RELATIONAL TECHNOLOGY, INC.

REPORT ON EXAMINATIONS OF CONSOLIDATED FINANCIAL STATEMENTS

for the years ended June 30, 1986, 1985 and 1984

Coopers & Lybrand

Certified Public Accountants

Coopers
&Lybrand

certified public accountants

To the Stockholders of
Relational Technology, Inc.:

We have examined the consolidated balance sheets of Relational Technology, Inc. as of June 30, 1986 and 1985 and the related consolidated statements of income, changes in stockholders' equity, and changes in financial position for each of the three years in the period ended June 30, 1986. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the consolidated financial statements referred to above present fairly the financial position of Relational Technology, Inc. as of June 30, 1986 and 1985, and the results of its operations and the changes in its financial position for each of the three years in the period ended June 30, 1986, in conformity with generally accepted accounting principles applied on a consistent basis, except for the change, with which we concur, in the method of accounting for revenue from maintenance fees as described in Note 2 to the consolidated financial statements.

Coopers & Lybrand

San Francisco, California
August 22, 1986

RELATIONAL TECHNOLOGY, INC.

CONSOLIDATED BALANCE SHEETS, June 30, 1986 and 1985

ASSETS	1986	1985
Current assets:		
Cash and cash equivalents	$ 1,856,078	$ 689,394
Trade accounts receivable (less allowance for doubtful accounts of $407,308 in 1986 and $108,200 in 1985)	10,998,885	5,102,070
Prepaid expenses	1,177,091	268,500
Total current assets	14,032,054	6,059,964
Equipment, net	7,633,348	5,302,872
Long-term trade receivables, less current portion	2,537,008	229,678
Other assets	64,320	81,397
Total assets	$24,266,730	$11,673,911
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 1,361,738	$ 846,326
Current portion of long-term debt	829,479	1,527,295
Deferred revenue, current portion	2,105,520	-
Accrued commissions	1,095,210	792,919
Accrued vacation	372,990	179,406
Income taxes payable	-	33,968
Deferred income taxes	-	8,528
Other current liabilities	1,153,644	184,258
Total current liabilities	6,918,581	3,572,700
Long-term debt, less current portion	2,604,254	2,145,018
Deferred revenue, less current portion	134,240	-
Deferred income taxes	515,505	87,855
	10,172,580	5,805,573
Commitments (Note 9).		
Stockholders' equity:		
Preferred stock, $.05 par value 1986, no par value 1985; authorized 3,000,000 shares	11,129,345	3,741,400
Common stock, $.05 par value 1986, no par value 1985; authorized 25,000,000 shares; issued and outstanding 3,167,989 shares in 1986 and 3,114,025 shares in 1985	462,978	300,469
Note receivable for purchase of common stock	(99,630)	-
Retained earnings	2,552,719	1,814,647
Foreign currency translation adjustment	48,738	11,822
	14,094,150	5,868,338
Total liabilities and stockholders' equity	$24,266,730	$11,673,911

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

RELATIONAL TECHNOLOGY, INC.

CONSOLIDATED STATEMENTS OF INCOME

for the years ended June 30, 1986, 1985 and 1984

	1986	1985	1984
Revenues	$28,137,644	$17,742,673	$8,130,682
Costs and expenses:			
Software costs	8,991,697	5,881,271	2,545,233
Sales and marketing	13,157,066	8,705,991	3,491,642
General and administrative	3,317,558	1,894,080	1,330,342
	25,466,321	16,481,342	7,367,217
Income from operations	2,671,323	1,261,331	763,465
Interest income	135,050	86,230	58,270
Interest expense	394,872	229,803	55,119
Income before taxes on income and cumulative effect of a change in accounting principle	2,411,501	1,117,758	766,616
Provision for taxes on income	591,667	88,788	73,634
Income before cumulative effect of a change in accounting principle	1,819,834	1,028,970	692,982
Cumulative effect on prior years of changing the method of accounting for revenue from maintenance fees, net of applicable deferred state income taxes of $98,508 (see Note 2)	1,081,762	-	-
Net income	$ 738,072	$ 1,028,970	$ 692,982
Pro forma net income assuming the new method of accounting for revenue from maintenance fees is applied retroactively	$ 1,819,834	$ 595,029	$ 197,645

