

**FINANCIAL STATEMENTS AND REPORT OF
INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS**

AVATAR SYSTEMS, LTD.

December 31, 1999 and 1998

Report of Independent Certified Public Accountants

To the Board of Directors and Partners
Avatar Systems, Ltd.

We have audited the accompanying balance sheet of Avatar Systems, Ltd. as of December 31, 1999, and the related statements of income, changes in partners' capital and cash flows for the years ended December 31, 1999 and 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Avatar Systems, Ltd. as of December 31, 1999, and the results of its operations and its cash flows for the years ended December 31, 1999 and 1998, in conformity with accounting principles generally accepted in the United States of America.



Dallas, Texas
August 25, 2000

Avatar Systems, Ltd.

BALANCE SHEET

December 31, 1999

ASSETS

CURRENT ASSETS

Cash and cash equivalents	\$ 378,551
Accounts receivable - trade	150,278
Prepaid expenses	<u>6,030</u>

Total current assets 534,859

PROPERTY AND EQUIPMENT – at cost, net 139,401

**PURCHASED SOFTWARE, net of accumulated amortization
of \$196,164** 665,498

CAPITALIZED SOFTWARE, net 431,185

Total assets \$1,770,943

LIABILITIES AND PARTNERS' CAPITAL

CURRENT LIABILITIES

Current maturities of long-term debt	\$ 173,333
Current maturities of capital lease obligations	4,826
Accounts payable - trade	128,733
Accrued expenses	105,340
Deferred revenue	<u>667,335</u>

Total current liabilities 1,079,567

LONG TERM DEBT, less current maturities 202,222

PARTNERS' CAPITAL 489,154

Total liabilities and partners' capital \$1,770,943

The accompanying notes are an integral part of this statement.

Avatar Systems, Ltd.

STATEMENTS OF INCOME

Years ended December 31,

	<u>1999</u>	<u>1998</u>
Revenue		
Software sales	\$ 141,495	\$ 299,197
Maintenance	844,569	439,328
Other professional services	245,631	276,370
Hardware sales	<u>171,940</u>	<u>808,513</u>
	1,403,635	1,823,408
Operating expenses		
Cost of sales	244,167	789,856
Salaries	525,705	536,204
General and administrative	<u>561,782</u>	<u>399,421</u>
	1,331,654	1,725,481
Operating income	71,981	97,927
Other income		
Interest income	18,019	12,759
Interest expense	<u>(46,905)</u>	<u>(20,228)</u>
	<u>(28,886)</u>	<u>(7,469)</u>
NET INCOME	<u>\$ 43,095</u>	<u>\$ 90,458</u>

The accompanying notes are an integral part of these statements.

Avatar Systems, Ltd.

STATEMENTS OF CHANGES IN PARTNERS' CAPITAL

Years ended December 31, 1999 and 1998

Balance at January 1, 1998	\$445,271
Capital contributions	80,000
Capital distributions	(76,552)
Net income	<u>90,458</u>
Balance at December 31, 1998	539,177
Capital distributions	(93,118)
Net income	<u>43,095</u>
Balance at December 31, 1999	<u>\$489,154</u>

The accompanying notes are an integral part of this statement.

Avatar Systems, Ltd.
STATEMENTS OF CASH FLOWS
Year ended December 31,

	<u>1999</u>	<u>1998</u>
Cash flows from operating activities		
Net income	\$ 43,095	\$ 90,458
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	189,873	113,668
Changes in operating assets and liabilities		
Accounts receivable - trade	342,425	(437,283)
Prepaid expenses and other	34,838	(36,539)
Accounts payable and accrued expenses	(37,178)	136,917
Deferred revenue	<u>82,847</u>	<u>451,721</u>
Net cash provided by operating activities	<u>655,900</u>	<u>318,942</u>
Cash flows from investing activities		
Software development costs capitalized	(431,185)	-
Purchase of property and equipment	(39,540)	(83,636)
Purchase of copyrights and other intangible assets	-	(629,760)
Payments received or notes receivable	<u>2,037</u>	<u>38,502</u>
Net cash used in investing activities	<u>(468,688)</u>	<u>(674,894)</u>
Cash flows from financing activities		
Capital contributions	-	80,000
Proceeds from borrowings	-	520,000
Capital contributions	(93,118)	(76,552)
Payments on note payable and capital lease obligations	<u>(156,902)</u>	<u>(13,037)</u>
Net cash provided by (used in) financing activities	<u>(250,020)</u>	<u>510,411</u>
Net increase (decrease) in cash and cash equivalents	(62,808)	154,459
Cash and cash equivalents at beginning of year	<u>441,359</u>	<u>286,900</u>
Cash and cash equivalents at end of year	<u>\$ 378,551</u>	<u>\$ 441,359</u>
Supplemental disclosure of cash paid for:		
Interest	\$ 46,905	\$ 20,227

The accompanying notes are an integral part of these statements.

