ICOP DIGITAL, INC
Form 10QSB
November 10, 2005

U.S. Securities and Exchange Commission

Washington, D.C. 20549

Form 10-QSB

(Mark One)

x **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2005

¨ **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number: 000-27321

ICOP Digital, Inc.

(Name of small business issuer in its charter)

Colorado	**84-1493152**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

16801 W. 116th Street, Lenexa, KS 66219

(Address of principal executive offices, including ZIP Code)

Issuer s telephone number: (913) 338-5550

N.A.

(Former name, address and fiscal year, if changed since last report)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 x No ¨

Transitional Small Business Disclosure Format Yes ¨ No x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.): Yes ¨ No x

The issuer had 4,828,182 shares of its common stock issued and outstanding as of November 7, 2005, the latest practicable date before the filing of this report.

ICOP DIGITAL, INC.

PART I - FINANCIAL INFORMATION

Forward-Looking Statements

This report on Form 10-QSB contains forward-looking statements that concern our business. Such statements are not guarantees of future performance and actual results or developments could differ materially from those expressed or implied in such statements as a result of certain factors, including those factors set forth in Item 2 - Plan of Operation and elsewhere in this report. All statements, other than statements of historical facts, included in this report that address activities, events or developments that we expect, believe, intend or anticipate will or may occur in the future, including the Company s ability to successfully maintain its existence while it identifies potential business opportunities, are forward looking statements.

These statements are based on certain assumptions and analyses made by us in light of our experience and our product research. Such statements are subject to a number of assumptions including the following:

risks and uncertainties;

general economic and business conditions;

the business opportunity that may be presented to and pursued by us;

changes in laws or regulations and other factors, many of which are beyond our control; and

ability to obtain financing on favorable conditions.

The cautionary statements contained or referred to in this report should be considered in connection with any subsequent written or oral forward-looking statements that may be issued by us or persons acting on our behalf. We undertake no obligation to release publicly any revisions to any forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

ITEM 1. FINANCIAL STATEMENTS

ICOP DIGITAL, INC.

Balance Sheet (Unaudited)

Assets	
Current assets:	
Cash	$ 3,836,924
Accounts receivable, net	611,583
Inventories, at cost	2,187,356
Prepaid expenses	101,697
Total current assets	6,737,560
Property and equipment, less accumulated depreciation of $99,959	502,162
Other assets:	
Deferred patent costs	61,480
Security deposit	15,000
	$ 7,316,202
Liabilities and Shareholders Equity	
Current liabilities:	
Accounts payable	$ 662,106
Accrued liabilities	274,163
Current maturities of long-term debt (Note 3)	28,261
Total current liabilities	964,530
Long-term debt, net of current maturities (Note 3)	83,678
Total liabilities	1,048,208
Shareholders equity (Note 4):	
Preferred stock, no par value; 5,000,000 shares authorized, -0- shares issued and outstanding	
Common stock, no par value; 50,000,000 shares authorized, 4,828,182 shares issued and outstanding	15,202,433
Accumulated other comprehensive loss, net of tax	19,120
Retained deficit	(8,953,559)
Total shareholders equity	6,267,994
	$ 7,316,202

See accompanying notes to financial statements.

ICOP DIGITAL, INC.