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

RELATIONAL TECHNOLOGY, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

for the years ended June 30, 1986, 1985, and 1984

	Series A Preferred Stock		Series B Preferred Stock		Series C Preferred Stock		Series D Preferred Stock		Series E Preferred Stock		Common Stock		Note Receivable for Purchase of Common Stock	Retained Earnings	Foreign Currency Translation Adjustment	Total
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount				
Balances, July 1, 1983	305,000	$305,000	192,000	$936,400							2,735,210	$217,025		$ 92,695		$ 1,551,120
Issue of Series C preferred stock					625,000	$2,500,000										2,500,000
Issue of common stock under employee stock purchase plan											567,000	93,884				93,884
Issue of common stock											3,000	360				360
Repurchase of common stock											(127,531)	(2,550)				(2,550)
Net income														692,982		692,982
Balances, June 30, 1984	305,000	305,000	192,000	936,400	625,000	2,500,000	—	—	—	—	3,177,679	308,719	—	785,677	—	4,835,796
Issue of common stock under employee stock purchase plan											266	200				200
Issue of common stock											300	225				225
Repurchase of common stock											(64,220)	(8,675)				(8,675)
Net income														1,028,970		1,028,970
Foreign currency translation adjustment															$11,822	11,822
Balances, June 30, 1985	305,000	305,000	192,000	936,400	625,000	2,500,000	—	—	—	—	3,114,025	300,469	—	1,814,647	11,822	5,868,338
Issue of Series D preferred stock							432,000	$2,700,000								2,700,000
Issue of Series E preferred stock									478,540	$4,687,945						4,687,945
Issue of common stock under employee incentive stock option plan											15,548	11,661				11,661
Issue of common stock											107,334	160,851	$(99,630)			61,221
Repurchase of common stock											(68,918)	(10,003)				(10,003)
Net income														738,072		738,072
Foreign currency translation adjustment															36,916	36,916
Balances, June 30, 1986	305,000	$305,000	192,000	$936,400	625,000	$2,500,000	432,000	$2,700,000	478,540	$4,687,945	3,167,989	$462,978	$(99,630)	$2,552,719	$48,738	$14,094,150

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

RELATIONAL TECHNOLOGY, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

for the years ended June 30, 1986, 1985 and 1984

	1986	1985	1984
Sources (uses) of funds:			
Net cash flow from operation activities:			
Income before cumulative effect of a change in accounting principle	$ 1,819,834	$ 1,028,970	$ 692,982
Changes (credits) to income not involving working capital:			
Cumulative effective of a change in accounting principle	(1,081,762)	-	-
Depreciation and amortization expense	1,501,697	891,609	305,724
Deferred income taxes	419,122	73,335	8,298
Deferred revenue	2,239,760	-	-
Foreign currency translation adjustment	36,916	11,822	-
Cash provided from operations before working capital changes	4,935,567	2,005,736	1,007,004
Changes in:			
Accounts receivable	(8,204,145)	(1,965,242)	(2,716,726)
Prepaid expenses	(908,591)	(211,716)	(27,751)
Accounts payable	515,412	(447,536)	1,197,453
Accrued commissions and vacation	495,875	789,328	150,672
Income taxes payable	(33,968)	(20,748)	43,682
Other current liabilities	969,386	90,880	85,404
	(2,230,464)	240,702	(260,262)
Net cash provided by (used in) investing activities:			
Short-term investment	-	1,000,000	(550,000)
Equipment additions	(3,838,264)	(3,811,784)	(2,032,496)
Other	23,168	47,738	(26,276)
	(6,045,560)	(2,523,344)	(2,869,034)
Net cash provided by (used in) funding activities:			
Increase in debt	4,114,698	5,961,184	555,376
Decrease in debt	(4,353,278)	(2,447,833)	(622,923)
Issuance of preferred stock	7,387,945	-	2,500,000
Issuance of common stock, net of repurchases	62,879	(8,250)	91,694
	7,212,244	3,505,101	2,524,147
Increase in cash and cash equivalents, bank overdraft	$ 1,166,684	$ 981,757	$ 344,887

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

1. Summary of Significant Accounting Policies:

Principles of Consolidation:

During the year ended June 30, 1986, Relational Technology International France S.A.R.L., Relational Technology GmbH, Relational Technology International Pty. Limited, and Relational Technology Finance, Inc., four wholly owned subsidiaries of the company, were incorporated. The consolidated financial statements include the accounts of the company and its wholly owned subsidiaries after elimination of intercompany accounts and transactions.

Revenue Recognition:

Software license fees are recorded in the accounts when the contract is accepted by the customer. Renewal fees and that portion of software license fees that represents maintenance are recognized on a straight-line basis over the term of the agreements (see Note 2). Software licenses sold on an installment basis are recorded currently at their present value. Interest income is earned as the payments become due. Software royalties are recorded when reported by the vendor. Other software revenue is reported based on the company satisfying substantially all of the related contract terms.

