ION NETWORKS INC
Form 10KSB/A
July 12, 2005

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-KSB/A
Amendment No. 2

|X| ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2004

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

For the transition period from ____________________.

Commission File No.: 0-13117

ION NETWORKS, INC.
(Name of Small Business Issuer in Its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	**22-2413505** (IRS Employer Identification Number)
120 Corporate Blvd., S. Plainfield, NJ (Address of Principal Executive Offices)	**07080** (Zip Code)

(908) 546-3900
(Issuer's telephone number, including area code)
Securities registered under Section 12(b) of the Exchange Act:

Title of Each Class	Name of Each Exchange On Which Registered
None	**None**

Securities registered under Section 12(g) of the Exchange Act:

Common Stock, $.001 par value
(Title of Class)

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_____

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B is not contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. |_|

The issuer's revenues for its most recent twelve-months ended December 31, 2004 totaled $ 3,616,261.

The aggregate market value of voting stock held by non-affiliates, based on the closing price of the Common Stock, par value $0.001 (the "Common Stock") on March 21, 2005 of $0.26, as reported on the OTC Bulletin Board was $5,262,167. Shares of Common Stock held by each officer and director and by each person who owns 5% or more of the outstanding Common Stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for any other purpose.

There were 27,050,044 shares of Common Stock outstanding as of July 11, 2005.

EXPLANATORY NOTE

This Amendment No. 2 on Form 10-KSB/A to ION Networks, Inc. (the "Company" or the "Registrant") Annual Report on Form 10-KSB for the year ended December 31, 2004 (the "Original Filing") which was filed with the Securities and Exchange Commission on March 24, 2005, and amended on April 22, 2005, is being filed to amend the Original Filing as follows:

§ Item 6: Management's Discussion and Analysis or Plan of Operations to reflect the change in classification of amortized expense related to capitalized software costs to cost of sales.

§ Item 7. Financial Statements was updated to reflect the change in classification of amortized expense related to capitalized software costs to cost of sales.

  § Note 2 of the Financial Statements were updated to reflect the change in classification of amortized expense related to capitalized software costs to cost of sales.

§ Note 3 of the Financial Statements were updated to reflect additional disclosures for restructuring, asset impairment and other credits.

§ Item 13 Exhibits and Reports of Form 8-K is updated to reflect the refilling of Independent Auditors Consent and the various CEO and CFO certifications, in connection with the amendments set forth herein.

Except for the amendments described above, this Form 10-KSB/A does not modify or update other disclosures in, or exhibits to, the Original Filing as previously amended.

Item 6: Management's Discussion and Analysis or Plan of Operation

Overview

ION Networks, Inc ("ION" or the "Company") designs, develops, manufactures and sells security solutions that protect enterprise network administrative interfaces from improper, unauthorized or otherwise undesirable access from external and internal sources. Administrative interfaces are the network access points used by highly trained technical individuals who are charged with the responsibilities of maintaining and supporting the networks and devices employed within the networks such as servers, routers, PBXs and similar network equipment. These technicians may be employees of the enterprise or employed by third parties such as managed service providers, consultants, device vendors or application developers. In all cases, they are considered "trusted insiders" since in order to perform their jobs; permission to enter and work within the network must be granted. The Company's solution, comprised of centralized management and control software, administrative security appliances and soft tokens, are designed to provide secure, auditable access to all administrative interfaces and monitored security once working within the network. Service Providers, Enterprises and Governmental Agencies utilize the ION solution globally in their voice, data and converged environments, to establish and maintain security policies while providing the support and maintenance required of networks and their devices.

The Company is a Delaware corporation founded in 1999 through the combination of two companies - MicroFrame ("MicroFrame"), a New Jersey Corporation (the predecessor entity to the Company, originally founded in 1982), and SolCom Systems Limited ("SolCom"), a Scottish corporation located in Livingston, Scotland (originally founded in 1994). The Scottish corporation was dissolved in 2003. The Company's principal objective was to address the need for security and network management and monitoring solutions, primarily for the PBX-based telecommunications market, resulting in a significant portion of our revenues being generated from sales to various telecommunications companies.

During 2004, the Company's financial condition improved particularly with the operating results in the last half of 2004 where the company posted two successive quarters of earnings and over $1.0 million in revenue for each quarter. The Company generated $108,279 in cash provided by operating activities in 2004 compared to $376,940 used in 2003. Also, in 2004 the Company increased its investments in new products to be rolled-out in 2005 and still was able to improve the overall annual usage of cash and cash equivalent of $70,274 versus $507,973 in 2003. The Company continues to have a delicate cash position and while the future viability of the organization has significantly improved, it is necessary for it to continue to strictly manage expenditures and to increase product revenues.

Results Of Operations

The Year Ended December 31, 2004 Compared to the Year Ended December 31, 2003

Revenues for the year ended December 31, 2004 were $3,616,261 as compared to $3,342,620 for the year ended December 31, 2003, an increase of approximately 8% or $273,641. This increase is attributable mainly to the growth in the number of units sold for the year 2004 compared to 2003 offset in part by a slight reduction in maintenance revenues. This reversal in the trend for the Company of declining year over year revenues was caused primarily by the growth of the ION’s Original Equipment Manufacturing (OEM) business caused by a general rebound in the telecommunications sector of the economy. The Company’s OEM revenues increased from $638,000 in 2003 to $1,372,000 in 2004. This change was due primarily to the increase in unit sales of higher margin 5500 model appliances from 79 to 335 units offset in part by a decline in sales of older product models i.e., 3100 from 515 to 440.

Gross margin for the year ended December 31, 2004 was $2,198,658 or 60.8% of revenue compared to $1,919,111 or 57.4% for the year ended December 31, 2003. Despite an 8% increase in revenues during the year ended 2004 compared to 2003, cost of sales remained flat resulting in reducing cost of sales as a percentage of revenue from 42.6% in 2003 to 39.2% in 2004. The increase in gross margin was due to a decline in amortization expense related to capital software from $531,136 or15.8% of revenue in 2003 to $352,160 or 9.7% in 2004 offset in part by a slight decline in prices during 2004 when compared to 2003.

Research and development expenses, net of capitalized software development, increased to $598,012 for the year ended December 31, 2004 from $503,146 for the year ended December 31, 2003, an increase of 18.8%. This increase for research and development expenditures was primarily due to the higher expenses related to the conversion of certain products to a Linux based platform from a proprietary software platform and the preliminary outside consulting services related to new product development.

Selling, general and administrative expenses decreased 5.6% from $2,452,031 for the year ended December 31, 2003 to $2,314,834 for the year ended December 31, 2004. This decline in expense was due primarily to certain cost containment programs implemented by management particularly for insurances, professional services and the full year impact of the move in 2003 of the Company’s headquarters to a more efficient facility.

Depreciation was $57,325 for the year ended December 31, 2004 compared to $205,558 for the year ended December 31, 2003, a decrease of $148,233 or approximately 72.1%. The primary reason for this reduction in 2004 as compared to 2003 was that the Company did not purchase depreciable fixed assets at a rate equal to prior periods due to a shift of the Company’s reduction in staff and outsourcing of certain manufacturing processes.

The Company acquired a corporation business tax benefit certificate pursuant to New Jersey law, which relates to the surrendering of unused net operating losses. For the year ended December 31, 2004 and for the year ended December 31, 2003, the Company received a benefit of $322,831 and $227,151, respectively.

During the year ended December 31, 2004 the Company recognized benefits from restructuring in the amount of $180,533 compared to $405,402 for the year ended December 31, 2003.