Statements of Operations (Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	**2004**	**2005**	**2004**
				Restated*
Sales, net of returns	$ 902,297	$	$ 1,229,691	$
Cost of sales	523,911		762,814	
Gross profit	378,386		466,877	
Operating expenses:				
Selling, general and administrative	750,674	702,282	1,617,240	1,561,794
Research and development	137,337	62,948	399,065	668,568
Total operating expenses	888,011	765,230	2,016,305	2,230,362
Loss from operations	(509,625)	(765,230)	(1,549,428)	(2,230,362)
Other income (expense):				
Realized gain (loss) on foreign currency transactions	1,283		(55,023)	
Unusual item:				
Gain on restructure of trade debt				485,482
Interest income	30,190		30,190	
Interest expense	(21,325)	(4,809)	(106,128)	(5,828)
Loss before income taxes	(499,477)	(770,039)	(1,680,389)	(1,750,708)
Income tax provision (Note 5)				
Net loss	$ (499,477)	$ (770,039)	$ (1,680,389)	$ (1,750,708)
Net loss available to common shareholders after beneficial conversion feature	$ (499,477)	$ (770,039)	$ (1,680,389)	$ (2,250,708)
Basic and diluted loss per share	$ (0.11)	$ (0.48)	$ (0.66)	$ (1.40)
Basic and diluted weighted average common shares outstanding	4,390,059	1,602,033	2,557,435	1,606,938

* See Note 6

See accompanying notes to financial statements.

ICOP DIGITAL, INC.

Statement of Changes in Shareholders Equity (Unaudited)

	Preferred Stock		Common Stock		Accumulated Other Comprehensive	Retained	
	Shares	**Amount**	**Shares**	**Amount**	**Loss**	**Deficit**	**Total**
Balance at December 31, 2004	250,000	$ 1,499,998	16,382,000	$ 3,221,268	$ (117,595)	$ (7,273,170)	$ (2,669,499)
Preferred shares converted to common shares (Note 4)	(38,333)	(229,998)	306,664	229,998			
February 28, 2005, conversion of shares due to reverse stock split (Note 4)	(190,502)		(15,019,802)				
Secondary offering of common stock (Note 4)			2,990,000	11,148,638			11,148,638
Secondary offering of common stock transaction costs (Note 4)				(667,471)			(667,471)
Preferred shares converted to common shares (Note 4)	(21,165)	(1,270,000)	169,320	1,270,000			
Unrealized effect of the change in foreign currency exchange rates					136,715		136,715
Net loss for the period ended September 30, 2005						(1,680,389)	(1,680,389)
Balance at September 30, 2005	(0)	$	4,828,182	$ 15,202,433	$ 19,120	$ (8,953,559)	$ 6,267,994

See accompanying notes to financial statements.

ICOP DIGITAL, INC.

Statements of Cash Flows (Unaudited)

	Nine Months Ended September 30,	
	2005	**2004**
Cash flows from operating activities:		
Net loss	$ (1,680,389)	$ (1,750,708)
Adjustments to reconcile net loss to net cash used by operating activities:		
Depreciation	61,779	20,633
Book value of equipment retired		1,734
Stock options issued		315,000
Gain on restructured trade debt		(485,482)
Changes in operating liabilities:		
(Increase) in accounts receivable, inventory and prepaid expenses	(2,822,888)	(31,059)
Increase (decrease) in accounts payable and accrued liabilities	(1,477,603)	845,658
Net cash used in operating activities	(5,919,101)	(1,084,224)
Cash flows from investing activities:		
Purchases of property and equipment	(406,017)	(26,678)
Deferred patent costs		(59,032)
Investment in Subsidiary		(450,000)
Deposits	(14,750)	3,000
Net cash used in investing activities	(420,767)	(532,710)
Cash flows from financing activities:		
Proceeds from issuance of notes payable	3,157,000	445,000
Principal payments on notes payable	(3,465,617)	(370,812)
Proceeds from the sale of preferred stock		1,099,998
Proceeds from the sale of common stock	11,148,638	395,000
Payment of offering costs	(667,471)	
Net cash provided by financing activities	10,172,550	1,569,186
Net change in cash	3,832,682	(47,748)
Cash, beginning of period	4,242	118,780
Cash, end of period	$ 3,836,924	$ 71,032
Supplemental disclosure of cash flow information:		
Income taxes	$	$
Interest	$ 115,887	$ 4,164

See accompanying notes to financial statements.

ICOP DIGITAL, INC.