Translation of Foreign Currencies:

Assets and liabilities are translated at the foreign exchange rates in effect at the balance sheet date. Revenues and expenses for the year are translated at the average exchange rate in effect during the year. Translation gains and losses are not included in determining net income but are accumulated and reported as a separate component of stockholders' equity. Net realized and unrealized gains and losses resulting from foreign currency transactions are credited or charged to income.

Software Costs:

Software costs are charged to expense in the year incurred. Statement of Financial Accounting Standards No. 86 "Accounting for the Costs of Computer Software to be Sold, Leased,

Continued

1. Summary of Significant Accounting Policies, continued:

Software Costs, continued:

or Otherwise Marketed" will be implemented during the year ending June 30, 1987. This statement could change the company's practice of expensing all software costs. The effect of early application of this principle has not been determined.

Equipment:

Equipment is stated at cost. Gain or loss on sale or retirement is included in operations, and the related cost and accumulated depreciation are eliminated. Leasehold improvements are capitalized and amortized over the remaining life of the lease. Depreciation on equipment is computed using the straight-line method beginning the first full month of operation over the following ranges of estimated useful lives:

	Range of Depreciable Lives	1986	1985	1984
Computer equipment	3-5	$ 7,582,102	$4,315,078	$2,213,867
Office equipment	2-5	1,832,743	1,461,043	600,332
Leasehold improvements	Various	894,321	695,866	134,299
		10,309,166	6,471,987	2,948,498
Less accumulated depreciation and amortization		2,675,818	1,169,115	490,085
		$ 7,633,348	$5,302,872	$2,458,413

Nonmonetary Transactions:

Nonmonetary exchanges of software licenses or royalties for hardware or software are recorded in revenue and equipment at the fair value of the item surrendered or received, whichever is more readily determinable.

Continued

1. Summary of Significant Accounting Policies, continued:

Tax Credits:

Investment tax credits reduce income tax using the flow-through method.

Reclassifications:

Certain items in the 1985 and 1984 financial statements have been reclassified to conform with 1986 presentation. These reclassifications have no effect on previously reported net income or stockholders' equity.

2. Change in Maintenance Revenue Accounting:

Renewal fees and a portion of software license fees are revenues for maintenance of software. Maintenance includes the rights to technical support and system updates. The company changed its method of accounting for this revenue for the year ended June 30, 1986. In prior years, these maintenance fees were recognized when the license was accepted by the customer, and thereafter on the annual renewal date. Under the new method, such maintenance fees are recognized on a straight-line basis over the terms of the agreements. This change was made to more appropriately reflect the earnings process of the technical support and systems updates. The effect of the change on 1986 operations was to decrease income before taxes on income and before the cumulative effect of a change in accounting principle by $746,586 and to decrease related tax expense by $343,429.

3. Transactions with Related Parties:

During the years ended June 30, 1986, 1985 and 1984, the company paid approximately $100,000, $76,350 and $58,470, respectively, in consulting fees to officers who are stockholders but not salaried employees of the company. These amounts are included in software development costs.

During the year ended June 30, 1986, the president of the company issued a $99,630 note to the company in exchange for 66,420 shares of the company's common stock. The principal and annual interest of 8.08% is due and payable on April 29, 1991 or earlier in the event of a public offering of the company's common stock or in the event that the president ceases to be an employee of the company.

Continued

4. Long-Term Receivables:

Long-term receivables consists of installment sales of software licenses at interest rates varying between 10.5% and 21%. The balances are shown at face value less applicable discount of $874,000. The annual principal payments on these notes are as follows:

1987	$3,954,139
1988	1,538,668
1989	913,964
1990	84,376
	$6,491,147

5. Long-Term Debt:

The company has long-term debt, which is summarized as follows:

	1986
Line of credit at bank reference rate plus 3/4% with maximum available borrowings up to $3,500,000, expires September 30, 1986	-
Term loan at bank reference rate plus 2%, monthly interest payments only until October 1986, then monthly principal and interest payments until October 1991	$ 584,000
Term loan at bank reference rate plus 2%, monthly principal and interest payments until May 1990	2,268,624
Equipment installment notes, 12% to 20%, monthly principal and interest payments until various maturing dates ranging from July 1986 to November 1988	89,723
Long-term notes	2,942,347
Capital lease (Note 9)	491,386
	$3,433,733

Both the line of credit and the term loans are collateralized by the company's accounts receivable and equipment. The bank reference rate at June 30, 1986 was 8.5%. The loans require the company, among other things, to maintain cash, marketable securities, and receivables equal to at least 1.5 times current liabilities; working capital not less than $5,500,000; net worth

