contingencies* (SFAS 5). The provisions of SFAS No. 141(R)-a are applicable to business combinations consummated after January 1, 2009 for calendar year entities. The adoption of SFAS 141(R)-a will have an impact on the Company's accounting for business combinations in connection with any future acquisitions.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

N/A

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

See financial statements appearing at pages 42-45 of this report

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

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Disclosure Controls and Procedures

An evaluation of the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13(a)-15(e) of the Securities Exchange Act of 1934, as amended (the Exchange Act)), as of December 31, 2009 was carried out by the Company under the supervision and with the participation of the Company's Chief Executive Officer (CEO) and Chief Financial Officer (CFO).

During the review of the Company's operating results for the period covered by this report, our CEO and CFO determined that, as of December 31, 2009, our disclosure controls and procedures were effective in providing reasonable assurance that information we are required to disclose in reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission rules and forms. Our management reached this conclusion after identifying our system to capture disclosure items, our internal process of review for account reconciliations, our documentation of internal controls and our internal process for preparing our annual report on Form 10-K for the fiscal year ended December 31, 2009 as being adequate to provide such assurance.

Table of Contents

Management's Annual Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate, the risk. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of our management, including our CEO and CFO, we have conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2009, based upon the framework in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management has concluded that our internal control over financial reporting was not effective as of December 31, 2009. Our management reached this conclusion after identifying the following two areas of material weakness in our internal control systems:

- i Inadequate and ineffective application of complex accounting; and

- ii Management did not sufficiently monitor internal control over financial reporting. Specifically the Company did not have sufficient personnel with an appropriate level of technical accounting knowledge and experience who could execute appropriate application of complex accounting with respect to derivatives, warrants and stock option modification.

Remediation plans include soliciting additional experts necessary to help ensure the accuracy of the complex accounting financial reporting.

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

Changes in Internal Control Over Financial Reporting

During the fiscal quarter ended December 31, 2009, the Company's acting Chief Financial Officer, Thomas Colatosti was replaced by Cecilia Welch.

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During the fiscal quarter ended December 31, 2009, the Company supplemented its review and reporting structure through the use of outside experts to assist in the preparation of the Company's annual report. The outside experts have also assisted with the review and testing of the Company's internal control over financial reporting as of December 31, 2009.

ITEM 9B. OTHER INFORMATION

None .

Table of Contents

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

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The following sets forth certain information about each director and executive officer of the Company.

NAME	AGE	POSITIONS HELD
Thomas J. Colatosti	61	Chairman of the Board of Directors
Michael W. DePasquale	55	Chief Executive Officer and Director
Jeffrey J. May (b)	50	Director
Charles P. Romeo(a) (c)	68	Director
John Schoenherr (b) (c)	57	Director
Cecilia Welch	50	Chief Financial Officer
Randy Fodero	51	Vice President of Sales
Mira K. LaCous	48	Vice President of Technology & Development
Charles Bud Yanak	53	Vice President of Marketing

(a) From April 2004 to February 2005, Mr. Romeo was employed by the Company.

(b) Audit Committee Member

(c) Compensation Committee Member

The following is a brief summary of the business experience of each of the above-named individuals:

THOMAS J. COLATOSTI has served as a Director of the Company since September 2002, as Chairman of the Board since January 3, 2003, and as Chief Financial Officer from November 17, 2008 to December 21, 2009. Mr. Colatosti also served as Co-Chief Executive Officer of the Company from July 2005 to August 2006. Mr. Colatosti also currently serves as the Chief Executive Officer of American Security Ventures, a Lexington, Massachusetts-based consulting firm he founded which specializes in providing strategic management consulting services to emerging and developing companies in the homeland security industry. Since July 2009, Mr. Colatosti has been serving as Chairman of Commodore Applied Technologies. Mr. Colatosti has served as a Director and President of Good Harbor Partners Acquisition Corp., a publicly-traded special purpose acquisition company formed to acquire businesses in the security sectors. From 1997 through June 2002, Mr. Colatosti served as the Chief Executive Officer of Viisage Technology, Inc., a publicly traded biometric technology company. Between 1995 and 1997, Mr. Colatosti served as President and Chief Executive Officer of CIS Corporation. Prior to CIS, Mr. Colatosti had a 21 year career with Digital Equipment Corporation. Among his executive positions he was Vice President and General Manager of the company's \$1.2 billion Government Systems Division. Mr. Colatosti is considered a security industry authority.

MICHAEL W. DEPASQUALE has served as the Chief Executive Officer and a Director of the Company since January 3, 2003. He served as Co-Chief Executive Officer of the Company from July 2005 to August 2006. Mr. DePasquale brings more than 26 years of executive management, sales and marketing experience to the Company. Prior to joining BIO-key, Mr. DePasquale served as the President and Chief Executive Officer of Prism eSolutions, Inc., a Pennsylvania-based provider of professional consulting services and online solutions for ISO-9001/14000 certification for customers in manufacturing, healthcare and government markets, since February 2001. From December 1999 through December 2000, Mr. DePasquale served as Group Vice President for WRC Media, a New York-based distributor of supplemental education products and software. From January 1996 until December 1999, Mr. DePasquale served as Senior Vice President of Jostens Learning Corp., a California-based provider of multi media curriculum. Prior to Jostes, Mr. DePasquale held sales and marketing management positions with McGraw-Hill and Digital Equipment Corporation. Mr. DePasquale earned a Bachelor of Science degree from the New Jersey Institute of Technology.

