SSW

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COMPUTER ASSOCIATES TO ACQUIRE STERLING SOFTWARE

$4 Billion Stock Transaction to Continue to Fuel CA's Surge in eBusiness Software and Services

Largest Acquisition in History of Software Industry Expected to be EBITDA Accretive

Leading Supplier of Storage and Network Management, EAI, Portals and Application Development

ISLANDIA, NY and DALLAS, TX, February 14, 2000 –Computer Associates International, Inc. (NYSE: CA) today announced an agreement to acquire Sterling Software, Inc. (NYSE: SSW), extending its arsenal of software and services to build, deploy, manage and secure eBusiness solutions.

The $4 billion stock-for-stock acquisition, which would be the largest ever in the history of the software industry, has been approved unanimously by the Boards of Directors of both Sterling Software and CA. The acquisition is expected to be accretive to CA's earnings per share, excluding any one-time research and development charge and amortization of acquisition intangibles, and is subject to certain closing conditions, including regulatory approvals. The acquisition will be accounted for using the purchase method.

Under terms of the agreement, a subsidiary of CA will commence an offer to exchange 0.5634 shares of CA stock for each outstanding Sterling share. The exchange ratio is subject to a collar. If the average trading price of CA stock for the designated period prior to the closing of the offer is greater than $77.12, the exchange ratio will be reduced so that each Sterling share tendered in the offer would be exchanged for $43.45 worth of CA stock. If the average trading price of CA shares for the period is less than $63.10, the exchange ratio will be increased so that each Sterling share tendered in the offer would be exchanged for $35.55 worth of CA stock. In this case, CA may elect to reduce the exchange ratio and make up the difference in cash and or stock. The tender offer will be followed by a back-end merger on the same terms of those in the offer. The offer will be subject to customary closing conditions, including that at least a majority of Sterling's outstanding shares has been tendered and antitrust clearance obtained. The parties expect the transaction will be one of the first to take advantage of the SEC's new "fast track" exchange offer rules designed to expedite stock-for-stock transactions.

Sterling Software solutions are deployed at more than 20,000 customer sites worldwide--including 90 percent of Fortune 100 companies--to create, control, automate and manage both traditional and eBusiness systems. Sterling Software's award-winning portal technology provides access to data stored in corporate databases, in the same way that Internet content portals provide access to the wealth of content on the Web.

The anticipated acquisition will expand CA's broad array of products and services, while accelerating their delivery. This will enable all companies -- from the newest "dot coms" to established brick-and-mortar businesses – to continue to exploit the latest opportunities driven by the Internet economy.

CA plans to enhance Sterling Software products with its industry-leading technology, including information visualization, Neugents neural network technology and infrastructure management solutions, providing clients with the world's most powerful and complete environment for end-to-end eBusiness.

In particular, the combination of Sterling Software's COOL suite and CA's Jasmine *ii* information infrastructure will deliver the most sophisticated and personalized enterprise application integration solution on the market.

"The merger of Sterling Software and CA brings together two outstanding organizations that share common values, and have compatible strategies and track records of achievement," said Charles B. Wang, CA chairman and CEO. "We look forward to providing an even broader range of eBusiness solutions to clients, greater opportunities for employees, and accelerated near and long-term return for shareholders."

"This merger will be extremely beneficial to our clients and employees," said Sterling L. Williams, president and chief executive officer of Sterling Software. "We have a deep appreciation for CA's commitment to quality, innovation and customer service, all in a corporate culture that is incredibly complementary to ours. Together, we'll be able to offer the best products and services for clients of both companies, as well as new and exciting career paths for employees."

The merger will create the industry's largest supplier of storage management technology, with solutions that cover the entire enterprise from OS/390 and distributed systems to desktops and even laptops. These will include the industry's leading distributed backup and recovery products, as well as Storage Area Network solutions unprecedented in their breadth and scope.

Customers from both companies will also benefit from increased delivery of Sterling Software solutions through CA's extensive global sales organization, including both direct and indirect channels.

"We are extremely focused on being the leading provider in storage and network management, business intelligence and portal solutions, and in the design, deployment and integration of enterprise applications," said Sanjay Kumar, CA president and COO. "CA's business, built on a combination of world-class technology and high value-added consulting services, will immediately benefit from complementary technology and services from Sterling Software. The combined company will be able to exploit the incredible opportunities of the Internet era by continuing to deliver superior value for our clients."

Sterling Software clients and partners will be invited to attend CA-World, CA's annual user conference from April 9-14 in New Orleans, in place of the Sterling Software Worldwide Customer Conference. CA also intends to publish papers on product development strategies and directions shortly after completion of the acquisition.

Founded in 1981, Sterling Software reported $807 million in revenues in fiscal 1999. The company has recorded 45 consecutive quarters of revenue and earnings per share growth.

CA was advised on this transaction by the law firm of Covington & Burling and by the investment banking firm of Morgan Stanley Dean Witter. Advisors for Sterling Software were the law firm of Skadden, Arps, Slate, Meagher & Flom LLP and the investment banking firms of Goldman Sachs and Co. and Broadview International LLC.

Sterling Software is a leading provider of software and services for the application development, business intelligence, information management, storage management, network management, VM systems management, and federal systems markets. The company is one of the 20 largest independent software companies in the world. Headquartered in Dallas, Sterling Software has a worldwide installed base of more than 20,000 customer sites and 3,800 employees in 90 offices worldwide. For more information on Sterling Software, visit the company's Web site at www.sterling.com.

Computer Associates International, Inc. (NYSE: CA), the world's leading business software company, delivers the end-to-end infrastructure to enable eBusiness through innovative technology, services and education. CA has 18,000 employees worldwide and had revenue of $6.3 billion for the year ended December 31, 1999. For more information, visit www.ca.com.

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All referenced product names are trademarks of their respective companies.

Statements in this release concerning the Company's future prospects are "forward-looking statements" under the Private Securities Litigation Reform Act of 1995. There can be no assurances that future results will be achieved, and actual results could differ materially from forecasts and estimates. Important factors that could cause actual results to differ materially include: the significant percentage of CA's and Sterling Software's quarterly sales consummated in the last few days of the quarter making financial predictions especially difficult and raising a substantial risk of variance in actual results; the risks of potential litigation arising from the Year 2000 date change for computer programs; the emergence of new competitive initiatives resulting from rapid technological advances or changes in pricing in the market; the risks associated with new product introductions as well as the uncertainty of customer acceptance of these new or enhanced products from either CA, Sterling or their competition; risks associated with the entry into new markets such as professional services; the risks associated with integrating newly acquired businesses and technologies; increasing dependency on large dollar licensing transactions; delays in product delivery; reliance on mainframe capacity growth; the ability to recruit and retain qualified personnel; business conditions in the client/server and mainframe software and hardware markets; uncertainty and volatility associated with Internet and eBusiness related activities; use of software patent rights to attempt to limit competition; fluctuations in foreign currency exchange rates and interest rates; the volatility of the international marketplace; and other risks described in filings with the Securities and Exchange Commission.

We urge investors and security holders to read the following documents, when they become available, regarding the exchange offer and the merger (described above), because they will contain important information:

- Computer Associates' preliminary prospectus, prospectus supplements, final prospectus, and tender offer material.
- Computer Associates' Registration Statement on Form S-4 and Schedule TO containing or incorporating by reference such documents and other information.
- Sterling Software's Solicitation/Recommendation Statement on Schedule 14D-9.

These documents and amendments to these documents will be filed with the United States Securities and Exchange Commission.

When these and other documents are filed with the SEC, they may be obtained free at the SEC's web site at www.sec.gov. You may also obtain for free each of these documents (when available) from Computer Associates by directing your request to Investor Relations at www.ca.com/invest/questions or by fax at 631-342-6864, or from Sterling Software by directing your request to investor@sterling.com or by fax at (214) 981-1215.

Burton Grad Associates, Inc.
7 Whitney Street Extension
Westport, Connecticut 06880
(203) 222-8718 Fax: (203) 222-8728
E-mail: burtgrad@aol.com

Date: February 12, 2000

To: Paul Baker

From: Burton Grad

Subject: Valuation of Acquired Intangible Assets

The following is a first cut at a proposed agenda for our planned February 18, 2000 meeting with Ernst & Young:

1. Review of SEC rules and procedures as formulated and currently interpreted by EY and other accounting firms

2. Review of AICPA committee status on preparing valuation rules and procedures

3. Review of FASB status and plans and industry responses to potential elimination of "pooling" accounting treatment on mergers and on FASB position on IPR&D writeoff rules

4. Review of SEC actions that have been taken against companies regarding IPR&D writeoffs, both in terms of restatements and limitations

5. Status of industry related activities on pooling and IPR&D writeoffs by trade associations, individual companies, accounting firms, etc.

6. Discussion of specific SSW acquisition valuations performed during past twelve months. Have there been any SEC questions/problems with these?

7. Discussion of key elements of current valuation process:

   - Revenue projections for acquired products, new technologies and current related SSW products

   - Cost projections for key factors: cost of revenue; marketing, sales and support; research and development; general and administrative. Any others?

8. Discussion of handling of acquired technologies in terms of:

   - Core technologies (acquired and SSW)
   - Percentage completion
   - Development cost treatment
   - Risk assessment (discount factors)
   - Projected economic life

9. Discussion of tax rates and other tax implications for U. S. and International, including interaction with core technologies valuation

10. Valuation of acquired staff

11. Valuation of acquired customer base

12. Valuation of goodwill

13. Analysis of total acquisition cost

Who should be involved in these reviews and discussions from EY and from SSW?

Would it be useful for EY, SSW and BGAI to prepare any working papers or distribute copies of current internal documents to help the participants prepare for the meeting? If so, what materials should be sent to whom?

Where and when will the meeting be held? I will arrive at the Dallas airport at 5:45 P.M. on Thursday and plan to stay at the Marriott Airport Hotel. Would you like to meet me Thursday for dinner?

Let's take advantage of this opportunity to ensure that our future valuations will be most effectively constructed to meet SSW's objectives within the applicable SEC, AICPA and FASB rules.

SSW / Valuation

$\boxed{\$875}$

SSW / Valuation process

2/18

2/17 LGA to Dallas

AA - 2^{45} - 5^{45} — ~~[illegible]~~

3^{00} - 6^{21}

3^{20} - 6^{33}

Hotel 2/17 Marriott

→ mail ~~return~~ BG ticket to Tim for replacement

Dinner 2/17 - Baker?

Dinner 2/18 - Phil Moore ?

2/18 for okh

1^{50}

2^{45}

3^{05}

3^{30}

4^{20}

Subj: **FW: Burt Grad**
Date: 01/15/2000 11:42:27 AM Eastern Standard Time
From: paul.baker@sterling.com
To: Burt.Grad@aol.com, BURTGRAD@aol.com

call Baker

FYI

> -----Original Message-----
> From: Baker, Paul
> Sent: Saturday, January 15, 2000 10:40 AM
> To: 'Fred.miller@ey.com'
> Subject: Burt Grad
>
> Fred
>
> Burt Grad is passing through Dallas on the 16th-18th of February. Would
> this be a good oppotunity to talk with him and your West Coast boys. Let
> me know what you think and the availabi lity of them and you/Jeff.
>
> Regards
>
> Paul

---------------------- Headers ----------------------------
Return-Path: <paul.baker@sterling.com>
Received: from rly-yd05.mx.aol.com (rly-yd05.mail.aol.com [172.18.150.5]) by air-yd03.mail.aol.com (v67.7) with ESMTP; Sat, 15 Jan 2000 11:42:27 -0500
Received: from plan-gate.sterling.com ([208.24.124.16]) by rly-yd05.mx.aol.com (v67.7) with ESMTP; Sat, 15 Jan 2000 11:42:25 1900
Received: from us001002.corp.sterling.com ([10.1.12.11])
by plan-gate.sterling.com (8.9.3/8.9.3) with ESMTP id KAA09727;
Sat, 15 Jan 2000 10:42:24 -0600 (CST)
From: paul.baker@sterling.com
Received: by US001002 with Internet Mail Service (5.5.2650.21)
id <CDH9XPAV>; Sat, 15 Jan 2000 10:41:55 -0600
Message-ID: <9B2A26DBF9E4D111958100805FA79114D8822F@US001002>
To: Burt.Grad@aol.com, BURTGRAD@aol.com
Subject: FW: Burt Grad
Date: Sat, 15 Jan 2000 10:41:54 -0600
MIME-Version: 1.0
X-Mailer: Internet Mail Service (5.5.2650.21)
Content-Type: text/plain;
charset="iso-8859-1"

B9

BURTON GRAD ASSOCIATES, INC.
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(203) 222-8718 FAX: (203) 222-8728
E-MAIL: BURTGRAD@AOL.COM

7U 12/22

Date: November 18, 1999

To: Paul Baker

From: Burton Grad

Subject: Potential Impact of AICPA IPR&D Task Force Recommendations

As you know, the current BGAI valuation process for acquired IPR&D is dependent on interpretations based on Lynn Turner's September 1998 letter on this subject. In some ways, the suggested "best practices" and tentative agreements referenced in Marc Asbra's e-mail may cause some further changes in the values which can be expensed for technology acquisitions.

The notes below compare our current procedures and the potential changes:

1. **What technologies are eligible for IPR&D write-offs?**

    - R&D projects which are planned and under way, but have not yet passed FAS86 technical feasibility tests.

    - No change; confirms that FAS86 date is "completion" date for present completion analysis. We will have to capitalize any projects which have passed FAS86 test even if not yet released, if SSW expects to market these products.

2. **What revenue will the new products achieve?**

    - SSW sales projections have been examined (typically only 3-4 years is available) and then discounted by BGAI to reflect somewhat slower growth and often lower prices. All directly related revenues have been included: new sales; add-on/upgrade sales; professional services (but not custom development or general consulting): maintenance/support. The economic life cycles used have been fairly long (7-10 years) and reflect platform currency and both functional and performance improvement, but the projections do not reflect the value of major enhancements; the business cycle ends with a replacement product eliminating maintenance revenue on the old product.

    - Significant changes in the need to provide "verifiable objective evidence" for all forecast assumptions. This will involve substantial quantitative market research data and examination of comparable products to justify units and prices based on market opportunity and market share.

- All ancillary revenue must be excluded. This will eliminate close to one-half or more of revenue and an even higher percentage of profits since maintenance is a very profitable segment. It will also reduce economic life to that period during which new sales are generated. The rules may eliminate any follow-on sales, though this is not clear from the wording.

3. What are the related operating costs?

- We have used general industry expense models for: cost of revenue; marketing, sales and support; research and development (including maintenance, improvement, etc.); and general and administrative. We have excluded any capitalization/amortization of software or any other acquisition related or capital costs. We have used appropriate SSW operating income margin values to adjust the various cost elements particularly after the initial years.

- Will probably be restricted to comparable company cost assumptions since would have to eliminate any buyer-specific synergies. This will not have much effect.

4. What reductions must be made to take into consideration values not attributable to technology contributions from the acquired IPR&D?

- We have been reducing the calculated value to consider the core technologies from the acquired company and from SSW. We have also been reducing the value based on the percent of work (complexity adjusted) not yet completed (required to meet FAS86 technical feasibility test).

- No further change

5. What other costs must be considered in determining value?

- We have ensured that the total development cost to bring each new product to general availability, including the cost to complete deferred functional or platform commitments, have been explicitly considered in the R&D costs.

- There will need to be significant additional increases in the costs to recognize charges for the use of contributory assets: labor force, customer base and core technologies. We will have to apply some return on investment figure to each of these assets, and then add this to the total costs before computing gross and net cash flow. Since each of these factors is already specifically valued and capitalized as part of "goodwill" and the costs are "phantom" costs (not cash flow), it is puzzling to understand why we have to charge the product for its "use" of these acquired assets. This may significantly reduce the value for the IPR&D operating income.

6. **What taxes should be deducted in determining cash flow?**

   - We have been deducting an effective tax rate for federal and state taxes for North American income and a blended tax rate for non-North American income. We have applied the discount rate to the after-tax cash flow.

   - This issue is not directly addressed

7. **What discount rate should be used?**

   - We have been using a discount rate of 20% on the new projects and have been projecting revenues to reflect this level of risk.

   - The new proposed practices insists that the discount rate must reflect the percent of completion as well as the weighted average cost of capital (WACC) for reasonable potential buyers. In the percent of completion consideration, technical risks and timeliness to market would also affect the discount rate. Early stage development projects would require a discount rate of 50%-70% while nearly completed projects would still require rates greater than 25%-30%.

8. **When does the IPR&D value have to be submitted?**

   - We have been determining the write-off and other values after the strategic planning is concluded; this has meant that usable values are typically available 20-30 days after the acquisition date. In the last few acquisitions, we have provided a preliminary estimate of the range we expect for the IPR&D value as of the acquisition date.

   - The new practice will require a best estimate of the IPR&D value as of the acquisition ate. If labeled as preliminary, it can be changed in a reasonable period of time, which is not defined. Presumably, if the IPR&D value must be stated at the acquisition date, so must the capitalization for the products and the overall goodwill. This implies that a reasonable strategy and business plan must be put together at least 1-2 weeks prior to the acquisition date so that the IPR&D calculations can be completed before the formal announcement.

The overall impact of the suggested best practices would be very substantial. While the difference would vary, it is my opinion that the net effect would be to reduce the IPR&D write-offs by at least 50% from maintenance and professional services revenue elimination and another 25% from contributory asset charges. Even assuming that we do not need to increase the discount rate above 25% (we are now using 20%), the total reduction in claimed IPR&D will be at least 75%. So, instead of being able to write off close to 30% of the acquisition costs as IPR&D, we will probably be limited to only 5%-10%.

IPR&D Valuation
from Ernst & Young (Marc Asbra)

Best Practices from Task Force:

1. IPR&D is supposed to represent fair value: the price at which the asset would be expected to be bought or sold in a "piece-meal" transaction.

2. Incorporate stage of completion in discount rate. If in "early stage," should be 50%-70%; if "almost complete," would be moderately above weighted average cost of capital (>25%-30%). Selection of factor depends on high risk issues (technical, timeliness to market).

3. Market participant assumptions regarding sales levels, cost structure and tax rates should be for reasonable potential buyers; must eliminate buyer-specific synergies.

4. (a) Revenue splitting if new product incorporates existing buyer products.
   (b) Ancillary revenue (customer support, implementation fees) are to be excluded.

5. Must charge for use of contributory assets (labor force, customer base, core technologies)

6. Need verifiable objective evidence for all assumptions: economic life, initial sales level, growth and decline rates, average selling prices, revenue splits, contributing asset charges, stage of completion, WACC for comparable companies.

7. Tax Benefit: DCF should consider any tax benefit from tax deduction (even if not direct).

Other factors:

1. Project must have substance: development plan, work having begun, costs incurred; must also be able to have fair value reliably determinable.

2. "Completed projects" (FAS86 tech feasibility) must be capitalized and amortized.

3. Alternative Future Use must be probable for it to be capitalized as of acquisition date.

4. Must make best estimate of allocation at acquisition date (disclose as preliminary); may change estimate if fair value determination is completed in a reasonable period of time.

5. FASB Interpretation four principles apply.

6. Must exclude software for internal use.

IPR&D Valuation

from Ernst & Young (Marc Asbra)

Best Practices from Task Force:

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Other factors:

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2. "Completed" projects (FAS86 tech feasibility) must be capitalized and amortized.

3. Alternative Future Use must be probable for it to be capitalized as of acquisition date.

4. Must make best estimate of allocation at acquisition date (disclose as preliminary); may change estimate if fair value determination ~~was~~ is completed in a reasonable period of time.

5. FASB Interpretation 9 four principles apply.

6. Must exclude software for internal use.

Subj: **FW: IPR&D guidance**
Date: 11/9/99 1:52:14 PM Eastern Standard Time
From: paul.baker@sterling.com
To: burtgrad@aol.com

Burt

Can we discuss

Regards

Paul

-----Original Message-----
From: Jeff S. Slate [mailto:Jeff.Slate@ey.com]
Sent: Tuesday, November 09, 1999 11:39 AM
To: Paul_Baker@sterling.com; Logan_Wray@sterling.com
Subject: IPR&D guidance

Paul, Logan,

I thought that you might find the update below regarding purchased R&D interesting. It's a good update as to the task force that's working on the issue and their most current thinking.

Paul, I don't have Burt's e-mail address and was hoping that you could forward a copy of this on to him.

Jeff
---------------------- Forwarded by Jeff S. Slate/Southwest/AUDIT/EYLLP/US on 11/09/99 11:36 AM ---------------------------

Marc Asbra
11/03/99 04:45 PM
Corporate Finance
Phone Number: 213.977.3792
Fax Number: 213.977.3617
Cell Phone: 310.344.5941 EYComm: 5266727

To: Jeff S. Slate/Southwest/AUDIT/EYLLP/US
cc:
Subject: IPR&D guidance

Have you seen this yet? Do you have Burt's e-mail address? He may be interested in hearing about these developments if he hasn't already.

Alert Number: 99/69
> (Embedded image moved to file: pic02616.pcx)
>
> AICPA IN-PROCESS RESEARCH AND DEVELOPMENT TASK FORCE
>
> Current Developments
>
> The Task Force met October 4 and 5 during which time it reviewed

portions
> of a first draft of what it hopes to publish as a "best practices"
> document for accounting, measuring and auditing acquired assets to be
> used in research and development activities (IPR&D). Lynn Turner, Chief
> Accountant of the SEC, attended a portion of the meeting. That first
> draft is clearly still a "work-in-progress." Additional meetings are
> scheduled in late October and again in late November that are intended
to
> bring the draft to a point that it would be suitable for discussion
> outside the Task Force. But some accounting and valuation "best
> practices" are evolving that you should be aware of, even though they
are
> still, at best, tentative.
>
> Emerging "best practices" in valuation include:
>
> 1) Basis of valuation. The IPR&D is to be valued on a piece-meal
> basis using the accounting definition of fair value, the
> approximate price at which the asset would be expected to be
bought
> or sold in a current transaction between a willing buyer and
> seller, and would be based on the best information available in
the
> circumstances. It is recognized that IPR&D projects are seldom
> sold on a piece-meal basis, however, that is not a reason to
> default to some other basis for valuation.
>
> 2) Incorporating the "stage of completion" in the discount rate.
> While it may be argued that this was being done before the
> September 1998 letter from the SEC's Chief Accountant, there was
no
> consistency in how the completion risk was reflected in the
> discount rate. The Task Force's present thinking is that expected
> cash flows from the "very early stage" project would be discounted
> at somewhere between 50 and 70% and that such rate would decline
to
> the point that the "almost complete" project would use a discount
> rate that is something moderately above the weighted average cost
> of capital (WACC) for enterprises in the same sector as being
> addressed by the IPR&D project that have just emerged from the
> development stage. It is unlikely that the low end of the
discount
> rate would be below the range of 25 to 30%. The rate would not
> necessarily decline in a linear fashion between the 50 and 70%
> starting point and the 25 to 30% ending point as the project moves
> to completion; rather its rate of decline would be influenced by
> when high-risk issues are resolved. Selection of a starting point
> between 50 and 70% would depend on the number and significance of
> high risk issues, e.g., the need to develop "breakthrough"
> technology, the risk of failure to be first to market, etc. The
> greater the risks, the closer to 70%.
>
> 3) Use of market participant assumptions. Assumptions as to
> introductory sales levels and subsequent sales growth and decline,
> cost structure, effective tax rate, etc. that are used in the
> discounted cash flow (DCF) analysis should be those of market
> participants. Market participants are defined as that universe of

Fair value

Discount rate

> potential buyers (other than financial buyers and investors that
> would not intend to actively manage the acquired enterprise) that
> have the ability to purchase and a plausible post-combination
> operating strategy. Thus, one would not look to the cost
structure
> of either the buyer or seller. A simple example: if the selling,
> general and administrative cost structure of market participants
> averaged 25% of revenues, that rate would be used even if the
> seller has historically experienced a 35% rate and the buyer a 20%
> rate. This is meant to eliminate "buyer-specific synergies" and
> gets more to the accounting definition of fair value for the
> discrete IPR&D asset.

"typical" cost structures

>
> 4) Revenue splitting and omission of ancillary revenue. If the
> expected output of the target's IPR&D project is to be sold in
> conjunction with technology of the seller (e.g., the target's
> software in development is to be embedded in the buyer's
hardware),
> forecasted revenue must be split between that derived from the
> technologies of the seller and the buyer and only the DCF related
> to the seller's IPR&D valued. Another example, if the IPR&D
> project is to develop the new razor that can use existing razor
> blades, only the DCF attributed to the razor is to be considered.
> Ancillary revenue, such as expected software post-contract
customer
> support and implementation fees arising from the original sale of
> the software license (or the razor blades in the just cited
> example) are to be excluded.

only revenue attributable to acquired tech (split with other tech)

no ancillary revenue - support implementation

>
> 5) A charge has to be considered for contributory assets. The DCF
for
> the IPR&D has to consider a charge for the return of and a return
> on all contributory assets that are used to generate the expected
> cash flows, e.g., labor force, customer lists and core technology.

Contrib assets: labor cust list core tech

>
> 6) All significant assumptions must be supported by verifiable
> objective evidence. This includes assumptions such as the
expected
> product's economic life, initial sales level and subsequent rate
of
> growth and later decline, average selling prices (which usually
> decline over the life of a technology product), revenue split if
> the IPR&D is only to be sold in conjunction with other purchased
> IPR&D, contributing asset charges, stage of completion, WACC for
> "just" past development stage enterprises in the same space,
(i.e.,
> low-end of the range from which the discount rate is selected)
etc.
> Mr. Turner emphasized the staff's expectation that there needs to
> be verifiable objective evidence to support the assumptions.

verifiable objective evidence

>
> 7) Where a tax deduction for the IPR&D intangible asset is possible,
> the DCF of the benefit for such deduction should be considered,
> even if the form of the specific transaction does not result in a
> tax deduction.

? tax deduction

>
> Aside from valuation issues, the Task Force has tentatively agreed:

>
> 1) An IPR&D project must have "substance" and the measurement of its
> fair value be "reliably determinable" before it can be considered
> in the purchase price allocation. Substance is indicated by
> verifiable evidence of the development plan and work having been
> begun, and the incurrence of costs meeting the definition of R&D
> costs in FASB Statement No. 2 and related guidance. Not all IPR&D
> projects that have substance have a fair value that is reliably
> determinable. Such a determination will depend on the existence
of
> verifiable objective evidence of the assumptions with respect to
> the DCF measurement.
>
> 2) The fair value of completed IPR&D projects must be capitalized and
> amortized over their expected economic lives. Completion would be
> evident by: a) for tangible products, first customer acceptance,
b)
> for software, FASB Statement No. 86's definition of technological
> feasibility (earlier than first customer acceptance), and c) for
> products that require regulatory approval before marketing, e.g.,
> pharmaceuticals, receipt of such approval (last stage, somewhat
> automatic approvals, such as the content of product labelling,
> would not be considered to preclude a conclusion that the project
> was complete). The date of completion for generic drugs is still
> being considered.

FASB 86 tech feasibility is definition of completion (product must be capitalized)

>
> 3) Alternative future uses of an IPR&D project - which would result
in
> their capitalization of the project's fair value - must be
probable
> of occurring within the combined enterprise based on the state of
> the project at the acquisition date.

7. Alternative future use

>
> 4) A "best estimate" of the allocation of the purchase price must be
> made at the acquisition date. Any subsequent change of the IPR&D
> value would be treated as a change in estimate if: (a) the
previous
> allocation had been disclosed as preliminary, and (b) the company
> had been diligent in its efforts to obtain all the information
> needed to determine fair value and such effort was completed in a
> reasonable period of time.
>
> 5) The principles of FASB Interpretation No. 4 apply to investments
> accounted for on the equity method as long as the allocation to
the
> fair value of IPR&D is based on verifiable objective evidence.
> Circumstances where the investor could not gain access to the
> sometimes sensitive data needed to develop the verifiable evidence
> to support the measurement of fair value are to be expected. In
> those instances, whatever value exists is included in "goodwill."
>
> 6) The scope of R&D costs exclude software developed for internal use
> inasmuch as SOP 98-1 states such expenses are not R&D costs.
> Particular attention should be paid to SOP 98-1's Appendix which
> sets forth examples of what is and is not internal use software.
> Also, particular attention should be paid to FASB Statement No. 2,
> paragraph 10 which describes costs that are not R&D costs. For

> example, costs of developing a "right of dot" software upgrade
> would not be R&D costs.
>
> In the area of auditing, expectations as to the "best practices"
> procedures the auditor should apply when using the work of a specialist
> will be set forth. That will be complemented by a description of what
> the auditor should expect, as a matter of best practices, to be included
> in the valuation specialist's report and the procedures that the
> valuation specialist should generally undertake to determine that the
DCF
> which underpins the valuation are based on management's best estimates
> that are verifiable and objectively determinable.
>
> Lynn Turner commented that it was his impression that the Task Force's
> progress to date reflected having reached the 50-yard line. While I
> think that understates the progress made (or maybe he is referring to a
> 70-yard race, not a football field), there is clearly work to be done.
> It is likely unrealistic to expect a completed document before year-end
> 1999. But with respect to the matters discussed above, the SEC staff
has
> considered them and thus far has not objected to them. Valuations today
> could be based on these principles, if all such principles are utilized.
> At the same time, one can continue to incorporate the stage of
completion
> by taking only that portion of the expected DCF (discounted at a rate
> moderately above WACC, as described above) represented by the stage of
> completion.
>
> Questions
>
> If you should have any questions concerning IPR&D you can contact John
> Dirks, (San Francisco, 415-393-8735), PwC's representatives on the Task
> Force, or Donna Coallier (Florham Park, 973-236-7207), Larry Dodyk
> (Florham Park, 973-236-7213), John Gribble (Florham Park, 973-236-7215)
> and Cody Smith (San Francisco, 415-697-6135).
>
> Attached Document(s):
>
> Issue Date: 10/26/99
>
>

>
>
> Name: pic02616.pcx
> pic02616.pcx Type: unspecified type (application/octet-stream)
> Encoding: base64

SSF/Valuation
+ Due Diligence
Invoices

12/14/99

4 pages

To: Steve Carey (fax) 001-214-981-~~1296~~ 1286

From: Burton Grad (Room 8)

Subject: Classification of BGAI Invoices

Attached are 3 sheets which allocate the invoice amounts from the Interlink, Cayenne and Information Advantage projects.

Please call my office if there are any questions (203-222-8718)

Sterling Software, Inc.
Interlink Transaction
Attorney/Client Work Product - Privileged and Confidential

Copies of your invoices are attached to assist you in providing the information that we are requesting. Please indicate the percentage of your fee allocable to the following categories: INV # 2936 6/8/99 6250.00] INTERLINK
.2943 7/6 99 12,176.66

General financial services	%
Abandoned merger/acquisition plans	%
Structuring, negotiating, and closing successful merger/acquisition plan	%
Due Diligence	%
Shareholder communications	%
Regulatory requirements	%
S.E.C. Filings	%
Employee issues such as compensation consulting, benefits and employee contracts (please provide detail)	%
Relocation	%
Debt obligations and cost of financing	%
Director's & Officer's Insurance	%
Outplacement services (please provide detail)	%
Auditing Services (please provide detail)	%
General Corporate Tax Advising (please provide detail)	%
Tax Compliance	%
Other (please provide detail) Valuation of Intangible assets acquired for	100 %

Detailed Response: allocation of purchase price -- required by SEC

Burton Grad 12/14/99

Attachment to Service Provider Request

Sterling Software, Inc.
Cayenne Transaction
Attorney/Client Work Product - Privileged and Confidential

Copies of your invoices are attached to assist you in providing the information that we are requesting. Please indicate the percentage of your fee allocable to the following categories:

INV # 2915 12/31/98 $8118.78
2928 5/6/99 3767.74 Cayenne

General financial services.. ________%

Abandoned merger/acquisition plans.. ________%

Structuring, negotiating, and closing successful merger/acquisition plan.. ________%

Due Diligence.. ________%

Shareholder communications.. ________%

Regulatory requirements.. ________%

S.E.C. Filings.. ________%

Employee issues such as compensation consulting, benefits and employee contracts (please provide detail).. ________%

Relocation.. ________%

Debt obligations and cost of financing.. ________%

Director's & Officer's Insurance .... ________%

Outplacement services (please provide detail).. ________%

Auditing Services (please provide detail).. ________%

General Corporate Tax Advising (please provide detail).. ________%

Tax Compliance.. ________%

Other (please provide detail). Valuation of Intangible 100 %

Detailed Response: Assets acquired for allocation of purchase price -- required by SEC

Burton Grad 12/14/99

Attachment to Service Provider Request

Sterling Software, Inc.
Information AdvantageTransaction
Attorney/Client Work Product - Privileged and Confidential

Copies of your invoices are attached to assist you in providing the information that we are requesting. Please indicate the percentage of your fee allocable to the following categories: INV # 2944 7/27/99 $7,934.50] Information
2949 9/3/99 10,000.00] Advantage

General financial services............	______%
Abandoned merger/acquisition plans............	______%
Structuring, negotiating, and closing successful merger/acquisition plan............	______%
Due Diligence.... #2944 - $7934.50	100 %
Shareholder communications............	______%
Regulatory requirements............	______%
S.E.C. Filings............	______%
Employee issues such as compensation consulting, benefits and employee contracts (please provide detail)............	______%
Relocation............	______%
Debt obligations and cost of financing............	______%
Director's & Officer's Insurance	______%
Outplacement services (please provide detail)............	______%
Auditing Services (please provide detail)............	______%
General Corporate Tax Advising (please provide detail)............	______%
Tax Compliance............	______%
Other (please provide detail) #2949 10,900 Valuation of Intangible Assets acquired for	100 %

Detailed Response: allocation of purchase price -- required by SEC

Burton Grad
12/14/99

Attachment to Service Provider Request

ERNST & YOUNG LLP

2121 San Jacinto Street, Suite 1500
Dallas, TX 75201
Main Phone: 214/969-8000
Direct Fax: 214/969-8321

Facsimile Transmittal Sheet

Please Deliver: Number of Pages (Including this Page): 5

To:	Burton Grad	**Date:**	December 8, 1999
Fax No.:	(203) 222-8728		
From:	Kim Harrington	Phone:	(214) 969-8630

Call Dorothy Helen at 214-969-8197 if the facsimile you received was incomplete or not legible.

Message:

STERLING SOFTWARE

Stephen C. Carey
Director, Tax

December 2, 1999

Burton Grad Associates, Inc.
101 Post Road East
Westport, Connecticut 06880

Dear Sir/Madam:

We are currently reviewing the Federal income tax treatment of transaction costs incurred in connection with the merger of Interlink Computer Sciences, Inc. with Sterling Software, Inc. ("the Merger"). We have engaged Ernst & Young LLP to assist us in this process. During their review of the transaction costs, it was noted that the following invoices for various valuation services pertaining to the merger do not provide an adequate description of the services provided to determine the appropriate federal income tax treatment of such fees. Identification of the assets the valuation relate to along with a description of the tasks performed is necessary in determining the federal income tax treatment of such costs.

Invoice Number	Invoice Date	Invoice Amount
2936	6/8/99	$6,250.00
2943	7/6/99	$12,176.66

We would appreciate your assistance in providing detail of the services rendered and corresponding amounts for those services, as such information will assist us in determining the income tax consequences of the fees. Attached is a list of categories to be considered when itemizing your fees and services. Please indicate the portion of your fee allocable to each category and provide a identification of the assets and a description of the valuation tasks performed.

As this information is of a time sensitive nature, we appreciate your prompt assistance with this inquiry. Your completed response can be faxed to Kim Harrington, Ernst & Young LLP, at (214) 969-8321. Please direct any questions concerning this request to Kim at (214) 969-8630.

