NEOMEDIA TECHNOLOGIES INC
Form 10-K/A
September 19, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K/A

(1st Amendment)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 :** For the Fiscal Year Ended December 31, 2013

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

Commission File Number 000-21743

NeoMedia Technologies, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**36-3680347**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1515 Walnut Street, Suite 100, Boulder, CO 80302

(Address, including zip code, of principal executive offices)

303-546-7946

(Registrants' telephone number, including area code)

Securities Registered Under Section 12(b) of the Act:	**None**
Name of exchange on which registered:	**None – Quoted on the OTC Markets (OTCQB)**
Securities registered pursuant to Section 12(g) of the Act:	**Common Stock, $0.001 par value per share**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ¨ No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨	Accelerated filer ¨	Non-accelerated filer ¨	Smaller Reporting Company 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 aggregate market value of the common stock held by non-affiliates of the registrant as of June 30, 2013 was $2,945,890 based on the closing sale price for the registrant's common stock as quoted on the OTC Markets.

The number of outstanding shares of the registrant's common stock on April 25, 2014 was 4,984,827,279.

Documents Incorporated By Reference: **None**

EXPLANATORY NOTE

We are filing this amendment to amend our annual report on Form 10-K for the fiscal year ended December 31, 2013, which was originally filed with the Securities and Exchange Commission on March 17, 2014.

During the three month period ended March 31, 2014, for fair value accounting of the derivative financial instruments and debentures payable, we reassessed the valuation techniques used to estimate the liability fair values. Based on the assessment, we determined that the valuation technique should be modified to consider the potentially dilutive impact on the stock price resulting from the issuance of additional shares of common stock upon the conversion of the instruments as well as the resulting value in comparison to our market capitalization.

On July 16, 2014, after a series of comment letters beginning November 22, 2013, we received correspondence from the Securities and Exchange Commission (“SEC”), requesting that (i) we restate certain of our financial statements by filing amendments to the reports containing such financials, and (ii) we file an 8-K to report non- reliance on such financials. In its correspondence, the SEC asserted that certain modifications in our valuation methodology, deemed as accounting estimates, contained errors with respect to the valuation of convertible debentures issued by us, in that such methodology did not capture the debentures’ potentially dilutive effect upon their conversion into common stock.

We agreed with the SEC’s assertion that certain modifications in our valuation methodology contained errors with respect to the valuation of convertible debentures issued by us. Thus, we are restating our financial statements for the fiscal year ended December 31, 2013 and sections related therewith to reflect the change in valuation technique and correction of the fair value accounting of the derivative financial instruments and debentures payable.

Our operational performance remains unchanged. All other information included in our annual report on Form 10-K for the fiscal year ended December 31, 2013 has not been amended. Except for the matter described above, this amendment does not modify or update disclosures in the originally filed annual report on Form 10-K, or reflect events occurring after March 17, 2014, which is the date of the filing of the originally filed annual report on Form 10-K.

NeoMedia Technologies, Inc.

FORM 10-K/A

(1st Amendment)

For the Fiscal Year Ended December 31, 2013

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NOTE ABOUT FORWARD LOOKING STATEMENTS

The information in this Annual Report on Form 10-K (this “Report”) contains “forward looking statements” and information within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), which may be subject to the “safe harbor” created by those sections. These forward looking statements include, but are not limited to, statements concerning our strategy, future operations, future financial position, future revenues, projected costs, prospects and plans and objectives of management. The words “anticipates,” “believes,” “estimates,” “expects,” “intends,” “may,” “plans,” “ “will,” “would” and similar expressions are intended to identify forward looking statements, although not all forward looking statements contain these identifying words. We may not actually achieve the plans, intentions or expectations disclosed in our forward looking statements and you should not place undue reliance on our forward looking statements. These forward looking statements involve known and unknown risks and uncertainties that could cause our actual results, performance or achievements to differ materially from those expressed or implied by the forward looking statements, including, without limitation, the risks set forth in Part I, Item 1A, Risk Factors in this Annual Report on Form 10-K and in our other filings with the Securities and Exchange Commission (“SEC”). Except as required by law, we assume no obligation to update these forward looking statements publicly, or to update the reasons actual results could differ materially from those anticipated in these forward looking statements, even if new information becomes available in the future.

As used herein, “NeoMedia”, “Company,” “we,” “us,” “our”, and similar terms include NeoMedia Technologies, Inc., a Delaware corporation, and its subsidiaries unless the context indicates otherwise.

PART I

ITEM 1A. Risk Factors

You should carefully consider the following factors and all other information contained in this Report before you make any investment decisions with respect to our securities.

Risks Related to Our Business

We may be unable to continue as a going concern based on our historical performance, which has included losses, an accumulated deficit, and a working capital deficit. We may continue to generate losses and be unable to service our outstanding liabilities in the future.

We have historically incurred operating losses and may continue to do so in the future. We must develop new customer relationships and substantially increase our revenue derived from products, services and IP licensing. We have expended and intend to continue to expend resources to develop, improve and to market our products and services. A number of factors could increase our operating expenses, such as: adapting infrastructure and administrative resources to accommodate additional customers and future growth; developing products, distribution, marketing, and management for the broadest possible market; broadening customer technical support capabilities; developing additional indirect distribution partners; and, incurring legal fees and settlements associated with litigation and contingencies. To the extent that operating expenses are not offset by increases in revenues, we could incur operating losses and negative free cash flow.

There can be no assurance that our efforts to execute our business plan will be successful. The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (“US GAAP”), which contemplate our continuation as a going concern. Our net income for the year ended December 31, 2013 was $28.5 million and our net loss for the year ended December 31, 2012 was $19.4 million, including $26.7 million net gain and $17.3 million net loss, respectively, related to our financing instruments. Our operating income was $1.0 million for 2013 as compared to an operating loss in 2012 of $5.5 million. Net cash used by operations during 2013 and 2012 was $0.4 million and $1.5 million, respectively. As of December 31, 2013, we have an accumulated deficit of $236.9 million. We also have a working capital deficit of $41.3 million, including $39.2 million in current liabilities for our derivative and debenture financing instruments.

We currently do not have sufficient cash or commitments for financing to sustain our operations for the next 12 months if we are unable to generate sufficient cash flows from operations. Our plan is to develop new customer relationships and substantially increase our revenue derived from our products/services and IP licensing. If our revenues do not reach the level anticipated in our plan, we may require additional financing in order to execute our operating plan; however, we believe that our revenues will reach such level and such additional financing will not be necessary. If additional financing is required, we cannot predict whether this additional financing will be in the form of equity, debt, or another form, and we may not be able to obtain the necessary additional capital on a timely basis, on acceptable terms, or at all. In the event that financing sources are not available, or that we are unsuccessful in increasing our revenues and profits, we may be unable to implement our current plans for expansion, repay our debt obligations or respond to competitive pressures, any of which would have a material adverse effect on our business, prospects, financial condition and results of operations.

In February 2014 as described in Note 11 – Subsequent Events, we initiated a merger with the intention to increase the quantity of authorized shares of common stock available for issuance to satisfy the conversion rights under certain outstanding convertible securities and avoid an event of default. We can provide no assurance that the additional quantity of authorized shares will be sufficient to satisfy all future conversions of the outstanding convertible securities. If we have insufficient authorized shares in the future due to security conversions or otherwise and are unable to respond to requests for conversion, we may be subject to an event of default under the terms of such instruments.

Our management and Board may be unable to execute their plans to grow our revenues and achieve continued profitability and positive cash flows, which could cause us to discontinue our operations. The risk associated with a possible discontinuance of the business could prevent us from attracting or retaining key personnel, which would have a material adverse effect on our business.

If our management and Board are unable to maintain and execute our plans, then we may fail to grow our revenues, manage costs and achieve continued profitability and positive cash flows, which may cause us to discontinue our operations. The risks associated with the possible discontinuance of the business could further prevent us from attracting and retaining management and staff, which would have a material adverse effect on our business.

All of our assets are pledged to secure certain debt obligations. If we fail to repay and/or otherwise satisfy the debt obligations, our assets could be seized and liquidated for the benefit of the debt holders.

The convertible debentures that were initially issued to YA Global are secured by all of our assets. The secured convertible debentures mature on August 1, 2015. In the event we are unable to repay and/or otherwise satisfy the secured convertible debentures in accordance with the related agreements, our assets could be seized and liquidated for the benefit of the debt holders and result in the discontinuance of our business.

Our future profitability depends on the timely introduction of new and updated products and the acceptance of these new and updated products in the marketplace.

Rapid technological change and market development are typical for the industries we serve. Our future revenue and profitability will depend in large part on timely development and introduction of new and upgraded products that address evolving market requirements. If we fail to effectively launch new and innovative products or allow our current product offerings to become stale in our advancing industry, we may lose market share to our competitors. Any inability, for technological or other reasons, to successfully grow and upgrade our product portfolio could materially adversely affect our business.

Existing shareholders will experience significant dilution when certain investors, such as YA Global, convert their preferred stock to common stock, convert convertible debentures to common stock, or when the investors exercise their warrants for common stock.

The issuance of shares of common stock pursuant to the conversion of our Series C and D convertible preferred stock, the conversion of convertible debentures to common stock, or the exercise of warrants could result in a significant increase in the outstanding shares of common stock and will have a material dilutive impact on our shareholders. Additionally, our net earnings per share would decrease and the market price of our common stock per share would decline.

Our common stock is deemed to be “penny stock” which may make it more difficult for investors to sell their shares due to suitability requirements.

Our common stock is deemed to be “penny stock” as defined in Rule 3a51-1 of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Certain requirements regarding penny stocks may reduce the potential market for our common stock by reducing the number of potential investors. The penny stock designation could make it more difficult for investors in our common stock to sell shares to third parties or to otherwise dispose of them. This could cause our stock price to decline.

Broker-dealers dealing in penny stocks are required to provide potential investors with a document disclosing the risks of penny stocks. Moreover, broker-dealers are required to determine whether an investment in a penny stock is a suitable investment for a prospective investor. These requirements reduce the potential market of investors in our stock and could cause the stock price to decline. The potential market for “penny stocks” is further reduced by a Deposit Trust Company (“DTC”) “chill”, which prevents trading from occurring on the electronic trading system as further described below.

The DTC placed a “chill” on deposits of the Company’s common stock, which may negatively impact an investor’s ability to trade in our common shares.

In November 2011, the DTC placed a “chill” on deposits of our common stock and is not clearing or settling trades in our common stock through its electronic trading system. The “chill” does not affect our normal business operations. However, shareholders with internet brokerage accounts may not be able to trade in our common shares because the internet brokers clear and settle trades through the DTC. We believe the “chill” may limit the ability of potential investors from purchasing our shares.

Due to the accounting treatment of the convertible preferred stock, warrants and convertible debenture instruments issued by us, our net income or loss may not be reflective of our operating performance and could have a material adverse impact on our market value.