Table of Contents

JEFFREY J. MAY has served as a Director of the Company since October 29, 2001. Since December 2006, Mr. May has served as the CEO and Director of MagnaLynx, a semiconductor company specializing in high speed chip level communications. Since 1997, Mr. May has served as the President of Gideons Point Capital, a Minnesota-based investment and consulting firm focusing on assisting start-up technology companies. In 1983, Mr. May co-founded Advantek, Inc., a manufacturer of equipment and materials for the semiconductor industry, which was sold in 1993. Mr. May continued to serve as a director and Vice-President of Operations of Advantek until 1997, when it had over 600 employees and sales in excess of \$100 million. Mr. May earned a Bachelor of Science degree in Electrical Engineering from the University of Minnesota in 1983.

CHARLES P. ROMEO has served as a director of the Company since February 28, 2005 and from January 29, 2003 to April 19, 2004. From April 2004 until February 2005, he served as Vice President of Sales, Public Safety Division of the Company. From November 2005 to November 2007, Mr. Romeo served as the Vice President of Sales and Marketing for UNICOM, a Rhode Island systems integrator. From September 2002 until April 2004 Mr. Romeo has served as the President and Chief Executive Officer of FreedomBridge Technologies, Inc., a Rhode Island-based consulting firm to technology companies in the homeland security industry specializing in implementing direct and channel selling programs, strategic alliances and partnerships in the law enforcement market. Prior to founding FreedomBridge, Mr. Romeo had a 33 year sales and marketing management career with Digital Equipment Corporation, Compaq Computer Corporation and Hewlett Packard. During his career, Mr. Romeo served as Vice President of Service Sales for a \$500 million business unit, and Director of Public Sector Sales, a \$275 million division of Hewlett Packard. Mr. Romeo authored *The Sales Manager's Troubleshooter*, Prentice Hall 1998, which was named as one of the top 10 must reads by Sales and Marketing Magazine. Mr. Romeo earned a Bachelor of Science degree in Mathematics and Economics from the University of Massachusetts and an Executive MBA from Babson College.

JOHN SCHOENHERR has served as a Director of the Company since December 30, 2004. Mr. Schoenherr served as Vice President of Corporate Performance Management for Oracle Corporation from 1995 through 2006. Prior to Oracle he served as Senior Vice President of Business Intelligence and Analytics at Information Resources, Inc. Mr. Schoenherr has over 25 years of experience in the area of business intelligence and strategic planning. His career includes a number of product development and management positions.

CECILIA WELCH has served as Chief Financial Officer of the Company since December 21, 2009. Ms. Welch joined the Company in 2007 and has served since then as the Company's Corporate Controller. Prior to joining the Company, from January 2006 to December 2006 she was the Controller for Savaje Technologies (acquired by Sun Microsystems), a developer of advanced mobile telephone software. From October 2004 to January 2006, she was Controller for Crystal Systems, a manufacturer of sapphire crystals used for industrial, semiconductor, defense and medical applications. From December 1988 to July 2004, she was the Controller for ATN Microwave (acquired by Agilent Technologies), a manufacturer of automated test equipment. Ms. Welch has a Bachelor's degree in Accounting from Franklin Pierce University.

RANDY FODERO has served as the Vice President of Sales since February 1, 2006. From July 2005 until February 2006, he was a sales consultant to the Company. Between July 2003 and July 2005, Mr. Fodero was the Vice President of Sales and Marketing, and from March 2003 to July 2003 Mr. Fodero was a member of the Company's sales organization. Mr. Fodero has more than 20 years of successful executive and sales management experience. Prior to joining the Company, Mr. Fodero served as Director of Global Accounts for Veritas Software from February 2002 until January 2003. Between 1999 and February 2002, Mr. Fodero served in executive sales capacities with companies in the enterprise software industry, including Agile Software, and Memco Software, a leading provider of information security software to Fortune 1000 companies, where he was instrumental in increasing sales and enhancing shareholder value in connection with the sale of Memco to Platinum Technology. From 1990 through

1998, Mr. Fodero served as Vice President of Sales of CommVault Systems, where he grew sales from startup to over \$36 million and participated in a management buyout.

MIRA K. LACOUS has served as Vice President of Technology & Development of the Company since May 15, 2000. Ms. LaCous has over 26 years of software development/architecture and project management experience with a background that includes successfully bringing numerous technologies to market, including automated voice response systems, automated building control systems, software piracy protection, intranet training materials and testing, page layout and design software, image scanning software and systems, biometric security, biometric algorithms and more. Ms. LaCous is also the author of five US Patented technologies, multiple international patents, and other patent pending solutions. She has been an officer or director of two other companies; National Computer Systems (NCS), and TEL-Line Systems. Ms. LaCous has a Bachelors in

Table of Contents

Computer Science from North Dakota State University. Ms. LaCous also serves on the Board of Directors of the Minnesota Sinfonia, a not-for-profit arts organization, as its chairperson.

CHARLES BUD YANAK served as Vice President of Marketing of the Company since July 1, 2004. Mr. Yanak has more than 25 years of experience leading the successful development, commercialization, marketing and licensing of technology for security, electronics and industrial companies. He has held executive-level marketing positions at organizations including Iridian Inc. as VP of Marketing and Business Development, a leading biometric company; Avery Dennison, a global supplier of barcode identification systems; and Mars Electronics Industrial Products Group. Most recently, Yanak was vice president of sales and marketing for BioLink Technologies, an enterprise security company. Mr. Yanak has a BS and MS in Engineering from Drexel University and an MBA from Temple University.