Sincerely,

Stephen C. Carey
Stephen C. Carey
Director, Tax

Attachments

200 Crescent Court · Suite 1200 · Dallas, TX 75201-7832 · 214/981-1096 · Fax 214/981-1286 · steve_carey@sterling.com

.8-99-01 ... Burton Grad 203 222 ... P.02

BURTON GRAD ASSOCIATES, INC.
101 POST ROAD EAST
WESTPORT, CONNECTICUT 06880
(203) 222-8718
(203) 222-8728 FAX
BURTGRAD@AOL.COM

Sterling Software, Inc.
300 Crescent Court
Suite 1200
Dallas, Texas 75201-1000

Invoice #2936

June 8, 1999

Project: #133-74

Attention: Paul Baker
Copy: Lee McElrath

INVOICE

Project: Valuation for Interlink Acquisition

Consulting Services: April 15 - May 31, 1999

Burton Grad	2.5 days @ $2,500/day		$6,250.00
		Total Fees	**$6,250.00**

Expenses: Expenses will be included in next invoice

Total Invoice	**$6,250.00**

JUN 0 8 1999

Payment Is Due Within 15 Days of Receipt of Invoice

OK to pay

INTERLINK ACQ COSTS

BURTON GRAD ASSOCIATES, INC.
101 POST ROAD EAST
WESTPORT, CONNECTICUT 06880
(203) 222-8718
(203) 222-8728 FAX
BURTONGRAD@AOL.COM

Invoice #2943

July 6, 1999

Project: #133-74

Sterling Software, Inc.
300 Crescent Court
Suite 1200
Dallas, Texas 75201-1000

Attention: Paul Baker
Copy: Lee McElrath
Logan Wray

INVOICE

Project: Valuation of Interlink Intangible Assets

Consulting Services: June 1 - 30, 1999

Burton Grad	4.5 days @ $2,500/day		$11,250.00
Elizabeth Virgo	.5 day @ $1,500/day		750.00
		Total Fees	**$12,000.00**

Expenses Incurred:

Express Delivery		$144.50
Telephone/fax		32.16
	Total Expenses	**$176.66**
	Total Invoice	**$12,176.66**

OK to pay

CHARGE TO
INTERLINK ACQ

CHECK ORIGINAL
NOT PAID
ALREADY

Payment Is Due Within 15 Days of Receipt of Invoice

CONSULTANTS ON SOFTWARE

BURTON GRAD ASSOCIATES, INC.
101 POST ROAD EAST
WESTPORT, CONNECTICUT 06880
(203) 222-8718
(203) 222-8728 FAX
BURTGRAD@AOL.COM

Sterling Software, Inc
300 Crescent Court
Suite 1200
Dallas, Texas 75201-1000

Attention: Logan Wray

Invoice #2915

December 31, 1998

Project: #133-68

INVOICE

Project: Valuation of Acquired Intangible Assets from Cayenne Software, Inc.

Consulting Services: October 2 - December 31, 1998

Burton Grad	2 days @ $2,500/day		$5,000.00
Sidney Dunayer	2 days @ $1,500/day		3,000.00
		Total Fees	**$8,000.00**

Expenses: Telephone/fax		41.78
FedEx		77.00
	Total Expenses	**$118.78**
	Total Invoice	**$8,118.78**

RECEIVED
JAN 13 1999
By_______

1300-Cayene

JW

Payment is due within 15 days of receipt of invoice

CONSULTANTS ON SOFTWARE

BURTON GRAD ASSOCIATES, INC.
101 POST ROAD EAST
WESTPORT, CONNECTICUT 06880
(203) 222-8718
(203) 222-8728 FAX
BURTGRAD@AOL.COM

Sterling Software, Inc.
300 Crescent Court
Suite 1200
Dallas, Texas 75201-1000

Attention: Paul Baker
Copy: John Mecke
Charlie Miller

Invoice #2928

May 6, 1999

Project: #133-68

INVOICE

Project: Valuation of Acquired Intangible Assets from Cayenne Software, Inc.

RECEIVED
MAY 07 1999

Consulting Services: March 1 - 31, 1999

Burton Grad	1 5 days @ $2,500/day	$3,750.00
	Total Fees	**$3,750.00**

Expenses:

6045

Telephone/fax	17.74
Total Invoice	**$3,767.74**

Ok to pay

Payment Is Due Within 15 Days of Receipt of Invoice

CONSULTANTS ON SOFTWARE

BURTON GRAD ASSOCIATES, INC.
101 POST ROAD EAST
WESTPORT, CONNECTICUT 06880
(203) 222-8718
(203) 222-8728 FAX
BURTGRAD@AOL.COM

Sterling Software, Inc.
300 Crescent Court
Suite 1200
Dallas, Texas 75201-1000

Invoice #2944

July 27, 1999

Project: #133-75

Attention: Paul Baker
Copy: Mark Kleinman
Steve Wilkinson

INVOICE

Project: **Technical Due Diligence Review of Information Advantage Products and Technologies**

Consulting Services: July 11 - 16, 199

Burton Grad	2.25 days @ $2,500/day		$5,625.00
Sid Dunayer	1.5 days @ $1,500/day		2,250.00
		Total Fees	$7,875.00

Expenses Incurred:

Telephone/fax		$25.00
Express Delivery		34.50
	Total Expenses	$59.50
	Total Invoice	$7,934.50

AUG 03 1999

SC

Payment Is Due Within 15 Days of Receipt of Invoice

Charge IA
thru Aug cost

CONSULTANTS ON SOFTWARE

99 11:05A Burton Grad 203 222 8728 P.03

00811

BURTON GRAD ASSOCIATES, INC.
101 POST ROAD EAST
WESTPORT, CONNECTICUT 06880
(203) 222-8718
(203) 222-8728 FAX
BURTGRAD@AOL.COM

SEP 07 1999

Sterling Software, Inc.
300 Crescent Court
Suite 1200
Dallas, Texas 75201-1000

Invoice #2949

September 3, 1999

Project: #133-78

Attention: Paul Baker
Copy: Steve Wilkinson

INVOICE

Project: Valuation of Information Advantage Acquisition

Consulting Services: August 3 - 31, 1999

Burton Grad	4 days @ $2,500/day		$10,000.00
		Total Fees	$10,000.00
		Total Invoice	$10,000.00

1300 InfAdv

OK to pay

IA Acquisition Costs

Payment Is Due Within 15 Days of Receipt of Invoice

CONSULTANTS ON SOFTWARE

ST Soft
Financial Info

STERLING SOFTWARE

Stephen C. Carey
Director, Tax

December 2, 1999

Burton Grad Associates, Inc.
101 Post Road East
Westport, Connecticut 06880

Dear Sir/Madam:

We are currently reviewing the Federal income tax treatment of transaction costs incurred in connection with the merger of Interlink Computer Sciences, Inc. with Sterling Software, Inc. ("the Merger"). We have engaged Ernst & Young LLP to assist us in this process. During their review of the transaction costs, it was noted that the following invoices for various valuation services pertaining to the merger do not provide an adequate description of the services provided to determine the appropriate federal income tax treatment of such fees. Identification of the assets the valuation relate to along with a description of the tasks performed is necessary in determining the federal income tax treatment of such costs.

Invoice Number	Invoice Date	Invoice Amount
2936	6/8/99	$6,250.00
2943	7/6/99	$12,176.66

We would appreciate your assistance in providing detail of the services rendered and corresponding amounts for those services, as such information will assist us in determining the income tax consequences of the fees. Attached is a list of categories to be considered when itemizing your fees and services. Please indicate the portion of your fee allocable to each category and provide a identification of the assets and a description of the valuation tasks performed.

As this information is of a time sensitive nature, we appreciate your prompt assistance with this inquiry. Your completed response can be faxed to Kim Harrington, Ernst & Young LLP, at (214) 969-8321. Please direct any questions concerning this request to Kim at (214) 969-8630.

Sincerely,

Stephen C. Carey

Stephen C. Carey
Director, Tax

Attachments

300 Crescent Court • Suite 1200 • Dallas, TX 75201-7832 • 214/981-1096 • Fax 214/981-1286 • steve_carey@sterling.com

Sterling Software, Inc.
Interlink Transaction
Attorney/Client Work Product - Privileged and Confidential

Copies of your invoices are attached to assist you in providing the information that we are requesting. Please indicate the percentage of your fee allocable to the following categories:

General financial services.. ________%

Abandoned merger/acquisition plans.................................. ________%

Structuring, negotiating, and closing successful merger/acquisition plan... ________%

Due Diligence... ________%

Shareholder communications.. ________%

Regulatory requirements... ________%

S.E.C. Filings.. ________%

Employee issues such as compensation consulting, benefits and employee contracts (please provide detail).......................... ________%

Relocation... ________%

Debt obligations and cost of financing................................. ________%

Director's & Officer's Insurance .... ________%

Outplacement services (please provide detail)...................... ________%

Auditing Services (please provide detail)............................. ________%

General Corporate Tax Advising (please provide detail)........... ________%

Tax Compliance.. ________%

Other (please provide detail)... ________%

Detailed Response: ____

____

____

____

____

____

Attachment to Service Provider Request

BURTON GRAD ASSOCIATES, INC.
101 POST ROAD EAST
WESTPORT, CONNECTICUT 06880
(203) 222-8718
(203) 222-8728 FAX
BURTGRAD@AOL.COM

Sterling Software, Inc.
300 Crescent Court
Suite 1200
Dallas, Texas 75201-1000

Attention: Paul Baker
Copy: Lee McElrath

Invoice #2936

June 8, 1999

Project: #133-74

INVOICE

Project: Valuation for Interlink Acquisition

Consulting Services: April 15 - May 31, 1999

Burton Grad	2.5 days @ $2,500/day	$6,250.00
	Total Fees	**$6,250.00**

Expenses: Expenses will be included in next invoice

Total Invoice	**$6,250.00**

JUN 08 1999

Payment Is Due Within 15 Days of Receipt of Invoice

OK to pay

INTERLNK ACQ COSTS

99 10:46A BURTON...

BURTON GRAD ASSOCIATES, INC.
101 POST ROAD EAST
WESTPORT, CONNECTICUT 06880
(203) 222-8718
(203) 222-8728 FAX
BURTGRAD@AOL.COM

Sterling Software, Inc.
300 Crescent Court
Suite 1200
Dallas, Texas 75201-1000

Invoice #2943

July 6, 1999

Project: #133-74

Attention: Paul Baker
Copy: Lee McElrath
Logan Wray

INVOICE

Project: Valuation of Interlink Intangible Assets

Consulting Services: June 1 - 30, 1999

Burton Grad	4.5 days @ $2,500/day	$11,250.00
Elizabeth Virgo	.5 day @ $1,500/day	750.00
	Total Fees	**$12,000.00**

Expenses Incurred:

Express Delivery		$144.50
Telephone/fax		32.16
	Total Expenses	**$176.66**
	Total Invoice	**$12,176.66**

OK to pay

CHARGE TO INTERLINK ACQ

CHECK ORIGINAL NOT PAID ALREADY

Payment Is Due Within 15 Days of Receipt of Invoice

CONSULTANTS ON SOFTWARE

STERLING SOFTWARE

Stephen C. Carey
Director, Tax

December 2, 1999

Burton Grad Associates, Inc.
101 Post Road East
Westport, Connecticut 06880

Dear Sir/Madam:

We are currently reviewing the Federal income tax treatment of transaction costs incurred in connection with the merger of Cayenne Software, Inc. with Sterling Software, Inc. ("the Merger"). We have engaged Ernst & Young LLP to assist us in this process. During their review of the transaction costs, it was noted that the following invoices for various valuation services do not provide an adequate description of the services provided to determine the appropriate federal income tax treatment of such fees. Identification of the assets the valuation related to along with a description of the tasks performed is necessary in determining the federal income tax treatment of such costs.

Invoice Number	Invoice Date	Invoice Amount
2915	12/31/98	$8,118.78
2928	5/6/99	$3,767.74

We would appreciate your assistance in providing detail of the services rendered and corresponding amounts for those services, as such information will assist us in determining the income tax consequences of the fees. Attached is a list of categories to be considered when itemizing your fees and services. Please indicate the portion of your fee allocable to each category and provide an identification of the assets and a description of the valuation tasks performed.

As this information is of a time sensitive nature, we appreciate your prompt assistance with this inquiry. Your completed response can be faxed to Kim Harrington, Ernst & Young LLP, at (214) 969-8321. Please direct any questions concerning this request to Kim at (214) 969-8630.

Sincerely,

Stephen C. Carey

Stephen C. Carey
Director, Tax

Attachments

300 Crescent Court · Suite 1200 · Dallas, TX 75201-7832 · 214/981-1096 · Fax 214/981-1286 · steve_carey@sterling.com

Sterling Software, Inc.
Cayenne Transaction
Attorney/Client Work Product - Privileged and Confidential

Copies of your invoices are attached to assist you in providing the information that we are requesting. Please indicate the percentage of your fee allocable to the following categories:

General financial services.. ________%

Abandoned merger/acquisition plans.................................. ________%

Structuring, negotiating, and closing successful merger/acquisition plan.. ________%

Due Diligence.. ________%

Shareholder communications.. ________%

Regulatory requirements... ________%

S.E.C. Filings.. ________%

Employee issues such as compensation consulting, benefits and employee contracts (please provide detail)......................... ________%

Relocation... ________%

Debt obligations and cost of financing.............................. ________%

Director's & Officer's Insurance .... ________%

Outplacement services (please provide detail)..................... ________%

Auditing Services (please provide detail)............................ ________%

General Corporate Tax Advising (please provide detail)........... ________%

Tax Compliance.. ________%

Other (please provide detail).. ________%

Detailed Response: ____

Attachment to Service Provider Request

BURTON GRAD ASSOCIATES, INC.
101 POST ROAD EAST
WESTPORT, CONNECTICUT 06880
(203) 222-8718
(203) 222-8728 FAX
BURTGRAD@AOL.COM

Sterling Software, Inc
300 Crescent Court
Suite 1200
Dallas, Texas 75201-1000

Attention: Logan Wray

Invoice #2915

December 31, 1998

Project: #133-68

INVOICE

Project: Valuation of Acquired Intangible Assets from Cayenne Software, Inc.

Consulting Services: October 2 - December 31, 1998

Burton Grad	2 days @ $2,500/day		$5,000.00
Sidney Dunayer	2 days @ $1,500/day		3,000.00
		Total Fees	**$8,000.00**

Expenses:

Telephone/fax		41.78
FedEx		77.00
	Total Expenses	**$118.78**
	Total Invoice	**$8,118.78**

RECEIVED
JAN 13 1999
By____

1300-Cayene

LW

Payment is due within 15 days of receipt of invoice

CONSULTANTS ON SOFTWARE

BURTON GRAD ASSOCIATES, INC.
101 POST ROAD EAST
WESTPORT, CONNECTICUT 06880
(203) 222-8718
(203) 222-8728 FAX
BURTGRAD@AOL.COM

Sterling Software, Inc.
300 Crescent Court
Suite 1200
Dallas, Texas 75201-1000

Invoice #2928

May 6, 1999

Project: #133-68

Attention: Paul Baker
Copy: John Mecke
Charlie Miller

INVOICE

Project: Valuation of Acquired Intangible Assets from Cayenne Software, Inc.

RECEIVED
MAY 07 1999

Consulting Services: March 1 - 31, 1999

Burton Grad	1.5 days @ $2,500/day	$3,750.00
	Total Fees	**$3,750.00**

Expenses:

6045

Telephone/fax	17.74
Total Invoice	**$3,767.74**

Ok to pay

Payment Is Due Within 15 Days of Receipt of Invoice

STERLING SOFTWARE

Stephen C. Carey
Director, Tax

December 2, 1999

Burton Grad Associates, Inc.
101 Post Road East
Westport, Connecticut 06880

Dear Sir/Madam:

We are currently reviewing the Federal income tax treatment of transaction costs incurred in connection with the merger of Information Advantage, Inc. with Sterling Software, Inc. ("the Merger"). We have engaged Ernst & Young LLP to assist us in this process. During their review of the transaction costs, it was noted that the following invoices for various valuation and due diligence services do not provide an adequate description of the services provided to determine the appropriate federal income tax treatment of such fees. Identification of the assets the due diligence and valuation relate to along with a description of the due diligence tasks performed is necessary in determining the federal income tax treatment of such costs.

Invoice Number	Invoice Date	Invoice Amount
2944	7/27/99	$7,934.50
2949	9/3/99	$10,000.00

We would appreciate your assistance in providing detail of the services rendered and corresponding amounts for those services, as such information will assist us in determining the income tax consequences of your fees. Attached is a list of categories to be considered when itemizing your fees and services. Please indicate the portion of your fee allocable to each category and provide a identification of the assets and a description of the due diligence and valuation tasks performed.

As this information is of a time sensitive nature, we appreciate your prompt assistance with this inquiry. Your completed response can be faxed to Kim Harrington, Ernst & Young LLP, at (214) 969-8321. Please direct any questions concerning this request to Kim at (214) 969-8630.

Sincerely,

Stephen C. Carey

Stephen C. Carey
Director, Tax

Attachments

300 Crescent Court • Suite 1200 • Dallas, TX 75201-7832 • 214/981-1096 • Fax 214/981-1286 • steve_carey@sterling.com

Sterling Software, Inc.
Information AdvantageTransaction
Attorney/Client Work Product - Privileged and Confidential

Copies of your invoices are attached to assist you in providing the information that we are requesting. Please indicate the percentage of your fee allocable to the following categories:

General financial services.. ________%

Abandoned merger/acquisition plans.................................. ________%

Structuring, negotiating, and closing successful merger/acquisition plan.. ________%

Due Diligence.. ________%

Shareholder communications... ________%

Regulatory requirements.. ________%

S.E.C. Filings.. ________%

Employee issues such as compensation consulting, benefits and employee contracts (please provide detail)............................ ________%

Relocation.. ________%

Debt obligations and cost of financing................................ ________%

Director's & Officer's Insurance .... ________%

Outplacement services (please provide detail)........................ ________%

Auditing Services (please provide detail)............................ ________%

General Corporate Tax Advising (please provide detail)........... ________%

Tax Compliance.. ________%

Other (please provide detail).. ________%

Detailed Response: ____

Attachment to Service Provider Request

BURTON GRAD ASSOCIATES, INC.
101 POST ROAD EAST
WESTPORT, CONNECTICUT 06880
(203) 222-8718
(203) 222-8728 FAX
BURTGRAD@AOL.COM

Sterling Software, Inc.
300 Crescent Court
Suite 1200
Dallas, Texas 75201-1000

Invoice #2944

July 27, 1999

Project: #133-75

Attention: Paul Baker
Copy: Mark Kleinman
Steve Wilkinson

INVOICE

Project: **Technical Due Diligence Review of Information Advantage Products and Technologies**

Consulting Services: July 11 - 16, 199

Burton Grad	2.25 days @ $2,500/day		$5,625.00
Sid Dunayer	1.5 days @ $1,500/day		2,250.00
		Total Fees	**$7,875.00**

Expenses Incurred:

Telephone/fax		$25.00
Express Delivery		34.50
	Total Expenses	**$59.50**
	Total Invoice	**$7,934.50**

AUG 03 1999

SK

Payment Is Due Within 15 Days of Receipt of Invoice

Charge IA
due Acq costs

00811

BURTON GRAD ASSOCIATES, INC.
101 POST ROAD EAST
WESTPORT, CONNECTICUT 06880
(203) 222-8718
(203) 222-8728 FAX
BURTGRAD@AOL.COM

SEP 07 1999

Sterling Software, Inc.
300 Crescent Court
Suite 1200
Dallas, Texas 75201-1000

Invoice #2949

September 3, 1999

Project: #133-78

Attention: Paul Baker
Copy: Steve Wilkinson

INVOICE

Project: **Valuation of Information Advantage Acquisition**

Consulting Services: August 3 - 31, 1999

Burton Grad	4 days @ $2,500/day	$10,000.00
	Total Fees	**$10,000.00**
	Total Invoice	**$10,000.00**

1300 InfAdv

OK to pay

IA Acquisition Costs

Payment Is Due Within 15 Days of Receipt of Invoice

ERNST & YOUNG LLP
2121 San Jacinto Street, Suite 1500
Dallas, TX 75201
Main Phone: 214/969-8000
Direct Fax: 214/969-8321

Facsimile Transmittal Sheet

Please Deliver: Number of Pages (Including this Page): 5

To:	Burton Grad	**Date:**	December 8, 1999
Fax No.:	(203) 222-8728		
From:	Kim Harrington	Phone:	(214) 969-8630

Call Dorothy Helen at 214-969-8197 if the facsimile you received was incomplete or not legible.

Message:

STERLING SOFTWARE

Stephen C. Carey
Director, Tax

December 2, 1999

Burton Grad Associates, Inc.
101 Post Road East
Westport, Connecticut 06880

Dear Sir/Madam:

We are currently reviewing the Federal income tax treatment of transaction costs incurred in connection with the merger of Interlink Computer Sciences, Inc. with Sterling Software, Inc. ("the Merger"). We have engaged Ernst & Young LLP to assist us in this process. During their review of the transaction costs, it was noted that the following invoices for various valuation services pertaining to the merger do not provide an adequate description of the services provided to determine the appropriate federal income tax treatment of such fees. Identification of the assets the valuation relate to along with a description of the tasks performed is necessary in determining the federal income tax treatment of such costs.

Invoice Number	Invoice Date	Invoice Amount
2936	6/8/99	$6,250.00
2943	7/6/99	$12,176.66

We would appreciate your assistance in providing detail of the services rendered and corresponding amounts for those services, as such information will assist us in determining the income tax consequences of the fees. Attached is a list of categories to be considered when itemizing your fees and services. Please indicate the portion of your fee allocable to each category and provide a identification of the assets and a description of the valuation tasks performed.

As this information is of a time sensitive nature, we appreciate your prompt assistance with this inquiry. Your completed response can be faxed to Kim Harrington, Ernst & Young LLP, at (214) 969-8321. Please direct any questions concerning this request to Kim at (214) 969-8630.

Sincerely,

Stephen C. Carey

Stephen C. Carey
Director, Tax

Attachments

300 Crescent Court · Suite 1200 · Dallas, TX 75201-7832 · 214/981-1096 · Fax 214/981-1286 · steve_carey@sterling.com

Sterling Software, Inc.
Interlink Transaction
Attorney/Client Work Product - Privileged and Confidential

Copies of your invoices are attached to assist you in providing the information that we are requesting. Please indicate the percentage of your fee allocable to the following categories:

General financial services.. ________%

Abandoned merger/acquisition plans.. ________%

Structuring, negotiating, and closing successful merger/acquisition plan... ________%

Due Diligence.. ________%

Shareholder communications.. ________%

Regulatory requirements.. ________%

S.E.C. Filings.. ________%

Employee issues such as compensation consulting, benefits and employee contracts (please provide detail)................................. ________%

Relocation.. ________%

Debt obligations and cost of financing.................................... ________%

Director's & Officer's Insurance .... ________%

Outplacement services (please provide detail)......................... ________%

Auditing Services (please provide detail).................................. ________%

General Corporate Tax Advising (please provide detail)........... ________%

Tax Compliance... ________%

Other (please provide detail).. ________%

Detailed Response:____

Attachment to Service Provider Request

BURTON GRAD ASSOCIATES, INC.
101 POST ROAD EAST
WESTPORT, CONNECTICUT 06880
(203) 222-8718
(203) 222-8728 FAX
BURTGRAD@AOL.COM

Sterling Software, Inc.
300 Crescent Court
Suite 1200
Dallas, Texas 75201-1000

Invoice #2936

June 8, 1999

Project: #133-74

Attention: Paul Baker
Copy: Lee McElrath

INVOICE

Project: Valuation for Interlink Acquisition

Consulting Services: April 15 - May 31, 1999

Burton Grad	2.5 days @ $2,500/day		$6,250.00
		Total Fees	**$6,250.00**

Expenses: Expenses will be included in next invoice

Total Invoice	**$6,250.00**

JUN 08 1999

Payment Is Due Within 15 Days of Receipt of Invoice

OK to pay

INTERLINK ACQ COSTS

BURTON GRAD ASSOCIATES, INC.
101 POST ROAD EAST
WESTPORT, CONNECTICUT 06880
(203) 222-8718
(203) 222-8728 FAX
BURTGRAD@AOL.COM

Invoice #2943

July 6, 1999

Project: #133-74

Sterling Software, Inc.
300 Crescent Court
Suite 1200
Dallas, Texas 75201-1000

Attention: Paul Baker
Copy: Lee McElrath
Logan Wray

INVOICE

Project: Valuation of Interlink Intangible Assets

Consulting Services: June 1 - 30, 1999

Burton Grad	4.5 days @ $2,500/day		$11,250.00
Elizabeth Virgo	.5 day @ $1,500/day		750.00
		Total Fees	**$12,000.00**

Expenses Incurred:

Express Delivery		$144.50
Telephone/fax		32.16
	Total Expenses	$176.66
	Total Invoice	**$12,176.66**

OK to pay

CHARGE TO INTERLINK ACQ

CHECK ORIGINAL NOT PAID ALREADY

Payment Is Due Within 15 Days of Receipt of Invoice

ERNST & YOUNG LLP
2121 San Jacinto Street, Suite 1500
Dallas, TX 75201
Main Phone: 214/969-8000
Direct Fax: 214/969-8321

Facsimile Transmittal Sheet

Please Deliver: Number of Pages (Including this Page): 5

To:	Burton Grad	**Date:**	December 8, 1999
Fax No.:	(203) 222-8728		
From:	Kim Harrington	Phone:	(214) 969-8630

Call Dorothy Helen at 214-969-8197 if the facsimile you received was incomplete or not legible.

Message:

STERLING SOFTWARE

Stephen C. Carey
Director, Tax

December 2, 1999

Burton Grad Associates, Inc.
101 Post Road East
Westport, Connecticut 06880

Dear Sir/Madam:

We are currently reviewing the Federal income tax treatment of transaction costs incurred in connection with the merger of Cayenne Software, Inc. with Sterling Software, Inc. ("the Merger"). We have engaged Ernst & Young LLP to assist us in this process. During their review of the transaction costs, it was noted that the following invoices for various valuation services do not provide an adequate description of the services provided to determine the appropriate federal income tax treatment of such fees. Identification of the assets the valuation related to along with a description of the tasks performed is necessary in determining the federal income tax treatment of such costs.

Invoice Number	Invoice Date	Invoice Amount
2915	12/31/98	$8,118.78
2928	5/6/99	$3,767.74

We would appreciate your assistance in providing detail of the services rendered and corresponding amounts for those services, as such information will assist us in determining the income tax consequences of the fees. Attached is a list of categories to be considered when itemizing your fees and services. Please indicate the portion of your fee allocable to each category and provide an identification of the assets and a description of the valuation tasks performed.

As this information is of a time sensitive nature, we appreciate your prompt assistance with this inquiry. Your completed response can be faxed to Kim Harrington, Ernst & Young LLP, at (214) 969-8321. Please direct any questions concerning this request to Kim at (214) 969-8630.

Sincerely,

Stephen C. Carey

Stephen C. Carey
Director, Tax

Attachments

Sterling Software, Inc.
Cayenne Transaction
Attorney/Client Work Product - Privileged and Confidential

Copies of your invoices are attached to assist you in providing the information that we are requesting. Please indicate the percentage of your fee allocable to the following categories:

General financial services.. ______%

Abandoned merger/acquisition plans.. ______%

Structuring, negotiating, and closing successful merger/acquisition plan.. ______%

Due Diligence.. ______%

Shareholder communications.. ______%

Regulatory requirements.. ______%

S.E.C. Filings.. ______%

Employee issues such as compensation consulting, benefits and employee contracts (please provide detail).. ______%

Relocation.. ______%

Debt obligations and cost of financing.. ______%

Director's & Officer's Insurance .... ______%

Outplacement services (please provide detail).. ______%

Auditing Services (please provide detail).. ______%

General Corporate Tax Advising (please provide detail).. ______%

Tax Compliance.. ______%

Other (please provide detail).. ______%

Detailed Response: ____

Attachment to Service Provider Request

BURTON GRAD ASSOCIATES, INC.
101 POST ROAD EAST
WESTPORT, CONNECTICUT 06880
(203) 222-8718
(203) 222-8728 FAX
BURTGRAD@AOL.COM

Sterling Software, Inc
300 Crescent Court
Suite 1200
Dallas, Texas 75201-1000

Attention: Logan Wray

Invoice #2915

December 31, 1998

Project: #133-68

INVOICE

Project: Valuation of Acquired Intangible Assets from Cayenne Software, Inc.

Consulting Services: October 2 - December 31, 1998

Burton Grad	2 days @ $2,500/day		$5,000.00
Sidney Dunayer	2 days @ $1,500/day		3,000.00
		Total Fees	**$8,000.00**

Expenses:	Telephone/fax		41.78
	FedEx		77.00
		Total Expenses	**$118.78**
		Total Invoice	**$8,118.78**

RECEIVED
JAN 13 1999
By

1300-Cayene

Payment is due within 15 days of receipt of invoice

CONSULTANTS ON SOFTWARE

BURTON GRAD ASSOCIATES, INC.
101 POST ROAD EAST
WESTPORT, CONNECTICUT 06880
(203) 222-8718
(203) 222-8728 FAX
BURTGRAD@AOL.COM

Sterling Software, Inc.
300 Crescent Court
Suite 1200
Dallas, Texas 75201-1000

Invoice #2928

May 6, 1999

Project: #133-68

Attention: Paul Baker
Copy: John Mecke
Charlie Miller

INVOICE

Project: Valuation of Acquired Intangible Assets from Cayenne Software, Inc.

RECEIVED
MAY 07 1999

Consulting Services: March 1 - 31, 1999

Burton Grad	1.5 days @ $2,500/day	$3,750.00
	Total Fees	**$3,750.00**

Expenses:

Telephone/fax	6045	17.74
	Total Invoice	**$3,767.74**

Ok to pay

Payment Is Due Within 15 Days of Receipt of Invoice

ERNST & YOUNG LLP
2121 San Jacinto Street, Suite 1500
Dallas, TX 75201
Main Phone: 214/969-8000
Direct Fax: 214/969-8321

Facsimile Transmittal Sheet

Please Deliver: Number of Pages (Including this Page): 5 :

To:	Burton Grad	**Date:**	December 8, 1999
Fax No.:	(203) 222-8728		
From:	Kim Harrington	Phone:	(214) 969-8630

Call Dorothy Helen at 214-969-8197 if the facsimile you received was incomplete or not legible.

Message:

STERLING SOFTWARE

Stephen C. Carey
Director, Tax

December 2, 1999

Burton Grad Associates, Inc.
101 Post Road East
Westport, Connecticut 06880

Dear Sir/Madam:

We are currently reviewing the Federal income tax treatment of transaction costs incurred in connection with the merger of Information Advantage, Inc. with Sterling Software, Inc. ("the Merger"). We have engaged Ernst & Young LLP to assist us in this process. During their review of the transaction costs, it was noted that the following invoices for various valuation and due diligence services do not provide an adequate description of the services provided to determine the appropriate federal income tax treatment of such fees. Identification of the assets the due diligence and valuation relate to along with a description of the due diligence tasks performed is necessary in determining the federal income tax treatment of such costs.

Invoice Number	Invoice Date	Invoice Amount
2944	7/27/99	$7,934.50
2949	9/3/99	$10,000.00

We would appreciate your assistance in providing detail of the services rendered and corresponding amounts for those services, as such information will assist us in determining the income tax consequences of your fees. Attached is a list of categories to be considered when itemizing your fees and services. Please indicate the portion of your fee allocable to each category and provide a identification of the assets and a description of the due diligence and valuation tasks performed.

As this information is of a time sensitive nature, we appreciate your prompt assistance with this inquiry. Your completed response can be faxed to Kim Harrington, Ernst & Young LLP, at (214) 969-8321. Please direct any questions concerning this request to Kim at (214) 969-8630.

Sincerely,

Stephen C Carey

Stephen C. Carey
Director, Tax

Attachments

Sterling Software, Inc.
Information AdvantageTransaction
Attorney/Client Work Product - Privileged and Confidential

Copies of your invoices are attached to assist you in providing the information that we are requesting. Please indicate the percentage of your fee allocable to the following categories:

General financial services... ____%

Abandoned merger/acquisition plans................................ ____%

Structuring, negotiating, and closing successful merger/acquisition plan.. ____%

Due Diligence.. ____%

Shareholder communications....................................... ____%

Regulatory requirements... ____%

S.E.C. Filings.. ____%

Employee issues such as compensation consulting, benefits and employee contracts (please provide detail).......................... ____%

Relocation.. ____%

Debt obligations and cost of financing............................ ____%

Director's & Officer's Insurance .... ____%

Outplacement services (please provide detail)..................... ____%

Auditing Services (please provide detail)........................... ____%

General Corporate Tax Advising (please provide detail)........... ____%

Tax Compliance.. ____%

Other (please provide detail)... ____%

Detailed Response: ____

Attachment to Service Provider Request

BURTON GRAD ASSOCIATES, INC.
101 POST ROAD EAST
WESTPORT, CONNECTICUT 06880
(203) 222-8718
(203) 222-8728 FAX
BURTGRAD@AOL.COM

Sterling Software, Inc.
300 Crescent Court
Suite 1200
Dallas, Texas 75201-1000

Invoice #2944

July 27, 1999

Project: #133-75

Attention: Paul Baker
Copy: Mark Kleinman
Steve Wilkinson

INVOICE

Project: **Technical Due Diligence Review of Information Advantage Products and Technologies**

Consulting Services: July 11 - 16, 199

Burton Grad	2.25 days @ $2,500/day		$5,625.00
Sid Dunayer	1.5 days @ $1,500/day		2,250.00
		Total Fees	**$7,875.00**

Expenses Incurred:

Telephone/fax		$25.00
Express Delivery		34.50
	Total Expenses	**$59.50**

Total Invoice	**$7,934.50**

AUG 03 1999

SK

Payment Is Due Within 15 Days of Receipt of Invoice

Charge IA
this Acq cost.

00811

BURTON GRAD ASSOCIATES, INC.
101 POST ROAD EAST
WESTPORT, CONNECTICUT 06880
(203) 222-8718
(203) 222-8728 FAX
BURTGRAD@AOL.COM

SEP 07 1999

Sterling Software, Inc.
300 Crescent Court
Suite 1200
Dallas, Texas 75201-1000

Invoice #2949

September 3, 1999

Project: #133-78

Attention: Paul Baker
Copy: Steve Wilkinson

INVOICE

Project: **Valuation of Information Advantage Acquisition**

Consulting Services: August 3 - 31, 1999

Burton Grad	4 days @ $2,500/day		$10,000.00
		Total Fees	**$10,000.00**
		Total Invoice	**$10,000.00**

1300 InfAdv

OK to pay

IA Acquisition Costs

Payment Is Due Within 15 Days of Receipt of Invoice

Sterling Software Announces Record First Quarter Results

Company's Fiscal Year 2000 Off to Strong Start With
Revenue Increasing 19% to $207 Million, and EPS Increasing 16% to $.36

DALLAS, Feb. 9 /PRNewswire/ -- Sterling Software, Inc. (NYSE: SSW) today announced record revenue, income and earnings per share for the company's quarter ended December 31, 1999 - the first quarter of its fiscal 2000. The results, which are in line with the company's previously announced preliminary results, mark Sterling Software's 45th consecutive quarter of revenue and earnings per share growth.

First quarter revenue increased 19% to $207.0 million, up from $174.5 million in the first quarter of 1999. The company's first quarter operating profit increased by 26% to $40.7 million, up from $32.4 million, and the operating profit margin grew to 20%, up from 19% a year ago. Excluding the amortization of intangibles associated with acquisitions, first quarter net income and earnings per share increased 27% to $38.1 million and 29% to $.44, respectively, compared to net income of $30.1 million and earnings per share of $.34 in the year-ago quarter on this basis. Including the amortization of acquisition-related intangibles, first quarter net income grew 14% to $31.0 million from $27.2 million a year ago, and earnings per share grew 16% to $.36 from $.31 in the same quarter last year. The prior year amounts exclude the one-time charges associated with the acquisition of Cayenne Software in October 1998.