During the years ended December 31, 2013 and 2012, we reported net income of $28.5 million and a net loss $19.4 million respectively. The net income for the year ended December 31, 2013 was mostly attributable to a change in methodology for valuing these securities to incorporate dilution. The net loss for the year ended December 31, 2012 resulted primarily from non-cash losses arising from the adjustment to value our derivative and debenture liabilities at fair value. The adjustments are primarily due to modifications to the terms of the convertible debentures including the extension of the maturity date to August 2015. We adjust the value of these liabilities to reflect the estimated fair value at each balance sheet date. As a result, we could experience significant fluctuations in our reported net income or losses in future periods from financing related gains or losses incurred to record the liabilities at fair value. The financing related gains and losses incurred to record the liabilities at fair value have historically been significant and have resulted in net losses that are not reflective of the Company’s operating performance as reporting in operating income or loss. The complexity associated the fair value calculations and sophistication required by investors to distinguish and understand our operating performance relative to the reported net income and losses may cause our financial statements to be difficult to comprehend, analyze, and assess. As a result, the potential investor market for our common stock could be reduced resulting in a material adverse impact on our market value.

A majority of our assets are intangible assets, which will have little or no value if our operations do not generate current or future cash flow.

At December 31, 2013, a majority of our total assets were intangible assets, consisting primarily of rights related to our patents, other intellectual property, and goodwill arising from the excess of the purchase price over the fair value of tangible assets acquired in our purchase of NeoMedia Europe GmbH. If our results of operations do not generate sufficient cash flows in the future, the assets will have little or no value, which could lead to us recognizing impairment losses for such assets. This could materially adversely affect the value of our stock and the ability of our shareholders to recoup their investments in our stock.

We review our amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. We test goodwill for impairment annually or when events or changes in circumstances may warrant. We may be required to record a significant charge to earnings in our financial statements during the period in which any impairment of our goodwill or amortizable intangible assets is determined, resulting in a materially adverse impact on our results of operations.

We may not be able to compete effectively in markets where our competitors have more resources, which could have a material adverse effect on our business.

Our market is highly competitive and characterized by an increasing number of entrants that have introduced or developed products and services similar to those we offer. We believe that competition will continue to intensify and increase in the near future. Our target market is rapidly evolving and is subject to continuous technological change. As a result, our competitors may be better positioned to address these developments or may react more favorably to these changes, which could have a material adverse effect on our business, prospects, financial condition, and results of operations.

We may be unable to protect our intellectual property rights and may be liable for infringing the intellectual property rights of others, which could have a material adverse effect on our business.

Our success is dependent upon our proprietary technology, including patents and other intellectual property, and on the ability to protect proprietary technology and other intellectual property rights. In addition, we must conduct our operations without infringing on the proprietary rights of third parties. We also intend to rely upon unpatented trade secrets and the know-how and expertise of our employees, as well as our patents. To protect our proprietary technology and other intellectual property, we rely primarily on a combination of the protections provided by applicable patent, copyright, trademark, and trade secret laws as well as on confidentiality procedures and licensing arrangements. Although we believe that we have taken appropriate steps to protect our unpatented proprietary rights, including requiring that our employees and third parties who are granted access to our proprietary technology enter into confidentiality agreements, we can provide no assurance that these measures will be sufficient to protect our rights against third parties. Others may independently develop or otherwise acquire patented or unpatented technologies or products similar or superior to ours.

Some provisions of our Certificate of Incorporation and Bylaws may deter takeover attempts, which may limit the opportunity of our shareholders to sell their shares at a premium to the then-current market price.

Some of the provisions of our Certificate of Incorporation and Bylaws could make it more difficult for a third party to acquire us, even if doing so might be beneficial to our shareholders by providing them with the opportunity to sell their shares at a premium to the then-current market price. On December 10, 1999, our Board adopted a shareholders' rights plan and declared a non-taxable dividend of the right to acquire one-one hundredth of a share of our Series A Preferred Stock, par value $0.01 per share, on each outstanding share of our common stock to shareholders of record on December 20, 1999 and each share of common stock issued thereafter until a pre-defined hostile takeover date. The shareholders' rights plan, or so-called "poison pill", was adopted as an anti-takeover measure. The shareholders' rights plan was designed to enable all shareholders not engaged in a hostile takeover attempt to receive fair and equal treatment in any proposed takeover of us and to guard against partial or two-tiered tender offers, open market accumulations, and other hostile tactics to gain control of us. The shareholders' rights plan was not adopted in response to any effort to acquire control of us at the time of adoption, however it may have the effect of rendering more difficult, delaying, discouraging, preventing, or rendering more costly an acquisition of us or a change in control of us. Certain shareholders, who were our founders, Charles W. Fritz, William E. Fritz and The Fritz Family Limited Partnership and their holdings, were exempted from the triggering provisions of our shareholders' rights plan, as a result of the fact that, as of the plan's adoption, their holdings might have otherwise triggered the plan.

In addition, our Certificate of Incorporation authorizes our Board to designate and issue preferred stock, in one or more series, the terms of which may be determined at the time of issuance by our Board, without further action by shareholders, and may include voting rights, including the right to vote as a series on particular matters, preferences as to dividends and liquidation, conversion, redemption rights, and sinking fund provisions.

Preferred stock may have a negative impact on other stockholders or the pursuit of certain corporate actions.

The issuance of any preferred stock could have a material adverse effect on the rights of holders of our common stock, and, therefore, could reduce the value of shares of our common stock. In addition, specific rights granted to future holders of preferred stock could be used to restrict our ability to merge with, or sell our assets to, a third party. The ability of our Board to issue preferred stock could have the effect of rendering more difficult, delaying, discouraging, preventing, or rendering more costly an acquisition of us or a change in our control.

In the future, there could be government regulations and legal uncertainties that could harm our business.

Any new legislation or regulation, the application of laws and regulations from jurisdictions whose laws do not currently apply to our business, or the application of existing laws and regulations to the internet and other online services, could have a material adverse effect on our business, prospects, financial condition, and results of operations. The growth and development of the market for mobile commerce may prompt calls for more stringent consumer protection laws to impose additional burdens on companies conducting business online. The adoption of any additional laws or regulations may decrease the growth of the internet, mobile telecommunications or other mobile services, which could, in turn, decrease the demand for our services and increase our cost of doing business, or otherwise have a material adverse effect on our business, prospects, financial condition, and results of operations.

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

Introduction

The following discussion and analysis should be read in conjunction with the Consolidated Financial Statements, and the Notes thereto included in this Report. The information contained below includes statements of management's beliefs, expectations, hopes, goals and plans that, if not historical, are forward looking statements subject to certain risks and uncertainties that could cause actual results to differ materially from those anticipated in the forward looking statements. For a discussion on forward looking statements, see the information set forth in the introductory note to this Report under the caption Note About Forward Looking Statements, which information is incorporated herein by reference.

Overview

NeoMedia has positioned itself to lead the world in mobile barcode technology and solutions that enable the mobile ecosystem. NeoMedia harnesses the power of the mobile device in innovative ways with state-of-the-art mobile barcode technology. With this technology, mobile devices with cameras become barcode scanners and this enables a range of practical applications including mobile marketing and mobile commerce. In addition, we offer licensing of our extensive intellectual property portfolio. We are focusing our activities primarily in the United States and Europe, although in other markets via partners or our self-service products.

Our key focus areas are to: 1) maximize our patent portfolio through IP licensing monetization and enforcement, 2) provide service to enterprises, brands and retailers to maximize the reach of our barcode creation and reader solutions, and 3) partner with key mobile marketing entities to expand the depth of our offering to provide full end-to-end solutions for our customers.

NeoMedia has been active in, and strives to be an innovator in, the mobile barcode field since the mid-1990s, and during that time has spearheaded the development of a robust IP portfolio. In September 2011, we announced an agreement with Global IP Law Group to help further monetize our patent portfolio, focusing on the US market. In 2013, we closed twenty five IP agreements and remain hopeful that our IP licensing activities will continue to generate new agreements in 2014 and beyond. We intend to continue to vigorously pursue or defend, as applicable, claims affecting the business interests and intellectual property of the Company and filed eight lawsuits, in this regard, in 2013. In 2013, we have successfully caused approximately 10 companies in the United States to cease and desist their mobile barcode operations that infringed upon our IP rights and have settled seven of the lawsuits we initiated.

On the product side of our business, our barcode management solutions include our barcode reader (NeoReader) as well as our barcode creation solutions (NeoSphere and QodeScan). Mobile barcodes continue to be an increasingly important activation element for brands and marketers and we continue to see growth in terms of new customer additions and traffic across our network.

NeoMedia remains strong and consistent in its approach to market and we believe that we will continue to differentiate ourselves on the basis of our high quality product and service offerings, our responsive customer service and support organization, our customizable and full service solutions and our robust intellectual property portfolio.

NeoReader has experienced continued growth in 2013 particularly in enterprise implementations. NeoReader continues to be pre-installed on Sony Mobile devices and is available for download from the key “app stores” including Apple App Store™, Google Play™, Nokia Ovi Store, BlackBerry App World™, Windows® Marketplace, Facebook and Amazon. Our barcode reader now has approximately 50+ million installations world-wide. Our reader is offered to consumers free of charge, leveraging an ad supported model, and we anticipate the growth in consumer utilization will continue as barcodes continue to be utilized for a wide variety of vertical applications. We also offer NeoReader SDK for enterprise opportunities. Our research suggests that we are one of the few providers in the global ecosystem to offer Aztec code support, in addition to QR, Data Matrix, Code 39, PDF417 and a variety of 1D symbologies.

In 2013, we launched QodeScan, our low cost self-service barcode creation product. QodeScan is for those users who don't have high scan volumes but would like the insight into analytics that a managed service provides. In addition to QodeScan, we continue to offer our NeoSphere product intended for enterprises, agencies and other large volume users. We have many Fortune 500 brands using our NeoSphere product in their global barcode operations. Our QR creation services utilize an indirect methodology for our customer, which is also embodied in our intellectual property.

Legal costs continue to be high for us. The costs to maintain our public company status, our IP licensing initiatives, satisfy our investor obligations as well as participate in an unexpected arbitration have catapulted our legal fees to approximately 30% of total operating expenses for us in 2013. Unfortunately, this has meant that funds earmarked for sales and marketing investment were spent on legal fees.

NeoMedia continues to operate on a self-sufficient basis and has not taken funding since 2012. We continue to support operations entirely from cash generated from our business and anticipate that we will continue to do so. NeoMedia had record revenue in 2013 and record operating profit/income. We believe that we will continue to see success from our business based on both the product and IP strategies we are deploying.

Critical Accounting Policies and Estimates

This discussion and analysis of financial condition and results of operations has been prepared by our management based on our consolidated financial statements, which have been prepared in accordance with US GAAP. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, our management evaluates our critical accounting policies and estimates, including those related to revenue recognition, valuation of accounts receivable, intangible assets, derivative liabilities and contingencies. Estimates are based on historical experience and on various assumptions believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. These judgments and estimates affect the reported amounts of assets and liabilities and the reported amounts of revenue and expenses during the reporting periods.