Notes to Financial Statements

Note A: Basis of Presentation

The financial statements presented herein have been prepared by the Company in accordance with the accounting policies in its audited financial statements for the period ended December 31, 2004, included in its annual report on Form 10-KSB/A as filed July 7, 2005, and should be read in conjunction with the notes thereto. The Company entered the development stage in accordance with Statement of Financial Accounting Standard (SFAS) No. 7 on May 24, 2002. It emerged from the development stage in June 2005 with the beginning of substantial revenue and now is an enterprise engaged in the design, development and marketing of an in-car video recorder system for use in the law enforcement industry.

In the opinion of management, all adjustments (consisting only of normal recurring adjustments) which are necessary to provide a fair presentation of operating results for the interim period presented have been made. The results of operations for the periods presented are not necessarily indicative of the results to be expected for the year.

Interim financial data presented herein are unaudited. The unaudited interim financial information presented herein has been prepared by the Company in accordance with the policies in its audited financial statements for the period ended December 31, 2004 and should be read in conjunction with the notes thereto.

The accompanying statements of operations and cash flows reflect the nine-month period ended September 30, 2005. The comparative figures for the nine-month period ended September 30, 2004 have been included in the accompanying statements of operations and cash flows for comparison on an unaudited basis.

Note 1: Nature of Operations, Merger, and Summary of Significant Accounting Policies

Operations and Merger

ICOP Digital, Inc. was incorporated in May 2002 in Nevada and merged into a wholly owned subsidiary of the Company as of December 31, 2003. The Company, a Colorado corporation formerly named Vista Exploration Corporation, subsequently changed its name to ICOP Digital, Inc. In June 2005, the Nevada subsidiary merged into the Colorado corporation and ceased to exist. The Company was a development stage enterprise until June 2005 when substantial sales began. It is engaged in the design, development and marketing of in-car video recorder systems for use in the law enforcement industry. The Company s offices are located in Lenexa, Kansas.

Certain changes have been made to the prior year s financial statements in order to conform to the current year s presentation. On February 28, 2005, the Company s shareholders approved a reverse stock split that exchanged one new share of stock for ten existing shares effective March 10, 2005. All share and per share amounts in this document have been changed to reflect the effect of this change.

The 2004 financial statements have been restated to record a deemed dividend of $500,000 during the first quarter of 2004 to the Company s preferred shareholders for the value of their right to convert shares of preferred stock to common stock. This non-cash dividend in the first quarter of 2004 did not effect net capital but increased the net loss to common shareholders. In addition, the financial statements have been restated to record a non-cash operating expense of $400,000 in the fourth quarter of 2004 as a result of issuing 6,667 shares of convertible preferred stock to settle a dispute.

In February 2003, the Company purchased all the issued and outstanding common stock of McCoy s Law Line, Inc. (McCoy s) to obtain access to McCoy s marketing organization and permit ICOP to sell and distribute law enforcement-related products in addition to the ICOP in-car digital video recording system. The purchase price consisted of 70,000 shares of ICOP common stock valued at $10.00 per share. In March 2004, ICOP determined to develop a different system to market its products and sold its investment in McCoy s. The sale price consisted of the 70,000 shares of ICOP common stock valued at $10.00 per share that had been paid for the purchase.

Effective December 31, 2003, ICOP Digital, Inc. (ICOP) exchanged 100 percent of its outstanding shares of common stock for 1,457,700 shares of the common stock of Vista Exploration Corporation (Vista) After January 2004, the two companies were consolidated. The acquisition has been treated as a recapitalization of ICOP, with Vista the legal surviving entity. Since Vista had, prior to the recapitalization of ICOP, no assets and net liabilities (consisting principally of accounts payable) and no operations, the recapitalization has been accounted for as the sale of 179,000 shares of ICOP common stock for the net liabilities of Vista. The historical financial statements presented herein have been restated and are those of ICOP. Costs of the transaction have been charged to the period. In November 2004, the Company changed its name from Vista to ICOP Digital, Inc.