"This was an outstanding quarter by all measures, and on-target results across the board have given us an excellent start to our new fiscal year," said Sterling L. Williams, the company's president and chief executive officer. "Storage management enjoyed continued strong product revenue growth, while benefiting from our strategy to provide end-to-end solutions across the enterprise. We just recently gained additional Storage Area Network expertise for our storage management business with the acquisition of Retrieve, Inc. This SAN technology has enormous potential for customers who are trying to optimize their e-business applications by dramatically improving the performance of their storage systems. Network management also turned in very strong results for the quarter, and our new business intelligence operation had outstanding results which equaled our high expectations following the Information Advantage acquisition."

Sterling Software's Systems Management segment posted record first quarter revenue of $68.0 million, up 41% from the first quarter of 1999 as a result of 54% product revenue growth. The business segment's storage management business grew total revenue 54% and its network management business grew total revenue 74%. Systems Management contributed $23.3 million to the quarter's operating profit, producing an outstanding 34% margin, up from 32% in the year-ago period.

(more)

The company's Business Intelligence segment, benefiting from last year's acquisition of Information Advantage, grew revenue 118% to $41.6 million in the first quarter of 2000, up from $19.1 million in the first quarter of 1999. And in its first full quarter following the acquisition, Business Intelligence contributed $9.8 million to the quarter's operating profit, up from $8.2 million a year ago. Business Intelligence had first quarter 2000 operating profit of $14.1 million excluding the impact of amortization of acquisition-related intangibles. The company's Federal Systems business had first quarter revenue of $41.4 million, up 7% from $38.6 million in the first quarter of 1999, and contributed $3.6 million of operating profit to the quarter's results, up from $2.8 million in the year-ago period.

Following the realignment of its Application Development business last year to focus on the tremendous e-business market opportunity, the company released its new Java development tool, COOL:Joe, for general availability at the end of the first quarter. Additional product releases supporting the e-business initiatives are planned for the company's second and third quarters. In the realignment of its Application Development business, the company added resources in new areas like Java tools and reduced resources in certain mature market areas. As planned, the Application Development segment's first quarter revenue declined 18% to $56.0 million due to this realignment. However, the realignment enabled the Application Development business to continue to produce strong margins, with the business contributing $12.6 million of operating profit to the quarter's results -- a 23% operating profit margin compared to a 20% margin in the first quarter of 1999.

Sterling Software is a leading provider of software and services for the application development, business intelligence, information management, storage management, network management, VM systems management, and federal systems markets. The company is one of the 20 largest independent software companies in the world. Headquartered in Dallas, Sterling Software has a worldwide installed base of more than 20,000 customer sites and 3,800 employees in 90 offices worldwide. For more information on Sterling Software, visit the company's Web site at www.sterling.com.

This news release contains certain forward-looking statements that reflect the current views and expectations of Sterling Software with respect to future events. Such statements are subject to a number of risks, uncertainties and assumptions, including those mentioned in the company's periodic reports filed with the Securities and Exchange Commission. Actual results may vary significantly.

(more)

STERLING SOFTWARE, INC.
RESULTS OF OPERATIONS
(in thousands, except per share information)
(unaudited)

	Three Months Ended December 31 1999	1998
Revenue:		
Products	$ 89,444	$ 64,313
Product support	55,952	51,541
Services	61,560	58,605
	206,956	174,459
Costs and expenses:		
Cost of sales:		
Products and product support	25,711	17,948
Services	52,004	53,160
	77,715	71,108
Product development and enhancement	8,290	9,355
Selling, general and administrative	80,283	61,609
Reorganization costs		19,655
Purchased research and development		9,623
	166,288	171,350
Income before other income (expense) and income taxes	40,668	3,109
Other income (expense):		
Interest expense	(70)	(130)
Investment income	6,245	8,762
Other	143	172
	6,318	8,804
Income before income taxes	46,986	11,913
Provision for income taxes	15,976	7,707
Net income	$ 31,010	$ 4,206
Income per common share (A),(B):		
Basic	$ .38	$ .05
Diluted	$ .36	$ .05

(A) Results of operations for the three months ended December 31, 1998 include reorganization costs and purchased research and development expense totaling $ 29.3 million ($23.0 million net of tax) related to the acquisition of Cayenne Software. For the three months ended

(more)

December 31, 1998, the company reported diluted earnings per common share before these one-time charges of $.31, calculated using fully diluted shares of 87.7 million.

(B) Diluted earnings per common share before amortization of acquisition-related intangibles was $.44 for the three months ended December 31, 1999, based on amortization of $10.8 million ($7.1 million net of tax, calculated using the company's effective tax rate) and calculated using fully diluted shares of 86.6 million. Diluted earnings per common share, before one-time charges and amortization of acquisition-related intangibles, was $.34 for the three months ended December 31, 1998, based on amortization of $4.4 million ($2.9 million net of tax, calculated using the company's effective tax rate before one-time charges) and calculated using fully diluted shares of 87.7 million.

STERLING SOFTWARE, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands, except share information)

ASSETS

	December 31 1999 (unaudited)	September 30 1999
Current assets:		
Cash and cash equivalents	$ 376,574	$ 318,748
Marketable securities	111,942	112,285
Accounts and notes receivable, net	239,093	294,409
Prepaid expenses and other current assets	29,247	28,732
Total current assets	756,856	754,174
Property and equipment, net of accumulated depreciation of $67,252 at December 31, 1999 and $63,134 at September 30, 1999	73,460	72,137
Computer software, net of accumulated amortization of $118,538 at December 31, 1999 and $114,813 at September 30, 1999	147,337	144,367
Excess cost over net assets of businesses acquired, net of accumulated amortization of $44,680 at December 31, 1999 and $38,742 at September 30, 1999	225,547	231,738
Other assets	23,126	27,615
	$1,226,326	$1,230,031

(more)

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:		
Accounts payable and accrued liabilities	$ 194,532	$ 226,510
Deferred revenue	96,620	105,828
Total current liabilities	291,152	332,338
Noncurrent deferred revenue	42,333	45,677
Other noncurrent liabilities	38,304	40,284
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $.10 par value; 10,000,000 shares authorized, no shares issued or outstanding		
Common stock, $.10 par value; 250,000,000 shares authorized; 87,959,000 and 86,873,000 shares issued at December 31, 1999 and September 30, 1999, respectively	8,796	8,687
Additional paid-in capital	910,743	895,391
Accumulated other comprehensive loss	(26,186)	(21,899)
Retained earnings	86,760	55,750
Less treasury stock, at cost; 5,924,000 and 5,953,000 shares at December 31, 1999 and September 30, 1999, respectively	(125,576)	(126,197)
Total stockholders' equity	854,537	811,732
	$1,226,326	$1,230,031

CONTACT: Julie Kupp, Vice President, Investor Relations of Sterling Software, Inc., 214-981-1000 or email, julie.kupp@sterling.com.

SOURCE Sterling Software, Inc.
-0- 02/09/2000
/CONTACT: Julie Kupp, Vice President, Investor Relations of Sterling Software, Inc., 214-981-1000 or email, julie.kupp@sterling.com/
/Web site: http://www.sterling.com/
(SSW)

-0-

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 September 30, 1999

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from __________ to __________

Commission File No. 1-8465

STERLING SOFTWARE, INC.

(Exact name of registrant as specified in its charter)

Delaware	**75-1873956**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

300 Crescent Court, Suite 1200
Dallas, Texas 75201
(Address of principal executive offices, including zip code)

(214) 981-1000
(Registrant's telephone number, including area code)

Securities Registered Pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, $0.10 Par Value	New York Stock Exchange
Rights to Purchase Series A Junior Participating Preferred Stock, $0.10 Par Value	New York Stock Exchange

Securities Registered Pursuant to Section 12(g) of the Act:
None

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 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. ☑

As of November 5, 1999, 79,965,918 shares of the Registrant's Common Stock were outstanding.

The aggregate market value of the Registrant's Common Stock held by non-affiliates of the Registrant was $1,717,049,423, based on the $22 3/16 closing price of the Registrant's Common Stock on the New York Stock Exchange on November 5, 1999.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the proxy statement for the Annual Meeting of Stockholders of the Registrant to be held during 2000 are incorporated by reference in Part III.

STERLING SOFTWARE, INC.

TABLE OF CONTENTS

Form 10-K Item		Page
Part I.		
Item 1.	Business	1
Item 2.	Properties	11
Item 3.	Legal Proceedings	11
Item 4.	Submission of Matters to a Vote of Security Holders	12
Part II.		
Item 5.	Market for Registrant's Common Equity and Related Stockholder Matters	12
Item 6.	Selected Financial Data	13
Item 7.	Management's Discussion and Analysis of Financial Condition and Results of Operations	15
Item 7A.	Quantitative and Qualitative Disclosure About Market Risk	31
Item 8.	Financial Statements and Supplementary Data	32
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	61
Part III.		
Item 10.	Directors and Executive Officers of the Registrant	61
Item 11.	Executive Compensation	61
Item 12.	Security Ownership of Certain Beneficial Owners and Management	61
Item 13.	Certain Relationships and Related Transactions	61
Part IV.		
Item 14.	Exhibits, Financial Statement Schedules and Reports on Form 8-K	62

PART 1

Item 1. *Business.*

General

Sterling Software, Inc. (''Sterling Software'' or the ''Company'') is a worldwide developer and supplier of systems management, business intelligence and application development software products and services, as well as a supplier of specialized information technology (''IT'') services for sectors of the federal government. Founded in 1981, Sterling Software's customer base includes 90 of the 100 largest U.S. industrial and service corporations, as ranked by 1998 revenues in *Fortune* magazine. Sterling Software's business segments are as follows:

- The systems management business segment provides solutions that enable customers to simplify the use of multiple computing environments and to increase the productivity of information systems, ultimately ensuring that the systems meet the business needs of the organization. The Company's systems management solutions help ensure application availability and performance, including e-business application availability and performance, and emphasize both breadth of coverage—monitoring all critical resources, and depth of coverage—mainframes, servers, desktops and laptops. These solutions include enterprise-level network management products, enterprise-level storage management products and comprehensive VM systems management products. The Company's network management products manage mission-critical networks in e-business environments, maximizing availability and performance, and providing tools for network capacity planning. Sterling Software's storage management products help to maximize the availability and performance of mission-critical storage systems, and provide the tools necessary for storage capacity planning. The Company's VM products provide comprehensive systems management solutions for IBM's VM operating environment.

- The application management business segment provides solutions for both business intelligence and application development. The Company's business intelligence solutions offer a complete range of web-based business intelligence capabilities centered around corporate portal technology—from a web-based integrated query, analysis and reporting product to a tool that enables complex analysis and reporting from terabyte-sized databases. In addition, Sterling Software's business intelligence solutions include products that structure and manage data and application resources, such as creating enterprise data warehouses and data marts, allowing customers to maximize their investment in existing assets. The Company's application development solutions include products and services that enable customers to deliver e-business applications for today's Internet-based economy. These solutions leverage existing assets to enhance customer relationships and supply chain efficiency by exposing today's applications to web services, aggregating systems to create new e-business processes, as well as creating new e-business applications based on Internet architectures.

- The federal systems business segment provides specialized IT services for sectors of the federal government, as well as state and local governments. Major customers include the U.S. Department of Defense (''DoD''), the military services, U.S. national intelligence agencies, the Federal Aviation Administration (''FAA'') and the National Aeronautics and Space Administration (''NASA'').

Worldwide revenue from the Company's systems management, application management and federal systems business segments represented 36%, 44% and 20%, respectively, of the Company's total 1999 revenue. Revenue from the Company's international operations represented 37% of the Company's total 1999 revenue. See Note 4 of Notes to Consolidated Financial Statements.

As of September 30, 1999, the Company employed approximately 3,700 employees in 90 offices worldwide. The Company has direct sales offices in 21 countries and distributors and agents in approximately 40 additional countries.

A large percentage of Sterling Software's business is recurring through annual and multi-year contracts. Product support contracts generally have terms that range from one to three years; fixed-term product lease and rental contracts generally have terms that range from month-to-month to year-to-year; and multi-year federal contracts generally have terms that range from one to five years. Recurring revenue represented 45% and 46% of the Company's total revenue in 1999 and 1998, respectively.

Consistent with Sterling Software's decentralized operating structure, the Company's businesses are conducted through independent operating groups. Within each of these groups are divisions that focus on specific business niches. In keeping with the Company's decentralized philosophy, the management team of each group and division is largely autonomous. Sterling Software believes that its decentralized organizational structure promotes operating flexibility, improves responsiveness to customer requirements and focuses management on achieving revenue and operating profit objectives.

The Company believes that several major trends are resulting in increased investment in both software applications and the software products that enable and manage the supporting systems infrastructure. These trends include the growing pervasiveness of the Internet, the rapidly increasing demand for e-business solutions to address fundamental business needs, and continuing technological advancements in computer processing capabilities, data storage capabilities and global communications networks. These trends are also driving the Company's customers to demand critical end-to-end enterprise storage management, network management and other systems management solutions; flexible, scalable and open business intelligence tools; and application development products that enable customers to rapidly build, deploy and adapt e-business applications. The Company is addressing these growing demands through both internal product development efforts and through strategic business and product acquisitions. See Item 7. ''Management's Discussion and Analysis of Financial Condition and Results of Operations—Business Combinations, Reorganizations and Divestitures.''

Five acquisitions completed in 1999 expanded the Company's storage management, network management and application development product offerings, and significantly expanded the Company's business intelligence offerings.

- In storage management, the Company acquired the Alexandria business of Spectra Logic Corporation, adding a high-performance backup and archiving product for very large databases—including Oracle, Informix and SAP R/3 databases—and for both UNIX databases and file systems, as well as Windows and Windows NT clients. With this product, now named SAMS:Alexandria, critical business data, including data used in e-business applications, can be backed up without interrupting critical business operations. The acquisition of CoreData, Inc. further extended the Company's strategy to provide end-to-end storage management with the addition of a product, now named SAMS:Lifeguard, which enables centralized storage and protection of critical data that resides on the rapidly growing number of laptops and remote PC's.

- In network management, the Company enhanced its ability to help organizations manage the networks in their e-business environments through the Company's acquisition of Interlink Computer Sciences, Inc. The Company added a new product, now named SOLVE:TCPaccess, that enables IBM's System 390 computers to use TCP/IP (Transmission Control Protocol/Internet Protocol) as a network communications protocol, enabling System 390 computers to act as enterprise servers in an e-business environment. In addition, the Company's SOLVE:Netmaster for TCP/IP product has been enhanced with access control capabilities added through the acquisition, resulting in the most comprehensive solution for managing TCP/IP networks connected to System 390 enterprise servers.

- The Company added significant business intelligence capabilities as a result of its 1999 acquisition of Information Advantage, Inc., the pioneer of the business intelligence portal. In business intelligence, the Company's strategy is to offer all the products necessary to fill an organization's business intelligence needs, integrated into a single, web-based platform from which information can be personalized for every user. With the products added through the acquisition and the Company's introduction of a new web-based integrated query, analysis and reporting product, Sterling Software now offers EUREKA:Suite, a full range of business intelligence solutions centered around corporate portal technology. Business intelligence tools are a necessity for e-business, where organizations must leverage the huge repositories of information residing in their databases—integrating, organizing, analyzing and personalizing it, and putting it to work for competitive advantage.

- The Company's application development strategy is to offer tools that enable customers to build, deploy and adapt e-business applications for today's Internet-based economy. The Company's acquisition of Cayenne Software, Inc. added its object-oriented modeling technologies and tools, which are used in application design and implementation, as well as new database design tools.

Systems Management

The systems management business segment provides solutions that enable customers to simplify the use of multiple computing environments and to increase the productivity of information systems, ultimately ensuring that the systems meet the business needs of the organization. The Company's systems management solutions help ensure application availability and performance, including e-business application availability and performance, and emphasize both breadth of coverage—monitoring all critical resources, and depth of coverage —mainframes, servers, desktops, and laptops. Enterprise-level network management solutions are provided through the SOLVE family of products, enterprise-level storage management solutions are provided through the SAMS family of products, and comprehensive systems management solutions for IBM's VM operating environment are provided through the VM family of products. Worldwide revenue from the systems management business segment represented 36%, 28% and 32% of the Company's total revenue during 1999, 1998 and 1997, respectively.

The *SOLVE* family of products helps customers manage their network infrastructure and the mission-critical applications that their businesses depend upon. SOLVE products exploit advancements in current technologies, including Java and the Web, to deliver easy-to-use management solutions for e-business environments. The Company's SOLVE:Netmaster products automate network management operations across large-scale enterprises, providing centralized command and control, diagnostics, performance management, and alert and status monitoring of TCP/IP, SNA (Systems Network Architecture) and SNMP (Simple Network Management Protocol) network events. SOLVE:TCPaccess enables System 390 enterprise servers to use TCP/IP as a network communications protocol, enabling these computers to act as enterprise servers in an e-business environment. The Company's SOLVE:Operations products provide and participate in enterprise-wide systems automation solutions, addressing both mainframe and distributed systems from a single point. SOLVE:Operations products are available as stand-alone products within the OS/390 environment and as plug-in components for three enterprise management platforms: Hewlett-Packard's "OpenView" and "OpenView IT/Operations" and Tivoli's "Tivoli/TME 10 NetView". SOLVE:Central is an integrated suite of products for running the enterprise IT service desk.

The *SAMS* family of products manages, monitors and automates data storage in both distributed and centralized environments, helping to maximize the availability and performance of mission-critical storage systems. The Company's SAMS:Vantage products deliver a wide array of storage resource management solutions. Moreover, these products interface with the Company's data management products, including SAMS:Disk, SAMS:Alexandria, SAMS:Lifeguard, SAMS:Allocate and SAMS:Vtape, providing a comprehensive storage management suite. SAMS:Vantage, OS/390 Edition, is a client/server system that provides comprehensive automation, interactive reporting, analysis and predictive modeling capabilities for complex OS/390 storage environments. SAMS:Vantage, Network Edition, delivers consolidated management of distributed storage across UNIX, Windows NT and NetWare environments and also incorporates a view of mainframe storage. SAMS:Vantage, ADSM Edition, is a tailored version of the product that adds value to IBM's Adstar Distributed Storage Manager (ADSM). From one workstation, the SAMS:Vantage product identifies and manages critical data defects and solves problems automatically, charts trends and forecasts storage capacity across platforms. The SAMS:Vantage storage management approach is designed to remain consistent across multiple platforms and to allow organizations to: manage enterprise data storage in a uniform manner, implement consistent storage management policies and standards, provide consolidated management of distributed data and enforce the protection of critical data, regardless of where it resides. This is particularly important when complex Storage Area Networks are deployed. The OS/390 Edition includes an automated tape storage management component that enhances tape management systems and assists in the management of robotic tape systems and high-capacity tape devices. SAMS:Alexandria, a high-performance backup and archiving product, combines both high speed and reliability in backing up very large databases without interrupting critical business operations. SAMS:Alexandria delivers these high-performance backup capabilities, low resource consumption and extreme fault tolerance to the backup of Oracle, Informix and SAP R/3 databases. It also provides complete, automated, client/server backup of both UNIX and Windows databases and file systems. SAMS:Lifeguard provides remote and mobile PC users with centralized data management, remote asset discovery and reporting technology. It enables protection of critical data that resides on laptops and remote PCs. SAMS:Disk is a centralized mainframe storage management backup, recovery, HSM and reporting system.

The *VM* family of products provides systems management software and Web-enabling software for IBM's VM/ESA operating system. The VM:Manager product family provides integrated solutions for automated operations, storage management, service-level management, security, recovery and SFS (Shared File System) management. VM:Manager is designed to enable VM sites to operate at maximum availability with minimal systems administration personnel, thereby controlling costs, improving performance and increasing user productivity. VM:Webgateway is a web-to-host solution that allows sites to provide virtually immediate access to legacy applications (VM, VSE and OS/390) via a Web browser, while leveraging the power of the mainframe. VM:Webgateway acts as a repository for home pages and documents created using HTML (Hypertext Markup Language) and also stores, retrieves and processes information in various formats including text, graphics, sound, images, video and Java applets. VM:DB is a comprehensive family of DB2/VM management products to help improve database and application performance and user productivity. VM:DB includes products designed to address database administration (VM:DBA) and application development and management (VM:DB/Developer). The Company's VM professional services group is capable of augmenting the customer's professional mainframe staff as project demands dictate. The group's offerings include training and education, software implementation and consulting, and system assessment for Year 2000 compliance.

As of September 30, 1999, the systems management business segment employed approximately 1,000 people. See Item 7. ''Management's Discussion and Analysis of Financial Condition and Results of Operations— Business Combinations, Reorganizations and Divestitures'' for a description of recent acquisitions in this business segment.

Application Management

The application management business segment provides solutions for business intelligence through its EUREKA and VISION product families, and application development solutions through its COOL product family. Worldwide revenue from the application management business segment represented 44%, 51% and 39% of the Company's total revenue during 1999, 1998 and 1997, respectively.

The *EUREKA* product family, centered around corporate portal technology, offers a complete range of web-based business intelligence tools and capabilities. The five products that comprise EUREKA:Suite offer a full range of capabilities—from a web-based integrated query, analysis and reporting product for typical business users, to a high-end, server-based tool that enables complex analysis and reporting from terabyte-sized databases. All of the EUREKA products are flexible, scalable and open. EUREKA:Intelligence is a new 100% Java, web-based tool for integrated query, analysis and reporting. This product enables users to ''slice and dice'' and drill into live data via graphical, interactive views including charts, reports and tables. It also lets users create multidimensional OLAP (On-Line Analytical Processing) reports for speedy analysis of complex data. Its zero administration architecture allows the customer's IT staff to deliver and maintain the application directly from the server. EUREKA:Strategy delivers high volumes of calculation-intensive, interactive reports from very large databases, and is typically used for customer-centered analysis such as the analysis of data produced by e-business applications. It includes an advanced calculation processor, which enables users to evaluate attributes for trend analysis, customer segmentation and inventory management. EUREKA:Analyst is an advanced, high-speed multidimensional analysis tool used for financial forecasting and business modeling. EUREKA:Reporter generates high volumes of sophisticated, interactive report documents in multiple formats through multiple publishing media. Serving as the single point of entry to all of these business intelligence tools is EUREKA:Portal, which gives users at all levels personalized, secure access to business information—much like an Internet portal such as Yahoo!™ delivers access to information available on the Internet. Since the portal product serves as the common platform for all of the EUREKA products, organizations can expand their business intelligence capabilities with minimal effort and cost.

The *VISION* family of products structure and manage data and application resources, allowing customers to maximize their investment in existing assets. These solutions help enterprises address issues related to complex implementation challenges such as data warehousing, desktop integration and legacy extension, mainframe reporting, and application management, using technologies that leverage web-based infrastructures. VISION:Pursuit, an integrated extraction, transformation and loading (ETL) tool for managing an enterprise information supply chain, allows organizations to quickly create enterprise data warehouses and data marts. VISION:Flashpoint provides powerful integration of disparate back-office systems into a single, customizable user desktop. This allows customers to extend the life of business critical applications and systems into new areas, such as e-business. VISION:Results is an information management and report generation system for IBM enterprise servers and a dynamic complement to COBOL. VISION:Builder and VISION:Transact are application development tools for batch and on-line environments, respectively, that operate on major IBM enterprise server platforms. The VISION:Legacy and VISION:Renaissance suites of products address the functions required to assess the quality and maintainability of applications, restructure old COBOL programs, re-document the flow of control through legacy systems, and graphically represent the architecture and flow of existing systems. Both product suites include VISION:Assess, VISION:Recode and VISION:Redocument, with VISION:Legacy operating on the IBM enterprise server and VISION:Renaissance providing PC-based operations. VISION:Phaseshift and VISION:Simulate are products specifically targeted at customers with "Year 2000" compliance issues. VISION:Phaseshift provides an interface to system resources and data files. It intercepts requests for date and time data and "windows" the dates back 28 years in an encapsulated environment. VISION:Simulate is a testing tool that allows for the simulation of dates into the future to test applications without changing the system date.

The *COOL* family of products provides customers the ability to deliver e-business solutions for both enterprise and mid-range environments. Using COOL products, organizations can pursue a variety of Internet strategies including web-enablement of existing applications, application integration through a combination of legacy application wrapping and package connections, and development of new Java-based applications built on an n-tier Internet architecture. COOL:Gen is an application integration and development environment for enterprise e-business applications leveraging MVS and UNIX servers with COM (Component Object Model) or Java standard web services. With COOL:Gen, high-level component specifications are driven forward into dynamic, scalable applications using model-based code generation. COOL:Joe, currently under a limited availability release, is an e-business development tool for delivering distributed systems running on an application server using Enterprise Java Beans (EJBs). COOL:Joe is a second generation Java development environment that incorporates advanced component modeling and generation capabilities that enable IS organizations to make the most of their existing Java expertise, implement EJB technology without having to worry about the underlying EJB code, and focus instead on delivering business solutions. COOL:Plex and COOL:2E deliver e-business applications for the mid-range computing environment, using AS/400 and NT servers. COOL:Plex is a model-based development environment that leverages pattern technology to rapidly generate high-quality, adaptable web and client/server applications using HTML, Java and Domino. COOL:2E is an industry leading AS/400 development environment supporting model based code generation. COOL:Biz is a comprehensive business modeling toolset that allows organizations to model different scenarios as they transform their businesses into e-businesses. The product's methodology for process mapping and workflow design allows business and IT professionals to work together to ensure that new e-business applications and new e-business processes are in sync. Using COOL:Spex, developers can model the architecture of component-based applications and define the interaction of existing and new components. The COOL portfolio also supports the development of real-time and embedded system software with COOL:Jex and COOL:Teamwork. COOL:Jex is an object-oriented analysis and design solution supporting the Unified Modeling Language (UML) industry standard notation. COOL:Jex allows modeling of complex application requirements, driven directly from business requirements. COOL:Teamwork is a structured engineering tool for requirements documentation and systems design.

As of September 30, 1999, the application management business segment employed approximately 1,500 people. See Item 7. ''Management's Discussion and Analysis of Financial Condition and Results of Operations—Business Combinations, Reorganizations and Divestitures'' for a description of recent acquisitions in this business segment.

Federal Systems

The federal systems business segment provides specialized IT services for sectors of the federal government, as well as state and local governments. Major customers include the DoD, the military services, U.S. national intelligence agencies, the FAA and NASA. In 1999, Sterling Software began its 33rd year of service to both NASA and the DoD. In 1999, the Company's federal systems business was performing work under approximately 253 contracts. Revenue from the federal systems business segment represented 20%, 21% and 21% of the Company's total revenue during 1999, 1998 and 1997, respectively.

The segment's Information Technology Division specializes in secure communications, message and data handling, weather forecast production and distribution, and systems integration and application development in support of various projects ranging from satellite data collection to air traffic control. Division computing resources include facilities approved for classified operations and substantial hardware and software configurations to support software lifecycle development activities in distributed processing environments. The division's software engineering and software development processes are certified at Software Engineering Institute Capability Maturity Model (SEI CMM) Level 3 and International Standards Organization (ISO) 9001. Customers include U.S. Air Force command, control and communications organizations, the U.S. Air Force Weather Agency, the FAA and NASA.

The segment's Applied Systems Division specializes in tactical military intelligence systems; command and control systems; advanced database techniques; modeling, simulation and synthetic training and rehearsal systems; and specialized studies and analyses and strategic planning systems. Customers include U.S. Army intelligence and battle command organizations, national intelligence agencies and the U.S. Air Force.

As of September 30, 1999, the federal systems business segment employed approximately 1,100 people. See Item 7. ''Management's Discussion and Analysis of Financial Condition and Results of Operations—Business Combinations, Reorganizations and Divestitures'' for a description of recent acquisitions in this business segment.

Product Licenses

Sterling Software's products are generally licensed under perpetual use, fixed-term or usage-based license agreements. Sterling Software typically does not sell or otherwise transfer title to its software products. The Company's license agreements prohibit reproduction, transfer or disclosure of the product and generally restrict the use of the product to designated sites or central processing units. However, some license agreements may cover multiple sites or multiple central processing units at one site. In 1999, 1998 and 1997, product revenue accounted for 45%, 40% and 41%, respectively, of the Company's total revenue.

Product Support

Product support is available to Sterling Software customers, typically through annual contracts generally priced from 12% to 22% of the current license fee. Sterling Software's product support contracts allow customers to receive updated versions of Sterling Software's products when and if they become available, as well as "bug fixing" and Internet and telephone access to Sterling Software's technical personnel. In 1999, 1998 and 1997, product support revenue accounted for 26%, 26% and 27%, respectively, of the Company's total revenue.

Services

Services provided by Sterling Software primarily consist of specialized IT services in support of federal government contracts provided through the Company's federal systems business. In addition, Sterling Software provides training and education in support of its software products in the form of customer training seminars, videos and instruction materials. Sterling Software also offers product-specific consulting, implementation and education services within its application management business to better enable customers to successfully use its products. In 1999, 1998 and 1997, services revenue accounted for 29%, 34% and 32%, respectively, of the Company's total revenue.

Product Development

Each domestic division within Sterling Software's systems management, application management, and federal systems businesses has its own product development function. Sterling Software's product development programs in each of these businesses include the enhancement of existing products and introduction of new products based upon current and anticipated customer needs. The Company believes that its decentralized organizational structure facilitates development cost control and focuses the development function on the customers' needs. Approximately 500 of Sterling Software's employees were engaged in product development as of September 30, 1999. Gross product development costs in 1999, 1998 and 1997 were $70,883,000, $63,118,000 and $51,370,000, respectively, of which the Company capitalized $31,311,000, $26,956,000 and $21,711,000, respectively, as the cost of developing and testing new or significantly enhanced software products. Gross product development costs were 11% of non-federal systems revenue in 1999, 1998 and 1997.

The Company believes that all of its currently offered products are year 2000 compliant. Each of the Company's product divisions has completed a year 2000 assessment of its currently offered products. This assessment included internal testing of the year 2000 capabilities of these products. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations—Year 2000 Issues".

Sales and Marketing

Consistent with its decentralized operating structure, Sterling Software conducts its sales and marketing activities in multiple software divisions focused on specific product markets. Sterling Software sells its products and services through a combination of direct sales and telesales organizations, and in certain foreign countries, through independent agents and distributors. Each domestic division within the systems management and application management businesses has its own U.S. sales and marketing organization. In addition, the systems management and application management businesses have divisions and business units that focus specifically on the international marketplace for their respective product lines. The federal systems business has its own sales organization, which focuses specifically on specialized IT service offerings to the federal IT market. Approximately 780 of Sterling Software's employees were engaged in sales as of September 30, 1999.

Customers

Sterling Software provides software and services to companies engaged in a wide range of industries around the world, including banking, insurance, manufacturing, telecommunications and many others, as well as to various governmental entities located in the U.S. and abroad. The Company's customers include 90 of the 100 largest U.S. industrial and service corporations, as ranked by 1998 revenues in *Fortune* magazine. In the year ended September 30, 1999, agencies, branches and departments of the U.S. government accounted for approximately 21% of the Company's total revenue.

Competition

The computer software and services industry is rapidly evolving and highly competitive. Sterling Software competes with both large companies with substantially greater resources and small specialized companies that compete in a particular geographic region or market niche. Sterling Software also competes with internal programming staffs of corporations and with hardware manufacturers. Continuing consolidation among providers of specialized IT services to the federal government is increasing the size and market presence of many of the Company's competitors in this market segment.

Sterling Software believes that its products will continue to be selected by customers due to superior product functionality, reliability and technical support, ease of product installation and use, close integration between the products and customer business applications and, finally, the Company's history of success and reputation for providing quality products.

Employees

Sterling Software's business is dependent upon its ability to attract and retain qualified personnel, who are in limited supply. The Company's operations could be adversely affected if it were to lose the services of a significant number of qualified employees or if it were unable to obtain additional qualified employees when needed. The market for highly qualified personnel in the IT industry is extremely competitive, making it difficult for companies in this industry, including Sterling Software, to attract and retain qualified employees. The Company strives to maintain excellent employee relations, attractive office facilities and challenging work environments, and offers competitive compensation and benefits packages.

At September 30, 1999, the Company employed approximately 3,700 people.

Intellectual Property

Sterling Software's success depends in part on its technology and intellectual property. The Company relies primarily on a combination of copyright, patent and trademark laws, confidentiality procedures and contractual provisions to protect its intellectual property. The Company routinely enters into nondisclosure and confidentiality agreements with employees, contractors, consultants, vendors and customers, and its product license agreements generally prohibit the unauthorized use or disclosure of the Company's proprietary intellectual property. Despite the Company's efforts to protect its proprietary rights, unauthorized parties may attempt to copy aspects of the Company's products or to obtain and use information that the Company regards as proprietary. In addition, the laws of some foreign countries do not protect the Company's proprietary rights to the same extent as the laws of the United States. In general, however, management believes that the competitive position of the Company depends primarily on the skill, knowledge, creativity and experience of Sterling Software's personnel and their ability to develop, market and support software products, and that its business is not materially dependent on copyright protection, trademarks or patents.

The Company does not believe that any of its products infringe in any material respect on the valid proprietary rights of third parties. However, a large number of patents, trademarks and copyrights have been, and are being, issued, registered or asserted in the software industry and there can be no assurance that the Company is aware of all intellectual property rights that may pose a risk of infringement by the Company's products, especially with respect to United States patents, which can cover extremely broad concepts and the applications for which are confidential until the patents are issued.

Licenses for a number of software products have been granted to the Company for its own use or for remarketing to its customers. In the aggregate, these licenses are significant to the business of the Company, but the Company believes that the loss of any one of these licenses would not materially affect the Company's business, financial condition or results of operations.

The SOLVE, SAMS, VM, EUREKA, VISION and COOL families of product names and the mark ''Sterling Software'' used herein are registered or unregistered trademarks owned by the Company.

Backlog

Sterling Software's backlog relates principally to the uncompleted portion of multi-year professional services contracts with agencies of the federal government, including renewal options with government agencies, a portion of which is restricted by law to a term ending on the last day of the government agencies' then-current fiscal year.

Determination of the Company's backlog involves estimation, particularly with respect to customer requirements contracts and multi-year contracts of a cost-reimbursement or incentive nature. A large portion of the Company's federal government contracts are funded for one year or less and are subject to contract award, extension or expiration at different times during the year, and all of the Company's federal government contracts are subject to termination by the government on short notice. Based upon past experience, the Company believes that the contract renewal options included in existing contracts will be exercised for the full period designated in such contracts, but no assurance can be given that such contracts will be renewed.

Total backlog, including federal government contract renewal options not yet exercised and multi-year product support contracts at September 30, 1999 and 1998, was $274,107,000 and $254,123,000, respectively. For both 1999 and 1998, 96% of these amounts related to federal government sources, primarily in the Company's federal systems business. The dollar value of federal government renewal options not yet exercised or funded included in the Company's total backlog at September 30, 1999 and 1998, was $138,899,000 and $159,421,000, respectively. Approximately $103,715,000 of the September 30, 1999 backlog is expected to be realized in the year ending September 30, 2000.

Executive Officers

The following information regarding the executive and other officers of Sterling Software is as of November 9, 1999.