Directors Terms of Office

Mr. May was initially elected to serve as a director in 2001, and was re-elected in 2004. Mr. Colatosti was initially elected to serve as a director in 2002, and was re-elected in 2004. Mr. DePasquale was initially elected as a director in 2003, and was re-elected in 2004. Mr. Schoenherr was initially elected as a director in 2004. Mr. Romeo was initially elected as a director in 2005. Each such director was elected to serve until the Company's next annual meeting or until his successor is duly elected and qualified in accordance with the By-laws of the Company.

Audit Committee

The Audit Committee is comprised of John Schoenherr and Jeffrey J. May, who may not qualify as audit committee financial experts under the applicable rules adopted by the Securities and Exchange Commission. However, the Board believes that each Audit Committee member has sufficient knowledge in financial and auditing matters to serve on the Audit Committee. Additionally, the Audit Committee has the ability on its own to retain independent accountants or consultants whenever it deems appropriate.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the U.S. Securities and Exchange Act of 1934, as amended (the Exchange Act), requires the Company's officers and directors and persons who own more than ten percent (10%) of the Company's Common Stock to file with the Securities and Exchange Commission (SEC) initial reports of ownership and reports of changes in ownership of the Company's Common Stock. Such officers, directors and ten percent (10%) stockholders are also required by applicable SEC rules to furnish the Company with copies of all forms filed with the SEC pursuant to Section 16(a) of the Exchange Act. Based solely on its review of the copies of such forms received by it, or written representations from such persons that no other reports were required for such persons, the Company believes that during the fiscal year ended December 31, 2009, all Section 16(a) filing requirements applicable to the Company's officers, directors and ten percent (10%) stockholders were satisfied in a timely fashion, except for the following:

- a) Thomas J. Colatosti one late Form 4 filing with respect to the issuance of a total of 50,000 options on February 27, 2009.

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- b) Michael DePasquale one late Form 4 filing with respect to the issuance of a total of 500,000 options on February 27, 2009.

- c) Jeff May one late Form 4 filing with respect to the issuance of a total of 75,000 options on February 27, 2009.

- d) Charles Romeo one late Form 4 filing with respect to the issuance of a total of 50,000 options on February 27, 2009.

- e) John Schoenherr one late Form 4 filing with respect to the issuance of a total of 100,000 options on February 27,

Table of Contents

2009.

Code of Ethics

We have adopted a Code of Ethics that applies to our principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions. Our Code of Ethics is designed to deter wrongdoing and promote: (i) honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships; (ii) full, fair, accurate, timely and understandable disclosure in reports and documents that we file with, or submit to, the SEC and in our other public communications; (iii) compliance with applicable governmental laws, rules, and regulations; (iv) the prompt internal reporting of violations of the code to an appropriate person or persons identified in the code; and (v) accountability for adherence to the code. Any person may obtain a copy of our Code of Ethics free of charge by sending a written request for such to the attention of the Chief Financial Officer of the Company, 3349 Highway 138, Building D Suite B, Wall, NJ 07719.

Internet Address and SEC Reports

We maintain a website with the address www.BIO-key.com. We are not including the information contained on our website as a part of, or incorporating it by reference into, this Annual Report on Form 10-K. We make available free of charge through our website our Annual Reports on Form 10-K (and, where applicable, 10-KSB), Quarterly Reports on Form 10-Q (and, where applicable, 10-QSB) and Current Reports on Form 8-K, and amendments to these reports, as soon as reasonably practicable after we electronically file such material with, or furnish such material to, the SEC. Our SEC filings are also available over the Internet at the SEC's website www.sec.gov. Members of the public may read and copy any materials the Company files with the SEC at the SEC's public reference room at 100 F Street, NE, Washington, DC 20549. Information on the operation of the public reference room is available by calling the SEC on 1800-SEC-0330.

ITEM 11. EXECUTIVE COMPENSATION

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The following table sets forth a summary of the compensation paid to or accrued by our chief executive officer (principal executive officer) and the two most highly compensated executive officers other than the principal executive officer, who were serving as executive officers at the end of December 31, 2009, for the fiscal years ended December 31, 2009 and 2008:

SUMMARY COMPENSATION TABLE

Name	Fiscal Year	Salary (\$)	Bonus (\$)	Stock Awards (\$)	Option Awards (\$)	Non-Equity Incentive Plan Compensation (\$)	Nonqualified Deferred Compensation Earnings (\$)	All Other Compensation (\$)	Total (\$)
Michael W. DePasquale Chief Executive Officer	2009	250,000			93,976(1)			425	344,401
	2008	250,000			(1)			775	250,775
Randy Fodero Vice President Sales	2009	170,000			34,938(1)	35,339		300	240,577
	2008	170,000			(1)	54,916		527	225,443
Mira K. LaCous Vice President Technology & Development	2009	145,665				(1)		248	145,913
	2008	140,400			8,421(1)			435	149,256
Thomas J. Colatosti Former Chief Financial Officer	(2) 2009	150,000			74,691(1)				224,691
	2008	109,500			10,874(1)				120,374

(1) The aggregate grant date fair value of the option awards was estimated using the Black-Scholes option pricing model, with the assumptions listed in Note A to the Company's financial statements. The amount shown in this column

Table of Contents

represents the grant date fair value calculated under ASC 718

(2) The compensation for Thomas J. Colatosti is presented in the above table pursuant to Item 402 (m)(2)(iii) of the Non-Financial Statement Disclosure requirements of Regulation S-K, as he would have been classified as one of Company's two most highly compensated executive officers other than the principal executive officer but for the fact that he was not serving as an executive officer at the end of the last completed fiscal year.