The Company had a loss of $249,840 for the year ended December 31, 2004 compared to a loss of $603,792 for the year ended December 31, 2003 or an improvement of $353,952.

Financial Condition And Capital Resources

The Company's working capital balance as of December 31, 2004 was $372,860 compared to $287,930 as of December 31, 2003.

Net cash provided by operating activities during the year ended December 31, 2004 was $108,279, compared to net cash used in operating activities of $376,940 during the year ended December 31, 2003. The $485,219 improvement in cash provided from operations was primarily a result of the decrease in net losses of $353,952 for the year ended

December 31, 2004 compared to the year ended December 31, 2003.

Net cash used in investing activities during the year ended December 31, 2004 was $321,963, compared to net cash used of $59,167 in year ended December 31, 2003. The increase of $262,796 of the net cash used in investing activities during the year ended December 31, 2004, was due to a slight increase of capitalized software expenditures in 2004 of $310,223 compared to $214,996 in 2003 and that in the prior year their were offsets against capital spending for the release of restricted cash of $125,700 and sale of certain assets of $30,129.

Net cash provided by financing activities during the year ended December 31, 2004 was $143,410, compared to $85,135 used in the year ended December 31, 2003. Financing activities during the year ended December 31, 2004 include the sale of a $200,000 convertible debenture to Mr. Steven Deixler in August 2004 (see item 5 - Recent Sales of unregistered securities) and exercise of $11,250 of employee stock options. During 2003 there were no financings.

Critical Accounting Policies

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

The significant estimates include the allowance for doubtful accounts, allowance for inventory obsolescence, capitalized software including estimates of future gross revenues, and the related amortization lives, deferred tax asset valuation allowance and depreciation and amortization lives.

Allowance for Doubtful Accounts Receivable -
Accounts receivable are reduced by an allowance to estimate the amount that will actually be collected from our customers. If the financial condition of our customers were to materially deteriorate, resulting in an impairment of their ability to make payments, additional allowances could be required.

Inventory, net -
Inventory is stated at the lower of cost (average cost) or market. Reserves for slow moving and obsolete inventories are provided based on historical experience and current product demand. If our estimate of future demand is not correct or if our customers place significant order cancellations, inventory reserves could increase from our estimate. We may also receive orders for inventory that has been fully or partially reserved. To the extent that the sale of reserved inventory has a material impact on our financial results, we will appropriately disclose such effects. Our inventory carrying costs are not material; thus we may not physically dispose of reserved inventory immediately.

Capitalized Software -
The Company capitalizes computer software development costs in accordance with the provisions of Statement of Financial Accounting Standards No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed" ("SFAS No. 86"). SFAS No. 86 requires that the Company capitalize computer software development costs upon the establishment of the technological feasibility of a product, to the extent that such costs are expected to be recovered through future sales of the product. There was no adjustment in the amount of amortization expense. Management is required to use professional judgment in determining whether development costs meet the criteria for immediate expense or capitalization. These costs are amortized to Cost of sales by the greater of the amount computed using (i) the ratio that current gross revenues from the sales of software bear to the total of current and anticipated future gross revenues from the sales of that software, or (ii) the straight-line method over the estimated useful life of the product. As a result, the carrying amount of the capitalized software costs may be reduced materially in the near term.

We record impairment losses on capitalized software and other long-lived assets used in operations when events and circumstances indicate that the assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amount of those items. Our cash flow estimates are based on historical results adjusted to reflect our best estimate of future market and operating conditions. The net carrying value of assets not recoverable is reduced to fair value. While we believe that our estimates of future cash flows are reasonable, different assumptions regarding such cash flows could materially affect our estimates.

Reclassifications -
Certain amounts in the financial statements for the year ended December 31, 2003 have been reclassified to conform to the presentation of the financial statements for the year ended December 31, 2004.

Item 7: Financial Statements

ION Networks, Inc. and Subsidiary

Index to Consolidated Financial Statements
For the Year Ended December 31, 2004 and 2003

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of

ION Networks, Inc.
South Plainfield, New Jersey

We have audited the accompanying consolidated balance sheet of ION Networks, Inc. and Subsidiary as of December 31, 2004, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the years ended December 31, 2004 and 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 ION Networks, Inc. and Subsidiary as of December 31, 2004, and the consolidated results of their operations and their cash flows for each of the years ended December 31, 2004 and 2003 in conformity with accounting principles generally accepted in the United States of America.

/s/ Marcum & Kliegman LLP

New York, New York
February 11, 2005 (Except for Note 16(b),
as to which the date is March 31, 2005).

ION Networks, Inc. and Subsidiary
Consolidated Balance Sheet

Assets		December 31, 2004
Current assets		
Cash and cash equivalents	$	287,437
Accounts receivable, less allowance for doubtful accounts of $16,923		578,491
Inventory, net		511,426
Prepaid expenses and other current assets		78,436
Total current assets		1,455,790
Property and equipment, net		11,847
Capitalized software, net		406,351
Other assets		12,836
Total assets	$	1,886,824
Liabilities and Stockholders' Equity		
Current liabilities		
Current portion of long-term debt		2,311
Accounts payable		354,602
Accrued expenses		549,730
Deferred income		160,212
Sales tax payable		6,074
Other current liabilities		10,000
Total current liabilities	$	1,082,929
Convertible debenture - related party		204,167
Long term debt, net of current portion		6,942
Total liabilities	$	1,294,038
Commitments and contingencies		
Stockholders' equity		
Preferred stock - par value $.001 per share; authorized 1,000,000 shares, 200,000 shares designated Series A; 158,335 shares issued and outstanding (Aggregate Liquidation Preference $285,003)		158
Common stock - par value $.001 per share; authorized 50,000,000 shares; 22,610,500 shares issued and outstanding		22,611
Additional paid-in capital		44,146,595
Accumulated deficit		(43,576,578)
Total stockholders' equity		592,786

Total liabilities and stockholders' equity	$	1,886,824

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

ION Networks, Inc. and Subsidiary
Consolidated Statements of Operations

	Years Ended December 31, 2004	2003
Net sales	$ 3,616,261	$ 3,342,620
Cost of sales	1,417,603	1,423,509
Gross margin	2,198,658	1,919,111
Research and development expenses	598,012	503,146
Selling, general and administrative expenses, including $58,750 and $(95,000) of non-cash stock based compensation/(recovery) for the years ended December 31, 2004 and 2003, respectively	2,314,834	2,452,031
Depreciation expenses	57,325	205,558
Restructuring, asset impairments and other credits	(180,533)	(405,402)
Loss from operations	(590,980)	(836,222)
Interest income	25,810	19,872
Interest income/(expense)- related party	(4,167)	-
Interest income/(expense)	(3,334)	(14,593)
Loss before income taxes	(572,671)	(830,943)
Income tax benefit	322,831	227,151
Net loss	$ (249,840)	$ (603,792)
Per share data		
Basic and diluted	$ (0.01)	$ (0.03)
Weighted average number of common shares outstanding		
Basic and diluted	23,294,325	23,900,500