Name	Age	Position
Sam Wyly	65	Chairman of the Board and Director
Charles J. Wyly, Jr.	66	Vice Chairman of the Board and Director
Sterling L. Williams	56	President, Chief Executive Officer and Director
Geno P. Tolari	56	Executive Vice President and Chief Operating Officer
F.L. ''Mike'' Harvey	61	Senior Vice President and Group President
Don J. McDermett, Jr.	41	Senior Vice President, General Counsel and Secretary
B. Carole Morton	53	Senior Vice President and Group President
Mark A. Theel	42	Senior Vice President and Group President
R. Logan Wray	40	Senior Vice President and Chief Financial Officer
Christopher C. Bruton *	41	Vice President, Business Development
Pamela L. Isbell *	40	Vice President, Financial Planning
Julie G. Kupp *	36	Vice President, Investor Relations
Paul M. Baker *	39	Controller
Susan D. Tiholiz *	51	Treasurer

* Although Christopher C. Bruton, Pamela L. Isbell, Julie G. Kupp, Paul M. Baker and Susan D. Tiholiz are officers of the Company, the Company does not consider such employees to be ''executive officers'' of the Company, as that term is defined in regulations promulgated by the Securities and Exchange Commission.

Sam Wyly has served as Chairman of the Board since co-founding the Company in 1981. He also serves as Chairman of the Executive and the 1996 and 1999 Stock Option Committees of the Board. Companies founded by Mr. Wyly were among the forerunners of the computer software and electronic commerce industries and the Internet. In 1963, he founded University Computing Company, which became one of the largest computer service and software companies. His data transmission company, Datran, Inc., was one of the pioneering telecommunications ventures that broke up the telephone monopoly. Sterling Commerce, Inc. (a provider of electronic commerce software and network services), a leader in this industry, was spun off to the Company's stockholders in 1996 and Mr. Wyly serves as Chairman of its Executive Committee. Mr. Wyly also serves as Chairman of Michaels Stores, Inc., a specialty retailer, Chairman of Scottish Annuity & Life Holdings, Ltd., a variable life insurance and reinsurance company, and Founding Partner of the General Partner of Maverick Capital, Ltd., an investment fund management company. Mr. Wyly is the father of Evan Wyly, also a director of the Company.

Charles J. Wyly, Jr. co-founded the Company in 1981 and since that time has served as a director of the Company, and as Vice Chairman since 1984. He served as an officer and director of University Computing Company, a computer software and services company, from 1964 to 1975, including President from 1969 to 1973. Mr. Wyly and his brother, Sam Wyly, founded Earth Resources Company, an oil refining and silver mining company, and Charles J. Wyly, Jr. served as its Chairman of the Board from 1968 to 1980. Mr. Wyly served as Vice Chairman of the Bonanza Steakhouse chain from 1967 to 1989. Mr. Wyly currently serves as Vice Chairman of Michaels Stores, Inc., as a director of Scottish Annuity & Life Holdings, Ltd. and as a director of Sterling Commerce, Inc. Mr. Wyly is a member of the Executive Committee and the 1996 and 1999 Stock Option Committees of the Board.

Sterling L. Williams co-founded the Company in 1981 and since that time has served as President, Chief Executive Officer and a director of the Company. Mr. Williams has served as Chairman of the Board and a director of Sterling Commerce, Inc. since December 1995. From December 1995 to October 1996, Mr. Williams also served as Chief Executive Officer of Sterling Commerce, Inc. Mr. Williams is a member of the Executive Committee and the 1996 and 1999 Stock Option Committees of the Board.

Geno P. Tolari has served as an Executive Vice President of Sterling Software since March 1990 and as Chief Operating Officer since April 1996. From November 1986 to March 1990, he served as a Senior Vice President of Sterling Software. Mr. Tolari served as President of the Systems Management Group from December 1994 to February 1997 and as President of the Federal Systems Group from October 1985 to December 1994.

F.L. "Mike" Harvey has served as a Senior Vice President of Sterling Software since June 1997 and as President of the Systems Management Group since October 1998. He served as President of the former Applications Management Group from October 1996 to October 1998. From March 1993 to June 1997, he served as President of Omega Consulting Group Inc., a software consulting company.

Don J. McDermett, Jr. has served as Senior Vice President and General Counsel of Sterling Software since May 1997 and as Secretary since October 1998. From July 1996 to May 1997, he served as Vice President, Legal of Sterling Software. Prior to that time Mr. McDermett was employed by Thompson & Knight, a Dallas-based law firm, having been a senior partner in that firm's corporate practice group since 1993.

B. Carole Morton has served as a Senior Vice President of Sterling Software since October 1996 and as President of Sterling Software's Business Intelligence Group (formerly the Information Management Group) since October 1998. She served as President of the Information Management Division from October 1995 to August 1999. From October 1996 to June 1997, she also served as President of the former Information Management Group. Ms. Morton served as President of Sterling Software's former Applications Engineering Division from December 1994 to October 1995 and President of the former Applications Management Division from July 1993 to November 1994.

Mark A. Theel has served as a Senior Vice President of Sterling Software since November 1998 and as President of Sterling Software's Application Development Group since October 1998. From January 1996 to August 1999, Mr. Theel was President of the former Application Development Division. From December 1994 to December 1995, Mr. Theel served as Vice President, Labs of the Application Development Division and from July 1993 to November 1994, he served as Vice President, Labs of the former Applications Management Division.

R. Logan Wray has served as Senior Vice President and Chief Financial Officer of the Company since May 1997. Prior to that time he was employed by Ernst & Young LLP, a national accounting firm, having been a partner in that firm since 1994.

Christopher C. Bruton has served as Vice President, Business Development of Sterling Software since July 1999. From June 1997 to June 1999, he served as Vice President, Finance and Administration, for the Systems Management Group. Prior to June 1997, Mr. Bruton served as Vice President, Finance and Administration, for the former Applications Management Group.

Pamela L. Isbell has served as Vice President, Financial Planning of Sterling Software since April 1996. From April 1988 to April 1996, Ms. Isbell served as a Financial Analyst of Sterling Software.

Julie G. Kupp has served as Vice President, Investor Relations of Sterling Software since April 1996. From September 1995 to April 1996, Ms. Kupp served as Director, Investor Relations and from April 1995 to September 1995, she served as Senior Financial Analyst of Sterling Software. From December 1993 to April 1995, Ms. Kupp served as Director of Accounting. Prior to December 1993, Ms. Kupp was employed by Ernst & Young LLP, most recently as Audit Senior Manager.

Paul M. Baker has served as Controller of Sterling Software since March 1999. From November 1998 to March 1999, he served as International Finance Director for the former Application Development Group. Mr. Baker served as Controller of the former Application International Division from July 1997 until November 1998. Prior to July 1997, he was employed by Ernst & Young, most recently as Senior Audit Manager.

Susan D. Tiholiz has served as Treasurer of the Company since November 1997. She served as Director of Treasury from June 1996 to November 1997 and as a consultant to the Company from December 1995 to June 1996. Prior to joining the Company, Ms. Tiholiz was employed by Atlantic Richfield Company (ARCO), a global energy company, serving in various capacities within finance, treasury and human resources.

Item 2. *Properties*.

With its principal executive office located in Dallas, Texas, the Company leases offices and facilities in or near more than 85 cities in the United States and worldwide. Headquarters offices for the Company's groups and divisions are located in the following cities: Bellevue, Nebraska; London, England; McLean, Virginia; Minneapolis, Minnesota; Paris, France; Plano, Texas; Rancho Cordova, California; Reston, Virginia; Sydney, Australia; and Woodland Hills, California. Other major United States and international facilities are located in Amsterdam, The Netherlands; Atlanta, Georgia; Brussels, Belgium; Cologne, Germany; Dusseldorf, Germany; Falls Church, Virginia; Herndon, Virginia; Madrid, Spain; Milan, Italy; Redwood Shores, California; Tokyo, Japan; and Wiesbaden, Germany.

Item 3. *Legal Proceedings*.

The Company is subject to various legal proceedings and claims that arise in the normal course of its business. While many of these matters involve inherent uncertainty, the Company's management believes that the amount of the liability, if any, ultimately incurred by Sterling Software with respect to any such existing proceedings and claims, net of applicable reserves and available insurance, will not materially affect the business, financial condition or results of operations of the Company. The foregoing statement concerning the belief of the

Company's management is a forward-looking statement within the meaning of the Private Securities Litigation Reform Act of 1995. Actual results could vary and are subject to a number of risks and uncertainties, including the risk of an adverse outcome in any given legal proceeding or claim and the risk of potentially increased litigation resulting from the so-called "Year 2000" issue. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations—Forward-Looking Information" and "—Year 2000 Issues".

Item 4. ***Submission of Matters to a Vote of Security Holders.***

The Company did not submit any matters to a vote of security holders during the fourth quarter of the fiscal year covered by this report.

PART II

Item 5. ***Market for Registrant's Common Equity and Related Stockholder Matters.***

The Company's common stock, par value $0.10 per share ("Common Stock"), is traded on the New York Stock Exchange under the symbol "SSW". The high and low sales prices (as adjusted for periods prior to April 6, 1998 to reflect a 2-for-1 stock split) for the Common Stock for the periods indicated are set forth below.

	Price Range	
	High	Low
Year Ended September 30, 1999:		
Quarter Ended:		
December 31, 1998	$30⅝	$22¼
March 31, 1999	$26⅝	$21¼
June 30, 1999	$26⅞	$18 9/16
September 30, 1999	$26⅞	$18⅛
Year Ended September 30, 1998:		
Quarter Ended:		
December 31, 1997	$20 27/32	$16¼
March 31, 1998	$28 13/16	$17¾
June 30, 1998	$30¼	$23 11/16
September 30, 1998	$32 13/16	$20⅛

At November 5, 1999, the Company had 995 holders of record of its Common Stock.

The Company did not pay any cash dividends on its Common Stock during the two years ended September 30, 1999 and does not expect to pay such dividends in the foreseeable future.

Item 6. ***Selected Financial Data.***

The following selected financial data should be read in conjunction with the consolidated financial statements of the Company included elsewhere herein. The Company's financial statements for periods prior to the acquisition of Synon Corporation (''Synon'') represent the combined financial statements of the previously separate entities. See Item 7. ''Management's Discussion and Analysis of Financial Condition and Results of Operations—Business Combinations, Reorganizations and Divestitures'' and Note 2 of Notes to Consolidated Financial Statements.

	Years Ended September 30				
	1999(1)	1998(2)	1997(3)	1996(4)	1995(5)
	(in thousands, except per share information)				
Operating data:					
Revenue	$807,004	$719,943	$ 569,202	$513,761	$467,093
Cost of sales	293,397	287,666	236,736	217,551	191,776
Product development and enhancement	39,572	36,162	29,659	26,402	32,644
Selling, general and administrative	289,056	264,450	231,185	206,648	181,482
Income from continuing operations before reorganization costs, purchased research and development, other income (expense) and income taxes	184,979	131,665	71,622	63,160	61,191
Reorganization costs	99,620	45,162	106,037		19,512
Purchased research and development	83,566		137,849		62,000
Income (loss) from continuing operations before income taxes	34,467	119,837	(134,556)	86,912	(17,705)
Income (loss) from continuing operations	(10,756)	76,044	(131,897)	62,117	(32,942)
Income from discontinued operations, net of taxes (4)				51,187	42,930
Gain on the initial public offering of subsidiary, net of taxes (4)				126,103	
Income (loss) applicable to common stockholders	(10,756)	76,044	(131,897)	239,407	9,843
Weighted average common shares outstanding	82,835	80,638	79,588	67,226	49,889
Per common share data:					
Income (loss) from continuing operations:					
Basic	$ (.13)	$ .94	$ (1.66)	$ .92	$ (.66)
Diluted	(.13)	.89	(1.66)	.86	(.66)
Net income (loss):					
Basic	(.13)	.94	(1.66)	3.56	.20
Diluted	(.13)	.89	(1.66)	3.26	.20

	September 30				
	1999(1)	1998(2)	1997(3)	1996(4)	1995(5)
	(in thousands)				
Balance sheet data:					
Working capital	$ 421,836	$ 673,301	$ 556,552	$ 730,107	$ 214,656
Total assets	1,230,031	1,188,988	1,100,278	1,130,579	689,082
Long-term debt					117,265
Other noncurrent liabilities	85,961	60,201	49,751	37,020	22,107
Stockholders' equity	811,732	861,558	757,491	887,336	354,636

(1) Results of operations for 1999 include $83,566,000 of purchased research and development costs charged to expense in accordance with the purchase method of accounting in connection with acquisitions completed by the Company in 1999 (the ''1999 Acquisitions''). Results of operations for 1999 also include reorganization costs of $99,620,000 primarily related to the 1999 Acquisitions, including costs associated with the realignment of the application development business within the application management business segment. See Item 7. ''Management's Discussion and Analysis of Financial Condition and Results of Operations—Business Combinations, Reorganizations and Divestitures'' and Note 2 of Notes to the Consolidated Financial Statements.

(2) Results of operations for 1998 include reorganization costs of $45,162,000 primarily related to the reorganization of the Company's operations in connection with the acquisition of Synon, and to a lesser extent, to the acquisition of Mystech Associates, Inc. (''Mystech''). See Item 7. ''Management's Discussion and Analysis of Financial Condition and Results of Operations—Business Combinations, Reorganizations and Divestitures '' and Note 2 of Notes to Consolidated Financial Statements.

(3) On June 30, 1997, Sterling Software completed the acquisition of substantially all of the assets used by the Software Division of Texas Instruments Incorporated (''TI Software'') for approximately $214,774,000. The acquisition was accounted for in accordance with the purchase method of accounting. Results of operations for 1997 include $137,849,000 of purchased research and development costs charged to expense in accordance with the purchase method of accounting. Results of operations for 1997 also include reorganization costs of $106,037,000 primarily related to the reorganization of the Company's operations in connection with the acquisition of TI Software, and to a lesser extent, the termination of the Company's international distributor arrangement with Sterling Commerce, Inc. (''Sterling Commerce''). See Item 7. ''Management's Discussion and Analysis of Financial Condition and Results of Operations—Business Combinations, Reorganizations and Divestitures'' and Note 2 of Notes to Consolidated Financial Statements.

(4) On March 13, 1996, Sterling Commerce, a former wholly owned subsidiary of Sterling Software, completed the initial public offering (the ''Offering'') of 13,800,000 shares of its common stock, par value $0.01 per share (''Commerce Stock''). Pursuant to the Offering, Sterling Software sold to the public 12,000,000 of its 73,200,000 shares of Commerce Stock and Sterling Commerce sold 1,800,000 previously unissued shares of Commerce Stock. The Offering resulted in net proceeds to Sterling Software of approximately $265,458,000 after deducting underwriting discounts and commissions and Sterling Software's pro rata share of Offering expenses. On September 30, 1996, Sterling Software completed the spin-off of Sterling Commerce with the pro rata distribution of its remaining 81.6% ownership in Sterling Commerce to Sterling Software's stockholders by means of a tax-free dividend. The distribution resulted in the reduction of Sterling Software's stockholders' equity in the amount of $113,549,000, representing the book value of net assets distributed. The results of operations of Sterling Commerce for 1995 and 1996 have been classified as discontinued operations. See Item 7. ''Management's Discussion and Analysis of Financial Condition and Results of Operations—Business Combinations, Reorganizations and Divestitures''.

(5) Results of operations for 1995 include $62,000,000 of purchased research and development costs charged to expense in accordance with the purchase method of accounting in connection with the merger of the Company with KnowledgeWare, Inc., as well as $19,512,000 of reorganization costs primarily related to the reorganization of the Company's operations in connection with that merger.

Item 7. ***Management's Discussion and Analysis of Financial Condition and Results of Operations.***

Business Combinations, Reorganizations and Divestitures

1999 Acquisitions

The acquisitions listed below were completed during 1999 and were accounted for in accordance with the purchase method of accounting. Accordingly, the results of operations of the acquired businesses are included in the Company's results of operations from the respective dates of the acquisitions.

- On October 26, 1998, Sterling Software acquired Cayenne Software, Inc. ("Cayenne"), a publicly held global supplier of analysis and design solutions for application and database development, in an $11,400,000 cash merger transaction.
- On April 15, 1999, Sterling Software acquired the distributed systems storage software business (the "Alexandria Business") of Spectra Logic Corporation in a cash asset acquisition transaction valued at approximately $33,000,000.
- On April 30, 1999, Sterling Software completed the acquisition of Interlink Computer Sciences, Inc. ("Interlink"), a publicly held global supplier of high-performance solutions for enterprise systems networking, in an all-cash transaction valued at approximately $63,907,000.
- On July 26, 1999, Sterling Software acquired CoreData, Inc. ("CoreData"), a privately held developer and supplier of backup software for remote and mobile PCs, in a cash merger transaction valued at approximately $14,015,000.
- On August 31, 1999, Sterling Software completed the acquisition of Information Advantage, Inc. ("Information Advantage"), a publicly held provider of web-based and enterprise business intelligence software, in an all-cash transaction valued at approximately $168,357,000.

The operations of Cayenne and Information Advantage have been included in the Company's operations as part of the Company's application management business segment since the date of acquisition. The operations of the Alexandria Business, CoreData and Interlink have been included in the Company's operations as part of the Company's systems management business segment since the date of acquisition.

The total cost of the 1999 Acquisitions was approximately $358,062,000, including direct costs related to the acquisitions of approximately $67,383,000, consisting of employee termination costs, transaction costs, costs associated with the elimination of duplicate facilities and other direct costs. The 1999 Acquisitions were funded from the Company's available cash balances. At September 30, 1999, the balance of the direct costs incurred in the 1999 Acquisitions that remained to be paid totaled $35,323,000, related primarily to employee severance and benefits and the elimination of duplicate facilities and leases.

Results of operations for 1999 include $83,566,000 of purchased research and development costs associated with the 1999 Acquisitions. Amounts attributed to purchased research and development were expensed at the date of acquisition as the Company determined that the purchased research and development had not reached technological feasibility based on the status of design and development activities that required further refinement and testing. The value of the purchased research and development attributable to each acquisition was determined by an independent valuation expert retained by the Company. The estimates used by the Company in valuing the purchased research and development were based upon assumptions regarding future events and circumstances the Company believes to be reasonable but that are inherently uncertain and unpredictable. The Company's assumptions may be incomplete or inaccurate, and no assurance can be given that unanticipated events and circumstances will not occur. Accordingly, actual results may vary from the assumed results. Any such variance may result in a material adverse effect on the results of operations of the Company.

The value of the purchased research and development attributable to each acquisition was determined by discounting the estimated projected net cash flows related to the applicable products for the next 10 years, including costs to complete the development of the technology and the future revenues to be earned upon release of the products. The rate utilized to discount the net cash flows to their present value, generally 20%, was based on the Company's weighted average cost of capital adjusted for the risks associated with the estimated growth, profitability and developmental and market risks of the acquired development projects. Projected net cash flows from such products are based on estimates of revenues and operating profits related to such products.

A summary description of the acquired in-process technology, the amount expensed and the estimated completion of the purchased research and development at the time of the relevant acquisition, expressed as a percentage of the total estimated completion effort, is set forth below:

Acquisition	Description of Purchased Research and Development	Amount Expensed	Estimated Percentage Completion at Acquisition
Cayenne	Technologies for integrating object-oriented technologies with component-based design and implementation	$ 9,623,000	80%
Alexandria Business	Technologies for data movement and backup capabilities to meet next generation, centralized, end-to-end storage management requirements for large, heterogeneous storage environments, and designed specifically to operate optimally in Storage Area Networks	$12,325,000	80%
Interlink	Technologies to provide access control facilities for OS/390 TCP/IP customers	$10,143,000	63% - 87%
CoreData	Technologies with the unique ability to use multiple devices for more efficient remote backup and restore	$ 4,431,000	40%
Information Advantage	Technologies allowing advanced profiling and search, increased report server capabilities and enhanced user interfaces for authoring reports and performing analysis of data	$47,044,000	62% - 90%

The Company is using the purchased research and development to create new products that are expected to become part of the product portfolios offered by the systems management and application management business segments. The Company expects that products developed from the purchased research and development generally will be released during fiscal year 2000. The development activities required to complete the purchased research and development technologies include additional coding, cross-platform porting and validation, quality assurance procedures and beta testing. The Company's management expects that the purchased research and development generally will be successfully developed into commercially viable products; however, there can be no assurance that commercial viability or timely release of these products will be achieved.

The Company planned to integrate technologies acquired in the Cayenne acquisition with core technologies of both its own and Cayenne's existing product offerings to produce a new product targeted at providing advanced object-oriented (OO) modeling technologies and tools for application design and implementation. But with increasing opportunities in the market for application development tools for e-business solutions – such as web-enablement of existing applications, and integration and extension of existing applications – combined with an increase in the estimated costs of integrating the acquired technologies with the Company's existing OO technologies, in September of 1999 the Company decided to discontinue development of the new, integrated product. Accordingly, the Company wrote off core technology and goodwill attributable to this product of approximately $7,800,000 in the fourth quarter of 1999.

See Note 2 of Notes to Consolidated Financial Statements.

1998 Acquisitions

The acquisitions listed below occurred in the fourth quarter of 1998 (the "1998 Acquisitions") and were both accounted for as poolings of interests:

- On July 9, 1998, Sterling Software acquired Mystech, a privately held federal information technology services contractor, in a stock-for-stock merger transaction (the "Mystech Merger"). As a result of the transaction, Sterling Software issued approximately 769,000 shares of its Common Stock in exchange for the previously outstanding shares of Mystech common stock and reserved approximately 174,000 shares of Common Stock for issuance upon exercise of assumed Mystech stock options. The Mystech Merger was valued at approximately $28,000,000 and the Mystech organization was added to the Company's federal systems business segment. The impact of the pooling of interests accounting on the Company's historical financial statements was not material; therefore, the Company's financial statements for periods prior to the Mystech Merger were not restated for this transaction.
- On July 31, 1998, Sterling Software acquired Synon, a privately held provider of application development software and services, in a stock-for-stock merger transaction (the "Synon Merger") valued at approximately $79,000,000. As a result of the transaction, Sterling Software issued approximately 2,603,000 shares of Common Stock in exchange for the previously outstanding shares of Synon capital stock and reserved approximately 375,000 shares of Common Stock for issuance upon exercise of assumed Synon stock options. The Company's financial statements for periods prior to the Synon Merger, including the results of the application management business segment, were restated to represent the combined financial statements of the previously separate entities.

1997 Acquisition of TI Software

On June 30, 1997, Sterling Software completed the acquisition (the "TI Software Acquisition") of certain assets (including the capital stock of certain foreign subsidiaries) of Texas Instruments Incorporated ("Texas Instruments"). Such assets constituted substantially all of the assets used by TI Software in its business of developing, marketing and supporting application development software and providing related consulting services. The results of operations of TI Software are included in the Company's results of operations, as part of the Company's application management business segment, from the date of the TI Software Acquisition.

The cash purchase price paid for such assets was $165,000,000. The total cost of the TI Software Acquisition was approximately $214,774,000, including costs directly related to the TI Software Acquisition of approximately $49,774,000, consisting of employee termination costs, transaction costs, costs associated with the elimination of duplicate facilities and other direct costs. At September 30, 1999, substantially all of the direct costs incurred in the TI Software Acquisition had been paid.

Results of operations for 1997 include $137,849,000 of purchased research and development costs, which is the portion of the purchase price attributed to in-process research and development, and which was charged to expense in accordance with the purchase method of accounting. At the acquisition date, TI Software was developing several new products for component-based development. These development activities resulted in the Company's release of three products. The first product, released in early 1998, has become the primary component-based application development product, and largest single revenue source, for the Company's application management business segment. A second product, for component architecture modeling and interface-based design for component specifications, was also released in 1998 and has been successfully marketed. A third product was released for limited availability in 1999 and is a development environment that incorporates advanced component modeling and generation capabilities.

Reorganization Costs

The Company's results of operations for the year ended September 30, 1999 include reorganization costs of $99,620,000 primarily related to the 1999 Acquisitions, including costs associated with the realignment of the application development business within the application management business segment.

The Company's results of operations for the year ended September 30, 1998 include reorganization costs of $45,162,000 primarily related to the reorganization of the Company's operations in the fourth quarter of 1998 in connection with the Synon Merger, and to a lesser extent, the Mystech Merger.

The Company's results of operations for the year ended September 30, 1997 include reorganization costs of $106,037,000 primarily related to the reorganization of the Company's operations in the third quarter of 1997 in connection with the TI Software Acquisition, and to a lesser extent, the termination of the Company's international distributor arrangement with Sterling Commerce, formerly a wholly owned subsidiary of the Company. These reorganization costs also include the write-down of certain excess cost over net assets acquired related to the Company's federal systems business.

The components of the above reorganization costs were as follows (in thousands):

	1999	1998	1997
Employee termination costs	$29,904	$17,342	$ 18,539
Elimination of duplicate facilities, equipment and other assets	25,872	8,295	19,993
Write-down of software products that will no longer be actively marketed	30,862	6,397	17,591
Write-down of excess cost over net assets acquired	996		38,955
Out of pocket costs related to the reorganization(s)	9,794	9,535	5,109
Other costs	2,192	3,593	5,850
	$99,620	$45,162	$106,037
Reorganization costs requiring cash outlays	$57,464	$35,610	$ 42,311
Remaining balance to be paid at September 30, 1999	$40,686	$ 7,488	$ 5,245

The remaining balances to be paid consist primarily of commitments under lease arrangements for office space and equipment for the 1997 and 1998 reorganizations, and employee termination costs and benefits, and commitments under lease arrangements for office space and equipment for the 1999 reorganizations.

The Company periodically reviews the estimates of remaining costs to be paid relating to reorganizations. This periodic review has not resulted in any significant change to aggregate existing accruals, and the Company does not expect to incur costs related to the above-described reorganizations in excess of the amounts previously charged to operations.

Termination of International Distributor Arrangement

Effective as of June 30, 1997, Sterling Software and Sterling Commerce completed an agreement terminating an international distributor arrangement under which Sterling Software acted as the exclusive distributor of Sterling Commerce's interchange and communications software products in markets outside the United States and Canada. The results of the Company's international operations related to selling, marketing and providing first level support for these products through June 30, 1997 are included in the business segment information presented herein under "Corporate and other."

Results of Operations

1999 Compared to 1998

Total revenue increased $87,061,000, or 12%, in 1999 over 1998 due to a 26% increase in products revenue and a 14% increase in product support revenue, partially offset by a 6% decline in services revenue. Because the Synon Merger was accounted for as a pooling of interests, the Company's results of operations in 1998 and prior years, including the results of the application management business segment, were restated to include the results of operations of the previously separate entities. Without the effect of the Synon restatement, total revenue would have increased 23% in 1999 over 1998.

The increase in products and product support revenue is due to increased products and product support revenue in both the systems management and application management business segments. The decline in services revenue is due to a decline in services revenue in the application management business segment partially offset by an increase in services revenue in the federal systems business segment. The decline in the application management business segment resulted from the execution of a new consulting services strategy in that business segment following the July 1998 Synon Merger. The Company reduced its services headcount substantially to effect the new strategy, which included directing customers to third-party service providers to perform many of the consulting services previously performed directly by the Company and Synon. The new strategy enabled the Company to focus its efforts primarily on project management and mentoring services, and the Company believes that the execution of this strategy has also enabled it to enhance its relationships with third party service providers—namely systems integrators and independent software vendors, who are also buyers of its application development tools. Without the effect of the Synon restatement, total services revenue would have increased 6% in 1999 over 1998.

Revenue from the systems management business segment increased $85,597,000, or 42%, in 1999 over 1998, primarily due to a 54% increase in products revenue and a 15% increase in product support revenue. The increase in products revenue was mainly attributable to strong internal growth as well as revenue added as a result of the Company's acquisitions of the Alexandria Business and Interlink. Domestic storage management products revenue grew substantially, and both the storage management and network management product lines produced strong worldwide product growth, while worldwide VM products revenue remained flat compared with the prior year. Approximately 44% of the systems management business segment's total revenue in 1999 was derived from the Company's international operations, compared to 47% in 1998.

Revenue from the application management business segment declined $8,168,000, or 2%, in 1999 over 1998 due to a 28% decline in services revenue, partially offset by a 3% increase in products revenue and a 13% increase in product support revenue. Without the effect of the Synon restatement, total application management revenue would have increased 18% in 1999 over 1998 with 16%, 34% and 1% increases in products, product support and services revenue, respectively. The increase in products revenue was due to growth in products revenue from the application development products. The increase was offset by a small decline in products revenue from the Company's historical business intelligence products due to extraordinary product revenue performance in this product line in the fourth quarter of 1998. The increase in product support revenue was due to growth in both the application development and business intelligence product lines. As noted above, the reported decline in services revenue is due to the execution of the Company's new consulting services strategy following the July 1998 Synon Merger. Although the application development business is now also working closely with its customers and partners to deliver a complete e-business solution—with particular focus on project support services, such as project management and mentoring—these services are not expected to substantially change the revenue mix in the application management business segment next year. Approximately 48% of the application management business segment's total revenue in 1999 was derived from the Company's international operations, compared to 50% in 1998.

Revenue from the federal systems business segment increased $10,260,000, or 7%, in 1999 over 1998 primarily due to higher contract billings in the segment's defense business as well as revenue added as a result of the Mystech Merger.

Total revenue generated from the Company's international operations was $299,530,000 and $277,428,000 in 1999 and 1998, respectively, representing an increase of $22,102,000, or 8%. This was due to a 32% year over year increase in international revenue generated by the systems management business segment, partially offset by a 5% year over year decline in international revenue generated by the application management business segment. Revenue from the Company's international operations represented 37% of total revenue for 1999 compared to 39% in 1998. Without the effect of the Synon restatement, revenue from the Company's international operations would have increased 22% year over year.

The Company's recurring revenue includes revenue from product support agreements generally having terms ranging from one to three years and federal contracts generally having terms ranging from one to five years. Like most federal contracts, Sterling Software's federal contracts permit termination by the government for convenience or for failure to obtain funding. Recurring revenue was 45% of total revenue in 1999 compared to 46% in 1998.

Total costs and expenses increased $171,771,000, or 27%, in 1999 over 1998. However, excluding the 1999 reorganization costs and purchased research and development costs of $99,620,000 and $83,566,000, respectively, and reorganization costs of $45,162,000 related to the 1998 Acquisitions, total costs and expenses increased $33,747,000, or 6%. An increase in total costs in the systems management and federal systems business segments of 38% and 6%, respectively, was partially offset by a 7% decline in total costs in the application management business segment. The increase in total costs in the systems management and federal systems business segments resulted from the higher revenues generated by these segments, although the cost increases were not as great as the revenue growth generated in these segments. The decrease in total costs in the application management business segment is primarily a result of the Company's lower cost structure in that business segment, compared to the cost structure of the former Synon operation.

Total cost of sales increased $5,731,000, or 2%, in 1999 over 1998, and represented 36% and 40% of total revenue in 1999 and 1998, respectively. Cost of sales for products and product support represented 15% of products and product support revenue in both 1999 and 1998. Cost of sales for services represented 89% of services revenue in 1999 compared to 87% in 1998. Improved services margins in the federal systems business segment were offset by lower services margins in the application management business segment domestically due to lower utilization rates.

Product development expense for 1999 was $39,572,000, net of $31,311,000 of capitalized software development costs, as compared to 1998 product development expense of $36,162,000, net of $26,956,000 of capitalized software development costs. Gross product development expense, before capitalization of software, was 11% of non-federal systems revenue in both 1999 and 1998. In 1999, the Company capitalized $31,311,000 of development costs, a 44% capitalization rate, and amortized $26,705,000 of software. This compares to $26,956,000 of capitalized development costs, or a 43% capitalization rate, and $20,791,000 of software amortization in 1998. The increase in both total and capitalized software development costs in 1999 over 1998 is attributable to an increase in product development efforts that were in process both in the application management and system management business segments. Product development expenses and the capitalization rate historically have fluctuated, and may in the future continue to fluctuate from period to period depending in part upon the number and status of software development projects that are in process.

Selling, general and administrative expenses increased $24,606,000, or 9%, in 1999 compared to 1998, and represented 36% and 37% of total revenue in 1999 and 1998, respectively. Lower selling, general and administrative expenses as a percent of revenue are due to the Company's lower cost structure in the application management business segment. The systems management business segment experienced an increase in selling, general and administrative expenses consistent with the revenue growth generated in that segment.

Investment income decreased $2,518,000 in 1999 compared to 1998, as a result of lower average cash and cash equivalents balances, primarily due to the use of cash in connection with the 1999 Acquisitions.

Income from continuing operations before income taxes in 1999 was $34,467,000 compared to $119,837,000 for 1998. However, excluding the 1999 reorganization costs and purchased research and development costs of $99,620,000 and $83,566,000, respectively, and reorganization costs of $45,162,000 related to the 1998 Acquisitions, income before income taxes was $217,653,000 in 1999, representing an increase of $52,654,000, or 32%, primarily due to higher profits in all three of the Company's business segments, partially offset by a decline in investment income.

The Company's effective tax rate for 1999 was 131% compared to 37% for 1998. The effective tax rate for 1999 was adversely impacted by one-time reorganization costs and purchased research and development costs totaling $183,186,000. The Company's effective tax rate for 1998 was adversely impacted by unbenefited losses incurred by Synon prior to the Synon Merger.

1998 Compared to 1997

Total revenue increased $150,741,000, or 26%, in 1998 over 1997 due to revenue increases in all three of the Company's business segments, partially offset by a decline in corporate and other revenue due to the termination of an international distributor arrangement with Sterling Commerce in the third quarter of 1997. Revenue from the application management, systems management and federal systems business segments increased 64%, 11% and 22%, respectively, in 1998 over 1997. During 1998 both the application management business segment and the federal systems business segment benefited substantially from the domestic and international operations acquired by Sterling Software in the 1997 acquisition of TI Software.

Revenue from the application management business segment increased $142,847,000, or 64%, in 1998 over 1997 due to a 72% increase in products revenue, a 58% increase in product support revenue and a 61% increase in services revenue. The significant increase in revenue from the application management business segment is primarily attributable to revenue from the application development products and services acquired in the 1997 acquisition of TI Software. Approximately 50% of the application management business segment's total revenue in 1998 was derived from the Company's international operations, compared to 40% in 1997.

Revenue from the systems management business segment increased $19,850,000, or 11%, in 1998 over 1997 primarily due to a 17% increase in products revenue partially offset by a 1% decline in product support revenue due in part to the adverse impact of foreign currency exchange rate fluctuations as a result of a stronger U.S. dollar. The increase in products revenue was mainly attributable to strong domestic product sales across all systems management product lines and strong international product sales in the network management product line. Approximately 47% of the systems management business segment's total revenue in 1998 was derived from the Company's international operations, compared to 49% in 1997.

Revenue from the federal systems business segment increased $26,983,000, or 22%, in 1998 over 1997 due primarily to a contract added to the Company's federal systems business segment as a result of the 1997 acquisition of TI Software, revenue added as a result of the Mystech Merger in the fourth quarter of 1998 and, to a lesser extent, to higher contract billings.

Total revenue generated from the Company's international operations was $277,428,000 and $217,347,000 in 1998 and 1997, respectively, representing an increase of $60,081,000, or 28%. This was due to a 102% year over year increase in international revenue generated by the application management business segment and a 6% year over year increase in international revenue generated by the systems management business segment. The overall increase in international revenue was partially offset by a decline in revenue from sales of Sterling Commerce's software products due to the termination of an international distributor arrangement in the third quarter of 1997. In addition, international operating results in 1998 were adversely impacted by foreign currency exchange rate fluctuations as a result of a stronger U.S. dollar. Had foreign currency exchange rates remained consistent with the previous year, international revenue for 1998 would have been approximately $15,000,000 greater. Revenue from the Company's international operations represented 39% of total revenue in 1998 compared to 38% of total revenue in 1997.

The Company's recurring revenue includes revenue from product support agreements generally having terms ranging from one to three years and federal contracts generally having terms ranging from one to five years. Like most federal contracts, Sterling Software's federal contracts permit termination by the government for convenience or for failure to obtain funding. Recurring revenue decreased to 46% of total revenue in 1998 compared to 48% in 1997, primarily due to the significant increase in products and services revenue from the application management business segment. Overall, services revenue increased from 32% of total revenue in 1997 to 34% of total revenue in 1998. This increase resulted primarily from generally higher levels of consulting services associated with product sales in the application management segment.