We consider the following accounting policies important in understanding our operating results and financial condition:

- ***Intangible Asset Valuation –*** Assessing the valuation of intangible assets is subjective in nature and involves significant estimates and assumptions as well as management's judgment. We periodically perform impairment tests on our long-lived assets, including our intangible assets, whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Long-lived assets are testing for impairment by first comparing the estimated future undiscounted cash flows from a particular asset or asset group to the carrying value. If the expected undiscounted cash flows are greater than the carrying value, no impairment is recognized. If the expected undiscounted cash flows are less than the carrying value, then an impairment charge is recorded for the difference between the carrying value and the expected discounted cash flows. The assumptions used in developing expected cash flow estimates are similar to those used in developing other information used by us for budgeting and other forecasting purposes. In instances where a range of potential future cash flows is possible, we use a probability-weighted approach to weigh the likelihood of those possible outcomes. As of December 31, 2013 and 2012, we do not believe any of our long-lived assets are impaired.

Goodwill – Our goodwill represents the excess of the purchase price paid for NeoMedia Europe GmbH over the fair value of the identifiable net assets and liabilities acquired, based on an independent appraisal of the assets and liabilities acquired. Goodwill is not amortized but is tested annually for impairment, and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value. Goodwill is tested for impairment by comparing the carrying amount of the asset to its fair value, which is estimated through the use of a discounted cash flows model. If the carrying amount exceeds fair value, an impairment loss is recognized for the difference. As of December 31, 2013 and 2012, we determined there were no impairments of our goodwill.

Derivative Financial Instruments – We do not use derivative financial instruments to hedge exposures to cash-flow risks or market-risks that may affect the fair values of our financial instruments. However, certain financial instruments, such as warrants and the embedded conversion features of our convertible preferred stock and convertible debentures, which are indexed to our common stock, are classified as liabilities when either (a) the holder possesses rights to net-cash settlement or (b) physical or net-share settlement is not within our control. In such instances, net-cash settlement is assumed for financial accounting and reporting purposes, even when the terms of the underlying contracts do not provide for net-cash settlement. Derivative financial instruments are initially recorded, and continuously carried, at fair value. Determining the fair value of these complex derivative financial instruments involves judgment and the use of certain relevant assumptions including, but not limited to, interest rate risk, credit risk, and equivalent volatility and conversion/redemption privileges. The use of different assumptions could have a material effect on the estimated fair value amounts.

For our convertible debentures, we have elected not to separately account for the embedded conversion feature as a derivative instrument but to account for the entire hybrid instrument at fair value in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("FASB ASC") 815, *Derivatives and Hedging*. For our convertible preferred stock, the underlying instruments are carried at amortized cost and the embedded conversion feature is accounted for separately at fair value in accordance with FASB ASC 815-40-05 and FASB ASC 815-40-15.

Financial Instruments and Concentration of Credit Risk – We believe the carrying values of our financial instruments consisting of cash and cash equivalents, accounts receivable, accounts payable, accrued expenses, derivative financial instruments, other current liabilities, convertible preferred stock, and convertible debenture financings approximate their fair values due to their short-term nature, or because they are carried at fair value.

Revenue Recognition – We derive revenues from the following primary sources: (1) license fees relating to intellectual property, and (2) software and service revenues related to mobile marketing barcode management, barcode readers and custom developed software.

We recognized revenue when: (a) persuasive evidence of the sales arrangement exists, (b) the arrangement fee is fixed or determinable, (c) service delivery or performance has occurred, (d) customer acceptance has been received, if contractually required, and (e) collectability of the arrangement fee is probable. Revenue associated with licensing agreements primarily consists of non-refundable upfront license fees. Non-refundable upfront license fees received under license agreements, whereby continued performance or future obligations are considered inconsequential to the relevant license technology, are recognized as revenue upon delivery of the technology. We typically use signed contractual agreements as persuasive evidence of a sales arrangement.

If at the inception of an arrangement the fee is not fixed or determinable, we defer revenue until the arrangement fee becomes due and payable. If we determine collectability is not probable, we defer revenue until we receive payment or collection becomes probable, whichever is earlier. The determination of whether fees are collectible requires judgment of our management, and the amount and timing of revenue recognition may change if different assessments are made.

- ***Multiple Element Transactions* –** From time to time, we enter into transactions involving multiple elements, such as customer agreements involving multiple patents. We account for multiple element transactions by first obtaining evidence of the estimated selling price of each element using vendor specific objective evidence (“VSOE”), third-party evidence (“TPE”), or management’s best estimate of selling price if neither VSOE nor TPE of selling price exists. Based on the determined selling price of each element of the transaction, the value of the single agreement is allocated to each deliverable based on each element's proportional value and accounted for as a separate unit of accounting. Multiple element transactions require the exercise of judgment in determining the estimated selling price of the different elements. The judgments could impact the amount of revenues and expenses recognized over the term of the contract, as well as the period in which they are recognized.

- ***Contingencies* –** From time to time, we are involved in various legal actions arising in the normal course of business, both as claimant and defendant. Although it is not possible to determine with certainty the outcome of these matters, we believe the eventual resolution of any ongoing legal actions is unlikely to have a material impact on our financial position or operating results. If the resolution of ongoing legal actions is not in our favor, our financial position and operating results could be materially adversely impacted.

- ***Income Tax Valuation Allowance –*** Deferred tax assets are reduced by a valuation allowance when, in the opinion of our management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. We recorded a 100% valuation allowance at December 31, 2013 and 2012.

Results of Operations

<u>Income (Loss) from Operations</u>

The following table sets forth certain data derived from our consolidated statements of operations (in thousands):

	Year Ended December 31, 2013	2012
Revenues	$ 5,024	$ 2,344
Cost of revenues	(731)	(2,181)
Gross profit	4,293	163
Sales and marketing expenses	(286)	(1,100)
General and administrative expenses	(2,549)	(3,593)
Research and development costs	(717)	(951)
Other operating income	229	-
Income (loss) from operations	$ 970	$ (5,481)

Revenues. Revenues for the years ended December 31, 2013 and 2012 were $5,024,000 and $2,344,000, respectively, an increase of $2,680,000, or 114%. The increases in revenues are primarily attributable to an increase in the quantity of new IP licensing agreements as well as an increase in revenue from our NeoReader SDK.

Cost of Revenues. Cost of revenues was $731,000 for the year ended December 31, 2013 compared with $2,181,000 in the prior year, a decrease of $1,450,000 or 66%. Cost of revenues primarily relates to third party professional fees incurred in connection with the sale of our IP licenses. Cost of revenues typically varies in a manner consistent with changes in our IP licenses revenues. Cost of revenues in the prior year period relative to revenue was unusually high due to the expensing of additional legal fees associated with monetization of our patents.

Sales and Marketing. Sales and marketing expenses were $286,000 and $1,100,000 for the years ended December 31, 2013 and 2012, respectively, a decrease of $814,000, or 74%. The decrease in sales and marketing expenses is due to cost containment efforts. We expect sales and marketing expenses will increase in future periods as we continue to develop and execute on our business goals.

General and Administrative. General and administrative expenses were $2,549,000 and $3,593,000 for the years ended December 31, 2013 and 2012, respectively, a decrease of $1,044,000, or 29%. Costs declined due to continued efforts to contain expenses and identify improved efficiencies in performing the general and administrative functions of the Company. The expense reductions are related to various items including lower personnel costs and lower service provider costs, such as accounting and legal related fees.

Research and Development. Research and development expenses were $717,000 and $951,000 for the years ended December 31, 2013 and 2012, respectively, a decrease of $234,000, or 25%. Research and development expenses decreased as we focused our development efforts in our 2D Core services and subsequently launched our QodeScan self-service barcode management platform, resulting in a reduced requirement for ongoing development services.

Other Operating Income. The $229,000 of other operating income realized during the year ended December 31, 2013 primarily related to an arbitration proceeding and settlement in our favor, which concluded during the three months ended June 30, 2013. There was no similar activity in the prior year.

Other Income (Expense)

The following table sets forth certain data derived from our consolidated statements of operations (in thousands):

	Year Ended December 31,	
	2013 (Restated)	2012
Gain (loss) from change in fair value of hybrid financial instruments	$ 21,809	$ 11,926
Gain from change in fair value of derivative liability - warrants	3,067	11,347
Loss from change in fair value of derivative liability - Series C and D preferred stock and debentures	1,841	(13,035)
Gain (loss) on extinguishment of debt	53	(27,479)
Impairment loss on cash surrender value of life insurance policy	-	(527)
Gain on de-recognition of accrued expenses and purchase price guarantee	-	8,300
Interest income (expense), net	16	(4,437)
Total other expense	$ 26,786	$ (13,905)

Gain (Loss) from Change in Fair Value of Hybrid Financial Instruments. We carry our debentures at fair value in accordance with the applicable accounting codification and do not separately account for the embedded conversion feature. The change in the fair value of these liabilities includes changes in the value of the accrued interest due under these instruments, as well as changes in the fair value of the common stock underlying the instruments. For year ended December 31, 2013 and 2012, the liability related to these hybrid instruments fluctuated resulting in a net gain of $21.8 million and $11.9 million, respectively. See Note 4 within the Notes to Consolidated Financial Statements for additional detailed discussion.

Gain from Change in Fair Value of Derivative Liability – Warrants. We account for our outstanding common stock warrants that were issued in connection with our preferred stock and debentures at fair value. For the years ended December 31, 2013 and 2012, the liability related to these instruments fluctuated, resulting in a net gain of $3.1 million and $11.3 million, respectively. See Note 4 within the Notes to Consolidated Financial Statements for additional detailed discussion.

Loss from Change in Fair Value of Derivative Liability – Series C and D Preferred Stock and Debentures. For our Series C and D Preferred Stock, and certain of our debentures, we account for the embedded conversion feature separately as a derivative financial instrument. We carry these derivative financial instruments at fair value. For the year ended December 31, 2013 and 2012, the liability related to these hybrid instruments fluctuated, resulting in a net gain of $1.8 million and a net loss of $13.0 million, respectively. See Note 4 within the Notes to Consolidated Financial Statements for additional detailed discussion.

The changes in the fair values of our hybrid and derivative financial instruments were primarily the result of fluctuations in the value of our common stock during the period as well as changes in the terms of the related financial instruments. Because our common stock price has been volatile and our hybrid and derivative financial instruments include variable discount conversion prices, further fluctuations in the market price of our common stock could cause the fair value of these instruments to be volatile and increase or decrease significantly in the future, resulting in future significant gains and losses from the change in the fair value of the instruments.

Impairment Loss On Cash Surrender Value of Life Insurance Policy. During the third quarter of 2012, we determined that we would be unable to collect the cash surrender value of a life insurance policy due to a dispute with the insurance company. Accordingly, we recorded a loss of $527,000 to impair the value of the policy as reflected in the results for the year ended December 31, 2012. There was no similar activity in 2013.

Gain on De-recognition of Accrued Expenses and Purchase Price Guarantee. We determined during the third quarter of 2012 that certain accrued purchase price obligations and disputed expenses associated with a 2006 acquisition were no longer legally enforceable due to the expiration of the statute of limitations. As a result, we de-recognized the liabilities, which resulted in an $8.3 million gain as reflected in the results for the year ended December 31, 2012. There was no similar activity in 2013.