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

ION Networks, Inc. and Subsidiary
Consolidated Statements of Cash Flows

	Years Ended December 31, 2004	2003
Cash flows from operating activities		
Net loss	$ (249,840)	$ (603,792)
Adjustments to reconcile net loss to net cash from operating activities:		
Restructuring, asset impairments and other charges, non-cash	(180,533)	(405,402)
Depreciation and amortization	409,485	736,694
Provision for inventory reserves	(48,880)	(26,002)
Other	(39,171)	-
Non-cash stock-based compensation charge (credit)	58,750	(95,000)
Non-cash interest income from notes receivable from officers	(24,884)	(13,130)
Changes in operating assets and liabilities:		
Accounts receivable, net	(180,747)	164,018
Inventory	239,496	583,228
Prepaid expenses and other current assets	49,702	75,796
Other assets	465	1,577
Accounts payable	126,723	(690,303)
Accrued expenses	20,714	(82,543)
Deferred income	(40,093)	45,284
Sales tax payable	(32,908)	(31,385)
Other current liabilities	-	(35,980)
Net cash provided by (used in) operating activities	108,279	(376,940)
Cash flows from investing activities		
Acquisition of property and equipment	(11,740)	-
Capitalized software expenditures	(310,223)	(214,996)
Proceeds from sale of equipment	-	30,129
Restricted cash	-	125,700
Net cash used in investing activities	(321,963)	(59,167)
Cash flows from financing activities		
Principal payments on debt and capital leases	(67,840)	(85,135)
Issuance of convertible debenture	200,000	-
Proceeds from the exercise of stock options	11,250	-
Net cash provided by (used in) financing activities	143,410	(85,135)
Effect of exchange rates on cash	-	13,269
Net decrease in cash and cash equivalents	(70,274)	(507,973)
Cash and cash equivalents - beginning of year	357,711	865,684
Cash and cash equivalents - end of year	$ 287,437	$ 357,711
Supplemental information		

Cash paid during period for interest	$ 3,334	$ 13,650

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

ION Networks, Inc. and Subsidiary
Consolidated Statements of Stockholders' Equity
For the Years Ended December 31, 2004 and 2003

	Preferred		Common		Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)
	Shares	Stock	Shares	Stock			
Balance, December 31, 2002	166,835	$ 167	24,875,500	$ 24,876	$ 44,680,740	$ (42,722,946)	$ (13,269)
Comprehensive loss							
Net loss						(603,792)	
Translation adjustments							13,269
Total comprehensive loss							
Notes receivable from officers -accrued interest							
Non-cash stock-based compensation to officers					(95,000)		
Balance, December 31, 2003	166,835	$ 167	24,875,500	$ 24,876	$ 44,585,740	$ (43,326,738)	$ -
Net loss						(249,840)	
Conversion of preferred stock to common stock	(8,500)	(9)	85,000	85	(76)		
Issuances of common stock upon exercise of options			250,000	250	11,000		
Notes receivable from officers - accrued interest							
Cancellation of restricted shares from former officers			(2,600,000)	(2,600)	(508,819)		

Non-cash stock-based compensation issued to officers					58,750		
Balance, December 31, 2004	158,335	$ 158	22,610,500	$ 22,611	$ 44,146,595	$ (43,576,578)	$ -

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

ION Networks, Inc. and Subsidiary
Consolidated Statements of Stockholders' Equity
For the Years Ended December 31, 2004 and 2003

	Notes Receivable from former Officers	Total Stockholders' Equity
Balance, December 31, 2002	$ (473,405)	$ 1,496,163
Comprehensive loss		
Net loss		(603,792)
Translation adjustments		13,269
Total comprehensive loss		(590,523)
Notes receivable from officers - accrued interest	(13,130)	(13,130)
Non-cash stock-based compensation to officers		(95,000)
Balance, December 31, 2003	$ (486,535)	$ 797,510
Net loss		(249,840)
Conversion of preferred stock to common stock		-
Issuances of common stock upon exercise of options		11,250
Notes receivable from officers - accrued interest	(24,884)	(24,884)
Cancellation of restricted shares from former officers	511,419	-
Non-cash stock-based compensation issued to officers		58,750
Balance, December 31, 2004	$ -	$ 592,786

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

ION Networks, Inc. and Subsidiary
Notes to Consolidated Financial Statements

1. Organization and Basis of Presentation

The Company

ION Networks, Inc. (the "Company"), a Delaware corporation founded in 1999 through the combination of two companies -- MicroFrame, a New Jersey Corporation (the predecessor entity to the Company, originally founded in 1982), and SolCom Systems Limited, a Scottish corporation located in Livingston, Scotland (originally founded in 1994), designs, develops, manufactures and sells network and information security and management products to corporations, service providers and government agencies. The Company's hardware and software suite of products are designed to form a secure auditable portal to protect IT and network infrastructure from internal and external security threats. ION's products operate in the IP, data center, telecommunications and transport, and telephony environments and are sold by a direct sales force and indirect channel partners mainly throughout North America and Europe.

2. Summary of Significant Accounting Policies

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of ION Networks, Inc. and a single Subsidiary in 2004 and two subsidiaries in 2003. All material inter-company balances and transactions have been eliminated in consolidation. Due to Management’s cost containment programs, the Company ceased its operations in Belgium and Scotland in 2003.

Use of Estimates

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

The significant estimates include the allowance for doubtful accounts, allowance for inventory obsolescence, capitalized software costs including estimates of future gross revenues, and the related amortization lives, deferred tax asset valuation allowance and depreciation and amortization lives.

Cash and Cash Equivalents

The Company considers all highly liquid investments with a maturity of three months or less at the time of purchase to be cash equivalents.

Allowance for Doubtful Accounts Receivable

Accounts receivable are reduced by an allowance to estimate the amount that will actually be collected from our customers. If the financial condition of our customers were to materially deteriorate, resulting in an impairment of their ability to make payments, additional allowances could be required.

Inventory, net

Inventory is stated at the lower of cost (average cost) or market. Reserves for slow moving and obsolete inventories are provided based on historical experience and current product demand. If our estimate of future demand is not correct or if our customers place significant order cancellations, inventory reserves could increase from our estimate. We may also receive orders for inventory that has been fully or partially reserved. To the extent that the sale of reserved inventory has a material impact on our financial results, we will appropriately disclose such effects. Our inventory carrying costs are not material; thus we may not physically dispose of reserved inventory immediately.

Property and Equipment

Property and equipment are stated at cost. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets, which are generally two to five years. Expenditures for maintenance and repairs, which do not extend the economic useful life of the related assets, are charged to operations as incurred. Gains or losses on disposal of property and equipment are reflected in the statements of operations in the period of disposal.

ION Networks, Inc. and Subsidiary
Notes to Consolidated Financial Statements

Capitalized Software

The Company capitalizes computer software development costs in accordance with the provisions of Statement of Financial Accounting Standards No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed" ("SFAS No. 86"). SFAS No. 86 requires that the Company capitalize computer software development costs upon the establishment of the technological feasibility of a product, to the extent that such costs are expected to be recovered through future sales of the product. Management is required to use professional judgment in determining whether development costs meet the criteria for immediate expense or capitalization. These costs are amortized to Cost of sales by the greater of the amount computed using (i) the ratio that current gross revenues from the sales of software bear to the total of current and anticipated future gross revenues from the sales of that software, or (ii) the straight-line method over the estimated useful life of the product. As a result, the carrying amount of the capitalized software costs may be reduced materially in the near term.

We record impairment losses on capitalized software and other long-lived assets used in operations when events and circumstances indicate that the assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amount of those items. Our cash flow estimates are based on historical results adjusted to reflect our best estimate of future market and operating conditions. The net carrying value of assets not recoverable is reduced to fair value. While we believe that our estimates of future cash flows are reasonable, different assumptions regarding such cash flows could materially affect our estimates.

The Company capitalized $310,223 and $214,996 of software development costs for the year ended December 31, 2004 and 2003, respectively. Amortization expense totaled $352,160 and $531,136 and is included in Cost of sales for the year December 31, 2004 and 2003, respectively.

Research and Development Costs

The Company charges all costs incurred to establish the technological feasibility of a product or enhancement to research and development expense in the period incurred.