Total costs and expenses decreased $108,026,000, or 15%, in 1998 compared to 1997. Excluding the reorganization costs of $45,162,000 related to the Synon Merger and the Mystech Merger in 1998 and reorganization costs of $106,037,000 and the write-off of purchased research and development costs of $137,849,000 related to the 1997 acquisition of TI Software, total costs and expenses increased $90,698,000, or 18%, in 1998 compared to 1997.

Total cost of sales increased $50,930,000, or 22%, in 1998 compared to 1997 and represented 40% and 42% of total revenue in 1998 and 1997, respectively. Cost of sales for products and product support decreased $8,220,000, or 10%, in 1998 compared to 1997 and represented 15% and 21% of products and product support revenue in 1998 and 1997, respectively. The decrease in cost of sales for products and product support is primarily attributable to the decrease in royalties payable to Sterling Commerce due to the termination of an international distributor arrangement, as well as a decrease in royalties payable to other third parties related to products no longer marketed by the Company. Cost of sales for services increased $59,150,000, or 38%, in 1998 compared to 1997 and represented 87% and 85% of services revenue in 1998 and 1997, respectively. The increase in cost of sales for services is primarily attributable to the increase in services revenue from the application management business segment.

Product development expense for 1998 was $36,162,000, net of $26,956,000 of capitalized software development costs, as compared to 1997 product development expense of $29,659,000, net of $21,711,000 of capitalized software development costs. Gross product development expense was 11% of non-federal systems revenue in both 1998 and 1997. In 1998, the Company capitalized $26,956,000 of development costs, a 43% capitalization rate, and amortized $20,791,000 of software. This compares to $21,711,000 of capitalized development costs, or a 42% capitalization rate, and $18,282,000 of software amortization in 1997. The increase in both total and capitalized software development costs in 1998 over 1997 is attributable to an increase in product development efforts that were in process. Product development expenses and the capitalization rate historically have fluctuated, and may in the future continue to fluctuate, from period to period depending in part upon the number and status of software development projects that are in process.

Selling, general and administrative expenses increased $33,265,000, or 14%, in 1998 compared to 1997 and represented 37% and 41% of total revenue in 1998 and 1997, respectively. The decrease in selling, general and administrative expenses as a percentage of total revenue is primarily attributable to the cost structure implemented by the Company in connection with the TI Software Acquisition and related reorganization in the third quarter of 1997 and cost savings resulting from the termination of the Company's international distributor arrangement with Sterling Commerce.

Investment income decreased $4,819,000 in 1998 compared to 1997 as a result of lower average cash and cash equivalents balances primarily due to the use of cash in connection with the TI Software Acquisition and the related reorganization in the third quarter of 1997.

Income before income taxes in 1998 was $119,837,000, compared to a loss before income taxes of $134,556,000 for 1997. However, excluding the reorganization costs of $45,162,000 related to the Synon Merger and Mystech Merger in the fourth quarter of 1998 and the reorganization costs of $106,037,000 and the write-off of purchased research and development costs of $137,849,000 related to the TI Software Acquisition in the third quarter of 1997, income before taxes increased $55,669,000, or 51%, primarily due to higher profits in the application management and systems management business segments partially offset by a decline in investment income.

The Company's effective tax rate for 1998 was 37% compared to an effective tax rate for 1997 of 2%. The 1998 effective tax rate was adversely impacted by unbenefitted losses incurred by Synon in 1998 prior to the Synon Merger. The 1997 effective tax rate benefit of 2% varies from the U.S. statutory rate due primarily to the write-down of excess cost over net assets acquired recorded in connection with previous acquisitions and the effect of non-U.S. tax rates.

Liquidity and Capital Resources

The Company maintained a strong liquidity and financial position with $421,836,000 of working capital at September 30, 1999, which includes $318,748,000 of cash and cash equivalents and $112,285,000 of marketable securities. Net cash provided by operating activities was $82,938,000 in 1999 compared to $101,685,000 in 1998. Net cash provided by operating activities in 1999 was reduced by payments of approximately $74,003,000 directly related to the 1999 Acquisitions and reorganizations. Net cash provided by operating activities in 1998 was reduced by payments made during the period of approximately $41,585,000 directly related to the Synon Merger, Mystech Merger and the TI Software Acquisition and the related reorganizations. Net cash provided by operating activities was $128,611,000 in 1997. Net cash provided by operating activities in 1997 was reduced by payments of approximately $40,539,000 directly related to the TI Software acquisition and the related reorganization that occurred in the third quarter of 1997. Operating cash flows in 1997 were negatively impacted by royalty and certain other payments of approximately $32,000,000 made to Sterling Commerce during that year.

Investing activities used $118,566,000 of cash in 1999 compared to $162,381,000 in 1998 and $216,222,000 in 1997. Net cash used in investing activities in 1999 included $265,787,000 of payments, net of cash acquired, related to acquisitions completed during 1999. Net cash used in investing activities in 1997 included the $165,000,000 payment to Texas Instruments on June 30, 1997 in connection with the TI Software Acquisition. Capital expenditures for 1999 were $29,554,000 compared to $33,200,000 for 1998 and $29,003,000 in 1997. Purchases and capitalized costs of computer software were $31,495,000, $27,854,000 and $21,860,000 for 1999, 1998 and 1997, respectively. Cash provided by operating activities, together with other available cash, was used to fund capital expenditures and additions to computer software.

Financing activities used $40,916,000 of cash in 1999 compared to $20,881,000 net cash provided by financing activities in 1998 and $281,000 net cash provided by financing activities in 1997. Sterling Software received proceeds of approximately $19,691,000, $17,895,000 and $1,460,000 from the exercise of employee stock options in 1999, 1998 and 1997, respectively. Also, the Company received proceeds of $12,750,000 and $5,586,000 from the issuance of Common Stock pursuant to the Company's employee stock purchase plan in 1999 and 1998, respectively.

On September 3, 1999, the Company announced a share repurchase program authorizing the repurchase of up to 5,000,000 shares of Common Stock from time to time. From September 3, 1999 to September 30, 1999 approximately 3,457,000 shares of Common Stock were repurchased under this program for an aggregate purchase price of approximately $72,413,000.

The Company is party to a bank credit agreement (the ''Credit Agreement'') that provides for unsecured revolving credit loans of up to $35,000,000. Borrowings under the Credit Agreement, which expires on June 30, 2000, bear interest at the lower of the lender's base rate or a Eurodollar lending rate plus one-half percent. No amounts were borrowed under the Credit Agreement during 1999 or 1998. At September 30, 1999, after giving effect to outstanding standby letters of credit in the aggregate amount of $3,868,000, approximately $31,132,000 was available for borrowing under the Credit Agreement.

At September 30, 1999, the Company's short and long-term cash commitments, including remaining costs related to the 1999 Acquisitions, the Synon Merger, the Mystech Merger, the TI Software Acquisition and the related reorganizations, consisted primarily of commitments under lease arrangements for office space and equipment, as well as commitments with respect to employee severance obligations that arose in connection with the Information Advantage acquisition and the realignment of the application development business within the application management business segment. The Company intends to meet such obligations primarily from cash provided by operating activities.

The Company believes available cash balances, cash equivalents and short-term investments combined with cash provided by operating activities and amounts available under existing credit agreements, are sufficient to meet the Company's cash requirements for the foreseeable future.

The Company maintains a strategy of seeking to acquire businesses and products to fill strategic market niches. This acquisition strategy has contributed significantly to the Company's growth in revenue and operating profit before reorganization and purchased research and development costs. The impact of future acquisitions on continued growth in revenue and operating profit cannot presently be determined. The Company expects to finance future acquisitions, if any, through a combination of cash on hand and cash from operations and the possible issuance of equity or debt securities. See "Certain Risks and Uncertainties That Could Affect the Company and Future Operating Results—Growth Through Acquisitions" below.

Year 2000 Issues

The following discussion regarding year 2000 matters constitutes a "Year 2000 Readiness Disclosure" within the meaning of the Year 2000 Information and Readiness Disclosure Act.

Identification of the "Y2K Issue"

Like most companies in the IT industry, the Company has been and is continuing to address the impact of the so-called "year 2000" issue. This issue is the result of computer programs written using two digits rather than four to define calendar years. These programs may recognize a date using "00" as the year 1900 rather than the year 2000, potentially resulting in complete system failures or miscalculations causing significant disruption of normal business activities. The Company has been and is continuing to assess and resolve year 2000 issues associated with the Company's products, its material internal systems and its material third party relationships. These efforts have been under way for some time and should be completed well before December 31, 1999. The Company has established a web page (http://www.sterling.com/y2k/) to update customers on the Year 2000 status of its software products and to assist them in understanding the Company's Year 2000 strategy.

Compliance of the Company's Products

The Company believes that all of its currently offered products are year 2000 compliant. Each of the Company's product divisions has completed a year 2000 assessment of its currently offered products. This assessment included internal testing of the year 2000 capabilities of these products. The Company has not had its products tested by an independent third party. The Company believes that a small number of customers who receive product support from the Company may be operating product versions that may not be year 2000 compliant or products that the Company has replaced with comparable, year 2000 compliant products. The Company believes that the vast majority of such customers are migrating and will continue to migrate to compliant versions and products, which the Company is strongly encouraging. In addition, certain former customers may be operating non-compliant versions of products in respect of which the Company's agreed-upon product support and warranty periods have expired. The Company has not undertaken an assessment of whether these former customers are taking appropriate steps to address any related year 2000 issues.

The Company does not expect customers who purchase or migrate to year 2000 compliant versions of its products to experience any year 2000 failures caused by such products. In addition, the Company believes that its product licenses and other agreements contain customary and appropriate limitations on the Company's obligations with respect to any year 2000 failures that may be caused by its current or former products. However, there can be no assurance that the Company's expectations and beliefs as to these matters will prove to be accurate. Moreover, the Company's products are used in IT systems comprised of third-party hardware and software, some of which may not be year 2000 compliant. The failure of any component of these IT systems could involve the Company in potential litigation even if the Company's products did not cause or contribute to the failure. Various commentators have predicted that a significant amount of litigation may arise out of year 2000 compliance issues. While the Company has not been subject to any year 2000 claims or lawsuits to date, there can be no assurance that customers or former customers will not bring claims or lawsuits against the Company seeking compensation for losses associated with year 2000-related failures. While not anticipated, a material adverse outcome in a year 2000 claim or lawsuit—as is the case with any claim or lawsuit—could have a material adverse effect on the Company's business, financial condition and results of operations.

Compliance of the Company's Internal Systems

The Company has undertaken a project to inventory, assess and, where necessary, remediate its material internal systems. An inventory of the Company's material internal systems (including embedded systems) has been completed and the assessment of the Year 2000 compliance status of such systems is substantially complete. Due to its predominant use of relatively current "off-the-shelf" software and systems (as opposed to older legacy or custom designed systems), the Company expects that any needed remediation of its internal systems will require only minimal corrective measures, most of which have already been completed or are currently in process and expected to be completed before December 31, 1999. Moreover, as a result of the Company's decentralized operating structure, any non-compliant systems are somewhat limited in their effect and easier to correct. Consequently, the Company does not anticipate the internal and external costs of its remediation measures to be material.

Compliance of Third Party Suppliers

A year 2000 assessment of the Company's material third party supplier relationships is substantially complete. In most cases, the Company has been forced to rely on third party representations (made in formal communications with, and year 2000 information made publicly available by, such suppliers), without any ability to do independent testing or evaluation. Where possible, however, the Company has attempted to verify readiness through the testing of relevant equipment, systems and interfaces. While it is the Company's intention to obtain adequate readiness and remediation assurances from the relevant third parties promptly upon discovery of any readiness issues that are material to the Company, there can be no assurance that the Company will receive all information necessary to fully evaluate the year 2000 readiness of all material suppliers. Moreover, the Company relies in various ways, both domestically and internationally, on governments, utilities, communications service providers, financial institutions and other third parties to conduct normal business operations. There can be no assurance that suppliers and other third parties upon whom the Company is reliant will not suffer business interruptions caused by year 2000 issues. Such interruptions could have a material adverse effect on the Company's business, financial condition and results of operations.

Potential Impact on Customer Purchasing Patterns

Among other risks associated with the year 2000 issue, some commentators have predicted that it may affect historical purchasing patterns and trends in the software industry. For example, certain industry analysts believe that many customers and potential customers are heavily engaged in testing and correcting year 2000 problems in their systems, and therefore, may choose to defer system investments during calendar 1999 and early calendar 2000, negatively impacting the revenues of enterprise software vendors like the Company. Other analysts have indicated that many enterprises that have completed their year 2000 corrective measures intend to make no changes to their existing computing environments during the latter part of calendar 1999 and the early part of 2000, also resulting in the potential deferral of system investments. Conversely, greater demand for certain of the Company's products may have been generated by customers who have been replacing or upgrading computer systems to address the Year 2000 issue. As a result, demand for some of these products may diminish as the Year 2000 arrives. Because of the unprecedented nature of the year 2000 issue and the general uncertainty that surrounds it, there can be no assurance that it will not affect customer purchasing patterns, lengthen the Company's sales cycles or otherwise negatively affect demand for the Company's products.

Contingency Plans

As the turn of the century approaches, the Company is continuing to assess the need for, implement and refine contingency plans associated with the year 2000 issue. Among other things, the Company's product support and internal MIS organizations are developing and refining plans to ensure the ready availability of adequate customer and product support resources, and the Company's critical business systems, in late December of 1999 and early January of 2000. The Company intends to continue to evaluate both existing and newly identified year 2000 risks and to develop and implement such further responsive measures and contingency plans as it deems appropriate.

No Anticipated Material Financial Impact

The costs of the Company's year 2000-related compliance activities have been and are being budgeted and funded as necessary and have not had and are not expected to have a material impact on the Company's results of operations or financial condition. This expectation assumes that the Company will not be obligated to incur significant year 2000 related costs on behalf of its customers and suppliers, and that the Company's critical suppliers will be able to meet their commitments to the Company. The Company cannot predict, however, the effects on the Company of year 2000-related difficulties of its business partners, suppliers and customers.

No Assurance Concerning Year 2000 Readiness Efforts

Although the Company believes that its year 2000 readiness efforts are designed to appropriately identify and address those year 2000 issues that are within the Company's control, there can be no assurance that the Company's efforts will be fully effective or that year 2000 issues will not have a material adverse effect on the Company's business, financial condition or results of operations. The novelty and complexity of the issues presented and the Company's dependence on the preparedness of third parties are among the factors that could cause the Company's efforts to be less than fully effective. Moreover, year 2000 issues present many risks that are simply beyond the Company's control, such as the potential effects of year 2000 issues on the economy in general and on the Company's business partners and customers in particular.

Certain Risks and Uncertainties That Could Affect the Company and Future Operating Results

Sterling Software and its businesses are subject to a number of risks, including those enumerated below. Any or all of such risks could have a material adverse effect on the business, financial condition and results of operations of the Company and on the market price for the Company's Common Stock. See also ''Forward-Looking Information'' below.

Market Risks; Factors Affecting Quarterly Financial Results

The market price of Sterling Software's Common Stock is subject to fluctuation, and there can be no assurance that the price of the Common Stock will not decline from time to time. Factors such as actual or anticipated fluctuations in quarterly financial results, changes in earnings estimates by securities analysts and announcements of material events by Sterling Software, its major customers or its competitors, as well as general industry or global or regional economic conditions, may cause the market price of the Common Stock to fluctuate, perhaps substantially. The Company's stock price is based in large part on current expectations of sustained future revenue and earnings growth rates. Any failure to meet anticipated revenue and earnings levels in a period or any negative change in perceived long-term growth prospects of the Company would likely have a significant adverse effect on the Company's stock price.

Fluctuations in Sterling Software's quarterly financial results could result from a variety of factors, including changes in the levels of revenue derived from sales of software products and services, market acceptance of new and enhanced versions of the products and services of Sterling Software or its competitors, the size and timing of significant orders, changes in operating expenses, changes in Sterling Software's strategy, the effect of acquisitions and general industry and global or regional economic factors. Sterling Software has limited or no control over many of these factors.

Timing and Size of License Contracts; Effect of Year 2000 Concerns

The Company's revenues and results of operations are difficult to predict and may fluctuate. The timing and amount of the Company's license revenues are subject to a number of factors that make estimation of operating results prior to the end of a quarter extremely uncertain. Except with respect to its federal systems business segment, the Company generally operates with little or no sales backlog and, as a result, license revenues in any quarter are dependent upon contracts entered into or orders booked and shipped in that quarter. Most of the

Company's sales are closed at the end of each quarter. There has been and continues to be a trend toward larger enterprise license transactions, which can have longer sales cycles and require approval by a customer's senior management. These transactions are typically difficult to manage and predict. Failure to close an expected individually significant transaction or multiple expected transactions could cause the Company's revenues and earnings in a period to fall short of expectations.

In addition, each customer's evaluation of its need to achieve Year 2000 compliance may affect its purchase decision. Many analysts believe that many customers and potential customers are heavily engaged in testing and correcting system Year 2000 problems and, therefore, such customers may choose to defer system investments during calendar 1999, negatively impacting the Company's revenues. In addition, the Company's sales cycles may lengthen in 1999 and future years due to lessened urgency of customers' system investment decisions. Because Year 2000 related impacts on customer purchasing decisions are unprecedented, the Company has a limited ability to forecast accurately the impact of the Year 2000 issue on its quarter-to-quarter revenues. See "Year 2000 Issues" above.

High Degree of Operating Leverage

The Company's business model is characterized by a high degree of operating leverage. A substantial portion of the Company's operating costs and expenses consist of employee and facility related costs, which are relatively fixed over the short term. In addition, the Company's expense levels and hiring plans are based substantially on the Company's projections of future revenue. If near term demand for the Company's products weakens in a given quarter, there would likely be a material adverse effect on operating results and a resultant drop in the Company's stock price.

Demand for Mainframe Processing Capacity

A portion of the Company's products and product support revenues depend upon customers' continuing need to use the Company's software products on greater mainframe processing capacity in future periods. If the processing capacity growth of these customers were to slow and/or if these customers were to perceive less relative benefit from the Company's current mainframe products, the Company's revenues could be adversely affected.

Competition

As noted above under Item 1. "Business—Competition", the computer software and services industry is rapidly evolving and highly competitive. Sterling Software generally expects competition to remain intense in the future from both existing competitors and other companies that may enter Sterling Software's markets. Sterling Software believes that its ability to compete successfully in its markets depends on numerous factors, including product performance, functionality and reliability, price and customer service and support. There can be no assurance that new or established competitors will not offer products and services that are superior to and/or lower in price than those of Sterling Software.

Technological Change; Dependence on New and Enhanced Products

The computer software and services industry is characterized by rapid technological change, frequent new product and service introductions and evolving industry standards. Sterling Software's future success will depend in significant part on its ability to anticipate industry standards, continue to apply advances in software product and service technologies, enhance existing software products and services and develop, introduce, acquire and support new software products and services in order to meet changing customer needs on a timely basis. There can be no assurance that Sterling Software will be successful in developing, acquiring or marketing new or enhanced products or services that respond to technological change or evolving industry standards, that Sterling Software will not experience difficulties that could delay or prevent the successful development, acquisition or marketing of such products or services or that its new or enhanced products and services will adequately meet the requirements of the marketplace or achieve market acceptance. If the Company fails to keep pace with technological change in its industry, such failure would have an adverse effect on its revenues and earnings.

Growth Through Acquisitions

Sterling Software's growth has been significantly enhanced through acquisitions of other businesses, products and technologies. If Sterling Software is unable to continue to make appropriate acquisitions on attractive terms, it may be more difficult for Sterling Software to achieve growth levels consistent with those historically achieved. There can be no assurance as to Sterling Software's ability to make attractive acquisitions, the timing thereof or the ultimate benefits therefrom to Sterling Software.

The integration of operations following any significant acquisition requires the dedication of management resources, and may be complicated by the necessity of integrating personnel with disparate business backgrounds and corporate cultures. In addition, the retention of key employees of any business acquired by Sterling Software may be critical to ensure continued advancement, development and support of the acquired business' technology, as well as on-going sales and marketing efforts. Consequently, there can be no assurance that Sterling Software's ability to increase or maintain revenue will not be diminished by management distractions, loss of personnel or other factors resulting from any significant acquisition.

Dependence on Key Personnel and Ability to Attract Qualified Personnel

Sterling Software's performance depends substantially on the performance of its executive officers and key employees. Sterling Software's business is also dependent upon its ability to attract and retain highly qualified managerial, technical and sales personnel. Competition for such personnel is intense. There can be no assurance that Sterling Software can retain its key managerial, technical and sales personnel or that it can attract, assimilate or retain such personnel in the future.

Risks Associated with International Operations and Euro Currency

Revenue from Sterling Software's international operations represented 37%, 39% and 38% of Sterling Software's fiscal 1999, 1998 and 1997 revenue, respectively. Sterling Software is currently incurring, and expects to continue to incur, significant costs in developing and marketing its products and services through its international operations. Sterling Software's ability to successfully maintain and expand its software products and related services business internationally will depend upon, among other things, its ability to attract and retain talented and qualified managerial, technical and sales personnel, as well as software product and related services customers outside the United States.

International operations are subject to certain inherent risks, including unexpected changes in regulatory requirements, tariffs and other trade barriers, software piracy, difficulties in staffing foreign operations, longer payment cycles, increased difficulties in collecting accounts receivable and potentially adverse tax consequences. To the extent international sales are denominated in foreign currencies, the conversion to U.S. dollars of amounts arising from international operations may contribute to fluctuations in Sterling Software's results of operations. In the past, Sterling Software has entered into, and may in the future enter into, hedging transactions in an effort to reduce its exposure to currency exchange risks.

The European Union's adoption of the Euro single currency raises a variety of issues associated with the Company's European operations. Although the transition will be phased in over several years, the Euro became Europe's single currency on January 1, 1999. The Company believes that the hardware and software systems it uses internally will accommodate this transition and any required policy or operating changes will not have a material adverse effect on future results, however, failure of any critical technology components to operate properly post-Euro may adversely affect business operations or require the Company to incur unanticipated expenses to remedy any problems. Furthermore, the Company's foreign exchange exposures to legacy sovereign currencies of the participating countries in the Euro became foreign exchange exposures to the Euro upon its introduction. Although the Company is not aware of any material adverse financial risk consequences of the change from legacy sovereign currencies to the Euro, conversion may result in problems, which may have an adverse impact on the Company's business since the Company may be required to incur unanticipated expenses to remedy these problems.

Risks Associated with Government Contracts

Federal government contracts historically have been a significant part of Sterling Software's business, representing approximately 21% of Sterling Software's total revenue during fiscal 1999 and 22% in both fiscal 1998 and 1997. Many of Sterling Software's federal government contracts are funded for one year or less and are subject to contract award, extension or expiration at different times during the year, and all of Sterling Software's federal government contracts are subject to termination by the government for convenience or for failure to obtain funding. Based upon past experience, Sterling Software believes that the contract renewal options included in existing government contracts will be exercised for the full period designated in such contracts, but no assurance can be given that such contracts will be renewed. See Item 1. "Business—Backlog" above.

Certain Antitakeover Provisions

Certain provisions of the Delaware General Corporation Law, Sterling Software's Restated Certificate of Incorporation (the "Certificate of Incorporation") and Bylaws and certain agreements to which Sterling Software is a party (including the Rights Agreement, dated December 18, 1996, between Sterling Software and BankBoston, N.A., as amended) may have the effect of delaying, deterring or preventing a change in control of Sterling Software. In addition, the Certificate of Incorporation authorizes the issuance of up to 250,000,000 shares of Common Stock and 10,000,000 shares of Preferred Stock, par value $0.10 per share ("Preferred Stock"), of Sterling Software. The Board of Directors of Sterling Software has the power to determine the price and terms under which any such additional capital stock may be issued and to fix the terms of such Preferred Stock, and existing stockholders of Sterling Software will not have preemptive rights with respect thereto.

Other Matters

The Board of Directors has adopted certain amendments to the Company's Bylaws, including, among others, the following:

The Bylaws provide that for business to be properly brought before an annual meeting by a stockholder, the stockholder must have given timely notice thereof. The Bylaws have been amended to require that, in order for a stockholder's notice to be timely, it must be delivered to or mailed to and received at the principal executive offices of the Company not later than 90 days prior to the anniversary date of the immediately preceding annual meeting. The notice must also contain the information required by Article II, Section 2 of the Bylaws. As a result of this amendment, stockholders desiring to bring proposals before the Company's 2000 Annual Meeting of Stockholders must deliver the Company written notice thereof no later than December 31, 1999 (which deadline shall also apply for a proposal to be "timely" within the meaning of Rule 14a-4(c) under the Securities Exchange Act of 1934).

The Bylaws have been amended to establish formal procedures which regulate the process by which stockholders owning 20% or more of the Company's outstanding shares may initiate a request to call a special meeting of the Company's stockholders and to establish orderly procedures for such stockholder-initiated meetings. The procedures would include, among other things, a requirement that such meeting be held not less than 90 days nor more than 120 days after the receipt and determination of the validity of the stockholders' request to call a special meeting.

The Bylaws have been amended to conform with Section 141(k) of the Delaware General Corporation Law, which provides that unless a company's certificate of incorporation otherwise provides, in the case of a company with a classified board, stockholders may remove directors only for cause. In addition, the Bylaws have been amended to provide for mandatory indemnification of the Company's officers, as well as its directors, to fullest extent permitted by law, as well as to provide for mandatory advancement of expenses incurred by an indemnified party in defending or investigating a threatened or pending action in advance of final disposition of the action.

In order to permit telephonic and electronic voting, the Bylaws have been amended to permit stockholders to vote by proxy in any manner permitted or not prohibited by the Delaware General Corporation Law.

A copy of the restated Bylaws of the Company are filed herewith as Exhibit 3.2 and are incorporated herein by reference. The foregoing description of the restated Bylaws does not purport to be complete and is qualified in its entirety by reference to the restated Bylaws filed herewith.

Forward-Looking Information

This report and other reports and statements filed by the Company from time to time with the Securities and Exchange Commission (collectively, ''SEC Filings'') contain or may contain forward-looking statements. Such statements are based upon the beliefs and assumptions of, and on information available to, the Company's management. The following statements are or may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995: (i) statements preceded by, followed by or that include the words ''may'', ''will'', ''could'', ''should'', ''believe'', ''expect'', ''future'', ''potential'', ''anticipate'', ''intend'', ''plan'', ''estimate'' or ''continue'' or the negative or other variations thereof and (ii) other statements regarding matters that are not historical facts. Such forward-looking statements are subject to various risks and uncertainties, including (i) risks and uncertainties relating to the possible invalidity of the underlying beliefs and assumptions, (ii) possible changes or developments in social, economic, business, industry, market, legal and regulatory circumstances and conditions, and (iii) actions taken or omitted to be taken by third parties, including customers, suppliers, business partners, competitors and legislative, regulatory, judicial and other governmental authorities and officials. In addition to any risks and uncertainties specifically identified in the text surrounding such forward-looking statements, the statements in the immediately preceding sentence, the statements under the caption ''Certain Risks and Uncertainties That Could Affect the Company and Future Operating Results'' above and the statements under captions such as ''Risk Factors'', ''Certain Considerations Relative to the Company'' and ''Special Considerations'' in other SEC Filings constitute cautionary statements identifying important factors that could cause actual amounts, results, events and circumstances to differ materially from those reflected in such forward-looking statements.

Item 7A. ***Quantitative and Qualitative Disclosures About Market Risk.***

Interest Rate Risk

The Company's exposure to market risk associated with changes in interest rates relates primarily to the Company's investment portfolio of marketable securities. The Company does not use derivative financial instruments in its investment portfolio. The stated objectives of the Company's investment guidelines are: safety of principal, liquidity, maximization of yield and diversification of risk. The Company invests in marketable securities of high credit quality U.S. issuers, principally highly rated corporations and tax-exempt issuers, and limits the amount of credit exposure to any one issuer. The Company's marketable securities portfolio includes only those securities with active secondary or resale markets to ensure portfolio liquidity.

The table below presents principal amounts and related weighted average interest rates by date of maturity for the Company's marketable securities. A substantial portion of the interest income earned on municipal obligations is exempt from federal and state income taxes. At September 30, 1999, the weighted average maturity of the marketable securities portfolio was less than 180 days. The fair value of the marketable securities portfolio is affected by changes in short-term U.S. dollar interest rates.

	Maturity					
	2000	2001	2002	Thereafter	Total	Fair Value at September 30, 1999
U.S. corporate notes	8,051	28,540	14,982		51,573	51,153
Average interest rate	5.62%	5.62%	6.08%		5.75%	
Municipal obligations	50,173	4,203	606	999	55,981	56,679
Average interest rate	5.48%	5.59%	5.33%	5.58%	5.49%	
Other	3,383				3,383	4,453
Total investment portfolio	61,607	32,743	15,588	999	110,937	112,285
Average interest rate	5.2%	5.62%	6.05%	5.58%	5.44%	

Foreign Currency Risk

The Company conducts business in various foreign currencies, primarily in Canada, Brazil, Europe, Australia, Japan and other Asian countries. As a result, the Company is exposed to the effect of foreign currency exchange rate fluctuations on the U.S. dollar value of foreign currency-denominated revenues and expenses. The Company mitigates a portion of its exposure to foreign currency exchange rate fluctuations through decentralized sales, marketing and support operations, and through international development facilities, in which substantially all costs are local-currency based. In the past, the Company has entered, and may in the future enter, into hedging transactions in an effort to reduce exposure to foreign currency exchange rate fluctuations. As of September 30, 1999, the Company was not engaged in a foreign currency hedging program.

Item 8. ***Financial Statements and Supplementary Data.***

STERLING SOFTWARE, INC.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

	Page
Report of Ernst & Young LLP, Independent Auditors	33
Consolidated Financial Statements:	
Consolidated Balance Sheets as of September 30, 1999 and 1998	34
Consolidated Statements of Operations for the Years Ended September 30, 1999, 1998 and 1997	35
Consolidated Statements of Stockholders' Equity for the Years Ended September 30, 1999, 1998 and 1997	36
Consolidated Statements of Cash Flows for the Years Ended September 30, 1999, 1998 and 1997	37
Notes to Consolidated Financial Statements	38

REPORT OF ERNST & YOUNG LLP, INDEPENDENT AUDITORS

The Board of Directors and Stockholders
Sterling Software, Inc.

We have audited the accompanying consolidated balance sheets of Sterling Software, Inc. (the "Company") as of September 30, 1999 and 1998, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended September 30, 1999. Our audits also included the financial statement schedule listed under Item 14(a) of the Company's Annual Report on Form 10-K for the year ended September 30, 1999. These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audits 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 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company at September 30, 1999 and 1998, and the consolidated results of its operations and its cash flows for each of the three years in the period ended September 30, 1999 in conformity with generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ Ernst & Young LLP

Dallas, Texas
October 29, 1999

STERLING SOFTWARE, INC.

CONSOLIDATED BALANCE SHEETS
September 30, 1999 and 1998
(in thousands, except share information)

	1999	1998
ASSETS		
Current assets:		
Cash and cash equivalents	$ 318,748	$ 397,312
Marketable securities	112,285	310,537
Accounts and notes receivable, net	294,409	200,428
Prepaid expenses and other current assets	28,732	32,253
Total current assets	754,174	940,530
Property and equipment, net	72,137	66,726
Computer software, net of accumulated amortization of $114,813 in 1999 and $112,734 in 1998	144,367	81,606
Excess cost over net assets of businesses acquired, net of accumulated amortization of $38,742 in 1999 and $27,316 in 1998	231,738	76,086
Other assets	27,615	24,040
	$1,230,031	$1,188,988
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	$ 226,510	$ 161,790
Deferred revenue	105,828	105,439
Total current liabilities	332,338	267,229
Noncurrent deferred revenue	45,677	27,649
Other noncurrent liabilities	40,284	32,552
Contingencies and commitments		
Stockholders' equity:		
Preferred stock, $.10 par value; 10,000,000 shares authorized; none issued		
Common stock, $.10 par value; 250,000,000 and 125,000,000 shares authorized in 1999 and 1998, respectively; 86,873,000, and 84,845,000 shares issued in 1999 and 1998, respectively	8,687	8,485
Additional paid-in capital	895,391	858,615
Accumulated other comprehensive loss	(21,899)	(16,044)
Retained earnings	55,750	66,506
Less treasury stock, at cost; 5,953,000 and 2,599,000 shares in 1999 and 1998, respectively	(126,197)	(56,004)
Total stockholders' equity	811,732	861,558
	$1,230,031	$1,188,988

See accompanying notes.

STERLING SOFTWARE, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
Years Ended September 30, 1999, 1998 and 1997
(in thousands, except per share information)

	1999	1998	1997
Revenue:			
Products	$363,763	$287,835	$ 234,240
Product support	208,888	183,631	150,886
Services	234,353	248,477	184,076
	807,004	719,943	569,202
Costs and expenses:			
Cost of sales:			
Products and product support	84,138	71,229	79,449
Services	209,259	216,437	157,287
	293,397	287,666	236,736
Product development and enhancement	39,572	36,162	29,659
Selling, general and administrative	289,056	264,450	231,185
Reorganization costs	99,620	45,162	106,037
Purchased research and development	83,566		137,849
	805,211	633,440	741,466
Income (loss) before other income (expense) and income taxes	1,793	86,503	(172,264)
Other income (expense):			
Interest expense	(463)	(424)	(540)
Investment income	31,569	34,087	38,906
Other	1,568	(329)	(658)
	32,674	33,334	37,708
Income (loss) before income taxes	34,467	119,837	(134,556)
Provision (benefit) for income taxes	45,223	43,793	(2,659)
Net income (loss)	$ (10,756)	$ 76,044	$(131,897)
Income (loss) per common share:			
Basic	$ (.13)	$ .94	$ (1.66)
Diluted	$ (.13)	$ .89	$ (1.66)

See accompanying notes.

STERLING SOFTWARE, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

Years Ended September 30, 1999, 1998 and 1997

(in thousands)

	Common Stock					Treasury Stock		
	Number of Shares	Par Value	Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Retained Earnings (Deficit)	Number of Shares	Cost	Total Stockholders' Equity
Balance at September 30, 1996	82,214	$ 8,221	$ 830,860	$(10,379)	$ 117,731	2,744	$ (59,097)	$ 887,336
Net loss					(131,897)			(131,897)
Adjustment to unrealized gains (losses) on available-for-sale securities, net of tax expense of $1,277				2,381				2,381
Foreign currency translation adjustment				(2,490)				(2,490)
Other				(520)				(520)
Total comprehensive loss								(132,526)
Issuance of common stock pursuant to stock options, including tax benefit of $450	212	21	1,889					1,910
Issuance of common stock to 401(k) plan			(295)			(40)	845	550
Other	(14)	(1)	221				1	221
Balance at September 30, 1997	82,412	8,241	832,675	(11,008)	(14,166)	2,704	(58,251)	757,491
Net income					76,044			76,044
Adjustment to unrealized gains (losses) on available-for-sale securities, net of tax benefit of $224				(418)				(418)
Foreign currency translation adjustment				(4,388)				(4,388)
Other				(230)				(230)
Total comprehensive income								71,008
Issuance of common stock pursuant to stock options, including tax benefit of $4,700	1,327	133	22,462					22,595
Issuance of common stock to 401(k) plan			(303)			(102)	2,189	1,886
Issuance of common stock pursuant to employee stock purchase plan	337	34	5,494			(3)	58	5,586
Adjustments for pooling of interests acquisition of Mystech	769	77	(1,713)		4,628			2,992
Balance at September 30, 1998	84,845	8,485	858,615	(16,044)	66,506	2,599	(56,004)	861,558
Net loss					(10,756)			(10,756)
Adjustment to unrealized gains (losses) on available-for-sale securities, net of tax benefit of $38				75				75
Foreign currency translation adjustment				(6,022)				(6,022)
Other				92				92
Total comprehensive loss								(16,611)
Acquisition of common stock under stock repurchase program						3,457	(72,413)	(72,413)
Issuance of common stock pursuant to stock options, including tax benefit of $4,584	1,463	146	24,129					24,275
Issuance of common stock to 401(k) plan			(47)			(103)	2,220	2,173
Issuance of common stock pursuant to employee stock purchase plan	565	56	12,694					12,750
Balance at September 30, 1999	86,873	$ 8,687	$ 895,391	$(21,899)	$ 55,750	5,953	$ (126,197)	$ 811,732

See accompanying notes.