Gain (Loss) on Extinguishment of Debt. During the year ended December 31, 2013, we modified and consolidated our outstanding debentures resulting in a $53,000 gain on extinguishment. During the year ended December 31 2012, we modified our debt causing the existing debentures to be effectively retired and new debentures issued. The differences in the fair values of the debt before and after the modification resulted in an extinguishment loss of $27.5 million.

Interest Income (Expense), Net. Following the May 25, 2012 modification of the debentures, which extended the due date, the debentures are no longer carried at amortized cost but are carried as hybrid financial instruments at fair value. As a result, the interest on these debentures subsequent to May 25, 2012 is reported as part of the Gain (Loss) from Change in Fair Value of Hybrid Financial Instruments and is no longer separately reported as interest expense. The $16,000 of net interest income reported for the year ended December 31, 2013 primarily relates to interest accrued on payments received in connection with an arbitration proceeding that settled in our favor during the year.

Other Comprehensive Income (Loss)

For the year ended December 31, 2013, other comprehensive gains were $133,000 as compared to other comprehensive losses of $56,000 for 2012. The other comprehensive gains and losses were due to the impact of fluctuations in currency exchange rates associated with our translation of the NeoMedia Europe GmbH subsidiary financial statements from its local currency, the Euro, to U.S. dollars. We determined during the third quarter of 2013 that the functional currency of the foreign subsidiary changed to the U.S. dollar and as a result of the change in functional currency, translation gains and losses associated with the conversion of the NeoMedia Europe GmbH financial statements are recorded in our results from operations rather than through other comprehensive income (loss) effective July 1, 2013.

Income Tax Benefit

During the year ended December 31, 2013, we determined that a deferred tax liability previously estimated to be realized by NeoMedia Europe GmbH should be reduced to zero based on certain economic changes of the subsidiary during 2013. The economic changes included, but were not limited to, the termination of its hardware business and related sales activities that allowed it to generate revenue independently in the local market or otherwise, and the completion of a repositioning of the subsidiary from a self-contained, revenue generating operation to a cost center primarily focused on research and development. As a result of the change in estimate, we recorded an income tax benefit of $706,000 to reduce the deferred tax liability to zero.

Liquidity

	Year Ended December 31,	
	2013	2012
	(in thousands)	
Cash and cash equivalents	$ 267	$ 611
Net cash used in operating activities	$ (399)	$ (1,536)
Net cash provided by investing activities	-	123
Net cash provided by financing activities	56	2,050
Effect of exchange rate changes on cash	(1)	(56)
Net change in cash and cash equivalents	$ (344)	$ 581

We funded our liquidity requirements in 2013 with existing cash resources. During 2012, we funded our liquidity requirements through our existing cash resources and borrowings under our convertible debentures with YA Global. As of December 31, 2013, we had $267,000 in cash and cash equivalents.

Going Concern

While we have historically incurred operating losses, and we may continue to generate negative cash flows as we implement our business plan, the business has been operating on a self-sufficient basis. However, there can be no assurance that our success in executing our business plan will continue. The accompanying consolidated financial statements have been prepared in conformity with US GAAP, which contemplates our continuation as a going concern given fair value accounting related to our debentures. Our net income for the year ended December 31, 2013 was $28.5 million and our net loss for the year ended December 31, 2012 was $19.4 million, including $26.7 million net gain and $17.3 million net loss, respectively, related to our financing instruments. The impact of our successful implementation strategy shows our operating income was $1.0 million for 2013 as compared to an operating loss in 2012 of $5.5 million.

Net cash used in operations during 2013 and 2012 was $0.4 million and $1.5 million, respectively. As of December 31, 2013, we have an accumulated deficit of $236.9 million. We also have a working capital deficit of $36.7 million, including $39.2 million in current liabilities for our derivative and debenture financing instruments.

We currently do not have sufficient cash or commitments for financing to sustain our operations for the next twelve months if we are unable to generate sufficient cash flows from operations. Our plan is to develop new client and customer relationships and substantially increase our revenue derived from our products/services and IP licensing. If our revenues do not reach the level anticipated in our plan, we may require additional financing in order to execute our operating plan; however, we believe that our revenues will reach such level and such additional financing will not be necessary. If additional financing is required, we cannot predict whether this additional financing will be in the form of equity, debt, or another form, and we may not be able to obtain the necessary additional capital on a timely basis, on acceptable terms, or at all. In the event that financing sources are not available, or that we are unsuccessful in increasing our revenues and profits, we may be unable to implement our current plans for expansion, repay our debt obligations or respond to competitive pressures, any of which would have a material adverse effect on our business, prospects, financial condition and results of operations.

The convertible debentures and preferred stock used to finance the Company, which may be converted into common stock at the sole option of the holders, have a highly dilutive impact when they are converted, greatly increasing the number of common shares outstanding. During 2013, there were 2,879 million shares of common stock issued for these conversions. We cannot predict if or when each holder may or may not elect to convert into common shares.

Our financial statements do not include any adjustments relating to the recoverability and reclassification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should we be unable to continue as a going concern.

Significant Liquidity Events

Financing Provided By YA Global. In 2012, all of our external financing was provided by YA Global. We received a gross total of $2.65 million from YA Global through the issuance of a series of six convertible debentures and common stock warrants. The debentures initially bore interest at 9.5% per annum and matured on August 1, 2014. We paid cash fees to YA Global from the proceeds of the secured convertible debentures and warrants of $150,000, resulting in net proceeds of $2.5 million. We also received two short-term loans, fully repaid within approximately 30 days of receipt, from YA Global totaling $112,000. We also repaid in full the July 20, 2012 debenture of $450,000.

Since July 2012, we have not received any debenture based financing from YA Global. We do not anticipate receiving additional financing in 2014. We believe our business plan will provide adequate cash flow to meet our operational requirements for the next twelve months.

At December 31, 2013, financial instruments arising from our financing transactions with YA Global, included shares of our Series C preferred stock issued in February 2006, Series D preferred stock issued in January 2010, a series of six consolidated secured convertible debentures (the “Consolidated Debentures”) issued July 1, 2013 and various warrants to purchase shares of our common stock. All of our assets are pledged to secure our obligations under the debt securities. At various times, YA Global has assigned or distributed portions of its holdings of these securities to other holders, including persons who are officers of YA Global and its related entities, as well as to other holders who are investors in YA Global’s funds. The rights of the assignees of the YA Global holdings are bound by the terms of the financial instruments held by YA Global, and amendments to the terms of the financial instruments held by YA Global could also impact the terms of the financial securities held by the assignees.

We had originally entered into financing transactions with YA Global, which included a series of twenty-seven secured convertible debentures issued between August 2006 and July 2012. Effective July 1, 2013, the terms of the debentures held by YA Global were modified to consolidate the principal and interest amounts outstanding under all of the outstanding secured convertible debentures previously issued by us to YA Global, such that, upon the issuance of the Consolidated Debentures and cancellation of the prior debentures, the amount of outstanding debentures issued to YA Global decreased from twenty-seven to six debentures. The maturity dates of these secured convertible debentures were also extended from August 1, 2014 to August 1, 2015.

The underlying agreements for each of the Consolidated Debentures are very similar in form. The Consolidated Debentures are convertible into our common stock, at the option of the holder, at the lower of a fixed conversion price per share or a percentage of the lowest volume-weighted average price ("VWAP") for a specified number of days prior to the conversion (the "look-back period"). The conversion is limited such that the holder cannot exceed 9.99% ownership of the outstanding common stock, unless the holder waives their right to such limitation. All of the debentures are secured according to the terms of a Security Pledge Agreement dated August 23, 2006, which was entered into in connection with the first convertible debenture issued to YA Global and which provides YA Global with a security interest in substantially all of our assets. The debentures are also secured by a Patent Security Agreement dated July 29, 2008. On August 13, 2010, our wholly owned subsidiary, NeoMedia Europe GmbH, became a guarantor of all outstanding financing transactions between us and YA Global, through pledges of their intellectual property and other movable assets. As security for our obligations to YA Global, all of our Pledged Property, Patent Collateral and other collateral is affirmed through the several successive Ratification Agreements executed in connection with each of the 2010, 2011 and 2012 financings. The 2013 modification and consolidation of the outstanding secured convertible debentures as well as the execution of an Amended and Restated Patent Security Agreement in October 2013 reaffirmed the Pledged Property, Patent Collateral and other collateral pledged as security for our obligations to YA Global.

YA Global holds warrants to purchase shares of our common stock that were issued in connection with the convertible debentures and the Series C and Series D preferred stock. The warrants are exercisable at a fixed exercise price which, from time to time, has been reduced due to anti-dilution provisions when we have entered into subsequent financing arrangements with a lower price. The exercise prices may be reset again in the future if we subsequently issue stock or enter into a financing arrangement with a lower price. In addition, upon each adjustment in the exercise price, the number of warrant shares issuable is adjusted to the number of shares determined by multiplying the warrant exercise price in effect prior to the adjustment by the number of warrant shares issuable prior to the adjustment divided by the warrant exercise price resulting from the adjustment.

See Note 4 within the Notes to Consolidated Financial Statements for additional detailed discussion on our financings.

Contractual Obligations

We are a “smaller reporting company” as defined by Rule 12b-2 of the Exchange Act and, as such, are not required to provide this information.

Recently Issued Accounting Standards

See Recent Accounting Pronouncements in Note 2 - Summary of Significant Accounting Policies within the Notes to Consolidated Financial Statements.

Off-Balance Sheet Arrangements

We are not currently engaged in the use of off-balance sheet derivative financial instruments to hedge or partially hedge interest rate exposure nor do we maintain any other off-balance sheet arrangements for the purpose of credit enhancement, hedging transactions, or other financial or investment purposes.

ITEM 8. Financial Statements and Supplementary Data

Restatement of 2013 Financial Statements

As discussed in Note 1 and Note 2 to the Condensed Consolidated Financial Statements, the Company restated its financial statements.

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<u>REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM</u>

To the Board of Directors and Shareholders of NeoMedia Technologies, Inc.:

We have audited the accompanying consolidated balance sheet of NeoMedia Technologies, Inc. (the "Company"), as of December 31, 2013, and the related consolidated statements of operations and comprehensive loss, shareholders' deficit and cash flows for the year then ended. 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 audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2013, and the results of its operations and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to such financial statements, the Company has suffered recurring losses from operations, has significant working capital and shareholders' deficits and may have ongoing requirements for additional capital investment. These factors raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are described in Note 2. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

As discussed in Note 2 to the financial statements, the entity's 2013 fair value accounting of derivative financial instruments and debentures payable previously reported as $284,576,000 should have been $42,001,000. This discovery was made subsequent to the issuance of the financial statements. The financial statements have been restated to reflect this correction.

/s/ StarkSchenkein, LLP

Denver, CO

March 17, 2014 except for Note 2, Restatement to 2013 Reporting, as to which the date is September 19, 2014

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of NeoMedia Technologies, Inc.:

We have audited the accompanying consolidated balance sheet of NeoMedia Technologies, Inc. (the "Company"), as of December 31, 2012, and the related consolidated statements of operations and comprehensive loss, shareholders' deficit and cash flows for the year then ended. 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 audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2012, and the results of its operations and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to such financial statements, the Company has suffered recurring losses from operations, has significant working capital and shareholder deficits and may have ongoing requirements for additional capital investment. These factors raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are described in Note 1. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Kingery & Crouse, P.A.