Advertising Costs

The Company incurred approximately $30,000 and $1,000 for the year ended December 31, 2004 and 2003, respectively.

Revenue Recognition Policy

The Company recognizes revenue from product sales to end users, value-added resellers (VARs) and original equipment manufacturers (OEMs) upon shipment if no significant vendor obligations exist and collectibility is probable. We do not offer our customers the right to return products, however the Company records warranty costs at the time revenue is recognized. Management estimates the anticipated warranty costs but actual results could differ from those estimates. Maintenance contracts are sold separately and maintenance revenue is recognized on a straight-line basis over the period the service is provided, generally one year.

Shipping and Handling Costs

Shipping and handling costs incurred are billed to the customer and included as part of cost of sales.

Fair Value of Financial Instruments

The carrying value of items included in working capital and debt approximates fair value because of the relatively short maturity of these instruments.

Net Loss Per Share of Common Stock

Basic net loss per share excludes dilution for potentially dilutive securities and is computed by dividing net loss attributable to common shareholders by the weighted average number of common shares outstanding during the period. Diluted net loss per share reflects the potential dilution that could occur if securities or other instruments to issue common stock were exercised or converted into common stock. Potentially dilutive securities of 9,327,672 and 4,783,505 at December 31, 2004 and 2003 are excluded from the computation of diluted net loss per share as their inclusion would be antidilutive.

ION Networks, Inc. and Subsidiary
Notes to Consolidated Financial Statements

Stock Compensation

The Company records stock-based employee compensation arrangements in accordance with provisions of Accounting Principals Board (“APB”) Opinion No. 25, "*Accounting for Stock Issued to Employees*", and complies with the disclosure requirements of Statement of Financial Accounting Standards (“SFAS”) No. 123, *"Accounting for Stock-Based Compensation” as amended by SFAS No. 148* “*Accounting for Stock-Based Compensation - Transition and Disclosure, an amendment of FASB Statement No. 123,*” *issued i*n December 2002. Under APB Opinion No. 25, compensation expense is based on the difference, if any, generally on the date of grant, between the fair value of our stock and the exercise price of the option. Equity instruments issued to non-employee vendors are recorded in accordance with the provisions of SFAS No. 123 and Emerging Issues Task Force (“EITF”) Issue No. 96-18, “Accounting for Equity Instruments That are Issued to Other Than Employees from Acquiring, or in Conjunction with Selling, Goods and Services”. All transactions in which goods or services are the consideration received for the issuance of equity instruments are accounted for based on the fair value of the consideration received or the fair value of the equity instrument issued, whichever is more reliably measurable. The measurement date of the fair value of the equity instrument issued is the date on which the counter party’s performance is complete.

The Company issued certain stock options in 2004. The fair value of each option grant for the Company’s common stock is estimated on the date of the grant using the Black Scholes option-pricing model. The assumptions used to value the 2004 options issued are as follows:

Expected Volatility	214.97%
Risk-free interest rate	4.00
Expected option lives	5.00 years

During the year ended December 31, 2003, the Company issued no stock options. The fair value of each option grant for the Company’s common stock is estimated on the date of the grant using the Black Scholes option-pricing model. If the Company had elected to recognize compensation costs based on the fair value at the date of grant for awards, consistent with the provisions of SFAS No. 123, the Company's net loss and basic and diluted net loss per share would have increased to the pro forma amounts indicated below:

	Years Ended December 31,	
	2004	2003
Net loss as reported	$(249,840)	$(603,792)
Add: Stock based compensation expense (recovery) included in net loss	58,750	(95,000)
Deduct: Stock based employee compensation determined under the fair value method	(454,493)	(217,158)
Pro forma net loss	$(645,583)	$(915,950)
Basic and diluted net loss per share of common stock		
As reported	(0.01)	(0.03)
Pro forma	(0.03)	(0.04)

Foreign Currency Translation

The financial statements of the foreign subsidiaries were prepared in local currency and translated into U.S. dollars based on the current exchange rate at the end of the period for the balance sheet and a weighted-average rate for the period on the statement of operations. Translation adjustments are reflected as foreign currency translation adjustments in stockholders' equity and, accordingly, have no effect on net loss. Transaction adjustments for the foreign subsidiaries are included in income and are not material. The Company ceased its foreign operations during the year ended December 31, 2003.

Income Taxes

Deferred income tax assets and liabilities are computed annually based on enacted tax laws and rates for temporary differences between the financial accounting and income tax bases of assets and liabilities. A valuation allowance is established, when necessary, to reduce deferred income tax assets to the amount that is more likely than not to be realized.

ION Networks, Inc. and Subsidiary
Notes to Consolidated Financial Statements

Warranty Costs

The Company estimates its warranty costs based on historical warranty claim experience. Future costs for warranties applicable to sales recognized in the current period are charged to cost of sales. Adjustments are made when actual warranty claim experience differs from estimates. The warranty accrual included in other current liabilities as of December 31, 2004 is $10,000.

	For the years ended December 31, 2004	December 31, 2003
Balance at beginning of the year	$ 48,388	$ 48,388
Change in liability due to preexisting warranty	(38,388)	-
Balance at the end of the year	$ 10,000	$ 48,388

Reclassifications

Certain amounts in the consolidated financial statements for the year ended December 31, 2003 have been reclassified to conform to the presentation of the consolidated financial statements for the year ended December 31, 2004.

3. Restructuring, Asset Impairments and Other Credits

The components of the restructuring, asset impairments and other credits recorded in 2004 and 2003 are as follows:

	Asset Impairment	Restructuring	Other Credits	Total
First Quarter 2004 charges	$ -	$ -	$ -	$ -
Second Quarter 2004 charges (reversals)	-	-	(59,570)	(59,570)
Third Quarter 2004 charges (reversals)	-	(63,716)	-	(63,716)
Fourth Quarter 2004 charges (reversals)	-	-	(57,247)	(57,247)
Total	$ -	$ (63,716)	$ (116,817)	$ (180,533)
First Quarter 2003 charges	$ -	$ 123,510	$ -	$ 123,510
Second Quarter 2003 charges (reversals)	192,617	(508,458)	-	(315,841)
Third Quarter 2003 charges (reversals)	-	-	(213,071)	(213,071)
Fourth Quarter 2003 charges	-	-	-	-
Total	$ 192,617	$ (384,948)	$ (213,071)	$ (405,402)

The total amount of restructuring, asset impairments and other credits for the year ended December 31, 2004 was $180,533. This amount consisted of three items for which the Company recognized credits; $67,671 for forgiveness of debt related to legal, taxes and loan amounts; $63,716 related to a change in management estimate reducing potential liability for damages previously accrued for related to the abandonment of an office lease and $49,146 related to the write-off of certain payables for which management believes are not valid liabilities.

As a result of the Company being notified by the landlord to cancel its lease effective August 15, 2003 at the Piscataway, NJ facility, the net book value of leasehold improvements amounting to $28,955 were written-off. In addition, the Company was required to sell property and equipment in order to move into its smaller newly leased facility. At June 30, 2003 the Company recorded an impairment loss of $163,662 which represents the difference between the cash proceeds of the August 2003 sale and carrying value prior to the impairment. There is no balance remaining at December 31, 2004.

The Company reserved an estimate of $508,458 in the quarter ended December 31, 2002 for the total potential remaining lease payments. During the quarter ended June 30, 2003, the Company completed a voluntary liquidation of its UK subsidiary, which by court action abated all future liabilities, and therefore the Company reversed the original accrual estimate. There is no balance remaining at December 31, 2004.