Continued

5. Long-Term Debt, continued:

(as defined) not less than $8,000,000; and debt no greater than net worth (as defined). Principal payments under the long-term notes are as follows:

1987	$ 743,231
1988	733,591
1989	710,306
1990	599,486
1991 and thereafter	155,733
	$2,942,347

6. Income Taxes:

The provision for income taxes for the years ended June 30, 1986, 1985 and 1984 consists of the following:

	1986	1985	1984
Deferred federal taxes:			
Installment sales	$340,860	-	-
Other	(43,860)	-	-
	297,000	-	-
Current state taxes	37,077	$15,453	$65,336
Deferred state taxes:			
Installment sales	190,650	7,005	8,298
Depreciation	12,832	66,330	-
Other	(30,592)	-	-
	172,890	73,335	8,298
Current foreign taxes	36,960	-	-
Deferred foreign taxes	47,740	-	-
	$591,667	$88,788	$73,634

Continued

6. Income Taxes, continued:

The effective income tax rates for the years ended June 30, 1986, 1985 and 1984 were 24.5%, 7.9%, and 9.6%, respectively. These effective rates differ from the federal statutory rate of 46% as follows:

	1986		1985		1984	
	Amount	% of Pretax Income	Amount	% of Pretax Income	Amount	% of Pretax Income
Tax provision at statutory rate	$1,109,290	46.0%	$514,168	46.0%	$ 352,643	46.0%
State income taxes, net of federal income tax benefit	113,382	4.7	47,945	4.3	39,762	5.2
Foreign income taxes, including the effect of net foreign losses	197,623	8.2	-	-	-	-
Surtax exemption	-		(20,250)	(1.8)	(20,250)	(2.6)
Investment tax and research credit	(850,279)	(35.3)	(445,460)	(39.9)	(298,521)	(39.0)
Other	21,651	.9	(7,615)	(.7)	-	-
	$ 591,667	24.5%	$ 88,788	7.9%	$ 73,634	9.6%

The company had carryforward amounts available to offset future federal taxable income and tax liabilities at June 30, 1986 as follows:

	For Financial Reporting Purposes	For Income Tax Purposes
Net operating loss carryover	-	$2,590,780
Investment tax credit carryover	$206,374	730,644
Credit for increasing research activities carryover	-	891,231

The carryovers expire over a three-year period ending June 30, 2001.

Continued

7. Stockholders' Equity:

Preferred Stock:

The components of noncumulative preferred stock are as follows:

	1986	1985
Series A convertible preferred stock; issued and outstanding 305,000 shares	$ 305,000	$ 305,000
Series B convertible preferred stock; issued and outstanding 192,000 shares	936,400	936,400
Series C convertible preferred stock; issued and outstanding 625,000 shares	2,500,000	2,500,000
Series D convertible preferred stock; issued and outstanding 432,000 shares	2,700,000	-
Series E convertible preferred stock; issued and outstanding 478,540 shares	4,687,945	-
	$11,129,345	$3,741,400

At the option of the Board of Directors, the company has the right to redeem the Series A and Series B preferred stock in whole or part, by paying in cash the price of $1.00 per share for Series A stock and $5.00 per share for Series B stock. At the option of the Board of Directors, the company can redeem Series C preferred stock in whole or in part by paying in cash a price between $4.60 and $4.00 per share, set based on the redemption date. At the option of the Board of Directors, the company can redeem, in whole or in part, the Series D preferred stock at any time after August 31, 1986 at a price between $7.50 and $6.25 per share, set based on the redemption date, and the Series E preferred stock at any time after March 31, 1987 at a price between $12.60 and $10.50 per share, set based on the redemption date. The company is required to issue a redemption notice to all preferred stockholders 60 days prior to the redemption date.

Each share of Series A and B preferred stock is convertible into five shares of common stock and each share of Series C, D, and E preferred stock is convertible into one share of

Continued

7. Stockholders' Equity, continued:

Preferred Stock, continued:

common stock at the option of the stockholder at any time on or prior to the fifth day prior to the redemption date fixed by the redemption notice. Each share of Series A, B, C, D and E stock automatically converts into shares of common stock immediately prior to the issuance of shares following the effective date of a registration statement under the Securities Act of 1933 covering the company's common stock in which the aggregate price to the public equals or exceeds $5,000,000 and in which the public offering price equals or exceeds $12.60 per share if effective on or before May 15, 1987 or $15.75 per share if effective after May 15, 1987. The conversion rate for Series E preferred stock adjusts for certain diluting issues. Any redemption must occur pro rata among the holders of Series A, Series B, Series C, Series D, and Series E preferred stock then outstanding such that the proportion of shares redeemed shall be the same for each series. The company has reserved 4,020,540 shares of common stock for issuance on conversion of preferred stock.