Certified Public Accountants

Tampa, FL

April 1, 2013

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NeoMedia Technologies, Inc. and Subsidiaries

Consolidated Balance Sheets

(in thousands, except share data)

	December 31, 2013 (RESTATED)	December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$ 267	$ 611
Accounts receivable, less allowances of $0	295	217
Prepaid expenses and other current assets	107	120
Total current assets	669	948
Property and equipment, net	5	44
Goodwill	3,418	3,418
Proprietary software, net	-	99
Patents and other intangible assets, net	1,213	1,490
Other long-term assets	-	40
Total assets	$ 5,305	$ 6,039
LIABILITIES AND SHAREHOLDERS' DEFICIT		
Current liabilities:		
Accounts payable	$ 236	$ 506
Accrued expenses	291	399
Deferred revenues and customer prepayments	2,252	3,735
Note payable	56	50
Deferred tax liability	-	706
Derivative financial instruments – warrants	620	3,687
Derivative financial instruments - Series C and D preferred stock and debentures payable	296	2,147
Debentures payable - carried at amortized cost	-	53
Debentures payable - carried at fair value	38,250	64,292
Total current liabilities	42,001	75,575
Commitments and contingencies		
Series C convertible preferred stock, $0.01 par value, 27,000 shares authorized, 4,816 and 4,840 shares issued and outstanding, liquidation value of $4,816 and $4,840 as of December 31, 2013 and 2012, respectively	4,816	4,840
Series D convertible preferred stock, $0.01 par value, 25,000 shares authorized, 3,481 and 3,481 shares issued and outstanding, liquidation value of $348 and $348 as of December 31, 2013 and 2012, respectively	348	348
Shareholders' deficit:		

Common stock, $0.001 par value, 5,000,000,000 shares authorized, 4,984,827,279 and 2,106,035,882 shares issued and outstanding as of December 31, 2013 and 2012, respectively	4,985	2,106
Additional paid-in capital	190,946	188,814
Accumulated deficit	(236,910)	(264,630)
Accumulated other comprehensive loss	(102)	(235)
Treasury stock, at cost, 2,012 shares of common stock	(779)	(779)
Total shareholders’ deficit	(41,860)	(74,724)
Total liabilities and shareholders’ deficit	$ 5,305	$ 6,039

See accompanying notes.

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NeoMedia Technologies, Inc. and Subsidiaries

Consolidated Statements of Operations and Comprehensive Loss

(in thousands, except share and per share data)

	Year Ended December 31,	
	2013 (RESTATED)	2012
Revenues	$5,024	$2,344
Cost of revenues	(731)	(2,181)
Gross profit	4,293	163
Operating expenses:		
Sales and marketing expenses	(286)	(1,100)
General and administrative expenses	(2,549)	(3,593)
Research and development costs	(717)	(951)
Other operating income	229	-
Total operating expenses	(3,323)	(5,644)
Income (loss) from operations	970	(5,481)
Other income (expense):		
Gain from change in fair value of hybrid financial instruments	21,809	11,926
Gain from change in fair value of derivative liability - warrants	3,067	11,347
Gain from change in fair value of derivative liability - Series C and D preferred stock and debentures	1,841	(13,035)
Gain (loss) on extinguishment of debt	53	(27,479)
Impairment loss on cash surrender value of life insurance policy	-	(527)
Gain on derecognition of accrued expenses and purchase price guarantee	-	8,300
Interest income (expense), net	16	(4,437)
Total other income (expense)	26,786	(13,905)
Net income (loss) before taxes	27,756	(19,386)
Income tax benefit	706	-
Net income (loss)	28,462	(19,386)
Deemed dividends on convertible preferred stock	(16)	-
Deemed dividends on convertible debentures	(726)	-
Net income (loss) available to common shareholders	$27,720	$(19,386)
Comprehensive income (loss):		

Net income (loss)	$28,462	$(19,386)
Foreign currency translation adjustment	133	(56)
Comprehensive income (loss)	$28,595	$(19,442)
Net income (loss) per common share, basic and diluted:		
Basic	$0.007	$(0.02)
Fully diluted	$0.007	$(0.02)
Weighted average number of common shares:		
Basic	4,119,387,609	1,276,601,569
Fully diluted	4,119,387,609	1,276,601,569

See accompanying notes.

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NeoMedia Technologies, Inc. and Subsidiaries`

Consolidated Statements of Shareholders' Deficit

(In thousands, except share data)

	Common Stock					Treasury Stock		
	Shares	Amount	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Shares	Amount	Total Shareholders' Deficit
Balance, December 31, 2011	541,984,111	$ 542	$ 170,006	$ (245,244)	$ (179)	2,012	$ (779)	$ (75,654)
Shares issued upon conversions of Series C preferred stock	34,168,248	34	844	-	-	-	-	878
Shares issued upon conversions of Series D preferred stock	142,457,436	143	2,199	-	-	-	-	2,342
Shares issued upon conversions of convertible debentures	1,387,426,087	1,387	15,751	-	-	-	-	17,138
Stock-based compensation expense	-	-	14	-	-	-	-	14
Comprehensive (loss – foreign currency translation adjustment	-	-	-	-	(56)	-	-	(56)
Net loss	-	-	-	(19,386)	-	-	-	(19,386)
Balance, December 31, 2012	2,106,035,882	2,106	188,814	(264,630)	(235)	2,012	(779)	(74,724)
Shares issued upon conversions of Series C preferred stock	41,237,113	41	10	-	-	-	-	51
Shares issued upon conversions of convertible debentures	2,837,554,284	2,838	2,121	-	-	-	-	4,959

Deemed dividend on Series C preferred stock	-	-	-	(16)	-	-	-	(16)
Deemed dividend on convertible debentures	-	-	-	(726)	-	-	-	(726)
Stock-based compensation expense	-	-	1	-	-	-	-	1
Comprehensive income – foreign currency translation adjustment	-	-	-	-	133	-	-	133
Net income (Restated)	-	-	-	28,462	-	-	-	32,705
Balance, December 31, 2013 (Restated)	4,984,827,279	$ 4,985	$ 190,946	$ (236,910)	$ (102)	2,012	$ (779)	$ (41,860)

See accompanying notes.

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NeoMedia Technologies, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

(In thousands)

	Year Ended December 31, 2013 (RESTATED)	2012
Cash Flows from Operating Activities:		
Net income (loss)	$ 28,462	$ (19,386)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	410	972
(Gain) loss on extinguishment of debt	(53)	27,479
Gain from change in fair value of hybrid financial instruments	(21,809)	(11,926)
Gain from change in fair value of derivative liability – warrants	(3,067)	(11,347)
(Gain) loss from change in fair value of derivative liability - Series C and D preferred stock and debentures	(1,841)	13,035
Deferred taxes	(706)	-
Stock-based compensation expense	1	14
Bad debt expense	-	457
Interest expense added to liabilities	-	4,406
Gain on derecognition of accrued expenses and purchase price guarantee	-	(8,300)
Impairment loss on cash surrender value of life insurance policy	-	527
Changes in operating assets and liabilities:		
Accounts receivable	(68)	-
Prepaid expenses and other assets	84	63
Accounts payable and accrued liabilities	(331)	555
Deferred revenue and other current liabilities	(1,481)	1,915
Net cash used in operating activities	(399)	(1,536)
Cash Flows from Investing Activities:		
Acquisition of property and equipment	-	(3)
Proceeds received from life insurance policy	-	126
Net cash provided by investing activities	-	123
Cash Flows from Financing Activities:		
Payments on convertible debt instruments	-	(450)
Borrowings under convertible debentures	-	2,500
Borrowings under short-term notes payable	110	-
Payments on short-term notes payable	(54)	-
Net cash provided by financing activities	56	2,050
Effect of exchange rate changes on cash	(1)	(56)
Net change in cash and cash equivalents	(344)	581

Cash and cash equivalents, beginning of year	611	30
Cash and cash equivalents, end of year	$ 267	$ 611
Supplemental cash flow information:		
Interest paid during the period	$ 5	$ 31
Series C preferred stock converted to common stock	$ 10	$ 878
Series D preferred stock converted to common stock	$ -	$ 2,342
Convertible debentures converted to common stock	$ 4,233	$ 17,138
Deemed dividend on Series C preferred stock conversion	$ 16	$ -
Deemed dividend on convertible debentures conversion	$ 726	$ -

See accompanying notes.

NeoMedia Technologies, Inc.

Notes to Consolidated Financial Statements

December 31, 2013

Note 1 – General

Business **–** NeoMedia, a Delaware corporation, was founded in 1989 and is headquartered in Boulder, Colorado. We have positioned ourselves to lead the development of 2D mobile barcode technology and infrastructure solutions that enable the mobile barcode ecosystem world-wide. NeoMedia harnesses the power of the mobile phone in innovative ways with state-of-the-art mobile barcode technology solutions. With this technology, mobile devices with cameras become barcode scanners, and this enables a range of practical applications including mobile marketing and mobile commerce. In addition, we offer licensing of our extensive intellectual property portfolio.

As we communicated in a Periodic Report on Form 8-K on July 29, 2014, we are restating certain of our financial statements by filing amendments to our previously filed Form 10-K for December 31, 2013 (and interim periodic reports on Form 10-Q). We and the SEC have concluded that certain modifications in the Company's valuation methodology, deemed as accounting estimates by the Company, contained errors with respect to the valuation of convertible debentures and preferred shares issued by the Company, in that such methodology did not capture the potentially dilutive effect upon their conversion into common stock. Please see the disclosure in Note 2 entitled "Restatement to 2013 Reporting" for further information as these changes in valuation methodology has affected our previously filed report on Form 10-K for December 31, 2013.

Note 2 – Summary of Significant Accounting Policies

The accompanying audited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("US GAAP"). All normal adjustments considered necessary for a fair presentation have been included.

Basis of Presentation – The consolidated financial statements include the accounts of NeoMedia Technologies, Inc. and our wholly-owned subsidiaries (collectively herein referred to as "NeoMedia," the "Company," "we," "us," "our," and similar terms). We operate as one reportable segment. All intercompany accounts, transactions and profits have been eliminated in consolidation. Certain prior year amounts in the consolidated financial statements and notes thereto have been reclassified to conform to the current year's presentation.

Use of Estimates – The preparation of consolidated financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Changes in facts and circumstances may result in revised estimates, which are recorded in the period in which they become known.

Restatement to 2013 Reporting – As noted above and disclosed initially in our Periodic Report on Form 8-K on July 29, 2014, during the three month period ended March 31, 2014, we reassessed the valuation techniques used to estimate the fair values of our derivative financial instruments and debentures payable. Based on the reassessment, including discussions with the third-party valuation firm assisting us with the calculation, we determined that the valuation technique should be modified to consider the potentially dilutive impact on the stock price resulting from the issuance of additional shares of common stock upon the conversion of the instruments as well as the resulting value in comparison to our market capitalization.