Narrative Disclosure to Summary Compensation Table

Compensation for BIO-key's executives is comprised of three main components: base salary, annual performance-based cash bonus and long-term equity awards. We do not target a specific weighting of these three components or use a prescribed formula to establish pay levels. Rather, the board of directors and compensation committee considers changes in the business, external market factors and our financial position each year when determining pay levels and allocating between long-term and current compensation for the named executive officers.

Cash compensation is comprised of base salary and an annual performance-based cash bonus opportunity. The committee generally seeks to set a named executive officer's targeted total cash compensation opportunity within a range that is the average of the applicable peer company and/or general industry compensation survey data, adjusted as appropriate for individual performance and internal pay equity and labor market conditions.

In setting cash compensation levels, we favor a balance in which base salaries are generally targeted at slightly below the peer average and a bonus opportunity that is targeted at slightly above the average. The committee believes that this higher emphasis on performance-based cash bonuses places an appropriate linkage between a named executive officer's pay, his or her individual performance and the achievement of specific business goals by placing a higher proportion of annual cash compensation at risk, thereby aligning executive opportunity with the interests of stockholders.

We include an equity component as part of our compensation package because we believe that equity-based compensation aligns the long-term interests of our named executive officers with those of stockholders.

These cash and equity compensation components of pay are supplemented by various benefit plans that provide health, life, accident, disability and severance benefits, most of which are the same as the benefits provided to all of our US based employees.

Employment Agreements

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Effective as of March 25, 2010, the Company entered into a one-year employment agreement with Michael W. DePasquale to serve as the Chief Executive Officer of the Company at an annual base salary of \$250,000, subject to adjustment by the Board or Compensation Committee. The agreement automatically renews for subsequent one-year terms, unless terminated by either party. In addition to the Base Salary, a Performance Bonus may be awarded to Mr. DePasquale on the basis of the Company achieving certain corporate and strategic performance goals, as determined by the Board in its sole discretion. There is a Change of Control provision that occurs if Mr. DePasquale is not offered continued employment with the Company or any successor, or within five years following such Change of Control, the Company or any successor terminates the Mr. DePasquale's employment without Cause, then Mr. DePasquale is to be paid his Base Salary and benefits earned but unpaid through the date of termination, and any prorated bonus earned during the then current bonus year, plus two times his then current Base Salary. The employment agreement contains standard and customary confidentiality, non-solicitation and work made for hire provisions as well as a covenant not to compete which prohibits Mr. DePasquale from doing business with any current or prospective customer of the Company or engaging in a business competitive with that of the Company during the term of his employment and for the one year period thereafter. This agreement also contains a number of termination provisions as described in Termination and Change in Control Arrangements in this Item.

On November 20, 2009, the Company renewed its one-year employment agreement with Mira K. LaCous to serve as the Vice President of Technology & Development of the Company at an annual base salary of \$140,000, subject to adjustment by the Board or Compensation Committee. The employment agreement contains standard and customary confidentiality, technical invention provisions, as well as a covenant not to compete which prohibits Ms. LaCous from doing business with any current or prospective customer of the Company or engaging in a business competitive with that of the Company during the term of her employment and for the one year period thereafter. This agreement also contains a number of termination provisions as described in Termination and Change in Control Arrangements in this Item.

In connection with his appointment to the Board of Directors in September 2002, and as acting Chief Financial Officer from November 2008 to December 2009, the Company has entered into a number of consulting arrangements with Thomas Colatosti. Under the most recent arrangement, which was entered into on January 12, 2010, Mr. Colatosti is to provide services to the Company and its subsidiaries and affiliates for a two year term ending December 31, 2011 at a rate of \$5,000 per month. The employment agreement contains standard and customary confidentiality and intellectual property provisions. This agreement also contains a number of termination provisions as described in Termination and Change in Control Arrangements in this Item.

Table of Contents

Stock Option Grants

In the event of any change in the outstanding shares of our common stock by reason of a stock dividend, stock split, combination of shares, recapitalization, merger, consolidation, transfer of assets, reorganization, conversion or what the board deems to be similar circumstances, the number and kind of shares subject to outstanding options, and the exercise price of such options shall be appropriately adjusted in a manner to be determined in the sole discretion of the board. Furthermore, these option agreements contain a change of control provision as described in Termination Arrangements in this Item.