Going Concern Basis

The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. As shown in the accompanying financial statements, the Company has suffered significant losses since inception. This factor, among others, may indicate that the Company will be unable to continue as a going concern.

The Company completed a public offering of its common stock in July 2005 with net proceeds of approximately $10 million and believes these proceeds will provide capital for inventory, marketing and sales, research and development and general operations for the coming twelve months. In the longer term, the Company plans to expand its acquired operations, continue to pursue sales of its products and become profitable. There is no assurance that the Company s products will gain market acceptance or that the Company will attain profitability.

The financial statements do not include any adjustments relating to the recoverability and classification of assets and/or liabilities that might be necessary should the Company be unable to continue as a going concern. The Company s continuation as a going concern is dependent upon its ability to meet its obligations on a timely basis and, ultimately, to attain profitability.

Note 2: Related Party Transactions

Notes and loans payable to related parties consisted of unsecured advances made to the Company under promissory note and loan agreements for working capital purposes and pay no interest. The notes payable are due on demand. During the six months ended June 30, 2005, shareholders and affiliates were repaid $20,000 on existing notes. In April 2005, a director loaned $300,000 to the Company to allow the Company to accelerate manufacturing of inventory. This note was due on closing of a secondary stock offering or in October 2005 and accrued interest at approximately 8% per annum. All notes and loans were repaid on completion of the secondary offering in July 2005.

Note 3: Notes Payable

In March 2005, the Company completed the sale of $2,200,000 in secured promissory notes and related common stock warrants. These notes were sold to accredited investors and were repaid when the public offering was completed in July 2005 along with accrued interest at a rate of 8% per annum.

In June 2005, the Company issued a non-interest bearing note payable to Paulson Investment Company in the amount of $600,000. This note was repaid when the public offering was completed in July 2005.

In June 2005, the Company obtained a one-year line of credit from a bank in the amount of $600,000 secured by customer purchase orders. Interest on this note is payable monthly at the rate of 2% over the bank index rate. At June 30, 2005 the balance outstanding on this note was $400,000 which was repaid when the public offering was completed in July 2005.

The company obtained six installment loans secured by vehicles. These loans require monthly payments of approximately $2,500 per month including interest at approximately 6% per annum and mature through August 2009.

Note 4: Shareholders Equity

Preferred Stock converted to common stock

In January 2005, a shareholder converted 1,333 shares of the Company s Class A preferred shares having a value of $79,998 into 10,664 shares of the Company s no par common stock. In April 2005, a shareholder converted 2,500 shares of the Company s Class A preferred shares having a value of $150,000 into 20,000 shares of the Company s no par common stock. All remaining preferred stock was converted to no par common stock when the public offering was completed in July 2005.

Common Stock offering

In July 2005, the Company completed an equity offering including a total of 2,990,000 shares of common stock and warrants to purchase another 2,990,000 shares of common stock for net proceeds of approximately $10.5 million, after deducting transaction costs of approximately $1.8 million. The warrants allow the holder to acquire common stock at a price of $6.19 per share for a period of five years. Immediate use of the proceeds was to reduce current liabilities by approximately $3.8 million, increase inventory by approximately $1.3 million and retain approximately $5.4 million in cash. In conjunction with the offering all preferred stock outstanding was converted to common stock.

Note 5: Income Taxes

The Company records its income taxes in accordance with Statement of Financial Accounting Standard No. 109, Accounting for Income Taxes . The Company incurred net operating losses during the periods shown on the condensed financial statements resulting in a deferred tax asset, which was reserved. Therefore, the net benefit and expense resulted in $0 income taxes.

Note 6: Restatement of Financial Statements

The Company restated its financial statements for the year ended December 31, 2004 and for the quarter ended March 31, 2005 to correct errors identified as a result of a regulatory review of the Company s financial statements and reflect the corresponding changes described below. There was no net change to cash provided by financing activities, cash used in operating or investing activities or net capital as a result of these errors. The comparative statement of operations for the nine months ended September 30, 2004 was restated to record a deemed dividend of $500,000 to increase the net loss available to common shareholders as a result of the changes.