STERLING SOFTWARE, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended September 30, 1999, 1998 and 1997
(in thousands)

	1999	1998	1997
Operating activities:			
Net income (loss)	$ (10,756)	$ 76,044	$(131,897)
Adjustments to reconcile income (loss) to net cash provided by operating activities:			
Depreciation and amortization	58,058	44,693	38,544
Provision for losses on accounts receivable	2,908	5,157	5,191
Provision (benefit) for deferred income taxes	8,883	18,800	(19,125)
Reorganization costs	42,156	9,552	63,726
Purchased research and development	83,566		137,849
Changes in operating assets and liabilities, net of effects of business acquisitions:			
(Increase) decrease in accounts and notes receivable	(71,683)	(49,435)	26,298
Decrease in amounts due to Sterling Commerce, Inc.			(35,134)
Decrease (increase) in prepaid expenses and other assets	12,682	(6,045)	(2,495)
(Decrease) increase in accounts payable, accrued liabilities and income taxes payable	(43,774)	(11,989)	40,259
Decrease in deferred revenue	(12,023)	(1,951)	(1,339)
Other	12,921	16,859	6,734
Net cash provided by operating activities	82,938	101,685	128,611
Investing activities:			
Purchases of property and equipment	(29,554)	(33,200)	(29,003)
Purchases and capitalized cost of development of computer software	(31,495)	(27,854)	(21,860)
Business acquisitions, net of cash acquired	(265,787)	(634)	(194,871)
Purchases of investments	(314,834)	(342,807)	(255,888)
Proceeds from sales of investments	523,313	240,495	284,703
Other	(209)	1,619	697
Net cash used in investing activities	(118,566)	(162,381)	(216,222)
Financing activities:			
Purchases of treasury stock	(72,413)		
Proceeds from issuance of common stock pursuant to the exercise of stock options	19,691	17,895	1,460
Proceeds from issuance of common stock pursuant to employee stock purchase plan	12,750	5,586	
Other	(944)	(2,600)	(1,179)
Net cash (used in) provided by financing activities	(40,916)	20,881	281
Effect of foreign currency exchange rate changes on cash	(2,020)	172	(2,314)
Decrease in cash and equivalents	(78,564)	(39,643)	(89,644)
Cash and cash equivalents at beginning of year	397,312	436,955	526,599
Cash and cash equivalents at end of year	$ 318,748	$ 397,312	$ 436,955
Supplemental cash flow information:			
Income taxes paid, net of refunds received	$ 23,237	$ 2,400	$ 6,670

See accompanying notes.

STERLING SOFTWARE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 1999, 1998 and 1997

1. Summary of Significant Accounting Policies

The Company

Sterling Software, Inc. (''Sterling Software'' or the ''Company'') was founded in 1981 and became a publicly owned corporation in 1983. Sterling Software is a worldwide developer and supplier of systems management, business intelligence and application development software products and services, as well as a supplier of specialized information technology (''IT'') services for sectors of the federal government.

Basis of Presentation

The consolidated financial statements include the accounts of Sterling Software after elimination of all significant intercompany balances and transactions. Certain amounts for periods ended prior to September 30, 1999, have been reclassified to conform to the current year presentation. The financial statements have been prepared in conformity with generally accepted accounting principles which require management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingencies at September 30, 1999 and 1998 and the results of operations for the years ended September 30, 1999, 1998 and 1997. While management has based its estimates and assumptions on the facts and circumstances known to it as of the date of this report, actual amounts may differ from such estimates and assumptions.

Revenue

Revenue from license fees for software products is recognized when persuasive evidence of a sale arrangement exists, delivery has occurred, the fee is fixed or determinable and collectibility is probable. Services revenue and revenue from products involving installation or other services are recognized as the services are performed.

If software product sale transactions include multiple elements, each element of the software sale is separately identified and accounted for based on the relative fair value of such element. Revenue is not recognized on any element of the sale arrangement if undelivered elements are essential to the functionality of the delivered elements.

Product support contracts allow customers to receive updated versions of Sterling Software's products when and if they become available, as well as bug fixing, and Internet and telephone access to the Company's technical personnel. Revenue from product support contracts, including product support included in initial license fees, is recognized ratably over the contract period. All significant costs and expenses associated with product support contracts are expensed ratably over the contract period.

When products, product support and services are billed prior to the time the related revenue is recognized, deferred revenue is recorded and any material related costs paid in advance are deferred.

Revenue from specialized IT services provided to the federal government under multi-year contracts is recognized as the services are performed. Revenue for services provided under other long-term contracts is recognized using the percentage-of-completion method of accounting. Losses on long-term contracts are recognized when the current estimate of total contract costs indicates a loss on a contract is probable.

Returns and allowances and other similar adjustments to revenue involving software products historically have not been material to the Company's results of operations.

Research and Development Costs

Research and development costs incurred for the development and testing of new or significantly enhanced software products are accounted for in accordance with the provisions of Statement of Financial Accounting Standard No. 86 (''FAS 86''), ''Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed''. Pursuant to FAS 86, costs are capitalized when technological feasibility of the product is established. Technological feasibility is established either upon the completion of a detailed program design or the completion of a working model. The establishment of technological feasibility and the ongoing assessment of recoverability of capitalized software development costs require judgment by management with respect to certain external factors, including, but not limited to, anticipated future revenues, estimated economic life and changes in software and hardware technologies. Software development capitalized costs include, among other things, programmers salaries and benefits, outside contractor costs, computer time and allocated facilities costs. Unamortized software development costs of $54,474,000 and $54,382,000 are included in ''Computer software, net'', at September 30, 1999 and 1998, respectively.

Purchased research and development determined not to have reached technological feasibility based on the status of design and development activities requiring further refinement and testing is expensed at the time of acquisition. The value of the Company's purchased research and development is determined by an independent valuation expert, generally by discounting the estimated projected net cash flows related to the applicable products for the next 10 years, including costs to complete the development of the technology and the future revenues to be earned upon release of the products.

Depreciation and Amortization

Property and equipment are recorded at cost and depreciated using the straight-line method over average useful lives of three to 15 years. Computer software costs are amortized on a product-by-product basis using the greater of the amount computed by taking the ratio of current year net revenue to estimated future net revenue or the amount computed by the straight-line method over periods ranging from three to seven years. Excess cost over net assets of businesses acquired is amortized on a straight-line basis over periods of seven to 40 years. Other intangible assets are amortized on a straight-line basis over periods of three to seven years.

Depreciation and amortization consists of the following for the years ended September 30, 1999, 1998 and 1997 (in thousands):

	1999	1998	1997
Property and equipment	$18,789	$16,094	$15,596
Purchased computer software	11,553	7,708	6,731
Capitalized computer software development costs	15,152	13,083	11,551
Excess cost over net assets of businesses acquired	12,415	7,570	4,403
Intangible assets	149	238	263
	$58,058	$44,693	$38,544

Income Taxes

The Company's income taxes are computed using the asset and liability method of accounting. Under the asset and liability method, a deferred tax asset or liability is recognized for estimated future tax effects attributable to temporary differences and carryforwards. The measurement of deferred income tax assets is adjusted by a valuation allowance, if necessary, to recognize future tax benefit only to the extent, based on available evidence, it is more likely than not such benefit will be realized.

Stock Options

The Company has elected to follow Accounting Principles Board Opinion No. 25 (''APB 25''), ''Accounting for Stock Issued to Employees'', in accounting for its employee stock options and employee stock purchase plan. Generally, under APB 25, if the exercise price of an employee's stock option equals or exceeds the market price of the underlying stock on the date of grant, no compensation expense is recognized.

Common Stock and Earnings Per Common Share

Basic earnings per common share data is computed using the weighted average number of common shares outstanding for the relevant period. Diluted earnings per common share data is computed using the weighted average number of common shares outstanding plus common share equivalents represented by stock options, if such stock options have a dilutive effect in the aggregate.

The following table sets forth the computation of basic and diluted earnings per share for the years ended September 30, 1999, 1998 and 1997 (in thousands, except per share data):

	1999	1998	1997
Basic:			
Net income (loss)	$(10,756)	$76,044	$(131,897)
Weighted average common shares outstanding	82,835	80,638	79,588
Net income (loss) per common share	$ (.13)	$ .94	$ (1.66)
Diluted:			
Net income (loss)	$(10,756)	$76,044	$(131,897)
Weighted average common shares outstanding	82,835	80,638	79,588
Effect of dilutive employee stock options		4,869	
Adjusted weighted average common shares	82,835	85,507	79,588
Net income (loss) per common share	$ (.13)	$ .89	$ (1.66)

Foreign Currency Translation

The financial statements of the Company's subsidiaries outside the United States are generally prepared using the local currency as the functional currency. Assets and liabilities of these subsidiaries are translated into U.S. dollars at exchange rates in effect as of the applicable balance sheet date and any resulting translation adjustments are included as a component of comprehensive income. Revenue and expense items of these subsidiaries are translated at average exchange rates during the month the transactions occur. Gains and losses from foreign currency transactions are included in net earnings. Foreign currency transaction gains and losses historically have not been material to the Company's results of operations.

Comprehensive Income

Effective October 1, 1998, the Company adopted Statement of Financial Accounting Standards No. 130 (''FAS 130''), ''Reporting Comprehensive Income''. FAS 130 requires the presentation of comprehensive income and its components in a full set of general-purpose financial statements. Comprehensive income is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners. At September 30, 1999, total accumulated other comprehensive loss of $21,899,000 consists primarily of foreign currency translation adjustments of $(20,949,000) and unrealized gains and losses on available-for-sale securities of $836,000. The adoption of

FAS 130 had no impact on the Company's net income for the three years ended September 30, 1999. Prior year financial statements have been reclassified to conform to the requirements of FAS 130.

Cash and Equivalents

Cash equivalents consist primarily of highly liquid investments in investment-grade commercial paper of various issuers and repurchase agreements backed by U.S. Treasury securities, with maturities of three months or less when purchased. Cash equivalents are recorded at fair value.

Marketable Securities and Other Investments

The Company currently invests excess cash in a diversified portfolio of marketable securities consisting of a variety of investment-grade securities, including commercial paper, medium-term notes, municipal obligations and certificates of deposit. The fair values for marketable securities are based on quoted market prices.

All marketable securities and long-term investments are classified as available-for-sale securities. Unrealized holding gains and losses on securities available-for-sale are recorded as a component of comprehensive income, net of any related tax effect. The amortized cost of debt securities in this category is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization is included in investment income. Realized gains and losses and declines in values judged to be other-than-temporary, if any, on available-for-sale securities are included in investment income.

Excess Cost Over Net Assets of Businesses Acquired

Excess cost over net assets of businesses acquired is amortized on a straight-line basis over periods of seven to 40 years. The carrying amount of such costs is reviewed by management if facts and circumstances suggest that such amount may be impaired. If this review indicates that the costs will not be recoverable, as determined based on the estimated discounted future cash flows of the business acquired over the remaining amortization period, the carrying amount is reduced by the estimated shortfall of cash flows. The carrying amount of excess cost over net assets of businesses acquired associated with other assets acquired in a purchase business combination is included in impairment evaluations when events or circumstances exist that indicate the carrying amount of those assets may not be recoverable.

Recent Developments

Effective October 1, 1998, the Company adopted Statement of Position 97-2, ''Software Revenue Recognition,'' as amended by Statement of Position 98-4, ''Deferral of the Effective Date of Certain Provisions of SOP 97-2'' (''SOP 97-2''). SOP 97-2 requires that each element of a software sale arrangement be separately identified and accounted for based on the relative fair value of such element. Revenue cannot be recognized on any element of the sale arrangement if undelivered elements are essential to the functionality of the delivered elements. Adoption of SOP 97-2 did not significantly affect the Company's results of operations for year ended September 30, 1999, nor is it expected to have a significant impact on future results as the Company's revenue recognition policies have historically been substantially in compliance with the practices required by SOP 97-2.

On December 15, 1998, the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants released Statement of Position 98-9, ''Modification of SOP 97-2, 'Software Revenue Recognition,' with Respect to Certain Transactions'' (''SOP 98-9''). SOP 98-9 amends SOP 97-2 to require that an entity recognize revenue for multiple element software product sale arrangements by means of the ''residual method'' when (1) there is vendor-specific objective evidence (''VSOE'') of the fair values of all of the undelivered elements that are not accounted for by means of long-term contract accounting, (2) VSOE of fair value does not exist for one or more of the delivered elements, and (3) all revenue recognition criteria of SOP 97-2 (other than the requirement for VSOE of the fair value of each delivered element) are satisfied.

The provisions of SOP 98-9 that extend the deferral of certain provisions of SOP 97-2 became effective December 15, 1998. All other provisions of SOP 98-9 will be effective for the Company's fiscal year beginning October 1, 1999. Retroactive application is prohibited. The adoption of SOP 98-9 is not expected to have a material impact on the financial position or results of operations of the Company.

In June 1998, the Financial Accounting Standards Board issued Statement No. 133 (''FAS 133''), ''Accounting for Derivative Instruments and Hedging Activities'', which, as amended, is required to be adopted in fiscal quarters beginning after June 15, 2000. Because the Company does not currently use derivatives to a significant extent, management does not anticipate that the adoption of FAS 133 will have a significant impact on the results of operations or the financial position of the Company.

2. Business Acquisitions, Reorganizations and Divestitures

1999 Acquisitions

The acquisitions listed below were completed during 1999 (the ''1999 Acquisitions'') and were accounted for in accordance with the purchase method of accounting. Accordingly, the results of operations of the acquired businesses are included in the Company's results of operations from the respective dates of the acquisitions.

- On October 26, 1998, Sterling Software acquired Cayenne Software, Inc. (''Cayenne''), a publicly held global supplier of analysis and design solutions for application and database development, in an $11,400,000 cash merger transaction.
- On April 15, 1999, Sterling Software acquired the distributed systems storage software business (the ''Alexandria Business'') of Spectra Logic Corporation in a cash asset acquisition transaction valued at approximately $33,000,000.
- On April 30, 1999, Sterling Software completed the acquisition of Interlink Computer Sciences, Inc. (''Interlink''), a publicly held global supplier of high-performance solutions for enterprise systems networking, in an all-cash transaction valued at approximately $63,907,000.
- On July 26, 1999, Sterling Software acquired CoreData, Inc. (''CoreData''), a privately held developer and supplier of backup software for remote and mobile PCs, in a cash merger transaction valued at approximately $14,015,000.
- On August 31, 1999, Sterling Software completed the acquisition of Information Advantage, Inc. (''Information Advantage''), a publicly held provider of web-based and enterprise business intelligence software, in an all-cash transaction valued at approximately $168,357,000.

The operations of Cayenne and Information Advantage have been included in the Company's operations as part of the Company's application management business segment since the date of acquisition. The operations of the Alexandria Business, CoreData and Interlink have been included in the Company's operations as part of the Company's systems management business segment since the date of acquisition.

The total cost of the 1999 Acquisitions was approximately $358,062,000, including direct costs related to the acquisitions of approximately $67,383,000, consisting of employee termination costs, transaction costs, costs associated with the elimination of duplicate facilities and other direct costs as follows (in thousands):

Cash transaction consideration	$290,679
Employee severance and benefits	31,761
Elimination of duplicate facilities and leases	14,650
Transaction costs	13,441
Other costs	7,531
	$358,062

At September 30, 1999, the balance of the direct costs incurred in the 1999 Acquisitions that remained to be paid totaled $35,323,000, related primarily to employee severance and benefits and the elimination of duplicate facilities and leases.

The costs of the 1999 Acquisitions have been allocated to the respective assets and liabilities acquired and to purchased research and development, with the remainder recorded as excess cost over net assets acquired, based on preliminary estimates of fair values as follows (in thousands):

Working capital	$ 32,126
Property and equipment	1,368
Developed software and core technology	85,436
Purchased research and development costs charged to expense	83,566
Other assets and liabilities (net)	(11,035)
Excess cost over net assets acquired	166,601
	$358,062

The estimates of fair value were determined by the Company's management based on information furnished by management of the acquired businesses and preliminary independent valuations of developed software, core technology and purchased research and development. Amounts attributed to purchased research and development were expensed at the date of acquisition as the Company determined that the purchased research and development had not reached technological feasibility based on the status of design and development activities that required further refinement and testing. The value of the purchased research and development attributable to each acquisition was determined by an independent valuation expert retained by the Company. The estimates used by the Company in valuing the purchased research and development were based upon assumptions regarding future events and circumstances the Company believes to be reasonable but that are inherently uncertain and unpredictable. The Company's assumptions may be incomplete or inaccurate, and no assurance can be given that unanticipated events and circumstances will not occur. Accordingly, actual results may vary from the assumed results. Any such variance may result in a material adverse effect on the results of operations of the Company.

The value of the purchased research and development attributable to each acquisition was determined by discounting the estimated projected net cash flows related to the applicable products for the next 10 years, including costs to complete the development of the technology and the future revenues to be earned upon release of the products. The rate utilized to discount the net cash flows to their present value, generally 20%, was based on the Company's weighted average cost of capital adjusted for the risks associated with the estimated growth, profitability and developmental and market risks of the acquired development projects. Projected net cash flows from such products are based on estimates of revenues and operating profits related to such products.

The Company is using the purchased research and development to create new products that are expected to become part of the product portfolios offered by the systems management and application management business segments. The Company expects that products developed from the purchased research and development will generally be released during fiscal year 2000. The development activities required to complete the purchased research and development technologies include additional coding, cross-platform porting and validation, quality assurance procedures and beta testing. The Company's management expects that the purchased research and development generally will be successfully developed into commercially viable products; however, there can be no assurance that commercial viability or timely release of these products will be achieved.

A description of the acquired in-process technology and the estimates made by the Company for each of the 1999 Acquisitions is set forth below.

- Information Advantage had four new products in active development at the date of acquisition, to which the Company assigned a value of approximately $47,044,000. These development efforts were aimed at incorporating technologies allowing advanced profiling and search, increasing report server capabilities and enhancing user interfaces for authoring reports and performing analysis of data. At the acquisition date, the research and development programs ranged in estimated completion from 62% to 90%. New product offerings are generally estimated to be released in the second quarter of fiscal year 2000 at an estimated cost to complete of approximately $2,000,000. Generally, the Company believes that the risks associated with the successful completion of the projects are relatively low. However, certain projects requiring integration of complementary technologies and the development of complex and unique intelligence analysis functions do entail significant technical risks. Significant delays in completion and release of product offerings could negatively affect the market position of the products. As the Information Advantage acquisition was completed only one month before the Company's year end, there have been no significant changes in the estimates of costs required to complete the development efforts or the product offering release dates.

- CoreData was developing a new product that would include the unique ability to use multiple devices for more efficient remote backup and restore, to which the Company assigned a value of approximately $4,431,000. Research and development efforts were estimated to be approximately 40% complete at the date of acquisition, with the release date of the product estimated for the second quarter of fiscal year 2000 at an estimated cost to complete of approximately $200,000. The Company believes that the risks associated with successful completion of the development efforts are relatively low. The Company believes that a delay of release of up to three months would have little impact on the estimated market share or revenues of the product. No significant changes have arisen since the acquisition date in the estimates of costs to complete the development efforts or the product offering release date.

- Interlink was developing four new product offerings at the acquisition date for OS/390 TCP/IP customers, to which the Company assigned a value of approximately $10,143,000. At the acquisition date research and development efforts ranged in estimated completion from 63%—87%. The release date of the new products is generally estimated to occur in the first quarter of fiscal year 2000 with estimated cost to complete the product offerings of approximately $830,000. The Company believes that the risks associated with successful completion of the development efforts are relatively low. The Company believes that a delay of release of up to six months would have little impact on the estimated market share or revenues of the product. No significant changes have arisen since the acquisition date in the estimates of costs to complete the development efforts or the product offering release date.

- The Alexandria Business was developing a new product offering for data movement and backup capabilities designed to meet next generation, centralized, end-to-end storage management requirements for large, heterogeneous storage environments. Designed specifically to operate optimally in Storage Area Networks (SANs), features include the movement of data on SANs and the management of shared tape libraries attached to SANs. Both UNIX and NT server versions will have the same characteristics as the current release, including high performance with low CPU overhead. Timed to be available before the release of Windows 2000, the Company will have a leading solution for customers deploying large scale mission-critical applications on this first Windows version that is capable of hosting commercial applications effectively. The Company assigned a value of $12,325,000 to these research and development efforts, which were estimated to be approximately 80% complete at the date of acquisition, with a product offering estimated to become generally available in the third quarter of fiscal year 2000 at an estimated cost to complete of approximately $2,000,000. The research and development efforts necessary to complete the product offering are technically complex and may affect what functions are available on differing planned delivery dates. However, the Company believes that, through its acquisition of the Alexandria Business, it has a leading position in this marketplace and that any delays should not significantly reduce market opportunities for the new product offering. Through September 30, 1999, the Company has expended approximately $600,000 for further development of this product offering. No significant changes have arisen since the acquisition date in the estimates of costs to complete the development efforts or the product offering release date.

- Cayenne was developing new technologies for integrating object-oriented technologies with component based design and implementation, to which the Company assigned a value of $9,623,000. The Company planned to integrate technologies acquired in the Cayenne acquisition with core technologies of both its own and Cayenne's existing product offerings to produce a new product targeted at providing advanced object-oriented (OO) modeling technologies and tools for application design and implementation. This was to be a unique capability and entailed a high degree of complexity and effort to provide full user functionality for multiple platforms. Research and development efforts were estimated to be approximately 80% complete at the date of acquisition and the Company believed that up to an additional 18 months and approximately $1,466,000 would be required to complete the new product offering. But with increasing opportunities in the market for application development tools for e-business solutions—such as web-enablement of existing applications, and integration and extension of existing applications—combined with an increase in the estimated costs of integrating the acquired technologies with the Company's existing OO technologies, in September of 1999 the Company decided to discontinue development of the new, integrated product. Accordingly, the Company wrote off core technology and goodwill attributable to this product of approximately $7,800,000 in the fourth quarter of 1999.

The following unaudited pro forma information presents the Company's results of operations as if the 1999 Acquisitions had occurred as of October 1, 1997. The pro forma information has been prepared by combining the results of operations of the Company and the acquired businesses for the years ended September 30, 1999 and 1998, adjusted for the elimination of fiscal year 1999 charges for purchased research and development costs and reorganization costs, additional amortization expense and the resulting impact on the provision for income taxes. This pro forma information does not purport to be indicative of what would have occurred had these acquisitions and related reorganizations occurred as of that date, or of results of operations that may occur in the future (in thousands, except per share data):

	Years ended September 30	
	1999	1998
Revenue	$880,015	$872,004
Income before other income (expense) and income taxes	$154,506	$ 56,733
Net income	$117,252	$ 48,957
Net income per share:		
Basic	$ 1.42	$ .61
Diluted	$ 1.34	$ .57

1998 Acquisitions

The following acquisitions occurred in the fourth quarter of 1998 and were both accounted for as poolings of interests:

- On July 9, 1998, Sterling Software acquired Mystech Associates, Inc. (''Mystech''), a privately held federal information technology services contractor, in a stock-for-stock merger transaction (the ''Mystech Merger''). As a result of the transaction, Sterling Software issued approximately 769,000 shares of its common stock, par value $0.10 per share (''Common Stock''), in exchange for the previously outstanding shares of Mystech common stock and reserved approximately 174,000 shares of Common Stock for issuance upon exercise of assumed Mystech stock options. The Mystech Merger was valued at approximately $28,000,000 and the Mystech organization was added to the Company's federal systems business segment. The impact of the pooling of interests accounting on the Company's historical financial statements was not material; therefore, the Company's financial statements for periods prior to the Mystech Merger were not restated for this transaction.

• On July 31, 1998, Sterling Software acquired Synon Corporation (''Synon''), a privately held provider of application development software and services, in a stock-for-stock merger transaction (the ''Synon Merger'') valued at approximately $79,000,000. As a result of the transaction, Sterling Software issued approximately 2,603,000 shares of Common Stock in exchange for the previously outstanding shares of Synon capital stock and reserved approximately 375,000 shares of Common Stock for issuance upon exercise of assumed Synon stock options. The Company's financial statements for periods prior to the Synon Merger, including the results of the application management business segment, were restated to represent the combined financial statements of the previously separate entities.

Separate and combined results of Sterling Software and Synon are as follows (in thousands):

	Sterling Software	Synon	Combined
Nine Months Ended June 30, 1998 (unaudited)			
Revenue	$ 469,771	$57,483	$ 527,254
Net income (loss)	$ 75,734	$ (7,285)	$ 68,449
Year Ended September 30, 1997			
Revenue	$ 488,978	$80,224	$ 569,202
Net income (loss)	$(132,968)	$ 1,071	$(131,897)

1997 Acquisition of TI Software

On June 30, 1997, Sterling Software completed the acquisition (the ''TI Software Acquisition'') of certain assets (including the capital stock of certain foreign subsidiaries) of Texas Instruments Incorporated (''Texas Instruments''). Such assets constituted substantially all of the assets used by Texas Instruments' Software Division (''TI Software'') in its business of developing, marketing and supporting application development software and providing related consulting services. The results of operations of TI Software are included in the Company's results of operations, as part of the Company's application management business segment, from the date of the TI Software Acquisition.

The cash purchase price paid for such assets was $165,000,000. The total cost of the TI Software Acquisition was approximately $214,774,000, including costs directly related to the TI Software Acquisition of approximately $49,774,000, consisting of employee termination costs, transaction costs, costs associated with the elimination of duplicate facilities and other direct costs. At September 30, 1999, substantially all of the direct costs incurred in the TI Software Acquisition had been paid.

Results of operations for 1997 include $137,849,000 of purchased research and development costs, which is the portion of the purchase price attributed to in-process research and development, and which was charged to expense in accordance with the purchase method of accounting. The components of the aggregate cost were as follows (in thousands):

Cash paid to Texas Instruments	$165,000
TI Software employee severance and benefits	28,696
Elimination of duplicate facilities and leases of TI Software	10,578
Transaction costs	4,904
Other costs	5,596
	$214,774

The TI Software Acquisition has been accounted for in accordance with the purchase method of accounting. The aggregate cost was allocated to the assets and liabilities acquired and to purchased research and development, with the remainder recorded as excess cost over net assets acquired, based on estimates of fair values as follows (in thousands):

Working capital (deficit)	$(10,100)
Property and equipment	4,530
Developed software and core technology	24,054
Purchased research and development costs charged to expense	137,849
Other liabilities	(32)
Excess cost over net assets acquired	58,473
	$214,774

The estimates of fair value were determined by the Company's management based on information furnished by management of TI Software and an independent valuation of developed software, core technology and purchased research and development. Amounts attributed to purchased research and development were expensed at the date of acquisition as the Company determined that the purchased research and development had not reached technological feasibility based on the status of design and development activities that required further refinement and testing.

At the acquisition date, TI Software was developing several new products for component-based development, to which the Company assigned a value of $137,489,000. These development activities resulted in the Company's release of three products. The first product, released in early 1998, has become the primary component-based application development product, and largest single revenue source, for the Company's application management business segment. A second product, for component architecture modeling and interface-based design for component specifications, was also released in 1998 and has been successfully marketed. A third product was released for limited availability in 1999 and is a development environment that incorporates advanced component modeling and generation capabilities.

The following unaudited pro forma information presents the Company's results of operations as if the TI Software Acquisition had occurred at October 1, 1996. The pro forma information has been prepared by combining the results of operations of the Company and TI Software for the year ended September 30, 1997, adjusted for the elimination of charges for purchased research and development costs and reorganization costs, additional amortization expense and the resulting impact on the provision for income taxes. This pro forma information does not purport to be indicative of what would have occurred had the TI Software Acquisition and related reorganization occurred as of that date or of results of operations which may occur in the future (in thousands, except per share data):

	Year ended September 30, 1997
Revenue	$733,577
Income before other income (expense) and income taxes	$ 43,306
Net income	$ 51,840
Net income per share	$ .65

Reorganization Costs

The Company's results of operations for the year ended September 30, 1999 include total reorganization costs of $99,620,000 primarily related to the 1999 Acquisitions, including costs associated with the realignment of the application development business within the application management business segment.

The Company's results of operations for the year ended September 30, 1998 include reorganization costs of $45,162,000 primarily related to the reorganization of the Company's operations in the fourth quarter of 1998 in connection with the Synon Merger, and to a lesser extent, the Mystech Merger.

The Company's results of operations for the year ended September 30, 1997 include reorganization costs of $106,037,000 primarily related to the reorganization of the Company's operations in the third quarter of 1997 in connection with the TI Software Acquisition, and to a lesser extent, the termination of the Company's international distributor arrangement with Sterling Commerce, Inc. (''Sterling Commerce''), formally a wholly owned subsidiary of the Company.

The components of the above reorganization costs were as follows (in thousands):

	1999	1998	1997
Employee termination costs	$29,904	$17,342	$ 18,539
Elimination of duplicate facilities, equipment and other assets	25,872	8,295	19,993
Write-down of software products that will no longer be actively marketed	30,862	6,397	17,591
Write-down of excess cost over net assets acquired	996		38,955
Out of pocket costs related to the reorganization(s)	9,794	9,535	5,109
Other costs	2,192	3,593	5,850
	$99,620	$45,162	$106,037
Reorganization costs requiring cash outlays	$57,464	$35,610	$ 42,311
Remaining balance to be paid at September 30, 1999	$40,686	$ 7,488	$ 5,245

The remaining balances to be paid consist primarily of commitments under lease arrangements for office space and equipment for the 1997 and 1998 reorganizations, and employee termination costs and benefits, and commitments under lease arrangements for office space and equipment for the 1999 reorganizations.

The Company periodically reviews the estimates of remaining costs to be paid relating to reorganizations. This periodic review has not resulted in any significant change to aggregate existing accruals, and the Company does not expect to incur costs related to the above-described reorganizations in excess of the amounts previously charged to operations.

Termination of International Distributor Arrangement

Effective as of June 30, 1997, Sterling Software and Sterling Commerce completed an agreement terminating an international distributor arrangement under which Sterling Software acted as the exclusive distributor of Sterling Commerce's interchange and communications software products in markets outside the United States and Canada. The results of the Company's international operations related to selling, marketing and providing first level support for these products through June 30, 1997 are included in the business segment information presented herein under ''Corporate and other.''

Contemporaneously with such termination, Sterling Software sold to Sterling Commerce certain of the assets formerly used by Sterling Software in connection with the distribution of these products. In consideration of the termination of the international distributor arrangement and the sale of assets described above, Sterling Commerce paid to Sterling Software $5,226,000 on June 30, 1997 and subsequently paid to Sterling Software $10,076,000, which was equal to the net book value of the acquired assets and certain assumed liabilities of Sterling Software.

3. Legal Proceedings and Claims

The Company is subject to various legal proceedings and claims that arise in the normal course of its business. While many of these matters involve inherent uncertainty, the Company's management believes that the amount of the liability, if any, ultimately incurred by Sterling Software with respect to any such existing proceedings and claims, net of applicable reserves and available insurance, will not materially affect the business, financial condition or results of operations of the Company.

4. Segment Information

The Company has adopted Statement of Financial Accounting Standard No. 131, ''Disclosures About Segments of an Enterprise and Related Information'' for the year ended September 30, 1999. Sterling Software is a worldwide developer and supplier of systems management, business intelligence and application development software products and services, as well as a supplier of specialized IT services for sectors of the federal government. The Company addresses these major markets through three business segments. The systems management business segment provides solutions that enable customers to simplify the use of multiple computing environments and to increase the productivity of information systems, ultimately ensuring that the systems meet the business needs of the organization, including e-business application availability and performance. The application management business segment provides solutions for both business intelligence and application development. Business intelligence solutions include a complete range of web-based business intelligence capabilities centered around corporate portal technology, as well as products that structure and manage data and application resources. Application development solutions include products and services that enable customers to deliver e-business applications for today's Internet-based economy. The federal systems business segment provides specialized IT services for sectors of the federal government, as well as state and local governments. Though June 30, 1997, the Company's international operations sold, marketed and provided first-level support outside of the United States and Canada for certain software products of Sterling Commerce, the results of which are included in the business segment and geographical information under ''Corporate and other.''

Financial information concerning the Company's operations, by business segment, for the years ended September 30, 1999, 1998 and 1997, is summarized as follows (in thousands):

Business Segment Information	**1999**	**1998**	**1997**
Revenue:			
Systems Management	$ 290,126	$ 204,529	$ 184,679
Application Management	357,845	366,013	223,166
Federal Systems	159,033	148,773	121,790
Corporate and other		628	39,567
Consolidated totals	$ 807,004	$ 719,943	$ 569,202
Operating Profit (Loss):			
Systems Management	$ 115,089	$ 77,337	$ 70,629
Application Management	89,375	75,981	23,747
Federal Systems	12,381	9,911	8,689
Reorganization costs	(99,620)	(45,162)	(106,037)
Purchased research and development	(83,566)		(137,849)
Corporate and other	(31,866)	(31,564)	(31,443)
Consolidated totals	$ 1,793	$ 86,503	$ (172,264)
Assets:			
Systems Management	$ 324,005	$ 187,310	$ 150,549
Application Management	441,232	256,737	229,261
Federal Systems	70,658	67,290	58,445
Corporate and other	394,136	677,651	662,023
Consolidated totals	$1,230,031	$1,188,988	$1,100,278
Expenditures for Long-Lived Assets (including additions to computer software and excluding business acquisitions):			
Systems Management	$ 21,924	$ 19,745	$ 16,919
Application Management	32,716	34,239	13,782
Federal Systems	1,353	1,145	1,284
Corporate and other	5,056	5,925	18,878
Consolidated totals	$ 61,049	$ 61,054	$ 50,863
Depreciation and Amortization:			
Systems Management	$ 22,971	$ 16,485	$ 16,014
Application Management	27,078	21,084	17,698
Federal Systems	2,777	2,346	2,231
Corporate and other	5,232	4,778	2,601
Consolidated totals	$ 58,058	$ 44,693	$ 38,544
Revenue from the U.S. Government:			
Systems Management	$ 5,140	$ 3,364	$ 4,140
Application Management	16,154	10,635	7,455
Federal Systems	146,538	140,822	112,802
Consolidated totals	$ 167,832	$ 154,821	$ 124,397

The Company's revenue in North America and other markets at September 30, 1999, 1998 and 1997 and for the years then ended are summarized as follows (in thousands):

Geographical Information	1999	1998	1997
Revenue:			
North America and Latin America	$ 518,381	$ 454,599	$ 353,061
Europe	231,290	213,601	136,311
Asia-Pacific	57,333	51,115	40,263
Corporate and other		628	39,567
	$ 807,004	$ 719,943	$ 569,202
Assets:			
North America and Latin America	$ 639,515	$ 303,828	$ 253,376
Europe	155,090	176,026	156,401
Asia-Pacific	41,290	31,483	28,478
Corporate and other	394,136	677,651	662,023
	$1,230,031	$1,188,988	$1,100,278

Segment profit represents the operating profit (loss) of each reportable segment excluding reorganization costs and purchased research and development costs charged to expense. Other income (expense) items are not allocated to individual business segments. The amounts presented for "Corporate and other" include corporate expense, cash balances, marketable securities, income tax balances, other assets, inter-segment eliminations and, through June 30, 1997, the results of operations relating to the international distribution of certain Sterling Commerce software products.