Table of Contents

**OUTSTANDING EQUITY AWARDS AT FISCAL YEAR END
DECEMBER 31, 2009**

The following table sets forth for each named executive officer, information regarding outstanding equity awards as at December 31, 2009:

Name	Option Awards				Stock Awards			Equity incentive plan awards: Market or payout value of unearned shares, units or other rights that have not vested (\$)
	Number of securities underlying unexercised options exercisable (#)	Number of securities underlying unexercised options unexercisable (#)	Equity incentive plan awards: Number of unearned shares or units or other rights that have not vested (#)	Option exercise price (\$)	Option expiration date	Number of shares or units of stock that have not vested (#)	Market value of shares or units of stock that have not vested (\$)	
Michael W. DePasquale	500,000			0.087	2/27/2016			
	601,938			0.300	11/2/2012			
Randy Fodero	340,000			0.300	11/2/2012			
Mira LaCous	37,500(1)	37,500(1)		0.180	8/13/2015			
	45,000			0.470	7/18/2010			
Thomas J. Colatosti		50,000 (2)		0.087	2/27/2016			
	90,241(3)	25,000 (3)		0.110	4/18/2015			
	384,164			0.300	11/2/2012			

- (1) The options vest equally in two annual installments commencing August 13, 2009; 37,500 vested on August 13, 2009; 37,500 will vest on August 13, 2010
- (2) The options vest equally in two annual installments commencing February 27, 2010
- (3) 65,241 of the options vested upon grant and the remaining options vest equally thereafter in two annual installments commencing April 18, 2009; 25,000 vested on April 18, 2009; 25,000 will vest on April 18, 2010

Narrative Disclosure to Outstanding Equity Awards at Fiscal Year End Table

The following are the material terms of each agreement, contract, plan or arrangement that provide for payments to one or more of our named executive officers at, following or pursuant to their resignation, retirement or termination, or in connection with a change in control of the Company.

Termination Arrangements

Effective as of March 25, 2010, the Company entered into a one-year employment agreement with Michael W. DePasquale to serve as the Chief Executive Officer of the Company. The Company may terminate the agreement at any time with or without cause. In the event of termination without cause, Mr. DePasquale shall continue to be paid his then current base salary for the greater of nine months from the date of such termination or the number of months remaining until the end of the term of the employment agreement. There is a Change of Control provision that occurs if Mr. DePasquale is not offered continued employment with the Company or any successor, or within five years following such Change of Control, the Company or any successor terminates the Mr. DePasquale's employment without Cause, then Mr. DePasquale is to be paid his Base Salary and benefits earned but unpaid through the date of termination, and any prorated bonus earned during the then current bonus year, plus two times his then current Base Salary.

On November 20, 2009, the Company renewed the annual agreement with Mira K. LaCous to serve as the Vice President of Technology & Development of the Company. The Company may terminate the agreement at any time with or without cause. In the event of termination without cause, Ms. LaCous shall continue to be paid her then current base salary for six months from the date of such termination.

On January 12, 2010, the Company entered into a two-year consulting agreement with Thomas Colatosti to serve as consultant to the Company. The Company may terminate the agreement at any time with or without cause. In the event of termination by the Company, Mr. Colatosti shall continue to be paid his then current base salary for the remaining term of the agreement.

Change in Control Provisions

The Company's 1996 Stock Option Plan (as amended to date, the 1996 Plan), 1999 Stock Option Plan and 2004 Stock

Table of Contents

Incentive Plan (the 1999 Plan and together with the 1996 Plan and 2004 Plan, the Plans) provide for the acceleration of the vesting of unvested options upon a Change in Control of the Company. A Change in Control is defined in the Plans to include (i) a sale or transfer of substantially all of the Company's assets; (ii) the dissolution or liquidation of the Company; (iii) a merger or consolidation to which the Company is a party and after which the prior shareholders of the Company hold less than 50% of the combined voting power of the surviving corporation's outstanding securities; (iv) the incumbent directors cease to constitute at least a majority of the Board of Directors; or (v) a change in control of the Company which would otherwise be reportable under Section 13 or 15(d) of the Exchange Act.

In the event of a Change In Control each Plan provides for the immediate vesting of all options issued thereunder. The 1999 Plan provides for the Company to deliver written notice to each optionee under the 1999 Plan fifteen (15) days prior to the occurrence of a Change In Control during which all options issued under the 1999 Plan may be exercised. Thereafter, all options issued under the 1999 Plan which are neither assumed or substituted in connection with such transaction, automatically expire unless otherwise determined by the Board. The 1996 Plan provides for all options to remain exercisable for the remainder of their respective terms and permits the Company to make a cash payment to any or all optionees equal to the difference between the exercise price of any or all such options and the fair market value of the Company's common stock immediately prior to the Change In Control. The 2004 Plan enables the Board to provide that all outstanding options be assumed, or equivalent options be substituted by the acquiring or succeeding corporation upon the occurrence of a Reorganization Event as defined. If such Reorganization Event also constitutes a Change in Control, then such assumed or substituted options shall be immediately exercisable in full. If the acquiring or succeeding corporation does not agree to assume, or substitute for such options, then the Board, upon written notice to the Participants, may provide that all unexercised options become exercisable in full as of a specified time prior to the Reorganization Event and terminate prior to the consummation of the Reorganization Event. Alternatively, if under the terms and conditions of the Reorganization Event, holders of common stock will receive a cash payment for their shares, then the Board may provide that all Participants receive a cash payment equal to the difference between the Acquisition Price and the Option Price multiplied by the number of options held by such Participants.

Options issued to executive officers outside of the Plans contain change in control provisions substantially similar to those contained in the 1999 Plan.