We agree with the SEC’s assertion that certain modifications in our valuation methodology contained errors with respect to the valuation of convertible debentures issued by us. We restated the year ended December 31, 2013 to reflect the change in valuation technique and correction of the fair value accounting of the derivative financial instruments and debentures payable. In addition, we also restated our December 31, 2013 Balance Sheet as it pertains to the Fair Value of our Warrants, Preferred Series C & D and Convertible Debentures to amounts as stated below from how they were originally reported as of December 31, 2013 in our Form 10-K:

	December 31, 2013 (as previously reported)	Adjustments	December 31, 2013 (Restated)
Derivative Financial Instruments – warrants	$ 684	$ (64)	$ 620
Derivative Financial Instruments – Series C and D	$ 23,606	$ (23,310)	$ 296
Debentures payable – carried at fair value	$ 257,451	$ (219,201)	$ 38,250
Total Liabilities	$ 284,576	$ (242,575)	$ 42,001
Accumulated deficit	$ (479,485)	$ 242,575	$ (236,910)
Total shareholders' deficit	$ (284,435)	$ 242,575	$ (41,860)

The table below reflects the changes in restating the derivative liabilities for the year ended December 31, 2013 (in thousands):

Derivative Liability Restatement for the 12 months ended December 31, 2013:

	Year Ended December 31, 2013 (as previously reported)	Adjustments	Year Ended December 31, 2013 (Restated)
Gain (loss) from change in fair value of hybrid financial instruments	$ (197,392)	$ 219,201	$ 21,809
Gain (loss) from change in fair value of derivative liability – warrants	$ 3,003	$ 64	$ 3,067
Gain (loss) from change in fair value of derivative liability – Series C & D	$ (21,469)	$ 23,310	$ 1,841
Net income (loss)	$ (214,113)	$ 242,575	$ 28,462
Net income (loss) available to common shareholders	$ (214,855)	$ 242,575	$ 27,720
Comprehensive income (loss)	$ (213,980)	$ 242,575	$ 28,595

The table below reflects the changes in restating the Statement of Cash Flows for the year ended December 31, 2013 (in thousands):

Statement of Cash Flow:

	Year Ended December 31, 2013 (as previously reported)	Adjustments	Year Ended December 31, 2013 (Restated)
Net income (loss)	$ (214,113)	$ 242,575	$ 28,462
Gain (loss) from change in fair value of hybrid financial instruments	$ (197,392)	$ 219,201	$ 21,809
Gain (loss) from change in fair value of derivative liability – warrants	$ 3,003	$ 64	$ 3,067
Gain (loss) from change in fair value of derivative liability – Series C & D	$ (21,469)	$ 23,310	$ 1,841
Net cash used in operating activities	$ (399)	$ -	$ (399)

Going Concern – While we have historically incurred operating losses, and we may continue to generate negative cash flows as we implement our business plan, the business has been operating on a self-sufficient basis. However, there can be no assurance that our success in executing our business plan will continue. The accompanying consolidated financial statements have been prepared in conformity with US GAAP, which contemplates our continuation as a going concern given fair value accounting related to our debentures. Our net income for the year ended December 31, 2013 and our net loss for the year ended December 31.2012 was $28.5 million and $19.4 million, respectively, including $26.7 million gain and $17.3 million loss, respectively, related to our financing instruments. The impact of our successful implementation strategy shows our operating income was $1.0 million for 2013 as compared to an operating loss in 2012 of $5.5 million.

Net cash used in operations during 2013 and 2012 was $0.4 million and $1.5 million, respectively. As of December 31, 2013, we have an accumulated deficit of $236.9 million. We also have a working capital deficit of $36.7 million, including $39.2 million in current liabilities for our derivative and debenture financing instruments.

We currently do not have sufficient cash or commitments for financing to sustain our operations for the next twelve months if we are unable to generate sufficient cash flows from operations. Our plan is to develop new client and customer relationships and substantially increase our revenue derived from our products/services and IP licensing. If our revenues do not reach the level anticipated in our plan, we may require additional financing in order to execute our operating plan; however, we believe that our revenues will reach such level and such additional financing will not be necessary. If additional financing is required, we cannot predict whether this additional financing will be in the form of equity, debt, or another form, and we may not be able to obtain the necessary additional capital on a timely basis, on acceptable terms, or at all. In the event that financing sources are not available, or that we are unsuccessful in increasing our revenues and profits, we may be unable to implement our current plans for expansion, repay our debt obligations or respond to competitive pressures, any of which would have a material adverse effect on our business, prospects, financial condition and results of operations.

The convertible debentures and preferred stock used to finance the Company, which may be converted into common stock at the sole option of the holders, have a highly dilutive impact when they are converted, greatly increasing the number of common shares outstanding. During 2013, there were 2,879 million shares of common stock issued for these conversions. We cannot predict if or when each holder may or may not elect to convert into common shares.

Our financial statements do not include any adjustments relating to the recoverability and reclassification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should we be unable to continue as a going concern.

Cash and Cash Equivalents – Cash and cash equivalents include cash in financial institutions, which are highly liquid investment instruments with original maturities of less than 90 days.

Revenue Recognition – We derive revenues from the following primary sources: (1) license fees relating to intellectual property, and (2) software and service revenues related to mobile marketing barcode infrastructure management and development, barcode readers and custom developed software.

We recognized revenue when: (a) persuasive evidence of the sales arrangement exists, (b) the arrangement fee is fixed or determinable, (c) service delivery or performance has occurred, (d) customer acceptance has been received, if contractually required, and (e) collectability of the arrangement fee is probable. Revenue associated with licensing agreements primarily consists of non-refundable upfront license fees. Non-refundable upfront license fees received under license agreements, whereby continued performance or future obligations are considered inconsequential to the relevant license technology, are recognized as revenue upon delivery of the technology. We typically use signed contractual agreements as persuasive evidence of a sales arrangement.

If at the inception of an arrangement the fee is not fixed or determinable, we defer revenue until the arrangement fee becomes due and payable. If we determine collectability is not probable, we defer revenue until we receive payment or collection becomes probable, whichever is earlier. The determination of whether fees are collectible requires judgment of our management, and the amount and timing of revenue recognition may change if different assessments are made.

Deferred revenues and customer prepayments on our consolidated balance sheets primarily represents amounts invoiced or cash payments received in advance of our performance related to the underlying agreement.

Change in Accounting Policy – In early 2013, we expanded our business strategy related to the monetization of intellectual property rights and have been pursuing brand licenses with major corporations. In connection with the strategy expansion, we reevaluated our revenue recognition accounting principles during the second quarter of 2013 and determined that the completed performance methodology for recognizing intellectual properly revenue was preferable to the historically used proportional performance methodology. The completed performance methodology is further described above within the revenue recognition discussion. As part of this change in accounting principle, we conducted a quantitative analysis to determine the impact the accounting policy change would have had on our 2012 balance sheet and statement of operations. The impact to our balance sheet as of December 31, 2012 would have been a decrease in each of the deferred revenues and customer prepayments, total current liabilities, and accumulated deficit of $208,000. The impact to our 2012 statement of operations would have been an increase in revenues and decrease in the net loss available to common shareholders of $208,000, and there would have been no impact on basic and diluted net loss per common share. Based on the analysis, the impact was deemed immaterial to the overall financial statements.

Multiple Element Transactions – From time to time, we enter into transactions involving multiple elements, such as customer agreements involving multiple patents. We account for multiple element transactions by first obtaining evidence of the estimated selling price of each element using vendor specific objective evidence (“VSOE”), third-party evidence (“TPE”), or management’s best estimate of selling price if neither VSOE nor TPE of selling price exists. Based on the determined selling price of each element of the transaction, the value of the single agreement is allocated to each deliverable based on each element's proportional value and accounted for as a separate unit of accounting. Multiple element transactions require the exercise of judgment in determining the estimated selling price of the different elements. The judgments could impact the amount of revenues and expenses recognized over the term of the contract, as well as the period in which they are recognized.

Basic and Diluted Loss Per Common Share – Basic net loss per common share is computed by dividing net loss available to common shareholders by the weighted average number of shares of common stock outstanding during the period. During the years ended December 31, 2013 and 2012, we reported a net loss available to common shareholders and excluded all outstanding stock options, warrants and convertible instruments from the calculation of diluted net loss per common share because inclusion of these securities would have been anti-dilutive.

The following table reflects the outstanding stock options, warrants, convertible debt and convertible preferred securities as of December 31, 2013 and 2012, which have been excluded from the diluted loss per common share calculation because inclusion of the securities would be anti-dilutive:

	December 31,	
	2013	2012
Stock options	1,173,020	1,340,000
Warrants	499,990,063	1,882,492,690
Convertible debt	234,287,861,850	22,696,138,542
Convertible preferred stock	26,617,345,361	990,409,508
	261,406,370,294	25,570,380,740

Foreign Currency – Historically, the functional currency of NeoMedia Europe GmbH was the euro, its local currency, and we recorded translation gains and losses associated with the conversion of the subsidiary financial statements to U.S. dollars in accumulated other comprehensive loss as a component of shareholders' deficit. During the third quarter of 2013, we determined that changes in economic facts and circumstances indicated that the functional currency of NeoMedia Europe GmbH had changed from the euro to the U.S. dollar. The changes included, among other things, the termination of the hardware business and related sales activities that would allow the subsidiary to generate revenue independently in the local market or otherwise, and the completion of a repositioning of the subsidiary from a self-contained, revenue generating operation to a cost center focused primarily on research and development. As a result of the change in functional currency, translation gains and losses associated with the conversion of the NeoMedia Europe GmbH financial statements will be prospectively recorded in our results from operations effective July 1, 2013.

Fair-valued Financial Instruments – Fair value measurement within the financial statements is primarily reflected in the accounting for our Convertible Preferred Stock, Convertible Debentures and Warrants, where we determine the fair value of certain hybrid instruments carried at fair value, and certain derivative liabilities which are recorded at fair value. See additional details below and at Note 4 – Financing.

Derivative Financial Instruments – We do not use derivative financial instruments to hedge exposures to cash flow risks or market risks that may affect the fair values of our financial instruments. However, certain financial instruments, such as warrants and the embedded conversion features of our convertible preferred stock and convertible debentures, which are indexed to our common stock, are classified as liabilities when either (a) the holder possesses rights to net-cash settlement or (b) physical or net-share settlement is not within our control. In such instances, net-cash settlement is assumed for financial accounting and reporting purposes, even when the terms of the underlying contracts do not provide for net-cash settlement. Derivative financial instruments are initially recorded, and continuously carried, at fair value. Determining the fair value of these complex derivative financial instruments involves judgment and the use of certain relevant assumptions including, but not limited to, interest rate risk, credit risk, and equivalent volatility and conversion/redemption privileges. The use of different assumptions could have a material effect on the estimated fair value amounts.

For our convertible debentures, we have elected not to separately account for the embedded conversion feature as a derivative instrument but to account for the entire hybrid instrument at fair value in accordance with FASB ASC 815, *Derivatives and Hedging*. For our convertible preferred stock, the underlying instruments are carried at amortized cost and the embedded conversion feature is accounted for separately at fair value in accordance with FASB ASC 815-40-05 and FASB ASC 815-40-15.