During the period from March 2002 through May 2002, the Company was billed and it booked accounts payable invoices totaling $243,071 from Xetel. Xetel filed for bankruptcy and ION settled the entire balance during the third quarter 2003 for a payment in the amount of $30,000. There is no balance remaining at December 31, 2004.

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The Company is in negotiations with the landlord from the Fremont, California location for the disposition of the reserved amount of $123,510 recorded in 2003. The Company has not occupied the space since approximately March 2003. In 2004, Management re-evaluated the current status of the ongoing negotiations and reversed its prior reserve amount by $63,716. Management believes that the final settlement amount should not exceed the reserved amount of $60,000..This amount is included in accrued expenses as of December 31, 2004.

The Company has recorded certain liabilities that may, in the future, result in additional restructuring credits. The Company recorded accounts payable for invoices rendered primarily for professional services in the amount of $153,687 and accrued expenses in the amount of $178,671 based on invoices rendered offset by certain credits for such services. These entries arose from alleged services provided to the Company between November 2002 through August 2003.The Company is disputing these amounts with the vendors however, at the present time management is unable to estimate the final outcome of these disputes but believes that the final settlement amount should not exceed the total of the above amounts. This amount is included in accrued expenses as of December 31, 2004.

In January 2003, the Company's sub-tenant, Multipoint voluntarily filed for Chapter 7 Bankruptcy with the U.S. Bankruptcy Court for the District of New Jersey. As a result of consideration of Multipoint's financial condition, culminating with the bankruptcy, the Company wrote-off an amount of $122,550 for the unpaid balance of rent due from Multipoint which is included in selling and general and administrative expenses.

4. Inventory

Inventory, net of reserves of $149,853, consists of the following:

	December 31, 2004
Finished goods	$ 448,742
Raw materials	61,844
Work-in-progress	840
Inventory, net	$ 511,426

The Company evaluates the inventory reserves on a quarterly basis. In 2004, the Company adjusted its inventory reserves which resulted in a benefit of $48,880 and this amount was included as part of cost of sales in its consolidated statements of operations. In 2003, the Company recorded a charge of $26,002 to cost of sales related to reserves for excess and obsolete inventory.

5. Property and Equipment, net

Property and equipment consists of the following:

December
31,
2004

Computer and other equipment	$	764,900
Furniture and fixtures		68,408
		833,308
Less accumulated depreciation		(821,461)
Property and equipment, net	$	11,847

Depreciation expense for property and equipment for the year ended December 31, 2004 and 2003, amounted to $57,325 and $205,558, respectively. During the year ended December 31, 2004 and 2003, the Company retired both fully and not fully depreciated assets amounting to $53,963 and $1,730,369, respectively. During the year ended December 31, 2003, the Company relocated its headquarters and therefore, recorded an asset impairment charge of $192,617 to recognize the retirement of assets not fully depreciated (see Note 3).

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Notes to Consolidated Financial Statements

6. Debt - Related Party

On August 5, 2004, the Company issued, for $200,000 cash, a convertible debenture (the “Debenture”) to Stephen M. Deixler, one of the Company’s directors. The Debenture matures on August 5, 2008 and bears interest at five (5%) percent per annum, compounded annually. The principal amount of the Debenture is convertible into shares of the Company’s common stock, $.001 par value at a conversion price equal to $0.083 per share (the “Conversion Price”), which is equal to the ten (10) day average of the closing prices of the Company’s common stock, as quoted on the OTC Bulletin Board during the five (5) trading days immediately prior to and subsequent to August 5, 2004. The principal amount of the Debenture is convertible at the Conversion Price at the option of the holder, or after August 5, 2005 at the Company’s option if the Company’s common stock trades at a price of at least $0.166 for twelve (12) trading days in any fifteen (15) trading day period. The Company is also entitled to prepay the principal amount of the Debenture, at any time after August 5, 2005, but shall be required to pay a premium of two (2%) percent in the second year after issuance of the Debenture of the principal amount prepaid, for prepayments made during that period. The Company has granted certain “piggyback” registration rights to the holder to register for resale the shares issuable upon conversion of the Debenture. In 2004, the Company recorded $4,167 of related party interest expense as part of the statement of operations.

7. Income Taxes

As of December 31, 2004, the Company has available federal and state net operating loss carry forwards of approximately $42,773,686 and $26,340,185, respectively, to offset future taxable income. The federal net operating loss carry forwards expire during the years 2011 through 2024. In addition, the Company has investment credit and research and development credit carry forwards aggregating approximately $405,000, which may provide future tax benefits, expiring from 2008 through 2020. The Internal Revenue Code contains provisions which will limit the net operating loss carry forward available for use in any given year if significant changes in ownership interest of the Company occur.

The Company obtained a corporation business tax benefit certificate pursuant to New Jersey law which allows the sale of unused state net operating losses. For the years ended December 2004 and 2003, the Company received a benefit of $322,831 and $227,151, respectively.

The tax effect of temporary differences which make up the significant components of the net deferred tax asset and liability at December 31, 2004 are as follows:

		December 31, 2004
Current deferred tax assets		
Inventory reserves	$	88,727
Accrued expenses		196,526
Allowance for doubtful accounts		85,239
Total current deferred tax assets		370,492
Valuation allowance		(370,492)
Net current deferred tax assets		-
Noncurrent deferred tax assets		
Depreciation and amortization		245,425

Net operating loss carry forwards		16,103,494
Research and development credit		405,078
Total noncurrent deferred tax assets		16,753,997
Valuation allowance		(16,591,457)
Net noncurrent deferred tax assets		162,540
Noncurrent deferred tax liabilities		
Capitalized software		(162,540)
Total noncurrent deferred tax liabilities		(162,540)
Net noncurrent deferred tax (liabilities) assets	$	-

The Company has recorded a full valuation allowance against the deferred tax assets, including the federal and state net operating loss carry forwards as management believes that it is more likely than not that substantially all of the deferred tax assets will not be realized. During the year ended December 31, 2004, the Company had an annual change in the valuation allowance of $1,948,386.

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8. Stockholders' Equity

Preferred Stock - On September 13, 2002 the Company received equity financing in the amount of $300,303 ($285,303, net of issuance costs) for the issuance of 166,835 unregistered shares of the Company's preferred stock at $1.80 per share. The Company has designated 200,000 of the 1,000,000 authorized shares of preferred stock as Series A Preferred Stock ("Preferred Stock"). Each share of Preferred Stock is convertible into 10 shares of the Company's common stock at the conversion price of $0.18 per share of common stock, which was the closing bid price of the Company's common stock on September 13, 2002. The Preferred Stock is non-voting, has a standard liquidation preference equal to its purchase price, and does not pay dividends. Proceeds of the equity financing will be used for working capital and general corporate purposes. All of the shares of Preferred Stock were purchased by directors and management of the Company. On December 27, 2004 8,500 of preferred stock was converted to 85,000 shares of common stock.

Restricted Stock - Effective October 2001, the Company approved and granted 2,600,000 shares of restricted stock (the “Restricted Shares”) to two executives stockholders at fair value. The Restricted Shares are subject to a repurchase right which will permit the Company to repurchase any shares which have not yet vested at the effective date of termination of the officers' employment, as defined in their employment agreements, for an amount equal to the purchase price per share paid by the officers. The Company received a series of partial recourse interest bearing (5.46% on an annual basis) promissory notes for the value of the Restricted Shares to be repaid by the officers. As of December 31, 2003 Mr. Kam Saifi owes approximately $282,618 (including approximately $24,618 of interest) for 2,000,000 Restricted Shares and; Mr. Cameron Saifi owes approximately $203,917 (including approximately $18,517 of interest) for 600,000 Restricted Shares.