During the first quarter of 2004, the Company received subscriptions for 25,000 post-split shares of convertible preferred stock and received payments totaling $1,099,998 for 18,333 of those post-split shares. In December 2004, the Company issued another 6,667 post-split shares for no additional consideration to one of the original subscribers to settle a dispute. The Company originally recorded these transactions as the sale of 25,000 post-split shares of preferred stock for proceeds of $1,099,998. The restatement separated the sales of preferred stock completed early in 2004 and recorded a deemed dividend for the benefit provided by the included conversion feature. The restatement next reported the December issuance as a separate transaction and records an expense for the settlement of the dispute.

For the first component, we revised our analysis of the beneficial conversion feature using as comparable fair value of our common stock the price received for most of the sales of common stock during 2003 and 2004, $10.00 per post-split share. A share of the preferred stock was convertible into eight shares of common stock, so the $60.00 per post-split share price was equivalent to a common stock price of $7.50 per post-split share, a difference of $2.50 per post-split common share. On an as converted basis, for the 200,000 post-split common shares, this calculation resulted in a value of the beneficial conversion feature of $500,000. The preferred stock was immediately convertible to common stock, so this value was immediately recorded as a deemed dividend to increase the net loss available to common shareholders for the year ended December 31, 2004.

For the second component, the investor had subscribed for 13,334 post-split preferred shares during the first quarter of 2004. The investor paid half of the subscription price or $400,000, at that time. A dispute subsequently arose over the terms of payment for the remaining shares subscribed. The Company issued an additional 6,667 post-split shares to the investor to settle this dispute during the fourth quarter of 2004. The Company restated its financial statements by recording an operating expense equal to the unpaid subscription price of $400,000 and increased paid in capital by the same amount. Originally, the Company had booked the sale of the entire 13,334 post-split shares of convertible preferred stock for $400,000, the total amount of cash received for the shares.

The following table shows the effect of the restatement:

	As Previously Reported	**As Restated**
For the six months ended September 30, 2004:		
Net Loss	$ (1,750,708)	$ (1,750,708)
Deemed dividend - beneficial conversion feature		(500,000)
Net loss available to common shareholders after beneficial conversion	(1,750,708)	(2,250,708)
Loss per share available to common shareholders	(1.09)	(1.40)

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

Results of Operations

Comparison of Three Months Ended September 30, 2005 and 2004

During the three months ended September 30, 2005, the Company reported sales of $902,297 and cost of sales of $523,911, incurred $137,337 in research and development expenses and $750,674 in sales, general and administrative expense, resulting in an operating loss of $509,625. During the three months ended September 30, 2004, the Company reported no sales and incurred $62,948 in research and development expenses and $702,282 in sales, general and administrative expense, resulting in an operating loss of $765,230. The increased level of expense is a result of the increased focus on sales and marketing as the Company completed equity funding and accelerated its business plan. Funding provided by the bridge loans and the completed secondary offering should permit expansion of sales, service and engineering personnel, facilitate acceleration of product manufacturing and help the Company to achieve operating breakeven over the coming twelve months.

Comparison of Nine Months Ended September 30, 2005 and 2004

During the nine months ended September 30, 2005, the Company reported sales of $1,229,691 and cost of sales of $762,814, incurred $399,065 in research and development expenses and $1,617,240 in sales, general and administrative expense, resulting in an operating loss of $1,549,428. During the nine months ended September 30, 2004, the Company had no sales and incurred $668,568 in research and development expenses and $1,561,794 in sales, general and administrative expense, resulting in an operating loss of $2,230,362. The reduced level of research and development expense is the result of completion of initial product development and the increased level of sales expense represents the change in focus to sales and marketing as the Company executes its business plan with completed funding for expansion. Funding provided by the completed secondary offering should permit expansion of sales, service and engineering personnel, facilitate acceleration of product manufacturing and help the Company to achieve operating breakeven over the coming twelve months.