Table of Contents**DIRECTOR COMPENSATION FOR THE FISCAL YEAR ENDED
DECEMBER 31, 2009**

The following table sets forth for each director, information regarding their compensation for the year ended December 31, 2009:

Name	Fees Earned or Paid in Cash (\$)	Stock Awards (\$)	Option Awards (\$)	Non-Equity Incentive Plan Compensation (\$)	Nonqualified Deferred Compensation Earnings (\$)	All Other Compensation (\$)	Total (\$)
Thomas J. Colatosti			74,691	(2)			74,691
Michael W. DePasquale	(1)						
Jeffrey J. May			6,084	(2)			6,084
Charles P. Romeo			19,144	(2)			19,144
John Schoenherr			7,408	(2)			7,408

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- (1) Refer to Narrative Disclosure To Summary Compensation Table for information pertaining to Mr. DePasquale's employment agreement.

- (2) The aggregate grant date fair value of the option awards was estimated using the Black-Scholes option pricing model, with the assumptions listed in Note A to the Company's financial statements. The amount shown in this column represents the grant date fair value calculated under ASC 718.

- (3) The aggregate number of stock and option awards outstanding at December 31, 2009 for each of the Company's directors are the same amounts as are listed in Item 12 Security Ownership Of Certain Beneficial Owners And Management And Related Stockholder Matters as at February 15, 2010.

Narrative Disclosure to Director Compensation Table

Directors who are also officers of the Company receive no additional compensation for serving on the Board of Directors. The Company's current policy is to issue options to purchase 50,000 shares of common stock to each non-employee director on an annual basis. The Chair of the Audit Committee receives options to purchase an additional 50,000 shares of common stock on an annual basis.

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On February 27, 2009, Thomas Colatosti, Jeffrey May, Charles Romeo and John Schoenherr were granted options to purchase 50,000, 75,000, 50,000, and 100,000 shares of common stock, respectively, at an exercise price of \$0.087 per share. Options totaling 25,000 issued to Jeffrey May, immediately vested on issuance, with the remaining options for all participants to vest in equal increments over two years. The options expire on February 27, 2016.

On November 2, 2009, in conjunction with the sale of the Law Enforcement Division, the Company cancelled options with an exercise price greater than \$0.30 per share and exchanged them for options with a \$0.30 exercise price. Thomas Colatosti, Jeffrey May, Charles Romeo and John Schoenherr had options for 200,000, 50,000, 400,000 and 50,000 shares of common stock, respectively, at exercise prices ranging from \$1.17 to \$1.39 per share cancelled and exchanged for options of 45,455, 11,364, 100,938, and 10,791 shares of common stock, respectively, at an exercise price of \$0.30 per share. All options immediately vested on issuance. The options expire on November 2, 2012.

In connection with his appointment to the Board of Directors in September 2002, and as acting Chief Financial Officer from November 2008 to December 2009, the Company has entered into a number of consulting arrangements with Thomas Colatosti. Under the most recent arrangement, which was entered into on January 12, 2010, Mr. Colatosti is to provide services to the Company and its subsidiaries and affiliates for a two year term ending December 31, 2011 at a rate of \$5,000 per month.

We reimburse each of our non-employee directors for their reasonable expenses incurred in connection with attending meetings of the board of directors and related committees.

Table of Contents

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

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The following table sets forth, as of February 17, 2010, information with respect to the securities holdings of all persons which the Company, pursuant to filings with the Securities and Exchange Commission, has reason to believe may be deemed the beneficial owners of more than five percent (5%) of the Company's outstanding common stock. The following table also sets forth, as of such date, the beneficial ownership of the Company's common stock by all officers and directors, individually and as a group. Unless otherwise indicated, the address of each person listed below is c/o BIO-key International, Inc., 3349 Highway 138, Building D, Suite B, Wall, NJ 07719.

Name and Address of Beneficial Owner	Amount and Nature of Beneficial Ownership(1)	Percentage of Class(1)
Thomas J. Colatosti	1,479,405	(2) 1.9 %
Michael W. DePasquale	1,101,938	(3) 1.4 %
Jeffrey May	241,845	(4) *
Charles P. Romeo	183,558	(5) *
John Schoenherr	134,721	(6) *
Randy Fodero	340,000	(7) *
Cecilia Welch	13,333	(8) *
Mira LaCous	82,500	(9) *
Charles Yanik	27,861	(10)*
All officers and directors as a group (8) persons	3,605,161	4.6 %

* Less than 1%

(1) The securities beneficially owned by an individual are determined in accordance with the definition of beneficial ownership set forth in the regulations promulgated under the Securities Exchange Act of 1934 and, accordingly, may include securities owned by or for, among others, the spouse and/or minor children of an individual and any other relative who has the same home as such individual, as well as, other securities as to which the individual has or shares voting or investment power or which each person has the right to acquire within 60 days through the exercise of options or otherwise. Beneficial ownership may be disclaimed as to certain of the securities. This table has been prepared based on 77,713,398 shares of common stock outstanding as of February 17, 2010.

(2) Includes 499,405 shares issuable upon exercise of options and 875,000 shares issuable upon conversion of Series D Redeemable Preferred Stock. Does not include 50,000 shares issuable upon options subject to vesting.

(3,7,10) Consists of shares issuable upon exercise of options.

(4) Consists of 241,845 shares issuable upon exercise of options. Does not include 75,000 shares issuable upon options subject to vesting.

(5) Consists of 183,558 shares issuable upon exercise of options. Does not include 75,000 shares issuable upon options subject to vesting.

(6) Consists of 134,721 shares issuable upon exercise of options. Does not include 75,000 shares issuable upon options subject to vesting.

(8) Consists of 13,333 shares issuable upon exercise of options. Does not include 6,667 shares issuable upon options subject to vesting.