The notes are to be repaid by the officers at the earlier of ten years or the date upon which the employees dispose of their shares or under certain circumstances, when the borrower’s employment with the Company terminates for any reason. The issuance of the restricted shares and the notes receivable due from the former officers is recorded in the Company's financial statements. On July 7, 2003, Mr. Kam Saifi and Mr. Cameron Saifi separated from the Company.

On March 29, 2004, the Company agreed to a final separation agreement with its former President and Chief Executive Officer. As part of the agreement, the Company agreed to accept the return of 2,000,000 shares of the Company’s common stock as full payment for the former officers’ total indebtedness to the Company of $294,493. In addition, the former officer released the Company from any obligations, which may have arisen from the separation of the officer from the Company.

On October 14, 2004, the Company agreed to a final separation agreement with its former Executive Vice President and Chief Operating Officer. As part of the agreement, the Company agreed to accept the return of 600,000 shares of the Company’s common stock as full payment for the former officers’ total indebtedness to the Company of $216,926. In addition, the former officer released the Company from any obligations for the sum of $8,000 as full compensation for said release.

The variable accounting method used to account for the partial recourse restricted stock granted to management resulted in a cashless charge of $95,000 for the period ended December 31, 2002. In accordance with accounting guidance for the partial recourse restricted stock granted to management resulted in a reversal of the cashless charge of $95,000 for the period ended December 31, 2003.

Common Stock - On February 14, 2002 the Company sold 4,000,000 shares of common stock at a price of $0.87 per share, for total consideration of $3,480,000. In connection with this sale, warrants to purchase 1,120,000 shares of common stock with an exercise price of $1.25 were issued. The warrants expire on February 14, 2007.

Stock Option Plans

In November 2000, the Company adopted its 2000 Stock Option Plan (the "2000 Plan"). The aggregate number of shares of common stock for which options may be granted under the 2000 Plan is 3,000,000. The maximum number of options which may be granted to an employee during any calendar year under the 2000 Plan is 400,000. The term of these non-transferable stock options may not exceed ten years. The exercise price of these stock options may not be less than 100% (110% if the person granted such options owns more than ten percent of the outstanding common stock) of the fair value of one share of common stock on the date of grant. During the year ended December 31, 2004 and 2003, the Company granted options to purchase 2,048,000 and zero shares, respectively. As of December 31, 2004, 2,626,000 options were outstanding under the 2000 Plan, of which 1,544,750 options were exercisable.

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The aggregate number of shares of common stock for which options may be granted under the 1998 Stock Option Plan (the "1998 Plan") is 3,000,000. The maximum number of options which may be granted to an employee during any calendar year under the 1998 Plan is 400,000. The term of these non-transferable stock options may not exceed ten years. The exercise price of these stock options may not be less than 100% (110% if the person granted such options owns more than ten percent of the outstanding common stock) of the fair value of one share of common stock on the date of grant. During the year ended December 31, 2004 and 2003, the Company granted options to purchase 1,285,000 and zero shares, respectively. As of December 31, 2004, 1,556,629 options were outstanding under the 1998 Plan, of which 1,020,900 options were exercisable.

In August 1994, the Company adopted its 1994 Stock Option Plan (the "1994 Plan"). The 1994 Plan, as amended, increased the number of shares of common stock for which options may be granted to a maximum of 1,250,000 shares. The term of these non-transferable stock options may not exceed ten years. The exercise price of these stock options may not be less than 100% (110% if the person granted such options owns more than ten percent of the outstanding common stock) of the fair market value of one common stock on the date of grant. During the year ended December 31, 2004 and 2003, there were no option grants provided under the 1994 Plan. As of December 31, 2004, 25,000 options were outstanding and exercisable under the 1994 Plan.

Warrants

In connection with the sale of common stock on February 14, 2002, warrants to purchase 1,120,000 shares of common stock with an exercise price of $1.25, subject to certain adjustments, were issued. As of March 18, 2005 the exercise price is $1.08. The warrants expire on February 14, 2007.

During July 2001 in connection with services being performed by a consultant, the Company issued warrants to purchase 48,000 shares of the Company's Common Stock at $0.62 per share. The warrants expire five years from the date of the grant.

During January 2002 in connection with services being performed by a consultant through June 30, 2002, the Company issued warrants to purchase 100,000 shares of the Company's common stock at $1.35 per share. Warrants to purchase an additional 50,000 shares of common stock are exercisable at $1.80. All 150,000 warrants expired in January 2005.

Other Options

On September 25, 1996, the Company issued options to certain officers and directors to purchase 620,000 shares of the Company's Common Stock, of which 420,000 vested immediately and 100,000 vested on April 1, 1998 and 1999. The options expire ten years from the date of grant. However, in the event of (a) the liquidation or dissolution of the Company or (b) a merger in which the Company is not the surviving corporation or a consolidation involving the Company, the options shall terminate, unless other provision is made in the transaction. There were no stock option exercised during the year ended December 31, 2004 and 2003. The exercise price of the options is $1.156 and equals to the market value of the Company's Stock on the date of grant. At December 31, 2004, 400,000 options were outstanding and exercisable.

During March 1999, the Company issued options to certain employees and consultants to purchase 20,000 shares of the Company's common stock, all of which vested on the first year anniversary of the date of the grant. The options expire six years from the date of the grant. The exercise price of the options is equal to the market value of the Company's common stock on the date of the grant. There were no stock options exercised during the year ended

December 31, 2004 and 2003. At December 31, 2004, 10,000 options were outstanding and exercisable.

In January 2004, the Company issued options to certain officers to purchase 1,000,000 shares of the Company's common stock, which vested immediately. The exercise price of the below market options ranged from $0.045 to $0.06 on the date of grant. The Company recorded a stock based compensation charge of $58,750. At December 31, 2004, 750,000 options were outstanding and exercisable.

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Accounting for Stock-Based Compensation

The Company continues to apply Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and related Interpretations in accounting for its options. During the year ended December 31, 2004 and 2003 the Company has recorded compensation expense (benefit) of $58,750 and ($95,000), respectively.

Details of the options granted are as follows:

	Shares	Weighted Average Exercise Price ($)
Options outstanding at December 31, 2002	3,667,102	1.62
Granted	-	-
Canceled	(1,821,947)	3.55
Exercised	-	-
Options outstanding at December 31, 2003	1,845,155	1.59
Granted	4,333,000	0.15
Expired	(73,250)	5.63
Canceled	(487,276)	1.16
Exercised	(250,000)	0..05
Options outstanding at December 31, 2004	5,367,629	0.51
Options exercisable at December 31, 2004	3,750,650	0.50

Range of Exercise	Number Outstanding	Weighted Average Remaining Years of Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$0.00 - 7.53	5,320,694	4.67	$ 0.36	3,737,550	$ 0.40
$7.54 - 15.06	36,605	4.85	13.62	3,600	13.62
$15.06 - 22.59	1,500	.05	22.00	1,500	22.00

$22.59 - 30.12	1,500	.25	29.25	1,500	29.25
$30.12 - 37.65	7,060	.49	34.69	6,500	34.66
$0.00 - 37.65	5,367,629	4.67	$0.51	3,750,650	$0.50

9. Commitments

Operating Leases

The Company entered into a lease on August 1, 2003 for approximately 7,000 square feet for its principal executive offices at 120 Corporate Blvd., South Plainfield, New Jersey. The base rent is $4,505 per month effective October 2003 through July 2006. The Company is also obligated to make additional payments to the landlord relating to certain taxes and operating expenses.