Financial Instruments and Concentration of Credit Risk – We believe the carrying values of our financial instruments consisting of cash and cash equivalents, accounts receivable, accounts payable, accrued expenses, derivative financial instruments, other current liabilities, convertible preferred stock, and convertible debenture financings approximate their fair values due to their short-term nature, or because they are carried at fair value.

Our cash balances in the United States periodically exceed federally insured limits. We have not experienced any losses in such accounts. The cash balances maintained by our wholly owned subsidiary, NeoMedia Europe GmbH, are also maintained in financial institutions that provide deposit guarantees and are governed by local public law. Our policies limit the concentration of accounts receivable credit exposure by requiring the majority of customers to prepay their renewal licenses prior to initiating services.

Accounts Receivable – We report accounts receivable at net realizable value. Our terms of sale provide the basis for when accounts become delinquent or past due. We provide an allowance for doubtful accounts equal to the estimated uncollectible amounts, based on historical collection experience and a review of the current status of accounts receivable. We do not require collateral and to the extent credit is granted to our customers, all open accounts receivable beyond 90 days are evaluated for recovery.

Goodwill – Our goodwill represents the excess of the purchase price paid for NeoMedia Europe GmbH over the fair value of the identifiable net assets and liabilities acquired, based on an independent appraisal of the assets and liabilities acquired. Goodwill is not amortized but is tested annually for impairment, and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value. Goodwill is tested for impairment by comparing the carrying amount of the asset to its fair value, which is estimated through the use of a discounted cash flows model. If the carrying amount exceeds fair value, an impairment loss is recognized for the difference. As of December 31, 2013, we determined there were no impairments of our goodwill.

Intangible Assets – Intangible assets consist of patents, customer contracts, copyrighted material, acquired software products, and brand names. Intangible assets acquired as part of a business combination are recognized apart from goodwill if the intangible asset arises from contractual or other legal rights or the asset is capable of being separated from the acquired enterprise. Intangible assets are reviewed for impairment by comparing the carrying amount of the intangible asset to its fair value. If the carrying amount exceeds fair value, an impairment loss is recognized for the difference. Intangible assets are amortized, using the straight-line method, over the estimated period of benefit as noted below:

Capitalized patents	5 - 17 years
Customer contracts	5 years
Copyrighted materials	5 years
Acquired software products	7 years
Brand names	10 years

Evaluation of Long-Lived Assets – We periodically perform impairment tests on each of our long-lived assets, including capitalized patent costs, customer contracts, copyrighted materials, brand names, and capitalized and purchased software costs, whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Long-lived assets are testing for impairment by first comparing the estimated future undiscounted cash flows from a particular asset or asset group to the carrying value. If the expected undiscounted cash flows are greater than the carrying value, no impairment is recognized. If the expected undiscounted cash flows are less than the carrying value, then an impairment charge is recorded for the difference between the carrying value and the expected discounted cash flows. The assumptions used in developing expected cash flow estimates are similar to those used in developing other information used by us for budgeting and other forecasting purposes. In instances where a range of potential future cash flows is possible, we use a probability-weighted approach to weigh the likelihood of those possible outcomes.

As of December 31, 2013 and 2012, we do not believe any of our long-lived assets are impaired.

Property and Equipment – Property and equipment, including software, are stated at cost less accumulated depreciation. Depreciation is recorded on a straight-line basis over the estimated useful lives of the assets as noted below:

Furniture and fixtures	3 - 7 years
Equipment	2 - 5 years

Research and Development – Costs associated with the planning and design phase of software development, including coding and testing activities, and related overhead, necessary to establish technological feasibility of our internally-developed software products, are classified as research and development and are expensed as incurred.

Stock-Based Compensation – We record the grant date fair value of stock-based compensation awards as an expense using a straight-line attribution method over the vesting period of the related stock options. In order to determine the fair value of the stock options on the date of grant, we use the Black-Scholes-Merton option-pricing model. Inherent in this model are assumptions related to expected stock-price volatility, forfeiture and option life, risk-free interest rate and dividend yield. Although the risk-free interest rates and dividend yield are less subjective assumptions based on factual data derived from public sources, the expected stock-price volatility, forfeiture rate and option life assumptions require a greater level of judgment. We use an expected stock-price volatility assumption that is based on historical volatilities of our common stock and estimate the forfeiture rate and option life based on historical data related to prior option grants.

We account for modifications of the terms of existing option grants as exchanges of the existing equity instruments for new instruments. The fair value of the modified option at the grant date is compared with the value at that date of the original option immediately before its terms are modified. Any excess fair value of the modified option over the original option is recognized as additional compensation expense.

Income Taxes – Deferred tax liabilities and assets reflect the difference between the financial statement and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the difference is expected to reverse. Deferred tax assets are reduced by a valuation allowance when it is more likely than not that some portion or all of the deferred tax assets will not be realized. We have recorded full valuation allowance as of December 31, 2013 and 2012.

Recent Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2013-02, *Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income*. The update improves the reporting of reclassifications out of accumulated other comprehensive income for certain transactions and is applied prospectively for periods beginning January 1, 2013. We do not anticipate that the accounting pronouncement will have a material impact on our consolidated financial statements in future periods.

In March 2013, the FASB issued ASU No. 2013-05, *Liabilities (Topic 830): Parent's Accounting for Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity.* The ASU is effective beginning after December 15, 2013 and requires the release of any cumulative translation adjustment into net income upon derecognition of certain subsidiaries or groups of assets within a foreign entity or of an investment in foreign entity. We do not anticipate that the accounting pronouncement will have a material impact on our consolidated financial statements in future periods.

In July 2013, the FASB issued ASU No. 2013-11, *Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists.* The ASU is effective for periods beginning after December 15, 2013 and standardizes the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. We do not anticipate that the accounting pronouncement will have a material impact on our consolidated financial statements in future periods.

From time to time, various other new accounting pronouncements are issued that we adopt as of the specified effective date. We believe that the impact of any other recently issued standards that are not yet effective will not have a material impact on our results of operations and financial position.

Note 3 – Capital Stock

***Common Stock* –** Holders of common stock are entitled to one vote for each share held of record on each matter submitted to a vote of shareholders. Holders of our common stock do not have a cumulative voting right. Upon a liquidation, dissolution, or winding up event, holders of common stock would be entitled to share ratably in all assets remaining after payment of liabilities and payment of accrued dividends and liquidation preferences on the preferred stock, if any. Shares of common stock that have been repurchased are held as treasury shares and used for general corporate purposes including, but not limited to, satisfying obligations under our employee benefit plans. Treasury stock is recorded at cost.

***Preferred Stock* –** We are authorized to issue 25 million shares of preferred stock with a par value $0.01 per share. Preferred stock may be issued in the future in connection with acquisitions, financings, or other matters, as our Board of Directors deems appropriate. The issuance of preferred stock could have the effect of delaying, deferring, or preventing a change in control of our company without further action by our shareholders, and may adversely affect the voting and other rights of the holders of our common stock. The issuance of preferred stock with voting and conversion rights may also adversely affect the voting power of the holders of our common stock, including the loss of voting control to others.

***Series A Preferred Stock* –** In December 1999, 200,000 shares of Series A Preferred Stock with a par value of $0.01 per share were authorized for issuance. The Series A Preferred Stock has the following rights:

- The right to receive mandatory cash dividends equal to the greater of $0.001 per share or 100 times the amount of all dividends (cash or non-cash, other than dividends of shares of common stock) paid to holders of the common stock, which dividend is payable 30 days after the conclusion of each calendar quarter and immediately following the declaration of a dividend on common stock;
- One hundred votes per share of Series A Preferred on each matter submitted to a vote of our shareholders;
- The right to elect two directors at any meeting at which directors are to be elected, and to fill any vacancy on our Board of Directors previously filled by a director appointed by the Series A Preferred holders;
- The right to receive an amount, in preference to the holders of common stock, equal to the amount per share payable to holders of common stock, plus all accrued and unpaid dividends, and following payment of 1/100th of the liquidation preference to the holders of each share of common stock, an additional amount per share equal to 100 times the per share amount paid to the holders of common stock;
- The right to exchange each share of Series A Preferred for 100 times the consideration received per share of common stock in connection with any merger, consolidation, combination or other transaction in which shares of common stock are exchanged for or converted into cash, securities or other property; and
- The right to be redeemed in accordance with our shareholder rights plan.

If accrued mandatory dividends associated with Series A Preferred stock are unpaid, we may not declare or pay dividends or distributions on, or redeem, repurchase or reacquire, shares of any class or series of junior or parity stock.

The Series A Preferred Stock was created in connection with our shareholders rights plan and as of December 31, 2013 and 2012, there were no issued or outstanding shares of Series A Preferred Stock.

Series A Convertible Preferred Stock – In June 2001, 47,511 shares of Series A Convertible Preferred Stock with a $0.01 par value per share were authorized for issuance. The Series A Convertible Preferred Stock has the following rights:

- Series A Convertible Preferred Stock is convertible into shares of common stock at a one-to-one ratio, which was proportionally adjusted to a one-to-one hundred ratio pursuant to a reverse stock split in 2011, and which is subject to proportional adjustment in the event of further stock splits or combinations, and dividends or distributions of shares of common stock. At the option of the holder, shares are subject to automatic conversion as determined in each agreement relating to the purchase of shares of Series A Convertible Preferred Stock;
- Each share of Series A Convertible Preferred Stock is entitled to receive a liquidation preference equal to the original purchase price of such share in the event of liquidation, dissolution, or winding up;
- Upon merger or consolidation, or the sale, lease or other conveyance of all or substantially all of our assets, shares of Series A Convertible Preferred are automatically convertible into the number of shares of stock or other securities or property (including cash) to which the common stock into which it is convertible would have been entitled; and
- Shares of Series A Convertible Preferred Stock are entitled to one vote per share of such stock, and vote together with holders of common stock.

As of December 31, 2013 and 2012, there were no shares of Series A Convertible Preferred Stock issued or outstanding.

Series B Convertible Redeemable Preferred Stock – In January 2002, 100,000 shares of Series B 12% Convertible Redeemable Preferred Stock with a par value of $0.01 per share were authorized for issuance. The Series B Convertible Redeemable Preferred Stock has the following rights:

- Series B Preferred shares accrue dividends at a rate of 12% per annum, or $1.20 per share, between the date of issuance and the first anniversary of issuance;
- Series B Preferred is redeemable to the maximum extent permitted by law (based on funds legally available for redemption) at a price per share of $15.00, plus accrued dividends (a total of $16.20 per share) on the first anniversary of issuance;

- Series B Preferred receive proceeds of $12.00 per share upon our liquidation, dissolution or winding up;
- To the extent not redeemed on the first anniversary of issuance, Series B Preferred is automatically convertible into the then existing general class of common stock on the first anniversary of issuance at a price equal to $16.20 divided by the greater of $20.00 or the lowest publicly-sold share price during the 90 day period preceding the conversion date, but in no event more than 19.9% of our outstanding capital stock as of the date immediately prior to conversion;
- Upon merger or consolidation, or the sale, lease or other conveyance of all or substantially all of our assets, shares of Series B Preferred are automatically convertible into the number of shares of stock or other securities or property (including cash) to which the common stock into which it is convertible would have been entitled; and
- Shares of Series B Preferred are entitled to one vote per share and vote with common stock, except where the proposed action would adversely affect the Series B Preferred or where the non-waivable provisions of applicable law mandate that the Series B Preferred vote separately, in which case Series B Preferred vote separately as a class, with one vote per share.