(9) Consists of 82,500 shares issuable upon exercise of options. Does not include 37,500 shares issuable upon options subject to vesting.

Table of Contents

The following table sets forth, as of December 31, 2009, information with respect to securities authorized for issuance under equity compensation plans.

EQUITY COMPENSATION PLAN INFORMATION

	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	45,000	\$ 0.47	
Equity compensation plans not approved by security holders	3,903,030	\$ 0.23	1,926,811
Total	3,948,030	\$ 0.24	1,926,811

During 1996, the Board of Directors and stockholders of the Company adopted the 1996 Stock Option Plan (the 1996 Plan). Under the 1996 Plan, 750,000 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 100% of fair market value for incentive stock options and 50% for all others. The term of stock options granted may not exceed ten years. Options issued under the 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 1996 Plan expired in May 2005.

As of December 31, 2009, there were outstanding options under the 1996 Plan to purchase 45,000 shares of common stock, and no shares were available for future grants.

The Company's 1999 Stock Option Plan (the 1999 Plan) was adopted by the Board of Directors of the Company on or about August 31, 1999. The material terms of the 1999 Plan are summarized below.

The 1999 Plan is currently administered by the Board of Directors of the Company (the Plan Administrator). The Plan Administrator is authorized to construe the 1999 Plan and any option issued under the 1999 Plan, select the persons to whom options may be granted, and determine the number of shares to be covered by any option, the exercise price, vesting schedule and other material terms of such option. Under the 1999 Plan 2,000,000 shares of common stock were reserved for issuance to officers, employees, directors and consultants of the Company at exercise prices not less than 85% of the last sale price of the Company's common stock as reported on the OTC Bulletin Board on the date of grant. Options have terms of not more than 10 years from the date of grant, are subject to vesting as determined by the Plan Administrator and are not transferable without the permission of the Company except by will or the laws of descent and distribution or pursuant to a domestic relations order. Options terminate three (3) months after termination of employment or other association with the Company or one (1) year after termination due to disability, death or retirement. In the event that termination of employment or association is for a cause, as that term is defined in the 1999 Plan, options terminate immediately upon such termination. The Plan Administrator has the discretion to extend options for up to three years from the date of termination or disassociation with the Company.

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The 1999 Plan provides for the immediate vesting of all options in the event of a Change In Control of the Company. In the event of a Change In Control, the Company is required to deliver written notice to each optionee under the 1999 Plan fifteen (15) days prior to the occurrence of a Change in Control, during which time all options issued under 1999 Plan may be exercised. Thereafter, all options issued under the 1999 Plan which are neither assumed or substituted in connection with such transaction, automatically expire, unless otherwise determined by the Board. Under the 1999 Plan, a Change In Control is defined to include (i) a sale or transfer of substantially all of the Company's assets; (ii) the dissolution or liquidation of the Company; (iii) a merger or consolidation to which the Company is a party and after which the prior shareholders of the Company hold less than 50% of the combined voting power of the surviving corporation's outstanding securities; (iv) the incumbent directors cease to constitute at least a majority of the Board of Directors; or (v) a change in

Table of Contents

control of the Company which would otherwise be reportable under Section 13 or 15(d) of the Exchange Act. The 1999 Plan expired in August 2009.

As of December 31, 2009, there were outstanding options under the 1999 Plan to purchase 500,000 shares of common stock, and no shares were available for future grants.

On October 12, 2004, the Board of Directors of the Company approved the 2004 Stock Option Plan (the 2004 Plan). The 2004 Plan has not yet been presented to stockholders for approval and thus incentive stock options are not available under this plan. Under the terms of this plan, 4,000,000 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 expires in October 2014.

As of December 31, 2009, there were outstanding options under the 2004 Plan to purchase 2,073,189 shares of common stock, and options to purchase an aggregate of 1,926,811 shares were available for future grants.

In addition to options issued under the 1996, 1999 and 2004 Plans, the Company has issued options to employees, officers, directors and consultants to purchase common stock under the non plan. As of December 2009, there were outstanding options under the non plan to purchase 1,329,841 shares of common stock. The terms of these options are substantially similar to the provisions of the 1999 Plan and options issued thereunder.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Employment Arrangements

The Company has entered into employment agreements with Michael W. DePasquale, Mira LaCous, and Thomas J. Colatosti. See **EXECUTIVE COMPENSATION Employment Agreements**.

Consulting Arrangement with Thomas J. Colatosti

In connection with his appointment to the Board of Directors in September 2002, and as acting Chief Financial Officer from November 2008 to December 2009, the Company has entered into a number of consulting arrangements with Thomas Colatosti. Under the most recent arrangement, which was entered into on January 12, 2010, Mr. Colatosti is to provide services to the Company and its subsidiaries and affiliates for a two year term ending December 31, 2011 at a rate of \$5,000 per month.

Under the previous arrangement, which was entered into on November 17, 2008, Mr. Colatosti, provided services to the Company and its subsidiaries and affiliates for the year ended November 16, 2009 at a rate of \$12,500 per month.

Director Independence

The Board applies the definition of independent director as set forth in NASDAQ Stock Market Rule 4200 (a)(15), as well as Rule 10A-3 under the Securities Exchange Act of 1934, as amended.