As a result of the Company being notified by the landlord of their intent to cancel its lease effective August 15, 2003, the Company no longer occupies the space at 1551 S. Washington Avenue, Piscataway, New Jersey. The Company entered into the lease on February 18, 1999 for approximately 26,247 square feet for its principal executive offices. On March 17, 2003, the Company signed an amendment with the landlord reducing the space from 26,247 to 12,722 square feet and the rent from $50,153.64 to $20,143.17 per month effective March 1, 2003. The Company was also obligated to make additional payments to the landlord relating to certain taxes and operating expenses.

The Company leases certain equipment under agreements which are classified as capital leases. Each of the capital lease agreements expire within five years and have purchase options at the end of the lease term.

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Future minimum payments, by year and in the aggregate, under non-cancelable capital and operating leases as of December 31, 2004 are as follows:

	Capital Leases	Operating Leases
Year ending December 31,		
2005	$ 2,691	$ 77,016
2006	2,691	44,926
2007	2,691	-
2008	2,243	-
Total minimum lease payments	$ 10,316	$ 121,942
Less amount representing interest	1,063	
Present value on net minimum lease payment	$ 9,253	

Rent expense under operating leases for the year ended December 31, 2004 and 2003 was approximately $74,500 and $210,800 , respectively.

Employment Contracts

The Company has entered into certain employment contracts with various officers. Included in these contracts is a provision for severance, where by such officers if terminated without cause as defined in the agreement is entitled to severance ranging in terms of three to eighteen months. At December 31, 2004 the Company had a potential loss for severance costs of approximately $735,000 under these employment contracts.

10. Contingent Liabilities

In the normal course of business the Company and its Subsidiary may be involved in legal proceedings, claims and assessments arising in the ordinary course of business. Such matters are subject to many uncertainties, and outcomes are not predictable with assurance.

11. Employee Benefit Plans

Effective April 1, 1993, the Company adopted a defined contribution savings plan. The terms of the plan provide for eligible employees who have met certain age and service requirements to participate by electing to contribute up to 15% of their gross salary to the plan, as defined, with a discretionary contribution by the Company matching 30% of an employee's contribution in cash up to a maximum of 6% of gross salary, as defined. Company contributions vest at the rate of 25% of the balance at each employee's second, third, fourth, and fifth anniversary of employment. The employees' contributions are immediately vested. As of January 1, 2003, the Company per the provisions of the plan decided not to make discretionary contributions until further notice.

12. Geographic Information

The Company's headquarters, physical production and shipping facilities are located in the United States. The Company's domestic and foreign export sales for each of the years ended December 31, 2004 and 2003 are as follows:

	Year Ended December 31, 2004	Year Ended December 31, 2003
United States	$ 2,875,996	$ 2,743,170
Europe	723,222	477,153
Pacific Rim	16,657	122,188
Other	386	109
	$ 3,616,261	$ 3,342,620

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Historically, we have been dependent on several large customers each year, but they are not necessarily the same every year. For the year ended December 31, 2004, our most significant customers (stated as an approximate percentage of revenue) were Avaya 38% and MCI 9%, with remaining accounts receivables of $275,662 and $20,170, respectively, compared to the year ended December 31, 2003, of Avaya 18%, Siemens 12%. Qwest 8% and MCI 7% with remaining accounts receivables of $80,929, $0, $0, $176,947, respectively.. In general, we cannot predict with certainty, which large customers will continue to order. The loss of any of these large customers, or the failure to attract new large customers would likely significantly decrease our revenues and future prospects, which could materially and adversely affect our business, financial condition and results of operations.

The loss of any of these customers or a significant decline in sales volumes from any of these customers could have a material adverse effect on the Company's financial position, results of operations and cash flows.

13. Concentration of Credit Risk

The Company maintains deposits in a financial institution which is insured by the Federal Deposit Insurance Corporation ("FDIC") up to $100,000. At December 31, 2004 and periodically throughout 2004, the Company had deposits in this financial institution in excess of the amount insured by the FDIC.

The Company designs its products utilizing readily available parts manufactured by multiple suppliers and the Company currently relies on and intends to continue to rely on these suppliers. The Company has been and expects to continue to be able to obtain the parts generally required to manufacture its products without any significant interruption or sudden price increase, although there can be no assurance that the Company will be able to continue to do so.

The Company sometimes utilizes a component available from only one supplier. If a supplier were to cease to supply this component, the Company would most likely have to redesign a feature of the affected device. In these situations, the Company maintains a greater supply of the component on hand in order to allow the time necessary to effectuate a redesign or alternative course of action should the need arise.

14. Supplemental Cash Flow Information

In 2004 the Company converted 8,500 shares of preferred stock into 85,000 of common stock.

15. New Accounting Pronouncements

During 2003, SFAS 150, “Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity” (“SFAS 150”) was issued. SFAS 150 establishes standards for classification and measurement of certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in certain cases). The provisions of SFAS 150 are effective for instruments entered into or modified after May 31,2003 and pre-existing instruments as of July 1, 2003. On October 29, 2003, the FASB voted to indefinitely defer the effective date of SFAS 150 for mandatory redeemable instruments as they relate to minority interests in consolidated finite-lived entities through the issuance of FASB Staff Position 150-3. The adoption of SFAS No. 150 did not have a material impact on the Company’s results of operations or financial position.

In December 2003, a revision of SFAS 132 “Employers’ Disclosures about Pensions and Other Postretirement Benefits” was issued, revising disclosures about pension loans and other post retirements benefits plans and requiring additional disclosures about the assets, obligations, cash flows, and net periodic benefit cost of defined benefit pension plans and other defined benefit postretirement plans. The adoption of SFAS No. 132 did not have a material impact on the Company's results of operations or financial position.

In December 2004, the FASB issued SFAS No. 123R "Shared Based Payment." This statement is a revision of SFAS Statement No. 123, "Accounting for Stock-Based Compensation" and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees," and its related implementation guidance. SFAS 123R addresses all forms of shared based payment ("SBP") awards, including shares issued under employee stock purchase plans, stock options, restricted stock and stock appreciation rights. Under SFAS 123R, SBP awards result in a cost that will be measured at fair value on the awards' grant date, based on the estimated number of awards that are expected to vest and will be reflected as compensation cost in the historical financial statements. This statement is effective for public entities that file as small business issuers - as of the beginning of the first interim or annual reporting period that begins after December 15, 2005. The Company is in the process of evaluating whether the SFAS No. 123R will have a significant impact on the Company's overall results of operations or financial position.

16. Subsequent Events

(a) Subsequent to December 31, 2004 the Company converted 2,778 shares of preferred stock into 27,780 of common stock.

(b) On March 31, 2005, we completed a private placement of 4,411,764 shares of common stock and warrants to purchase an additional 2,205,882 shares of common stock. The total offering price was $750,000. The shares of common stock were issued at $0.17 cents per share and the warrants are exercisable at a price of $0.23 per share subject to certain anti-dilution adjustments. The warrants will expire on March 31, 2010. The Company has the right to call the warrants in the event that its common stock trades at a price exceeding $0.69 per share for twenty (20) consecutive trading sessions and certain other conditions are met. The Company also agreed to register for resale the shares of common stock as well as the shares issued upon exercise of the warrants.