Avatar Systems, Ltd.

NOTES TO FINANCIAL STATEMENTS

December 31, 1999

NOTE A - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business

Avatar Systems, Ltd. (the "Partnership") was formed in 1996 to provide ERP accounting software to small to medium-sized oil and gas producers located throughout the United States.

Cash Equivalents

The Partnership considers investments with original maturity dates of 90 days or less to be cash equivalents.

Property and Equipment

Property and equipment are recorded at cost. Expenditures for maintenance and repairs are expensed as incurred. Depreciation of property and equipment is provided for using accelerated methods for book and tax purposes over the estimated useful lives of such property and equipment. The estimated lives used in determining depreciation are:

Computer and telecommunication equipment	5 years
Software	3 years
Furniture and fixtures	7 years
Purchased software	7 years

Revenue Recognition

The Partnership recognizes revenue from the initial license for computer software product sales upon delivery of a software package. Revenue from installation, training and customer support is recognized in the period in which the services are provided. Revenue from contracts to maintain its computer software products is recognized over the term of the contracts.

Capitalized Software

The Partnership capitalizes the costs of developing and testing new or significantly enhanced software products in accordance with the provisions of Statement of Financial Accounting Standards No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed" (SFAS 86). Under SFAS 86, the costs incurred to establish the technological feasibility is established, costs of producing the computer software product are capitalized until the product is available for general release to customers. Capitalized software development costs are amortized on a product-by-product basis using the greater of the amount computed by the ratio of current year net revenue to estimated future net revenue, or the amount computed by the straight-line method over a period which approximates the estimated economic life of the products, which historically has been four years. The amount by which unamortized software costs exceed the net realizable value, if any, is recognized in the period the excess is determined.

Avatar Systems, Ltd.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 1999

**NOTE A - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES -
Continued**

Impairment of Long-Lived Assets

The Partnership reviews its long-lived assets and certain identifiable intangibles for impairment when events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. In reviewing recoverability, the Company estimates the future cash flows expected to result from using the assets and eventually disposing of them. If the sum of the expected future cash flows (undiscounted and without interest charges) is less than the carrying amount of the asset, an impairment loss is recognized.

Federal Income Taxes

Federal income taxes are not reflected in the financial statements, as the partners individually report their shares of taxable income or loss of the Partnership.

Use of Estimates in the Preparation of Financial Statements

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

NOTE B - PROPERTY AND EQUIPMENT

Property and equipment are summarized as follows:

Furniture and fixtures	\$ 58,701
Computer equipment and software	205,811
Telecommunication equipment	<u>18,419</u>
	282,931
Less accumulated depreciation	<u>(143,530)</u>
	<u>\$ 139,401</u>

Avatar Systems, Ltd.

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 1999

NOTE C - LONG-TERM DEBT

Long-term debt consist of the following:

Note payable to bank, bearing interest at 10.5% per annum, monthly principal and interest payments of \$14,444 through maturity in February 2002, collateralized by substantially all assets of the Company and guaranteed by an affiliate	\$375,555
Less current maturities	<u>173,333</u>
	<u>\$202,222</u>

Future principal payments are as follows:

2000	\$173,333
2001	173,333
2002	<u>28,889</u>
	<u>\$375,555</u>

NOTE D - LEASE OBLIGATIONS

The Company leases its office facility under a non-cancelable operating lease. Future minimum payments for years subsequent to December 31, 1999 under the lease, which expires in fiscal 2000 are approximately \$50,000.

Rent expense under the operating leases was approximately \$50,910 for the year ended December 31, 1999.

NOTE E - SUBSEQUENT EVENTS

In June 2000, the Partnership sold a 20% ownership interest in the Company to an unrelated party for \$1.6 million. Concurrently, all of the partners contributed their partnership interests into a Texas corporation (the Corporation) owned by the general partner in exchange for a pro rata interest in the Corporation.

In August 2000, the Corporation entered into an agreement to merge into a publicly traded Delaware corporation. Upon completion of the merger, the shareholders of the Corporation will own approximately 92% of the outstanding shares of the public corporation.