In accordance with this guidance, the Board considers Mr. May, Mr. Schoenherr, and Mr. Romeo to be independent. Mr. May and Mr. Schoenherr are the members of the Company's Audit Committee, while Mr. Schoenherr and Mr. Romeo are the members of the Company's Compensation Committee.

Table of Contents

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

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The following table shows fees for professional audit services billed to us by CCR LLP (CCR) for the audit of our annual consolidated financial statements for the years ended December 31, 2009, and 2008, and fees billed to us by CCR for other services during 2009 and 2008:

	2009	2008
Audit Fees:		
CCR	\$ 110,500	\$ 148,400
Audit-Related Fees		
CCR	20,787	6,800
Tax Fees:		
CCR	41,473	51,670
Total Fees	\$ 172,760	\$ 206,870

Audit Fees consist of fees billed for professional services rendered for the audit of our financial statements and review of the interim financial statements included in quarterly reports and services that are normally provided by CCR in connection with statutory and regulatory filings or engagements. Audit fees also include fees for services provided in connection with registration of securities, comfort letters, and review of documents filed with the SEC.

Audit-Related Fees consist of fees billed for assurance and related services that are reasonably related to the performance of the audit or review of our financial statements and which are not reported under audit fees. These services relate primarily to mergers and acquisitions due diligence as well as advisory services as it pertains to the Sarbanes-Oxley Act and related rules and regulations;

Tax Fees consist of fees billed for professional services for tax compliance assistance rendered during the fiscal year.

Audit Committee Pre-Approval Procedures

The Audit Committee of our Board of Directors consists of Jeffrey J. May and John Schoenherr. The Audit Committee approves the engagement of our independent auditors to render audit and non-audit services before they are engaged. All of the fees for 2009 and 2008 shown above were pre-approved by the Audit Committee.

The Audit Committee pre-approves all audit and other permitted non-audit services provided by our independent auditors. Pre-approval is generally provided for up to one year, is detailed as to the particular category of services and is subject to a monetary limit. Our independent auditors and senior management periodically report to the Audit Committee the extent of services provided by the independent auditors in accordance with the pre-approval, and the fees for the services performed to date. The Audit Committee may also pre-approve particular services on a case-by-case basis.

Our audit committee will not approve engagements of our independent registered public accounting firm to perform non-audit services for us if doing so will cause our independent registered public accounting firm to cease to be independent within the meaning of applicable SEC rules. In other circumstances, our audit committee considers, among other things, whether our independent registered public accounting firm is able to provide the required services in a more or less effective and efficient manner than other available service providers.

Table of Contents

ITEM 15. EXHIBITS

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(a) The following documents are filed as part of this Report. Portions of Item 13 are submitted as separate sections of this Report:

(1) Financial statements filed as part of this Report:

Report of Independent Registered Public Accounting Firm

Balance Sheets as at December 31, 2009 and 2008

Statements of Operations Years ended December 31, 2009 and 2008

Statement of Stockholders Equity (Deficit) Years ended December 31, 2009 and 2008

Statements of Cash Flows Years ended December 31, 2009 and 2008

Notes to Financial Statements December 31, 2009 and 2008

(2) The exhibits listed in the Exhibits Index immediately preceding such exhibits are filed as part of this Report

ITEM 8 FINANCIAL STATEMENTS

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

<u>Report of Independent Registered Public Accounting Firm, CCR LLP</u>	41
<u>Balance Sheets as at December 31, 2009 and 2008</u>	42
<u>Statements of Operations Years ended December 31, 2009 and 2008</u>	43
<u>Statement of Stockholders Equity (Deficit) Years ended December 31, 2009 and 2008</u>	44
<u>Statements of Cash Flows Years ended December 31, 2009 and 2008</u>	45
<u>Notes to the Financial Statements December 31, 2009 and 2008</u>	46

Table of Contents

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
BIO-key International, Inc.

Westford, MA

We have audited the accompanying consolidated balance sheets of BIO-key International, Inc. and Subsidiary as of December 31, 2009 and 2008, and the related consolidated statements of operations, stockholders' equity (deficit) and cash flows for each of the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with 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 BIO-key International, Inc. and Subsidiary as of December 31, 2009 and 2008, 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, and has an accumulated deficit at December 31, 2009, 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/ CCR LLP

Westborough, Massachusetts
March 26, 2010

Table of Contents**BIO-key International, Inc and Subsidiary****CONSOLIDATED BALANCE SHEETS**

	December 31,	
	2009	2008
ASSETS		
Cash and cash equivalents	\$ 792,426	\$ 1,712,912
Restricted cash	40,500	
Accounts receivable, net of allowance for doubtful accounts of \$11,526 and \$5,845 at December 31, 2009 and December 31, 2008, respectively	847,215	96,131
Note receivable, current portion	1,334,000	
Inventory	14,935	13,159
Prepaid expenses and other	123,911	54,843
Continuing operations total current assets	3,152,987	1,877,045
Discontinued operations total current assets		810,708
Equipment and leasehold improvements, net	39,243	25,677
Deposits and other assets	8,712	7,812
Restricted cash		40,500
Note receivable, net of current portion	2,666,000	
Intangible assets less accumulated amortization	230,259	251,812
Continuing operations total non-current assets	2,944,214	325,801
Discontinued operations total non-current assets		8,234,436
TOTAL ASSETS	\$ 6,097,201	\$ 11,247,990
LIABILITIES		
Accounts payable	\$ 340,241	\$ 252,213
Accrued liabilities	708,765	663,567
Deferred revenue		