Item 13. Exhibits and Reports on Form 8-K

(a) Exhibits:

Exhibit No:	Description
3.1	(i)Certificate of Incorporation of the Company, as filed with the Secretary of State of the State of Delaware on August 5, 1998./(2)/
	(ii)Certificate of Amendment of the Certificate of Incorporation, as filed with the Secretary of State of the State of Delaware on December 11, 1998./(2)/
	(iii)Certificate of Amendment of the Certificate of Incorporation, as filed with the Secretary of state of the State of Delaware an October 12, 1999./(3)/
	(iv)Amended and Restated Certificate of Designation of Rights Preferences, Privileges and Restrictions of Series A Preferred Stock of ION Networks, Inc. /15/
3.2	By-Laws of the Company./(19)/
3.3	Form of Specimen Common Stock Certificate of the Company./(4)
4.1	1994 Stock Option Plan of the Company. /(1)/+
4.2	Stock Option Plan of the Company./(2)/+
4.3	U.K. Sub-Plan of the Company, as amended./(2)/+
4.4	2000 Stock Option Plan of the Company./(12)/+
4.5	Form of Warrant Agreement dated July 17, 2001./(11)/+
4.6	Form of Warrant Agreement dated February 14, 2002./(11)/

4.7	Convertible Debenture dated August 5, 2004./19/
10.3	Agreement dated as of December 19, 1994 by and between LeeMAH DataCom Security Corporation and Siemens Rolm Communications Inc./(4)/
10.4	Equipment Lease Agreements dated October 29, 2003 by and between the Company and GE Capital Corporation. /(21)/
10.5	(i) Non-negotiable Promissory Note in the principal amount of $750,000 issued by Stephen B. Gray to the Company./(5)/
	(ii) First Amendment to Promissory Note dated as of August 5, 2000 by and between the Company and Stephen B. Gray./(5)/

Exhibit No.	Description
10.6	(i) Separation and Forbearance Agreement made as of October (ii)Promissory Note in the amount of $163,000 dated October 5, 2000 made by Stephen B. Gray to the Company./(6)/
10.7	Materials and Services Contract dated January 16, 2001, between the Company and SBC Services, Inc./(7)/
10.8	Stock Purchase Agreement dated August 11, 2000 by and between the Company and the parties identified therein./(7)/
10.9	Purchase Agreement by and between the Company and the Selling Shareholders set forth therein dated February 7, 2002./(13)/
10.10	Employment Agreement dated October 4, 2001 between the Company and Kam Saifi./(9)/+
10.11	Employment Agreement dated October 17, 2001 between the Company and Cameron Saifi./(10)/+
10.12	Employment Agreement dated February 25, 2002, between the Company and William Whitney./15/+
10.13	Amended and Restated Employment Agreement dated August 15, 2003, between the Company and Norman E. Corn./16/+
10.14	Employment Agreement dated September 15, 2003, between the Company and Patrick E. Delaney./14/+
10.15	Lease Agreement dated July 21, 2003 by and between the Company and 116 Corporate Boulevard, LLC, Inc. / 17 /
10.16	Separation Agreement dated March 29, 2004 between the Company and Kam Saifi. / 21 /
10.17	Separation Agreement dated October 14, 2004 between the Company and Cameron Saifi. / 21 /
10.18	First Amendment to the Amended and Restated Employment Agreement dated September 8, 2003 by and between the Company and Norman E. Corn dated November 10, 2004 /(21)/+
10.19	First Amendment to the Employment Agreement dated September 15, 2003 by and between the Company and Patrick E. Delaney dated November 10, 2004. /(21)/+
10.20	Employment Agreement dated August 31, 2004 by and between the Company and Henry A. Hill. /20/+
10.21	

	Severance Agreement dated September 2, 2004 by and between the Company and William Whitney. /(21)/+
10.22	Severance Agreement dated September 2, 2004 by and between the Company and Henry Gold. /(21)/+

Exhibit No.	Description
10.23	Option Agreement dated January 28, 2004 by and between the Company and Norman E. Corn. /(21)/+
10.24	Option Agreement dated January 28, 2004 by and between the Company and Patrick E. Delaney. /(21)/+
10.25	Agreement dated February 25, 2005 by and between the Company and Sprint/Untied Management Company. /(21)/
10.26	Agreement dated October 28, 2004 by and between the Company and General Dynamics Network Systems. /(21)/
16.1	Letter dated October 31,2003, from Deloitte & Touche, LLP. To the Securities and Exchange Commission./(8)/
21.1	List of Subsidiaries./(21)/
23.1	Independent Auditors Consent.*
31.1	Certification of CEO Pursuant to Section 302 of the Sarbanes Oxley Act of 2002.*
31.2	Certification of CFO Pursuant to Section 302 of the Sarbanes Oxley Act of 2002.*
32.1	Certification of CEO Pursuant to Section 906 of the Sarbanes Oxley Act of 2002.*
32.2	Certification of CFO Pursuant to Section 906 of the Sarbanes Oxley Act of 2002.*

(1) Incorporated by reference to the Company's Registration Statement on Form S-8 filed on August 15, 1995.
(2) Incorporated by reference to the Company's Registration Statement on Form S-8 filed on April 22, 1999.
(3) Incorporated by reference to the Company's Registration Statement on Form S-8 filed on March 17, 2000.
(4) Incorporated by reference to the Company's Annual Report on Form 10-KSB for the fiscal year ended March 31, 1999.
(5) Incorporated by reference to the Company's Annual Report on Form 10-KSB filed on June 28, 2000.
(6) Incorporated by reference to the Company’s Quarterly report on Form 10-QSB filed on November 14, 2000
(7) Incorporated by reference to the Company’s Annual report on Form 10-KSB filed on June 29, 2001.
(8) Incorporated by reference to the Company’s Annual report on Form 8-KSB filed on October 31, 2003.
(9) Incorporated by reference to the Company’s Current Report on Form 8-K filed on October 23, 2001.
(10) Incorporated by reference to the Company’s Current Report on Form 8-K filed on October 24, 2001.
(11) Incorporated by reference to the Company’s Annual Report on Form 10-KSB for the fiscal year ended March 31, 2002, as filed on July 1, 2002.
(12) Incorporated by reference to the Company’s Registration Statement on Form S-8 filed on January 11, 2002.
(13) Incorporated by reference to the Company’s Registration Statement on Form S-3 filed on March 4, 2002.

(14) Incorporated by reference to the Company’s Quarterly Report on Form 10-QSB filed on November 17, 2003.
(15) Incorporated by reference to the Company’s Annual Report on Form 10-KSB for the fiscal year ended December 31, 2002, as filed on April 15, 2003.
(16) Incorporated by reference to the Company’s Quarterly Report on Form 10QSB filed on September 12, 2003.
(17) Incorporated by reference to the Company’s Annual Report on Form 10-KSB filed for the year ended December 31, 2003.
(18) Incorporated by reference to the Company's Annual Report on Form 10-KSB/A, Amendment No.2, for the fiscal year ended March 31, 2002, as filed on August 2, 2002.
(19) Incorporated by reference to the Company’s Quarterly Report on Form 10QSB filed on August 13, 2004.
(20) Incorporated by reference to the Company’s Quarterly Report on Form 10QSB filed on November 15, 2004.
(21) Incorporated by reference to the Company's Annual Report on Form 10-KSB for the fiscal year ended December 31, 2004, as filed on March 24, 2005.

* Filed herewith
+ Management contract for compensatory plan or arrangement

(b) Reports on Form 8-K

On November 8, 2004, the Company filed a report on Form 8-K, reporting the appointment of Mr. Harry Immerman to the Board of Directors.

On November 12, 2004, the Company filed a report on Form 8-K, reporting the award of a contract by General Dynamics.

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this amendment No.2 to Form 10-KSB to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: July 11, 2005

ION NETWORKS, INC.

By: /s/ Norman E. Corn
Norman E. Corn
Chief Executive Officer