The Company's long-lived assets are primarily located in the U.S.

5. Marketable Securities

At September 30, 1999 and 1998, all of the Company's marketable securities were classified as available-for-sale and consist of the following (in thousands):

	Aggregate Fair Value	Amortized Cost Basis	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses
September 30, 1999:				
U.S. corporate notes	$ 51,153	$ 51,573	$ 2	$(422)
Municipal obligations	56,679	55,981	747	(49)
Other	4,453	3,383	1,076	(6)
	$112,285	$110,937	$1,825	$(477)
September 30, 1998:				
Commercial paper	$ 51,734	$ 51,734		
U.S. corporate notes	90,319	89,601	$ 718	
U.S. government obligations	20,023	20,001	22	
Municipal obligations	141,835	141,633	202	
Other	6,626	6,333	293	
	$310,537	$309,302	$1,235	

At September 30, 1999, scheduled maturities of investments in debt securities were: $58,196,578 principal amount within one year and $49,635,539 principal amount between one and five years.

6. Accounts and Notes Receivable

Accounts and notes receivable consist of the following at September 30 (in thousands):

	1999	1998
Trade	$ 275,080	$ 181,256
Unbilled	45,503	36,295
	320,583	217,551
Less: Allowance for doubtful accounts	26,174	17,123
	$ 294,409	$ 200,428

At September 30, 1999 and 1998, accounts receivable include $56,026,000 and $45,820,000, respectively, due under contracts with the federal government and related agencies. The remainder of the Company's receivables is due principally from corporations in diverse industries located in North America, Europe and Asia-Pacific, which mitigates exposure to concentrations of credit risk. Trade receivables are generally not collateralized. The Company performs periodic credit evaluations of its customers' financial conditions.

7. Property and Equipment

Property and equipment consist of the following at September 30 (in thousands):

	1999	1998
Computer and peripheral equipment	$ 58,525	$ 45,729
Furniture, fixtures and other equipment	50,097	47,158
Leasehold improvements	26,649	23,671
	135,271	116,558
Less: Accumulated depreciation	63,134	49,832
	$ 72,137	$ 66,726

8. Credit Agreement

Effective July 1, 1997, the Company entered into an amended bank credit agreement ("Credit Agreement"). The Credit Agreement requires that certain financial ratios be maintained. Borrowings under the Credit Agreement bear interest at the lower of the lender's base rate or the Eurodollar lending rate plus one-half percent and mature on June 30, 2000. No amounts were borrowed during 1999 or outstanding under the Credit Agreement at September 30, 1999. At September 30, 1999, after giving effect to outstanding standby letters of credit in the aggregate amount of approximately $3,868,000, approximately $31,132,000 was available for borrowing under the Credit Agreement.

9. Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities consist of the following at September 30 (in thousands):

	1999	1998
Trade accounts payable	$ 32,469	$ 31,571
Accrued compensation	64,323	57,169
Accrued acquisition and reorganization costs	79,930	34,276
Other accrued liabilities	49,788	38,774
	$226,510	$161,790

Accrued acquisition and reorganization costs at September 30, 1999 are primarily due to the Information Advantage and Interlink acquisitions and the realignment of the application development business within the application management business segment, and are primarily for the remaining commitments pursuant to employee termination costs and benefits and the elimination of duplicate facilities and equipment.

10. Income Taxes

The provision (benefit) for income taxes on net income (loss) is composed of the following (in thousands):

	Years ended September 30		
	1999	1998	1997
Current:			
Federal	$25,719	$17,011	$11,309
State	2,205	2,928	2,310
Foreign	8,416	5,054	2,098
Deferred:			
Federal	10,178	16,557	(17,330)
State	872	1,489	(1,685)
Foreign	(2,167)	754	639
	$45,223	$43,793	$(2,659)

The effective income tax rate on income (loss) before income taxes differed from the federal income tax statutory rate for the following reasons (in thousands):

	Years ended September 30		
	1999	1998	1997
Tax expense (benefit) at U.S. federal statutory rate	$12,063	$41,943	$(47,095)
Increases (reductions) in tax expense (benefit) resulting from:			
Purchased research and development for which no income tax benefit was recognized	34,030		36,251
Effect of non-U.S. tax rates	(4,732)	(4,553)	(1,182)
Recognition of previously unrecognized deferred income tax asset			(3,022)
Nondeductible amortization of excess cost over net assets acquired	2,394	564	14,663
Foreign sales corporation	(2,337)	(1,896)	(1,891)
State income taxes, net of federal benefit	3,077	4,417	(125)
Unbenefitted losses		3,112	
Other	728	206	(258)
	$45,223	$43,793	$ (2,659)

Income (loss) before income taxes includes foreign pretax earnings (losses) of $41,363,000, $11,253,000 and $(7,021,000) for the years ended September 30, 1999, 1998 and 1997, respectively. Earnings of certain non-U.S. subsidiaries have been indefinitely reinvested and, accordingly, no provision has been made for taxes due upon remittance of these earnings.

Deferred income tax assets and liabilities reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's net deferred tax asset as of September 30 were as follows (in thousands):

	1999	1998
Deferred income tax assets:		
Net operating loss carryforwards	$ 50,166	$ 37,669
General business and alternative minimum tax credit carryforwards	5,381	6,799
Foreign tax credit carryforwards	780	1,232
Reserves and reorganization accruals	92,162	65,692
Deferred income tax assets	148,489	111,392
Deferred income tax liabilities:		
Capitalized software costs	51,206	21,729
Depreciation and amortization	5,065	5,709
Other future income tax liabilities	42,382	35,438
Deferred income tax liabilities	98,653	62,876
Deferred income tax asset net of deferred income tax liability	49,836	48,516
Less valuation allowance	(41,889)	(44,138)
Net deferred income tax asset	$ 7,947	$ 4,378

The valuation allowance relates principally to certain net operating loss and credit carryforwards. Although realization is not assured, management believes that future taxable income based on expected future earnings of the Company will more likely than not utilize a portion of the net operating loss carryforwards, tax credit carryforwards and other future tax deductions in existence at September 30, 1999, equivalent to the net deferred income tax asset. As there can be no assurances on amounts in excess of the net deferred income tax asset, the aforementioned valuation allowance has been recorded and may change as estimates during the carryforward periods change.

At September 30, 1999, the Company had net operating loss and tax credit carryforwards for federal income tax purposes of approximately $117,678,000 and $6,414,000, respectively. These carryforwards will expire at various times between 2000 and 2018, with approximately $109,200,000 of the net operating loss carryforwards expiring between 2008 and 2013. The utilization of substantially all of these carryforwards is restricted to future taxable income of certain of the Company's wholly owned subsidiaries and limited by Section 382 of the Internal Revenue Code of 1986, as amended ("the Code"). Thus, the Company's utilization of these carryforwards cannot be assured.

11. Commitments

The Company leases certain facilities and equipment under operating leases. Total rent expense for the years ended September 30, 1999, 1998 and 1997 was $27,649,000, $28,691,000 and $26,435,000, respectively. At September 30, 1999, minimum future rental payments due under all operating leases, net of estimated future sublease income, were as follows (in thousands):

2000	$ 29,284
2001	27,048
2002	20,872
2003	17,421
2004	15,791
Thereafter	48,516
	$158,932

12. Stockholders' Equity

Preferred Stock

The Company is authorized to issue up to 10,000,000 shares of preferred stock, par value $0.10 per share ("Preferred Stock"). The Board of Directors of Sterling Software has authorized the issuance of up to 1,250,000 shares of Preferred Stock, designated as Series A Junior Participating Preferred Stock ("Series A Junior Preferred Stock"), pursuant to the terms of the Rights Agreement dated as of December 18, 1996, as amended (the "Rights Plan"). The Board of Directors of the Company is authorized, without action by the stockholders, to issue Preferred Stock and fix for each series the number of shares, designation, dividend rights, voting rights, redemption rights and other rights.

Increase in Authorized Common Stock

On March 31, 1999, the Sterling Software stockholders approved an amendment to the Company's Certificate of Incorporation increasing the number of authorized shares of Common Stock from 125,000,000 shares to 250,000,000 shares.

Rights Plan

On December 18, 1996, the Board of Directors of the Company declared a dividend distribution of one right (a "Right") for each share of Common Stock outstanding at the close of business on December 31, 1996 (the "Record Date"), pursuant to the terms of the Rights Plan. The Rights Plan also provides, subject to specified exceptions and limitations, that shares of Common Stock issued after the Record Date will be entitled to and accompanied by Rights. Pursuant to the Rights Plan, one Right to purchase 1/100th of a share of Series A Junior Preferred Stock (structured so as to be substantially the equivalent of a share of Common Stock) is attached to each issued and outstanding share of Common Stock. Subject to certain conditions, each Right entitles the holder to purchase 1/100th of a share of Series A Junior Preferred Stock at a price (the "Purchase Price") of $100.00 per 1/100th of a share of Junior Preferred Stock (subject to adjustment).

In general, the Rights will not become exercisable, or transferable apart from the shares of Common Stock, unless a person or group of affiliated or associated persons becomes the beneficial owner of, or commences a tender offer that would result in beneficial ownership of, 15% or more of the outstanding shares of Common Stock (any such person or group of persons being referred to in the Rights Plan as an "Acquiring Person"). Thereafter, under certain circumstances, each Right (other than any Rights that are or were beneficially owned by an Acquiring Person, which Rights will be void) could become exercisable to purchase at the Purchase Price a number of shares of Common Stock (or, in certain circumstances, the common stock of a company into which the Company is merged or consolidated or to which the Company sells all or substantially all of its assets) having a market value equal to two times the Purchase Price. The Rights will expire on December 31, 2006, unless earlier redeemed by Sterling Software at a redemption price of $.01 per Right (subject to adjustment), or otherwise exchanged or amended in accordance with the terms of the Rights Plan.

Stock Options

In May 1996 Sterling Software's stockholders approved the 1996 Stock Option Plan (the "1996 Plan"). Options granted pursuant to the 1996 Plan become exercisable generally at a rate of 25% per year and expire either five or ten years from the date of grant, although options may be granted with shorter vesting periods and shorter terms. In March 1999, the Board of Directors of Sterling Software adopted the 1999 Employee Stock Option Plan (the "1999 Plan"), a broad based stock option plan, participation in which is limited to employees other than directors and officers. Options granted pursuant to the 1999 Plan become exercisable generally at the rate of 25% per year and expire five years from the date of the grant, although options may be granted with alternative vesting periods and terms that comply with local tax laws in certain countries. Any tax benefit associated with the exercise of options is credited to paid-in capital.

Stock option transactions for the three years ended September 30, 1999 are summarized below:

	1999		1998		1997	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Options outstanding at beginning of year	17,740,718	$14.61	18,686,785	$14.19	757,483	$ 9.63
Options assumed in business acquisitions	1,367,339	12.51	174,146	10.49		
Options granted	4,442,469	25.24	842,482	23.44	19,185,277	14.27
Options exercised	(1,462,537)	13.47	(1,327,084)	13.48	(212,036)	6.87
Options terminated and canceled	(779,128)	26.19	(635,611)	15.24	(1,043,939)	13.84
Options outstanding at end of year	21,308,861	16.34	17,740,718	14.61	18,686,785	14.19
Options exercisable at end of year	12,300,332	14.20	10,694,178	14.03	9,399,391	13.93
Options available for grant under the Company's 1996 Plan at the end of the year	1,196,867		883,888		971,090	

Information related to options outstanding at September 30, 1999 is summarized below:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Options	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
$ 2.00—$ 13.63	2,558,404	6 Years	$11.83	1,818,909	$11.58
$13.64—$ 14.13	11,985,393	6 Years	$14.12	9,451,849	$14.12
$14.14—$ 24.50	5,745,475	5 Years	$20.83	948,206	$17.04
$24.51—$503.74	1,019,589	6 Years	$28.52	81,368	$49.18
	21,308,861			12,300,332	

Employee Stock Purchase Plan

In February 1998 Sterling Software's stockholders approved the Company's Employee Stock Purchase Plan (the ''ESPP''). Under provisions of the ESPP, employees can purchase Common Stock at a specified price through payroll deductions during an offering period, currently established on a semi-annual basis. During the year ended September 30, 1999, approximately 565,000 shares were issued to employees under the ESPP. At September 30, 1999, approximately $2,504,000 had been contributed by employees that will be used to purchase shares at the end of the offering period in December 1999. At September 30, 1999, the Company could issue up to approximately 147,000 shares under the ESPP, based on withholdings through September 30, 1999 and the Company's stock price at September 30, 1999.

Statement of Financial Accounting Standard No. 123 ("FAS 123")

FAS 123 requires disclosure of pro forma net earnings and net earnings per common share information computed as if the Company had accounted for its employee stock options and the Company's ESPP under the fair value method set forth in FAS 123. The fair value of the Company's outstanding stock options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions:

	Years ended September 30		
	1999	1998	1997
Expected option life in years	4.0	4.0	4.0
Risk-free interest rate	5.64%	5.59%	6.14%
Volatility factor	0.40	0.40	0.40

The Company does not have a history of paying cash dividends and none have been assumed in estimating the fair value of its options or rights under the ESPP.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including expected stock price volatility. Because, among other things, changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable measure of the fair value of its employee stock options or ESPP participation rights. For purposes of pro forma disclosures, the estimated fair value of the options and ESPP participation rights is amortized to expense over the options' vesting periods and the ESPP's semi-annual offering periods.

	Years ended September 30		
	1999	1998	1997
Pro forma net income (loss)	$(28,539)	$64,658	$(172,864)
Pro forma net income (loss) per share:			
Basic	$ (.34)	$ .80	$ (2.17)
Diluted	$ (.34)	$ .76	$ (2.17)
Weighted average fair value of options granted during the year	$ 9.96	$ 9.24	$ 6.00

13. Postretirement Benefits

The Company has a plan to provide retirement benefits under the provisions of Section 401(k) of the Code for full time employees and for part time employees who have completed a specified term of service. Pursuant to this plan, eligible participants may elect to contribute a percentage of their annual gross compensation and the Company will contribute additional amounts, as provided by the plan. Benefits under the plan are limited to the assets of the plan. Company contributions charged to expense during 1999, 1998 and 1997 were $5,185,000, $3,908,000 and $2,829,000, respectively. One-half of the Company's contributions are invested in the Company's Common Stock. Effective October 1, 1996, the portion of the plan consisting of the Company's contributions was designated as an employee stock ownership plan. During 1999, 1998 and 1997, the investment of the Company's contributions included 102,953, 102,407 and 39,542 shares of Common Stock of the Company, respectively.

14. Change-in-Control and Employment Arrangements

As of September 30, 1999, the Company had change-in-control agreements with 18 of its current or former officers providing for payments based on the individual officer's respective cash compensation and benefits if there is a change in control (as defined) in the Company and actual or constructive termination of employment occurs. The change-in-control agreements further provide that the Company will make certain payments to each individual party thereto to compensate such individual for the economic effect of such individual's liability to pay excise taxes to the extent that payments received by such individual, pursuant to the change-in-control agreement, stock option agreements or otherwise, are considered as "contingent on a change in ownership or control" under Section 280G of the Code (each, a "Tax Payment"). Based on certain assumptions, at September 30, 1999, the Company's maximum liability for cash compensation, benefits and Tax Payments under these agreements was estimated to be approximately \$43,000,000. The Company's actual liability, if any, under these agreements will depend on a number of factors, including the level of salaries, bonuses and benefits being received by the then covered individuals prior to a change in control and the price at which any change-in-control transaction occurs.

As of September 30, 1999, the Company had entered into severance agreements with 11 of its officers providing for payments based on the individual officer's respective cash compensation and continuation of benefits if the Company terminates the officer's employment. In addition, the Company has entered into an agreement with one executive officer that provides for an annual base salary plus agreed-upon bonuses and benefits and converts to a consulting agreement upon the occurrence of certain events. The Company has also entered into a consulting agreement with one of its directors that provides for termination payments, based on the director's consulting compensation, upon the occurrence of certain events. At September 30, 1999, the Company's maximum estimated liability for future salaries, fees, bonuses and benefits under these agreements was approximately \$16,000,000.

15. Quarterly Financial Results (Unaudited)

The Company's consolidated operating results for each quarter of 1999 and 1998 are summarized below (in thousands, except per share data). The Company's financial statement for periods prior to the Synon Merger represent the combined financial statements of the previously separate entities:

	Three Months Ended			
	December 31	March 31	June 30	September 30
Year ended September 30, 1999:				
Revenue				
Products	$ 64,313	$ 82,868	$ 99,238	$117,344
Product support	51,541	50,849	52,163	54,335
Services	58,605	58,669	58,364	58,715
	174,459	192,386	209,765	230,394
Cost of sales				
Products and product support	17,948	19,821	21,034	25,335
Services	53,160	50,724	52,565	52,810
	71,108	70,545	73,599	78,145
Product development and enhancement	9,355	9,524	9,250	11,443
Selling, general and administrative	61,609	67,840	74,618	84,989
Reorganization costs	19,655		14,098	65,867
Purchased research and development	9,623		22,468	51,475
Net income (loss)	4,206	35,160	9,311	(59,433)
Weighted average common shares outstanding	82,536	83,197	83,536	83,708
Income (loss) per common share:				
Basic	$ .05	$ .42	$ .11	$ (.71)
Diluted	.05	.40	.11	(.71)
Year ended September 30, 1998:				
Revenue				
Products	$ 64,979	$ 69,922	$ 71,266	$ 81,668
Product support	45,910	45,656	46,425	45,640
Services	57,990	62,006	63,100	65,381
	168,879	177,584	180,791	192,689
Cost of sales				
Products and product support	18,072	16,991	17,007	19,159
Services	51,108	53,513	54,708	57,108
	69,180	70,504	71,715	76,267
Product development and enhancement	10,608	9,410	8,090	8,054
Selling, general and administrative	69,004	67,993	66,407	61,046
Reorganization costs				45,162
Net income	17,322	23,916	27,211	7,595
Weighted average common shares outstanding	79,785	80,015	80,650	82,075
Income per common share:				
Basic	$ .22	$ .30	$ .34	$ .09
Diluted	.21	.28	.32	.09

Information concerning the Company's operations by business segment for each quarter of 1999, 1998 and 1997 is set forth below (in thousands):

	Three Months Ended			
	December 31	March 31	June 30	September 30
Year ended September 30, 1999:				
Revenue:				
Systems Management	$ 48,241	$ 60,279	$ 76,120	$105,486
Application Management	87,598	93,117	93,106	84,024
Federal Systems	38,620	38,990	40,539	40,884
Consolidated totals	$174,459	$192,386	$ 209,765	$230,394
Operating Profit (Loss):				
Systems Management	$ 15,616	$ 23,193	$ 29,479	$ 46,801
Application Management	22,028	26,300	27,514	13,533
Federal Systems	2,810	3,098	3,136	3,337
Reorganization costs	(19,655)		(14,098)	(65,867)
Purchased research and development	(9,623)		(22,468)	(51,475)
Corporate and other	(8,067)	(8,114)	(7,831)	(7,854)
Consolidated totals	$ 3,109	$ 44,477	$ 15,732	$(61,525)
Year ended September 30, 1998:				
Revenue:				
Systems Management	$ 42,061	$ 50,314	$ 49,983	$ 62,171
Application Management	92,525	91,365	93,649	88,474
Federal Systems	33,665	35,905	37,159	42,044
Corporate and other	628			
Consolidated totals	$168,879	$177,584	$ 180,791	$192,689
Operating Profit (Loss):				
Systems Management	$ 13,838	$ 18,680	$ 19,524	$ 25,295
Application Management	11,809	16,591	20,418	27,163
Federal Systems	2,239	2,468	2,412	2,792
Reorganization costs				(45,162)
Corporate and other	(7,799)	(8,062)	(7,775)	(7,928)
Consolidated totals	$ 20,087	$ 29,677	$ 34,579	$ 2,160
Year ended September 30, 1997:				
Revenue:				
Systems Management	$ 36,950	$ 43,916	$ 46,045	$ 57,768
Application Management	44,427	40,310	41,327	97,102
Federal Systems	27,858	27,954	30,919	35,059
Corporate and other	10,381	13,040	15,265	881
Consolidated totals	$119,616	$125,220	$ 133,556	$190,810
Operating Profit (Loss):				
Systems Management	$ 12,889	$ 17,099	$ 18,530	$ 22,111
Application Management	4,408	3,120	3,522	12,697
Federal Systems	2,395	2,303	1,826	2,165
Reorganization costs			(106,037)	
Purchased research and development			(137,849)	
Corporate and other	(8,767)	(9,075)	(6,328)	(7,273)
Consolidated totals	$ 10,925	$ 13,447	$(226,336)	$ 29,700

Item 9. ***Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.***

None.

PART III

Item 10. ***Directors and Executive Officers of the Registrant.***

Information concerning the directors of the Company will be set forth in the Proxy Statement to be provided to stockholders in connection with the Company's 1999 Annual Meeting of Stockholders (the "Proxy Statement") under the heading "Election of Directors", which information is incorporated herein by reference. Information concerning compliance with Section 16 of the Securities Exchange Act of 1934, as amended, by persons subject to such Section will be set forth in the Proxy Statement under the heading "Section 16(a) Beneficial Ownership Reporting Compliance", which information is incorporated herein by reference. The name, age and position of each executive officer of the Company is set forth under the heading "Executive Officers" in Part I of this report, which information is incorporated herein by reference.

Item 11. ***Executive Compensation.***

Information concerning executive compensation will be set forth in the Proxy Statement under the headings "Management Compensation" and "Election of Directors", which information is incorporated herein by reference. Information contained in the Proxy Statement under the caption "Management Compensation—Report of the Executive and Option Committees on Executive Compensation" and "—Stock Performance Chart" is not incorporated by reference herein.

Item 12. ***Security Ownership of Certain Beneficial Owners and Management.***

Information concerning security ownership of certain beneficial owners and management will be set forth in the Proxy Statement under the heading "Security Ownership of Management and Certain Stockholders", which information is incorporated herein by reference.

Item 13. ***Certain Relationships and Related Transactions.***

Information concerning certain relationships and related transactions will be set forth in the Proxy Statement under the headings "Management Compensation—Executive and Stock Option Committee Interlocks and Insider Participation" and "Certain Transactions", which information is incorporated herein by reference.

PART IV

Item 14. ***Exhibits, Financial Statement Schedules and Reports on Form 8-K.***

(a) The following documents are filed as a part of this Annual Report on Form 10-K.

1. Consolidated Financial Statements:

   See Index to Consolidated Financial Statements at Item 8.

2. Consolidated Financial Statement Schedule:

   Schedule II—Valuation and Qualifying Accounts for the Years Ended September 30, 1999, 1998 and 1997.

3. Exhibits:

- 2.1 Asset Purchase Agreement, dated April 18, 1997, by and between Texas Instruments Incorporated and the Company (2), (3)
- 2.2 Amendment No. 1 to Asset Purchase Agreement, dated June 19, 1997, by and between Texas Instruments Incorporated, the Company and certain subsidiaries of the Company, and Amendment No. 2 to Asset Purchase Agreement, dated June 28, 1997, by and between Texas Instruments Incorporated, the Company and certain subsidiaries of the Company (4)
- 2.3 Agreement and Plan of Merger, dated as of May 27, 1998, among the Company, Sterling Software (Connecticut), Inc. and Mystech Associates, Inc. (2), (5)
- 2.4 Agreement and Plan of Merger, dated as of June 20, 1998, among the Company, Sterling Software (Southern), Inc. and Synon Corporation (2), (6)
- 2.5 Agreement and Plan of Merger, dated as of August 27, 1998, among the Company, Sterling Software (Southern), Inc. and Cayenne Software, Inc. (1), (2)
- 2.6 Asset Purchase Agreement, dated as of March 6, 1999, between the Company, Spectra Logic Corporation, Sterling Software (U.S.A.), Inc., Nathan C. Thompson and Michael J. Sausa (2), (7)
- 2.7 Agreement and Plan of Merger, dated as of March 23, 1999, among the Company, Sterling Software (Southwest), Inc. and Interlink Computer Sciences, Inc. (2), (8)
- 2.8 Agreement and Plan of Merger, dated as of July 12, 1999, among the Company, Sterling Software (Arizona), Inc. and CoreData, Inc. (1), (2)
- 2.9 Agreement and Plan of Merger, dated as of July 15, 1999, among the Company, Sterling Software Acquisition Corp. and Information Advantage, Inc. (2), (15)
- 3.1 Restated Certificate of Incorporation of the Company (1)
- 3.2 Restated Bylaws of the Company (1)
- 4.1 Form of Common Stock Certificate (10)
- 4.2 Rights Agreement, dated December 18, 1996, by and between the Company and The First National Bank of Boston, as Rights Agent (11)
- 4.3 First Amendment to Rights Agreement, dated as of March 12, 1998, by and between the Company and BankBoston, N.A., as Rights Agent (12)
- 10.1 Supplemental Executive Retirement Plan II of Informatics General Corporation (''SERP II''), as amended by Amendment to SERP II (13), (14)
- 10.2 Sterling Software, Inc. Amended and Restated Employee Stock Purchase Plan (effective as of March 20, 1998) (9), (14)
- 10.3 Sterling Software, Inc. Deferred Compensation Plan (restated effective December 21, 1998) (14), (19)
- 10.4 Sterling Software, Inc. Amended and Restated 1996 Stock Option Plan (1), (14)
- 10.5 Form of Stock Option Agreement between the Company and each of Sam Wyly and Charles J. Wyly, Jr. (14), (16)
- 10.6 Form of Stock Option Agreement between the Company and Sterling L. Williams (14), (16)

10.7	Form of Stock Option Agreement between the Company and Geno P. Tolari (14), (16)
10.8	Form of Stock Option Agreement between the Company and F.L. ''Mike'' Harvey (1), (14)
10.9	Form of Amendment to Stock Option Agreement, dated March 20, 1998, between the Company and each of its executive officers (9), (14)
10.10	Fiscal 1999 Executive Compensation Plan for Group Presidents (14), (23)
10.11	Fiscal 2000 Executive Compensation Plan for Group Presidents (1), (14)
10.12	Consulting Agreement, dated October 1, 1996, between the Company and Michael C. French (14), (17)
10.13	CEO Agreement, dated February 12, 1996, between the Company and Sterling L. Williams (14), (18)
10.14	Amendment to CEO Agreement, dated May 31, 1998, between the Company and Sterling L. Williams (14), (23)
10.15	Form of Change-in-Control Severance Agreement, dated October 22, 1999, between the Company and each of Sam Wyly and Charles J. Wyly, Jr. (1), (14)
10.16	Form of Change-in-Control Severance Agreement, dated October 22, 1999, between the Company and Sterling L. Williams (1), (14)
10.17	Form of Change-in-Control Severance Agreement, dated October 22, 1999, between the Company and each of Geno P. Tolari and F.L. ''Mike'' Harvey (1), (14)
10.18	Form of Severance Agreement, dated February 12, 1996, between the Company and Geno P. Tolari (14), (18)
10.19	Form of Severance Agreement, dated June 30, 1997, between the Company and F.L. ''Mike'' Harvey (1), (14)
10.20	Form of Amendment to Severance Agreement, dated August 15, 1997, between the Company and each of Geno P. Tolari and F.L. ''Mike'' Harvey (14), (16)
10.21	Form of Indemnity Agreement between the Company and each of its directors and officers (1)
10.22	Third Amended and Restated Revolving Credit Agreement, dated July 1, 1997, by and among the Company, BankBoston, N.A. and Bank One, Texas, National Association and BankBoston, N.A. as agent for itself and Bank One, Texas, National Association (20)
10.23	Tax Allocation Agreement, dated March 4, 1996, between the Company and Sterling Commerce, Inc. (21)
10.24	Indemnification Agreement, dated March 4, 1996, between the Company and Sterling Commerce, Inc. (22)
10.25	Agreement dated September 19, 1996 by Sterling Commerce, Inc. for the benefit of the Company (17)
21.1	Subsidiaries of the Company (1)
23.1	Consent of Ernst & Young LLP (1)
27.1	Financial Data Schedule (1)

(1) Filed herewith.

(2) In accordance with Item 601 of Regulation S-K, the schedules and exhibits relating to the agreement have been omitted. The Company will furnish supplementally to the Securities and Exchange Commission such schedules and exhibits upon request.

(3) Previously filed as an exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1997 and incorporated herein by reference (SEC File No. 97605952).

(4) Previously filed as an exhibit to the Company's Current Report on Form 8-K dated June 30, 1997, as amended, and incorporated herein by reference (SEC File No. 97633732).

(5) Previously filed as Appendix A to the Proxy Statement/Prospectus forming a part of the Company's Registration Statement No. 333-53747, dated May 28, 1999, and incorporated herein by reference (SEC File No. 98632583).

(6) Previously filed as an exhibit to the Company's Current Report on Form 8-K dated June 21, 1998 and incorporated herein by reference (SEC File No. 98652676).

(7) Previously filed as an exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1999 and incorporated herein by reference (SEC File No. 99617213).

(8) Previously filed as an exhibit to the Company's Tender Offer Statement on Schedule 14D-1 dated March 30, 1999 and incorporated herein by reference (SEC File No. 99579124).

(9) Previously filed as an exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1998 and incorporated herein by reference (SEC File No. 98602908).

(10) Previously filed as an exhibit to the Company's Registration Statement No. 2-86825 and incorporated herein by reference (SEC File No. S766400).

(11) Previously filed as an exhibit to the Company's Current Report on Form 8-K dated December 18, 1996 and incorporated herein by reference (SEC File No. 96682898).

(12) Previously filed as an exhibit to the Company's Registration Statement No. on Form 8-A/A filed April 3, 1998 and incorporated herein by reference (SEC File No. 98587026).

(13) Previously filed as an exhibit to the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 1993 and incorporated herein by reference (SEC File No. 93278187).

(14) Management contract or compensatory plan or arrangement required to be filed as an exhibit to this form pursuant to Item 14(c) of Form 10-K.

(15) Previously filed as an exhibit to the Company's Tender Offer Statement on Schedule 14D-1 dated July 21, 1999 and incorporated herein by reference (SEC File No. 99667898).

(16) Previously filed as an exhibit to the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 1997 and incorporated herein by reference (SEC File No. 97724719).

(17) Previously filed as an exhibit to the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 1996 and incorporated herein by reference (SEC File No. 96672084).

(18) Previously filed as an exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1996 and incorporated herein by reference (SEC File No. 96560921).

(19) Previously filed as an exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 1998 and incorporated herein by reference (SEC File No. 99531526).

(20) Previously filed as an exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1997 and incorporated herein by reference (SEC File No. 97660034).

(21) Previously filed as an exhibit to Registration Statement No. 33-80595 filed by Sterling Commerce, Inc. and incorporated herein by reference (File/ID #001-14196, SEC File No. 96042701).

(22) Previously filed as an exhibit to the Quarterly Report on Form 10-Q for the quarter ended March 31, 1996 filed by Sterling Commerce, Inc. and incorporated herein by reference (File ID #001-14196, SEC File No. 96560893).

(23) Previously filed as an exhibit to the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 1998 and incorporated herein by reference (SEC File No. 98755025).

(b) Reports on Form 8-K.

During the three-month period ended September 30, 1999, the Company filed a Report on Form 8-K dated September 2, 1999. Such report includes information reported under Item 5—Other Events.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

STERLING SOFTWARE, INC.

Date: November 11, 1999

By /s/ STERLING L. WILLIAMS

Sterling L. Williams
President, Chief Executive Officer and Director
(Principal Executive Officer)

Date: November 11, 1999

/s/ R. LOGAN WRAY

R. Logan Wray
Senior Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)

1490-10K-99

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K/A

AMENDMENT NO. 1

(X) ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended September 30, 1999

OR

( ) TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ____________ to ____________

Commission File No. 1-8465

STERLING SOFTWARE, INC.

(Exact name of registrant as specified in its charter)

Delaware	**75-1873956**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

300 Crescent Court, Suite 1200
Dallas, Texas 75201
(Address of principal executive offices, including zip code)
Registrant's telephone number, including area code: **(214) 981-1000**

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, $0.10 Par Value	New York Stock Exchange
Rights to Purchase Series A Junior Participating Preferred Stock, $0.10 Par Value	New York Stock Exchange

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:
None

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 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. ____

As of December 31, 1999, 82,034,929 shares of the Registrant's Common Stock were outstanding.

The aggregate market value of the Registrant's Common Stock held by non-affiliates of the Registrant was $2,505,585,820 based on the $31.50 closing sales price of the Registrant's Common Stock on the New York Stock Exchange on December 31, 1999.

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

AMENDMENT TO APPLICATION OR REPORT
FILED PURSUANT TO SECTION 12, 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

STERLING SOFTWARE, INC.

FORM 10-K/A
AMENDMENT NO. 1

The undersigned registrant hereby amends the following items, financial statements, exhibits or other portions of its Annual Report on Form 10-K for the fiscal year ended September 30, 1999 as set forth in the pages attached hereto:

Item 10. Directors and Executive Officers of the Registrant.

Item 11. Executive Compensation.

Item 12. Security Ownership of Certain Beneficial Owners and Management.

Item 13. Certain Relationships and Related Transactions.

Item 14. Exhibits, Financial Statement Schedules and Reports on Form 8-K—Exhibits

PART III

Item 10. ***Directors and Executive Officers of the Registrant***

The name, age and position of each executive officer of Sterling Software, Inc. (the "Company") is set forth under the heading "Executive Officers" in Part I of the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 1999.

Board of Directors

The Company's Certificate of Incorporation provides for a board of directors (the "Board") divided into three classes, as nearly equal in number as possible, with the term of office of one class expiring each year at the Company's Annual Meeting of Stockholders. Each class of directors is elected for a term of three years except in the case of elections to fill vacancies or newly created directorships.

The current Class A directors of the Company, whose terms will expire at the Annual Meeting of Stockholders in 2000, are as follows:

Robert J. Donachie, age 71. Mr. Donachie has served as a director of the Company since May 1983. He has been principally employed as a private business consultant since March 1981. Mr. Donachie formerly served as President of the Institute of Management Accountants, a worldwide professional organization devoted to the development of accounting and control practices and promotion of ethical standards, and he remains a lifetime member of its Board of Directors. Mr. Donachie is Chairman of the Audit Committee and a member of the 1996 Special Stock Option Committee of the Board.

Alan W. Steelman, age 57. Mr. Steelman has served as a director of the Company since February 1997. He is President of Steelman Stonebridge, Inc., a corporate advisory and investment firm. From 1993 through August 1999, he was a Senior Principal with Monitor Company, a leading international management consulting firm. Mr. Steelman also currently serves as Vice President of Consulting for Maxager Technology, a software company based in San Rafael, California, as a director of Aristocrat Leisure Ltd., a software and machine manufacturing firm based in Sydney, Australia, and serves on the Advisory Board of Asia Information Services, a Beijing-based information technology company. Prior to joining Monitor Company, Mr. Steelman was Chief Operating Officer of Alexander Proudfoot Company, a consulting company listed on The London Stock Exchange. During his 15 years at Alexander Proudfoot, Mr. Steelman held several assignments, including Group President of the Asia-Pacific region and Executive Vice President of worldwide sales and marketing. Prior to joining Alexander Proudfoot, Mr. Steelman served in the U.S. Congress, representing Texas' 5th Congressional District, and also held several appointed positions in government. Mr. Steelman is a member of the Audit Committee and the 1996 Special Stock Option Committee of the Board.