Dividends may not be paid to common stockholders unless a dividend per share equivalent to five times the common dividend has first been paid on Series A and Series B preferred stock and a dividend equal to the amount of the common stock dividend has been paid on Series C, Series D and Series E preferred stock in that year. Dividends are paid at the approval of the Board of Directors on all series of preferred stock contemporaneously. To the extent that a dividend is declared on the preferred stock, each share of Series A stock and Series B stock shall be paid an amount equal to five times the amount paid for Series C, Series D and Series E stock. In the event of liquidation, holders of Series A, Series B, Series C, Series D and Series E preferred stock are entitled to $1.00, $5,00, $4.00, $6.25, and $10.50, respectively, per share in preference to any distribution of any of the assets or surplus funds of the company to the holders of the common stock.

Continued

7. Stockholders' Equity, continued:

Stock Option and Stock Purchase Plans:

The company has reserved 1,000,000 shares of common stock for an Employee Incentive Stock Option Plan, and 1,300,000 shares of common stock for an Employee Stock Purchase Plan. The option or purchase price is determined by the Board of Directors but may not be less than the fair market value of the stock at the date the option is granted or purchase offered.

A summary of the activity under the company's Employee Incentive Stock Option Plan is set forth below:

	Shares	Exercise Price
Outstanding at June 30, 1984	-	-
Granted	448,050	$.75
Exercised	-	-
Terminated	(9,768)	$.75
Outstanding at June 30, 1985	438,282	$.75
Granted	564,170	$.75-$2.50
Exercised	(15,548)	$.75
Terminated	(101,445)	$.75-$1.50
Outstanding at June 30, 1986	885,459	$.75-$2.50
Exercisable at June 30, 1986	196,506	

8. Segment Information:

The company operates in one industry segment--the development and marketing of computer software. The company also provides technical support for its products. The company's products were initially marketed outside the United States through foreign distributors. Beginning in fiscal 1985, products marketed outside the United States have been primarily marketed through foreign subsidiaries in Canada, Europe, and the United Kingdom. These subsidiaries pay royalties to the parent approximating 50% of product revenues from unaffiliated customers.

Continued

8. Segment Information, continued:

The company's operations by geographic area are as follows:

	Year ended June 30		
	1986	1985	1984
	(in thousands)		
Revenues from unaffiliated customers:			
United States (including export sales to distributors and others of $3,599, $1,716, and $635 for 1986, 1985, and 1984, respectively)	$22,940	$16,835	$8,131
Canada	968	414	-
United Kingdom	3,966	494	-
Europe	264	-	-
Consolidated	$28,138	$17,743	$8,131
Intercompany royalty revenues:			
United States	$ 2,389	$ 295	-
Operating income (loss):			
United States	$ 3,052	$ 1,088	$ 763
Canada	(28)	110	-
United Kingdom	(96)	63	-
Europe	(257)	-	-
Consolidated	$ 2,671	$ 1,261	$ 763
Identifiable assets:			
United States	$20,207	$10,954	$6,935
Canada	484	220	-
United Kingdom	3,002	500	-
Europe	574	-	-
Consolidated	$24,267	$11,674	$6,935

During 1986 and 1985, two different customers accounted for 12% and 13% of revenues, respectively. No single customer accounted for 10% or more of revenues in 1984.

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9. Leased Assets and Commitments:

The company has both capital and operating leases. The capital lease is for computer equipment and is capitalized at a value of $491,386. As of June 30, 1986, no depreciation has been taken because the lease was entered into during June 1986. The operating leases are for automobiles and for office space in 22 locations, under rental agreements expiring at varying dates between 1985 and 2010. One of the rental agreements requires a review of the rent every five years starting in 1990 and ending in 2005 to assure that rent is at market rates.

The company's rental expense under the operating leases for the years ended June 30, 1986, 1985 and 1984 aggregated $1,979,868, $1,004,302 and $337,472, respectively.

The minimum rental payments due under the leases described above are as follows:

Year Ending June 30	Capital Lease	Operating Leases
1987	$114,948	$ 2,410,904
1988	114,948	2,177,960
1989	114,948	2,001,034
1990	114,948	1,953,725
1991 and thereafter	114,948	4,173,795
Total minimum lease payments	574,740	$12,717,418
Less amount representing interest	83,354	
Present value of net minimum lease payments	$491,386	

The lease for the company's headquarters contains an option to extend the term for an additional five years in 1990. If the term is not extended, the company is obligated to pay a $585,565 cancelation fee.