Liquidity and Capital Resources

On September 30, 2005, the Company had $3,836,924 in cash, $611,583 in accounts receivable, $2,187,356 in inventory, $101,697 in prepaid expenses and $964,530 in current liabilities, resulting in working capital of $5,773,030. Net cash used in operating activities for the nine months ended September 30, 2005 was $5,919,101 compared to cash used in operating activities of $1,084,224 for the nine months ended September 30, 2004. Net cash used in investing activities for the nine months ended September 30, 2005 was $420,767. Net cash provided by financing activities was $10,172,550 for the nine months ended September 30, 2005, substantially from the secondary offering of common stock, offset by payment of offering costs.

Our auditors included an explanatory paragraph in their opinion on our financial statements for the year ended December 31, 2004, to state that our losses since inception and our net capital deficit at December 31, 2004 raise substantial doubt about our ability to continue as a going concern. In July 2005 we completed a secondary offering of common stock and warrants that generated net proceeds of approximately $10.5 million dollars which we believe will provide the working capital necessary for the coming year. Our ability to continue as a going concern is ultimately dependent upon achieving profitable operations. We cannot assure you that our plan of operation will be successful in addressing this issue.

Our Capital Requirements

We believe that with the completion of the secondary offering in July 2005 we have adequate funds to finance our planned operations during the next 12 months. We have no commitments for material capital expenditures.

Employees

We have twenty-two full time employees at September 30, 2005.

ITEM 3 CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

In connection with the preparation of this Quarterly Report on Form 10-QSB, the Company carried out an evaluation under the supervision and with the participation of the Company s management, including the CEO and CFO, as of September 30, 2005 of the effectiveness of the design and operation of the Company s disclosure controls and procedures, as such term is defined under Rules 13a-15(e) and 15d-15(e) under the Exchange Act. Based upon this evaluation, the CEO and CFO concluded that, as of September 30, 2005, the Company s disclosure controls and procedures were effective.

The Company restated its previously issued financial statements for the year ended December 31, 2004 and for the three months ended March 31, 2005 as described more fully in those filings.

Changes in Internal Control over Financial Reporting

There have not been changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the third quarter of 2005 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS ON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

On August 12, 2005, the Annual Meeting of the Shareholders was held for the purpose of electing members to the board of directors. The meeting was attended in person or by proxy by 1,143,495 of a total possible 1,838,182 voting shares. Noel Koch was elected to a three year term as a Class A director by a vote of 1,092,995 for and 50,500 withheld. L. Derrick Ashcroft was elected to a two year term as a Class B director by a vote of 1,037,995 for and 105,500 withheld. Charles A. Ross, David C. Owen and Roger Mason did not stand for election at this meeting but continue to serve as members of the board of directors. No other matters were brought before the meeting or submitted to shareholder vote.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

The following exhibits are furnished as part of this report:

Exhibit 31.1	Certification required by Section 302 of the Sarbanes-Oxley Act of 2002.
Exhibit 31.2	Certification required by Section 302 of the Sarbanes-Oxley Act of 2002.
Exhibit 32.1	Certification required by Section 906 of the Sarbanes-Oxley Act of 2002.
Exhibit 32.2	Certification required by Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

In accordance with the requirements of the Securities and Exchange Act of 1934, as amended, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

	ICOP DIGITAL, INC.	
Date: November 10, 2005	By:	/s/ DAVID C. OWEN **David C. Owen, President** **Chief Executive Officer** **Principal Executive Officer**
Date: November 10, 2005	By:	/s/ JOHN C. GARRISON **John C. Garrison** **Chief Financial Officer** **Principal Accounting Officer**