Evan A. Wyly, age 38. Mr. Wyly has served as a director of the Company since July 1992. He has been a Managing Partner of Maverick Capital, Ltd., an investment fund management company, since 1991. In 1988, Mr. Wyly founded Premier Partners Incorporated, a private investment firm, and served as its President prior to joining Maverick Capital, Ltd. Mr. Wyly also currently serves as a director of Sterling Commerce, Inc., a provider of electronic commerce software and network services, and as a director of Michaels Stores, Inc., a specialty retailer.

The current Class B directors of the Company, whose terms will expire at the Company's Annual Meeting of Stockholders in 2001, are as follows:

Charles J. Wyly, Jr., age 66. Mr. Wyly co-founded the Company in 1981 and since such time has served as a director of the Company, and as Vice Chairman since 1984. He served as an officer and director of University Computing Company, a computer software and services company, from 1964 to 1975, including President from 1969 to 1973. Mr. Wyly and his brother, Sam Wyly, founded Earth Resources Company, an oil refining and silver mining company, and Charles J. Wyly, Jr. served as its Chairman of the Board from 1968 to 1980. Mr. Wyly served as Vice Chairman of the Bonanza Steakhouse chain from 1967 to 1989. Mr. Wyly currently serves as Vice

Chairman of Michaels Stores, Inc., as a director of Scottish Annuity & Life Holdings, Ltd., a variable life insurance and reinsurance company, and as a director of Sterling Commerce, Inc. Mr. Wyly is a member of the Executive Committee and the 1996 and 1999 Stock Option Committees of the Board. Mr. Wyly is the father-in-law of Donald R. Miller, Jr., also a director of the Company.

Michael C. French, age 56. Mr. French has served as a director of the Company since July 1992. He currently serves as Chief Executive Officer, President and a director of Scottish Annuity & Life Holdings, Ltd. Mr. French is also a Partner of Maverick Capital, Ltd. and a consultant to the international law firm of Jones, Day, Reavis & Pogue. He was a partner with the law firm of Jackson & Walker, L.L.P. from 1976 through 1995. Mr. French is also a director of Michaels Stores, Inc.

Paul V. Barber, age 38. Mr. Barber has served as a director of the Company since December 1999. He has served as a General Partner of JMI Equity Fund, a private equity investment firm, since November 1998. From August 1990 to September 1998, Mr. Barber was employed by Alex. Brown & Sons, an investment banking firm, most recently as a managing director. He also currently serves as a director of eBenX, Inc., a provider of e-commerce and connectivity solutions for healthcare transactions.

Mr. Phillip A. Moore served as a Class B director until his retirement and resignation from the Board on December 14, 1999.

The current Class C directors of the Company, whose terms will expire at the Company's Annual Meeting of Stockholders in 2002, are as follows:

Sam Wyly, age 65. Mr. Wyly has served as Chairman of the Board since co-founding the Company in 1981. He also serves as Chairman of the Executive and 1996 and 1999 Stock Option Committees of the Board. Companies founded by Mr. Wyly were among the forerunners of the computer software and electronic commerce industries and the Internet. In 1963, he founded University Computing Company, which became one of the largest computer service and software companies. His data transmission company, Datran, Inc., was one of the pioneering telecommunications ventures that broke up the telephone monopoly. Sterling Commerce, Inc., a leader in this industry, was spun off to the Company's stockholders in 1996 and Mr. Wyly serves as Chairman of its Executive Committee. Mr. Wyly also serves as Chairman of Michaels Stores, Inc. and Chairman of Scottish Annuity & Life Holdings, Ltd. and is Founding Partner of the General Partner of Maverick Capital, Ltd. Mr. Wyly is the father of Evan Wyly, also a director of the Company.

Sterling L. Williams, age 56. Mr. Williams co-founded the Company in 1981 and since such time has served as President, Chief Executive Officer and a director of the Company. Mr. Williams has served as Chairman of the Board and a director of Sterling Commerce, Inc. since December 1995. From December 1995 to October 1996, Mr. Williams also served as Chief Executive Officer of Sterling Commerce, Inc. Mr. Williams is a member of the Executive Committee and the 1996 and 1999 Stock Option Committees of the Board.

Donald R. Miller, Jr., age 45. Mr. Miller has served as a director of the Company since September 1993. He has served as Vice President-Market Development of Michaels Stores, Inc. since November 1990 and also currently serves as a director of Michaels Stores, Inc.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), requires the Company's directors and executive officers, and persons who own more than 10% of the Company's outstanding common stock, $.10 par value (the "Common Stock"), to file initial reports of ownership and reports of changes in ownership of Common Stock with the Securities and Exchange Commission (the "SEC") and the New York Stock Exchange (the "NYSE"). Such persons are required by SEC regulations to furnish the Company with copies of all Section 16(a) reports they file.

Based solely on its review of such reports received by the Company with respect to fiscal 1999 and written representations from such reporting persons, the Company believes that, except as noted herein, all reports required to be filed under Section 16(a) have been timely filed by such persons. A Form 4 was filed on behalf of Sterling L.

Williams on January 7, 2000 disclosing the previously unreported sale of Common Stock by his spouse. The subject shares were acquired by his spouse prior to their marriage and Mr. Williams disclaimed beneficial ownership of such securities held and sold by his spouse.

Item 11. ***Executive Compensation.***

Summary Compensation Table

The following table sets forth certain information regarding compensation paid or accrued for services rendered during each of the Company's last three fiscal years to the Company's Chief Executive Officer and each of the other four most highly compensated executive officers of the Company and its subsidiaries (collectively, the "Named Executive Officers") based on salary and bonus earned during fiscal 1999.

		Annual Compensation			Long Term Compensation Awards	
Name and Principal Position	Year	Salary (1)	Bonus (1)	Other Annual Compensation(2)	Securities Underlying Options(3)	All Other Compensation
Sterling L. Williams	1999	$800,000	$400,000	$91,863(4)	0	$42,016(5)
President, Chief Executive	1998	650,000	250,000	22,539(6)	0	47,550
Officer and Director	1997	650,000	250,000	35,868(6)	3,600,000	42,252
Sam Wyly	1999	1,000,000(7)	500,000	24,281(6)	0	187,313(8)
Chairman of the	1998	1,000,000(7)	500,000	38,248(6)	0	156,881
Board and Director	1997	1,000,000(7)	500,000	53,363(6)	3,600,000	182,691
Charles J. Wyly, Jr.	1999	500,000(9)	250,000	23,308(6)	0	34,119(10)
Vice Chairman of the	1998	500,000(9)	250,000	44,197(6)	0	41,640
Board and Director	1997	500,000(9)	250,000	29,249(6)	1,800,000	49,669
Geno P. Tolari	1999	520,000	255,000	30,342(6)	0	12,967(11)
Executive Vice President and	1998	485,000	240,000	25,043(6)	0	20,805
Chief Operating Officer	1997	435,000	215,000	3,302(6)	1,200,000	9,121
F. L. "Mike" Harvey	1999	285,000	160,660	0	0	4,800(12)
Senior Vice President and	1998	285,000	137,080	0	0	0
Group President	1997	142,500	0	76,235(13)	350,000	0

(1) Reflects salary and bonus earned during the fiscal year. In some instances, the payment of all or a portion of salary or bonus was deferred to a subsequent year.

(2) Excludes perquisites and other personal benefits if the aggregate amount of such compensation is less than the lesser of $50,000 or 10% of the total annual salary and bonus reported for such Named Executive Officer.

(3) Reflects options to purchase Common Stock. Options to purchase Common Stock have been adjusted to reflect the two-for-one stock split dividend paid on April 3, 1998, consisting of one share of Common Stock for each share of Common Stock held. The Company has not granted stock appreciation rights.

(4) Includes $31,915 relating to Mr. Williams' personal use of a Company-owned aircraft and a $29,716 reimbursement for the payment of taxes.

(5) Consists of $4,800 in Company contributions to the Sterling Software, Inc. Savings and Security Plan (the "Savings Plan") and $37,216 in respect of premiums on life insurance policies for Mr. Williams' benefit.

(6) Consists of reimbursements for the payment of taxes.

(footnotes continued on following page)

(7) Includes director's fees of $500,000 paid to Sam Wyly in each of fiscal 1999, 1998 and 1997 for his services as Chairman of the Board of the Company.
(8) Consists of $4,800 in Company contributions to the Savings Plan, $29,319 in respect of premiums on a life insurance policy for Mr. Wyly's benefit and $153,194 representing compensation deemed received by Mr. Wyly as a result of insurance policy premiums paid by the Company pursuant to a split dollar insurance agreement (which dollar amount was determined based on an actuarial computation in accordance with SEC regulations).
(9) Includes director's fees of $250,000 paid to Charles J. Wyly, Jr. in each of fiscal 1999, 1998 and 1997 for his services as Vice Chairman of the Board of the Company.
(10) Consists of $4,800 in Company contributions to the Savings Plan and $29,319 in respect of premiums on a life insurance policy for Mr. Wyly's benefit.
(11) Consists of $4,800 in Company contributions to the Savings Plan and $8,167 in respect of premiums on a life insurance policy for Mr. Tolari's benefit.
(12) Consists of $4,800 in company contributions to the Savings Plan.
(13) Consists of a reimbursement of $76,235 in relocation expenses.

Option Grants in Fiscal 1999

No options to purchase Common Stock were granted to any Named Executive Officer during fiscal 1999. The Company has not granted stock appreciation rights.

Option Exercises in Fiscal 1999 and Fiscal Year-End Option Values

The following table provides information related to options to purchase Common Stock exercised by the Named Executive Officers during fiscal 1999 and the number and value of such options held at September 30, 1999, the last day of fiscal 1999. The Company does not have any outstanding stock appreciation rights.

Name	Shares Acquired On Exercise	Value Realized (1)	Number of Securities Underlying Unexercised Options at September 30, 1999		Value of Unexercised In-the-Money Options at September 30, 1999 (2)	
			Exercisable	Unexercisable	Exercisable	Unexercisable
Sterling L. Williams	0	$ 0	3,600,000	0	$ 21,350,000	$ 0
Sam Wyly	0	0	1,875,000(3)	0	11,115,625(3)	0
Charles J. Wyly, Jr.	0	0	900,000(4)	0	5,337,500(4)	0
Geno P. Tolari	100,000	1,037,500	500,000	325,000	2,937,500	1,640,625
F. L. "Mike" Harvey	62,500	651,300	87,500	175,000	432,813	865,625

(1) Value was calculated based on the difference between the option price and the closing market price of Common Stock on the date of exercise multiplied by the number of shares to which the exercise related.
(2) The closing price of the Common Stock as reported by the NYSE on September 30, 1999 was $20.00. In accordance with SEC regulations, value is calculated based on the difference between the option exercise price and $20.00, multiplied by the number of shares of Common Stock underlying the options.
(3) In fiscal 1999, Sam Wyly transferred options to purchase 1,725,000 shares of Common Stock and disclaims beneficial ownership of such transferred options and the underlying shares of Common Stock. The table above does not include the number or value of securities underlying such transferred options.
(4) In fiscal 1999, Charles J. Wyly, Jr. transferred options to purchase 900,000 shares of Common Stock and disclaims beneficial ownership of such transferred options and the underlying shares of Common Stock. The table above does not include the number or value of securities underlying such transferred options.

Director Compensation

Each of Messrs. Donachie, French, Miller, Moore and Steelman received an annual directors' fee of $36,000 for his service as a director of the Company, plus $2,500 for each meeting of the Board and each meeting of any committee of the Board that he attended during fiscal 1999. During fiscal 1999, Sam Wyly and Charles J. Wyly, Jr. received annual directors' fees of $500,000 and $250,000 in their capacities as Chairman and Vice Chairman of the Board, respectively. For fiscal 2000, Sam Wyly and Charles J. Wyly, Jr. will receive annual directors' fees of $537,500 and $268,750, respectively. The annual retainers and meeting fees to be received by each other director will remain at the same level for fiscal 2000 as for fiscal 1999. Messrs. Williams and Evan Wyly did not receive directors' fees for their services as directors in fiscal 1999.

Pursuant to the terms of the Sterling Software, Inc. 1996 Stock Option Plan (the "1996 Stock Option Plan"), Messrs. Donachie and Steelman, as members of the 1996 Special Stock Option Committee of the Board, are each entitled every five years to receive a formula grant of options to purchase 100,000 shares of Common Stock.

See Item 13. "Certain Relationships and Related Transactions" for a discussion of certain agreements between the Company and certain directors of the Company.

Change-in-Control, Severance and Employment Agreements

The Company has entered into an agreement (a "Change-in-Control Agreement") with each of the Named Executive Officers and certain of its other officers. Each Change-in-Control Agreement provides for certain payments and benefits upon the termination of employment of such person with the Company following a Change in Control (as defined in such agreement). Each Change-in-Control Agreement covers termination within a specified number of years after the date of a Change in Control and requires the Company to pay to such officer, if prior to the expiration of such period his or her employment is terminated with or without cause by the Company (other than upon such officer's death) or by such officer upon the occurrence of certain constructive termination events, a lump-sum amount equal to a multiple of such officer's annual cash compensation and to continue all benefits and perquisites for a specified number of months. In addition, if any payments (including payments under the Change-in-Control Agreement, any stock option agreement or otherwise) to such officer are determined to be "excess parachute payments" under the Internal Revenue Code of 1986, as amended (the "Code"), such officer would be entitled to receive an additional payment (net of income taxes) to compensate such officer for any excise tax imposed by the Code on such payments. The specified number of years, the multiple and the specified number of months referred to above are seven, 700% and 84, in the case of each of Messrs. Williams, Sam Wyly and Charles J. Wyly, Jr.; five, 500% and 60, in the case of Mr. Tolari; and two, 200% and 24 in the case of Mr. Harvey.

The Company has also entered into an agreement (the "CEO Agreement") with Sterling L. Williams, providing for a minimum base salary (subject to mutually agreeable annual increases) and certain benefits, plus such bonuses and other benefits which the Company and Mr. Williams may agree upon. Mr. Williams' base salary for fiscal 1999 was $800,000. Under the terms of the CEO Agreement, upon the termination of Mr. Williams' employment by (i) the Company (with or without cause) or (ii) Mr. Williams as a result of a reduction in his compensation or of the nature or scope of his authority or duties, the CEO Agreement will convert into a seven-year consulting agreement. In such event, Mr. Williams would be entitled to continue receiving compensation and benefits at the levels specified in the CEO Agreement. Prior to the expiration of its seven-year term, the consulting agreement may be terminated by Mr. Williams at any time and by the Company at Mr. Williams' death. In the event of termination of Mr. Williams' employment following a Change in Control, at Mr. Williams' option, the terms of his Change-in-Control Agreement may govern such termination in lieu of the conversion of the CEO Agreement into a consulting agreement. In the event of a Change in Control following conversion of the CEO Agreement into a consulting agreement, Mr. Williams would have the option of terminating the consulting agreement and would be entitled to receive a lump-sum amount equal to all compensation due through the unexpired portion of the seven-year consulting agreement.

The Company has entered into an agreement (a "Severance Agreement") with Mr. Tolari, Mr. Harvey and certain of its other officers (other than Messrs. Williams, Sam Wyly and Charles J. Wyly, Jr.), providing for the continued compensation of such officer in the event that the Company terminates his or her employment, with or without cause. Each Severance Agreement expires a specified number of years after the date on which notice of termination is given to him or her by the Company and requires the Company to continue to pay such officer, following his or her termination from employment by the Company, for a specified number of months, the salary, bonus and certain benefits in effect prior to the termination of his or her employment. The specified number of years and months referred to above are five and 60 for Mr. Tolari and two and 24 for Mr. Harvey. In the event of a termination of employment following a Change in Control, at the officer's option, the terms of his or her Change-in-Control Agreement may govern such termination in lieu of the terms of his or her Severance Agreement.

SERP II

In connection with its acquisition of Informatics General Corporation ("Informatics") in 1985, the Company retained the Informatics Supplemental Executive Retirement Plan II ("SERP II"). As of December 31, 1999, Geno P. Tolari had accrued approximately 29 years of service under SERP II. None of the other Named Executive Officers participates or is eligible to participate in SERP II. The annual benefit payable upon retirement at age 65 or above under SERP II is equal to the lesser of the following amounts: (i) 2% of the participant's "final average pay," which is equal to the highest average of the participant's base salary plus the participant's bonuses (up to a maximum bonus amount not to exceed 50% of the participant's base salary) over three consecutive years of service, multiplied by the participant's years of service and (ii) 50% of the participant's final average pay less the annuity equivalent of the participant's account balance under the Sterling Software, Inc. Subsidiary Retirement Plan (a former Informatics plan) as of June 30, 1987 (plus interest) and the annuity equivalent of the assumed Company matching contribution under the Savings Plan thereafter, plus interest (collectively, the "annuity offset"). Benefits paid under SERP II are adjusted in the event of disability or retirement prior to age 65. Benefits are also adjusted annually, upward or downward, to the extent that the increase or decrease, if any, in the Consumer Price Index for the preceding calendar year compared to the Consumer Price Index for the next preceding calendar year exceeds 5%. Amounts paid under SERP II are taxable as income. SERP II is not funded and benefits are paid as they become due. Benefits under SERP II are paid in the form of a joint and 50% survivor annuity.

The following table shows the estimated annual benefits payable upon the retirement at age 65 to Mr. Tolari under SERP II for the indicated level of three-year average annual compensation and various periods of service. The amounts shown in the table may be subject to the annuity offset, the amount of which depends on the pay history of Mr. Tolari and the return on amounts held in the Savings Plan.

	Years of Service				
Remuneration	15	20	25	30	35
$600,000	$180,000	$240,000	$300,000	$300,000	$300,000
700,000	210,000	280,000	350,000	350,000	350,000
800,000	240,000	320,000	400,000	400,000	400,000
900,000	270,000	360,000	450,000	450,000	450,000

Executive and Stock Option Committee Interlocks and Insider Participation

During fiscal 1999, the members of the Executive Committee were primarily responsible for determining executive compensation, and the members of the 1996 Special Stock Option Committee made decisions related to stock option grants to executive officers. The following directors, who also are members of the Executive Committee, 1996 Stock Option Committee, 1999 Stock Option Committee and/or 1996 Special Stock Option Committee, participated in meetings with respect to executive officer compensation matters: Sam Wyly, Charles J. Wyly, Jr., Sterling L. Williams, Robert J. Donachie and Alan W. Steelman. Each of Sam Wyly, Charles J. Wyly, Jr. and Sterling L. Williams is an executive officer of the Company.

Sam Wyly and Charles J. Wyly, Jr. are executive officers of both the Company and Michaels Stores, Inc., members of the executive committees and the boards of directors of the Company, Sterling Commerce, Inc. and Michaels Stores, Inc., members of the stock option committees of the Company and Sterling Commerce, Inc. and members of the board of directors of Scottish Annuity & Life Holdings, Ltd. Sam Wyly and Charles J. Wyly, Jr. are also members of the compensation committee of the Michaels Stores, Inc. board of directors. Sterling L. Williams is an executive officer of the Company and a member of the executive and stock option committees of both the Company and Sterling Commerce, Inc. Accordingly, Sam Wyly and Charles J. Wyly, Jr. have participated in decisions related to compensation of executive officers of each of the Company, Sterling Commerce, Inc. and Michaels Stores, Inc. and Sterling L. Williams has participated in decisions related to compensation of executive officers of each of the Company and Sterling Commerce, Inc. Evan A. Wyly, a director of the Company, who served as an officer of the Company until November 1998, is also a director of Michaels Stores, Inc. and Sterling Commerce, Inc. See Item 13. "Certain Relationships and Related Transactions."

Item 12. ***Security Ownership of Certain Beneficial Owners and Management.***

The following table sets forth information regarding the beneficial ownership of Common Stock by each director of the Company, each of the Named Executive Officers, the directors and executive officers of the Company as a group and each person or entity known by the Company to own 5% or more of the outstanding shares of Common Stock. The persons and entities named in the table have sole voting and investment power with respect to all shares of Common Stock owned by them, except as otherwise noted.

	Shares of Common Stock Owned Beneficially (1)		
Name	Number		Percent of Class
Sam Wyly	2,678,481	(2)	3.1%
Sterling L. Williams.	3,607,520	(3)	4.2%
Charles J. Wyly, Jr.	2,300,746	(4)	2.7%
Paul V. Barber	0		*
Robert J. Donachie	65,700	(5)	*
Michael C. French.	26,600	(6)	*
F. L. "Mike" Harvey.	2,015	(7)	*
Donald R. Miller, Jr.	80,000	(8)	*
Alan W. Steelman	50,077	(9)	*
Geno P. Tolari	512,215	(10)	*
Evan A. Wyly.	309,305	(11)	*
All current directors and executive officers as a group (15 persons)	10,206,572	(12)	11.3%
AXA Conseil Vie Assurance Mutuelle and related entities, AXA and The Equitable Companies Incorporated	9,208,467	(13)	11.2%
Wellington Management Company, LLP	8,427,920	(14)	10.2 %

* Less than 1%.

(1) The number of shares shown includes outstanding shares owned by the person or entity indicated on December 31, 1999 and shares underlying options owned by such person on December 31, 1999 that were exercisable within 60 days of such date. Persons holding shares of Common Stock pursuant to the Savings Plan generally have sole voting power, but not investment power, with respect to such shares.

(2) Includes 1,875,000 shares of Common Stock that may be acquired upon exercise of options granted under the 1996 Option Plan, options to purchase 150,000 of which are currently held of record by the marital trust of Sam Wyly's spouse. Also includes 521,458 shares of Common Stock owned by family trusts of which Sam Wyly is trustee and 277,224 shares of Common Stock held of record by a limited partnership of which Sam Wyly is a general partner. Also includes 4,799 shares of Common Stock held pursuant to the Savings Plan.

(3) Includes 3,600,000 shares of Common Stock that may be acquired upon exercise of options granted under the 1996 Option Plan, 520 shares of Common Stock held pursuant to the Savings Plan and 6,000 shares of Common Stock owned by family trusts of which Sterling Williams is trustee. Also includes 1,000 shares owned by Mr. Williams' spouse of which Mr. Williams disclaims beneficial ownership.

(4) Includes 900,000 shares of Common Stock that may be acquired upon exercise of options granted under the 1996 Option Plan, all of which are currently held of record by a limited partnership of which Charles J. Wyly, Jr. is general partner. Also includes 513,148 shares of Common Stock held of record by such limited partnership and 883,398 shares of Common Stock owned by family trusts of which Charles J. Wyly, Jr. is trustee. Also includes 4,200 shares of Common Stock held pursuant to the Savings Plan.

(5) Includes 50,000 shares of Common Stock that may be acquired upon exercise of options granted under the 1996 Option Plan and 4,500 shares held in a retirement account directed by Mr. Donachie.

(6) Consists of 25,000 shares of Common Stock that may be acquired upon exercise of options granted under the 1996 Option Plan and 1,600 shares held in a retirement account directed by Mr. French.

(7) Includes 284 shares of Common Stock held pursuant to the Savings Plan.

(8) Consists of 75,000 shares of Common Stock that may be acquired upon exercise of options granted under the 1996 Option Plan and 5,000 shares held by a family partnership of which Donald R. Miller, Jr. is a general partner.

(9) Consists of 50,000 shares of Common Stock that may be acquired upon exercise of options granted under the 1996 Option Plan and 77 shares held in an individual retirement account for the benefit of Mr. Steelman's son.

(10) Includes 500,000 shares of Common Stock that may be acquired upon exercise of options granted under the 1996 Option Plan and 9,964 shares of Common Stock held pursuant to the Savings Plan.

(11) Consists of 158,880 shares of Common Stock held by a family limited partnership of which Evan Wyly is a general partner, 150,000 shares of Common Stock that may be acquired upon exercise of options granted under the 1996 Option Plan and held of record by such partnership and 425 shares held pursuant to the Savings Plan.

(footnotes continued on following page)

(12) Includes 489,050 shares of Common Stock that may be acquired upon exercise of options granted under the 1996 Option Plan and 18,478 shares of Common Stock held pursuant to the Savings Plan, in each case by executive officers of the Company not named in the table above.

(13) Based on a Schedule 13G/A filed February 16, 1999 by AXA Conseil Vie Assurance Mutuelle (formerly Alpha Assurances Vie Mutuelle), AXA Assurances I.A.R.D. Mutuelle, AXA Assurances Vie Mutuelle and AXA Courtage Assurance Mutuelle, as a group, AXA (formerly AXA-UAP) and The Equitable Companies Incorporated. It was reported that four subsidiaries of The Equitable Companies Incorporated, The Equitable Life Assurance Society of the United States, Alliance Capital Management L.P., Donaldson, Lufkin & Jenrette Securities Corporation and Wood, Struthers and Winthrop Management Corp., are deemed to have sole voting power with respect to 2,122,501 shares, shared voting power with respect to 6,897,301 shares, sole dispositive power with respect to 9,124,627 shares and shared dispositive power with respect to 78,840 shares. The address of AXA Conseil Vie Assurance Mutuelle is 100-101 Terrasse Boieldieu, 92042 Paris La Defense, France; the address of AXA Assurances I.A.R.D. Mutuelle and AXA Assurances Vie Mutuelle is 21, rue de Chateaudun, 75009 Paris, France; the address of AXA Courtage Assurance Mutuelle is 26, rue Louis le Grand, 75002 Paris, France; the address of AXA is 9 Place Vendome, 750081 Paris, France; and the address of The Equitable Companies Incorporated is 1290 Avenue of the Americas New York, New York 10104. The information regarding beneficial ownership of Common Stock by this group is included in reliance on a report filed with the Securities and Exchange Commission (the "SEC") by such parties, except that the percentage of Common Stock beneficially owned is based upon the Company's calculations made in reliance upon the number of shares of Common Stock reported to be beneficially owned by such parties in such report and the number of shares of Common Stock outstanding on December 31, 1999.

(14) Based on a Schedule 13G/A filed on October 18, 1999 by Wellington Management Company, LLP ("Wellington"). Wellington has shared voting power with respect to 5,932,014 shares and shared dispositive power with respect to 8,427,920 shares. The address of Wellington is 75 State Street, Boston, Massachusetts 02109. The information regarding beneficial ownership of Common Stock by Wellington is included in reliance on a report filed with the SEC by Wellington, except that the percentage of Common Stock beneficially owned is based upon the Company's calculations made in reliance upon the number of shares of Common Stock reported to be beneficially owned by such person in such report and the number of shares of Common Stock outstanding on December 31, 1999.

Item 13. *Certain Relationships and Related Transactions.*

Pursuant to a consulting arrangement with the Company, Michael C. French, a director of the Company, received from the Company a non-refundable retainer of $17,500 per month during fiscal 1999 for his assistance in significant acquisitions and other Company-related matters. Mr. French received $1,000 per month as an employee of the Company, which amount is deducted from amounts paid to him as a retainer. Jones, Day, Reavis & Pogue, a law firm for which Mr. French is currently a consultant, has provided legal services to the Company. Such firm does not charge the Company for any time spent by Mr. French on Company-related matters.

Deutsche Banc Alex. Brown, an investment banking firm for which Paul V. Barber, a director of the Company, served as a Managing Director until September 1998, has provided investment banking and financial advisory services to the Company.

In February 1998, the Company's Information Technology Division entered into an agreement with GreenMountain.com ("GreenMountain"), a Vermont-based supplier of renewable electricity. Under that agreement, the Company provides GreenMountain with network management services and other information systems consulting services. In addition, in early 1999, GreenMountain entered into another agreement with the Company's Information Technology Division for the 1999 calendar year which expanded the scope of the Company's services to include programming and operational support for data transmissions with all utility companies with which GreenMountain interfaces, development of an enterprise database for GreenMountain's information network and other software development projects for an approximate contract amount of $4.4 million. Since the beginning of fiscal 1999, GreenMountain has incurred charges totaling $3,604,000 for services provided by that Division under such agreements. Sam Wyly is Chairman and a director, and Evan A. Wyly is Vice Chairman and a director, of GreenMountain.

Since July 1999, Mr. Williams has leased an apartment owned by the Company in Paris, France for a monthly rental of $5,000.

PART IV

Item 14. ***Exhibits, Financial Statement Schedules and Reports on Form 8-K***

3. Exhibits:

2.1	Asset Purchase Agreement, dated April 18, 1997, by and between Texas Instruments Incorporated and the Company (2), (3)
2.2	Amendment No. 1 to Asset Purchase Agreement, dated June 19, 1997, by and between Texas Instruments Incorporated, the Company and certain subsidiaries of the Company, and Amendment No. 2 to Asset Purchase Agreement, dated June 28, 1997, by and between Texas Instruments Incorporated, the Company and certain subsidiaries of the Company (4)
2.3	Agreement and Plan of Merger, dated as of May 27, 1998, among the Company, Sterling Software (Connecticut), Inc. and Mystech Associates, Inc. (2), (5)
2.4	Agreement and Plan of Merger, dated as of June 20, 1998, among the Company, Sterling Software (Southern), Inc. and Synon Corporation (2), (6)
2.5	Agreement and Plan of Merger, dated as of August 27, 1998, among the Company, Sterling Software (Southern), Inc. and Cayenne Software, Inc. (1), (2)
2.6	Asset Purchase Agreement, dated as of March 6, 1999, between the Company, Spectra Logic Corporation, Sterling Software (U.S.A.), Inc., Nathan C. Thompson and Michael J. Sausa (2), (7)
2.7	Agreement and Plan of Merger, dated as of March 23, 1999, among the Company, Sterling Software (Southwest), Inc. and Interlink Computer Sciences, Inc. (2), (8)
2.8	Agreement and Plan of Merger, dated as of July 12, 1999, among the Company, Sterling Software (Arizona), Inc. and CoreData, Inc. (1), (2)
2.9	Agreement and Plan of Merger, dated as of July 15, 1999, among the Company, Sterling Software Acquisition Corp. and Information Advantage, Inc. (2), (15)
3.1	Restated Certificate of Incorporation of the Company (1)
3.2	Restated Bylaws of the Company (1)
4.1	Form of Common Stock Certificate (10)
4.2	Rights Agreement, dated December 18, 1996, by and between the Company and The First National Bank of Boston, as Rights Agent (11)
4.3	First Amendment to Rights Agreement, dated as of March 12, 1998, by and between the Company and BankBoston, N.A., as Rights Agent (12)
10.1	Supplemental Executive Retirement Plan II regarding benefits of Geno P. Tolari under former Informatics General Corporation Supplemental Executive Retirement Plan II (13), (14)
10.2	Sterling Software, Inc. Amended and Restated Employee Stock Purchase Plan (effective as of March 20, 1998) (9), (14)
10.3	Sterling Software, Inc. Deferred Compensation Plan (restated effective December 21, 1998) (14), (18)
10.4	Sterling Software, Inc. Amended and Restated 1996 Stock Option Plan (1), (14)
10.5	Form of Stock Option Agreement between the Company and each of Sam Wyly and Charles J. Wyly, Jr. (14), (16)
10.6	Form of Stock Option Agreement between the Company and Sterling L. Williams (14), (16)
10.7	Form of Stock Option Agreement between the Company and Geno P. Tolari (14), (16)
10.8	Form of Stock Option Agreement between the Company and F.L. "Mike" Harvey (1), (14)
10.9	Form of Amendment to Stock Option Agreement, dated March 20, 1998, between the Company and each of its executive officers (9), (14)
10.10	Fiscal 1999 Executive Compensation Plan for Group Presidents (14), (22)
10.11	Fiscal 2000 Executive Compensation Plan for Group Presidents (1), (14)

10.12	Consulting Agreement, dated October 1, 1996, between the Company and Michael C. French (14), (17)
10.13	CEO Agreement, dated November 15, 1999, between the Company and Sterling L. Williams (13), (14)
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10.20	Form of Indemnity Agreement between the Company and each of its directors and officers (1)
10.21	Third Amended and Restated Revolving Credit Agreement, dated July 1, 1997, by and among the Company, BankBoston, N.A. and Bank One, Texas, National Association and BankBoston, N.A. as agent for itself and Bank One, Texas, National Association (19)
10.22	Tax Allocation Agreement, dated March 4, 1996, between the Company and Sterling Commerce, Inc. (20)
10.23	Indemnification Agreement, dated March 4, 1996, between the Company and Sterling Commerce, Inc. (21)
10.24	Agreement dated September 19, 1996 by Sterling Commerce, Inc. for the benefit of the Company (17)
21.1	Subsidiaries of the Company (1)
23.1	Consent of Ernst & Young LLP (1)
27.1	Financial Data Schedule (1)

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(1) Previously filed as an exhibit to the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 1999 and incorporated herein by reference (SEC File No. 99746823).

(2) In accordance with Item 601 of Regulation S-K, the schedules and exhibits relating to the agreement have been omitted. The Company will furnish supplementally to the Securities and Exchange Commission such schedules and exhibits upon request.

(3) Previously filed as an exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1997 and incorporated herein by reference (SEC File No. 97605952).

(4) Previously filed as an exhibit to the Company's Current Report on Form 8-K dated June 30, 1997, as amended, and incorporated herein by reference (SEC File No. 97633732).

(5) Previously filed as Appendix A to the Proxy Statement/Prospectus forming a part of the Company's Registration Statement No. 333-53747 dated May 28, 1999 and incorporated herein by reference (SEC File No. 98632583).

(6) Previously filed as an exhibit to the Company's Current Report on Form 8-K dated June 21, 1998 and incorporated herein by reference (SEC File No. 98652676).

(7) Previously filed as an exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1999 and incorporated herein by reference (SEC File No. 99617213).

(8) Previously filed as an exhibit to the Company's Tender Offer Statement on Schedule 14D-1 dated March 30, 1999 and incorporated herein by reference (SEC File No. 99579124).

(9) Previously filed as an exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1998 and incorporated herein by reference (SEC File No. 98602908).

(10) Previously filed as an exhibit to the Company's Registration Statement No. 2-86825 and incorporated herein by reference (SEC File No. S766400).

(11) Previously filed as an exhibit to the Company's Current Report on Form 8-K dated December 18, 1996 and incorporated herein by reference (SEC File No. 96682898).
(12) Previously filed as an exhibit to the Company's Registration Statement No. on Form 8-A/A filed April 3, 1998 and incorporated herein by reference (SEC File No. 98587026).
(13) Filed herewith.
(14) Management contract or compensatory plan or arrangement required to be filed as an exhibit to this form pursuant to Item 14(c) of Form 10-K.
(15) Previously filed as an exhibit to the Company's Tender Offer Statement on Schedule 14D-1 dated July 21, 1999 and incorporated herein by reference (SEC File No. 99667898).
(16) Previously filed as an exhibit to the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 1997 and incorporated herein by reference (SEC File No. 97724719).
(17) Previously filed as an exhibit to the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 1996 and incorporated herein by reference (SEC File No. 96672084).
(18) Previously filed as an exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 1998 and incorporated herein by reference (SEC File No. 99531526).
(19) Previously filed as an exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1997 and incorporated herein by reference (SEC File No. 97660034).
(20) Previously filed as an exhibit to Registration Statement No. 33-80595 filed by Sterling Commerce, Inc. and incorporated herein by reference (File/ID #001-14196, SEC File No. 96042701).
(21) Previously filed as an exhibit to the Quarterly Report on Form 10-Q for the quarter ended March 31, 1996 filed by Sterling Commerce, Inc. and incorporated herein by reference (File ID #001-14196, SEC File No. 96560893).
(22) Previously filed as an exhibit to the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 1998 and incorporated herein by reference (SEC File No. 98755025).

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Form 10-K/A, Amendment No. 1 to its Annual Report on Form 10-K, to be signed on its behalf by the undersigned, thereunto duly authorized.

STERLING SOFTWARE, INC.

Date: January 28, 2000 By ______________________________

Sterling L. Williams
President, Chief Executive Officer and Director
(Principal Executive Officer)

Date: January 28, 2000 ______________________________

R. Logan Wray
Senior Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)

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