As of December 31, 2013 and 2012, there were no shares of Series B Convertible Redeemable Preferred Stock issued or outstanding.

Series C Convertible Preferred Stock – In February 2006, 27,000 shares of Series C Convertible Preferred Stock with a par value of $0.01 per share were authorized for issuance. The Series C Convertible Preferred Stock has the following rights:

- Series C preferred shares are entitled to dividends at a rate of 8% per annum, if, as and when declared by the Board of Directors;
- Series C preferred shares receive proceeds of $1,000 per share upon our liquidation, dissolution or winding up;
- Each share of Series C preferred stock is convertible, at the option of the holder, into shares of our common stock at the lesser of (i) $50.00 or (ii) 97% of the lowest closing bid price of our common stock for the 125 trading days immediately preceding the date of conversion; and
- Series C preferred shares have voting rights on an as-converted basis with the common stock.

As of December 31, 2013 and 2012, there were 4,816 shares and 4,840 shares of Series C Convertible Preferred Stock issued and outstanding, respectively. The holders of our outstanding shares are limited by the certificate of designation and by the contractual provisions of the related Securities Purchase Agreements under which the Series C Convertible Preferred Stock was issued and other related transaction documents from beneficial control of more than 9.99% of our voting securities. Therefore, unless the holder waives this limitation upon 61 days' notice to us, the holders may not exercise all the voting rights otherwise described in the certificate of designation of these securities (see Note 4 – Financing).

Series D Convertible Preferred Stock – In January 2010, 25,000 shares of Series D Convertible Preferred Stock with a par value of $0.01 per share was authorized for issuance. The Series D Convertible Preferred Stock has the following rights:

- Series D preferred shares are entitled to dividends at a rate of 8% per annum, if, as and when declared by the Board of Directors;
- Series D preferred shares receive proceeds of $100 per share upon our liquidation, dissolution or winding up;
- Each share of Series D preferred stock is convertible, at the option of the holder, into shares of our common stock at the lesser of (i) $2.00 or (ii) 97% of the lowest closing bid price of our common stock for the 125 trading days immediately preceding the date of conversion; and
- Series D preferred shares have voting rights on an as-converted basis with the common stock.

As of December 31, 2013 and 2012, 3,481 shares of Series D preferred stock were issued and outstanding.

Shareholder Rights Plan – On December 10, 1999, our Board of Directors adopted a shareholder rights plan and declared a non-taxable dividend that provides shareholders with the right to acquire one-one hundredth of a share of our Series A Preferred Stock for each outstanding share of our common stock to shareholders of record on December 20, 1999 and each share of common stock issued thereafter until a pre-defined hostile takeover date. As further defined in detail within the shareholder rights plan, the rights generally will be exercisable only if (1) an Acquiring Person or Adverse Person acquires beneficial ownership equal to or greater than 25% or 15%, respectively, or (2) commences a tender offer upon consummation of which the Acquiring Person or Adverse Person would have beneficial ownership equal to or greater than 25% or 15%, respectively. The shareholder rights plan was designed to enable all shareholders not engaged in a hostile takeover attempt to receive fair and equal treatment in any proposed takeover and to guard against partial or two-tiered tender offers, open market accumulations, and other hostile tactics to gain control of us. This shareholder rights plan may have the effect of rendering more difficult, delaying, discouraging, preventing, or rendering more costly an acquisition or a change in control.

In addition, our Certificate of Incorporation authorizes our Board of Directors to designate and issue our preferred stock, in one or more series, the terms of which may be determined at the time of issuance by our Board of Directors, without further action by shareholders, and may include voting rights, including the right to vote as a series on particular matters, preferences as to dividends and liquidation, conversion, redemption rights, and sinking fund provisions.

Note 4 – Financing

At December 31, 2013, financial instruments arising from our financing transactions with YA Global Investments, L.P. ("YA Global"), an accredited investor, included shares of our Series C preferred stock issued in February 2006, Series D preferred stock issued in January 2010, a series of six consolidated secured convertible debentures (the "Consolidated Debentures") issued July 1, 2013 and various warrants to purchase shares of our common stock. All of our assets are pledged to secure our obligations under the debt securities. At various times, YA Global has assigned or distributed portions of its holdings of these securities to other holders, including persons who are officers of YA Global and its related entities, as well as to other holders who are investors in YA Global's funds.

Secured Debentures – We had originally entered into financing transactions with YA Global, which included a series of twenty-seven secured convertible debentures issued between August 2006 and July 2012. Effective July 1, 2013, the terms of the debentures held by YA Global were modified to consolidate the principal and interest amounts outstanding under all of the outstanding secured convertible debentures previously issued by us to YA Global, such that, upon the issuance of the Consolidated Debentures and cancellation of the prior debentures, the amount of outstanding debentures issued to YA Global decreased from twenty-seven to six debentures. The maturity dates of these secured convertible debentures were also extended from August 1, 2014 to August 1, 2015.

The underlying agreements for each of the Consolidated Debentures are very similar in form. The Consolidated Debentures are convertible into our common stock, at the option of the holder, at the lower of a fixed conversion price per share or a percentage of the lowest volume-weighted average price ("VWAP") for a specified number of days prior to the conversion (the "look-back period"). The conversion is limited such that the holder cannot exceed 9.99% ownership of the outstanding common stock, unless the holder waives their right to such limitation. All of the debentures are secured according to the terms of a Security Pledge Agreement dated August 23, 2006, which was entered into in connection with the first convertible debenture issued to YA Global and which provides YA Global with a security interest in substantially all of our assets. The debentures are also secured by a Patent Security Agreement dated July 29, 2008. On August 13, 2010, our wholly owned subsidiary, NeoMedia Europe GmbH, became a guarantor of all outstanding financing transactions between us and YA Global, through pledges of their intellectual property and other movable assets. As security for our obligations to YA Global, all of our Pledged Property, Patent Collateral and other collateral is affirmed through the several successive Ratification Agreements executed in connection with each of the 2010, 2011 and 2012 financings. The 2013 modification and consolidation of the outstanding secured convertible debentures as well as the execution of an Amended and Restated Patent Security Agreement in 2013 reaffirmed the Pledged Property, Patent Collateral and other collateral pledged as security for our obligations to YA Global.

We evaluated the financing transactions in accordance with ASC 815, *Derivatives and Hedging*, and determined that the conversion features of the Series C and Series D preferred stock and the Consolidated Debentures were not afforded the exemption for conventional convertible instruments due to their variable conversion rates. The contracts have no explicit limit on the number of shares issuable, so they did not meet the conditions set forth in current accounting standards for equity classification. Accordingly, either the embedded derivative instruments, including the conversion option, must be bifurcated and accounted for as derivative instrument liabilities or, as permitted by ASC 815-15-25-4, *Recognition of Embedded Derivatives*, the instruments may be carried in their entirety at fair value.

At inception, we elected to bifurcate the embedded derivatives related to the Series C and Series D preferred stock, while electing the fair value option for the Consolidated Debentures. ASC 825, *Financial Instruments*, allows us to elect the fair value option for recording financial instruments when they are initially recognized or if there is an event that requires re-measurement of the instruments at fair value, such as a significant modification of the debt.

The terms of the debentures held by YA Global prior to the consolidation were modified on May 25, 2012 to extend the stated maturity dates to August 1, 2013 and reduce the interest rates to 9.5% per year, with interest being payable on the maturity date in cash or, provided certain equity conditions are satisfied, in shares of our common stock at the applicable conversion price. Because the effect of the modifications exceeded a significance threshold relative to cash flows prescribed by ASC 470-50, *Debt Modifications and Extinguishments*, the modifications of the amounts due under these arrangements were accounted for as extinguishments, whereby the existing debentures are considered to be retired and new debentures issued. The existing instruments were first adjusted to fair value as of May 25, 2012 using the interest rate and maturity date prior to the amendment. The fair value of the new instruments was then calculated using the modified interest rate and maturity date to determine the fair value of the instrument subsequent to the amendment. The differences in the fair values before and after the amendment were recorded as an extinguishment loss of approximately $27.5 million in the accompanying statements of operations for the year ended December 31, 2012.

On February 4, 2013, we entered into a Debenture Extension Agreement with YA Global to extend the maturity dates of the secured convertible debentures to August 1, 2014. Because the effect of the extension did not exceed a significance threshold relative to cash flows prescribed by ASC 470-50, *Debt Modifications and Extinguishments*, extinguishment accounting was not applicable. On July 1, 2013, in addition to consolidating the secured debentures into six Consolidated Debentures, the maturity date was extended to August 1, 2015. Four of the Consolidated Debentures are non-interest bearing while the remaining two Consolidated Debentures accrue interest at 9.5% as outlined in further detail below. Debentures assigned to other investors by YA Global were also modified effective July 1, 2013 to extend the maturity date to August 1, 2015. We evaluated the impact of the modification on the accounting for the Consolidated Debentures in accordance with ASC 470-50-40-6 through 12 to determine whether extinguishment accounting was appropriate. Because the effect of the extension did not exceed a significance threshold relative to cash flows prescribed by ASC 470-50, *Debt Modifications and Extinguishments*, extinguishment accounting was not applicable.

The following table summarizes the significant terms of each of the debentures for which the entire hybrid instrument is recorded at fair value as of December 31, 2013:

				Conversion Price – Lower of Fixed Price or Percentage of VWAP for Look-back period	
				Anti-Dilution	
Debenture	Face	Interest	Fixed	Adjusted	Look-back

Issuance Year	Amount (in thousands)	Rate	Price	Price	%	Period
2006	$ 1,962	9.5 %	$2.00	$ 0.00018	90 %	125 Days
2007	567	9.5 %	$2.00	$ 0.00018	90 %	125 Days
2007	272	-	$2.00	$ 0.00019	95 %	125 Days
2008	1,217	9.5 %	$2.00	$ 0.00018	90 %	125 Days
2008	830	-	$2.00	$ 0.00019	95 %	125 Days
2009	134	9.5 %	$2.00	$ 0.00018	90 %	125 Days
2011	852	9.5 %	$2.00	$ 0.00018	90 %	125 Days
2012	762	9.5 %	$2.00	$ 0.00018	90 %	125 Days
2012	210	-	$2.00	$ 0.00019	95 %	125 Days
2013	22,084	9.5 %	$2.00	$ 0.00018	90 %	125 Days
2013	12,127	-	$2.00	$ 0.00019	95 %	125 Days
Total	$ 41,017					

We bifurcate the compound embedded derivatives related to the Series C and Series D preferred stock and carry these financial instruments as liabilities in the accompanying balance sheet. Election to carry the instruments at fair value in their entirety is not available since their terms have not been modified. Significant components of the compound embedded derivative include (i) the embedded conversion feature, (ii) down-round anti-dilution protection features and (iii) default, non-delivery and buy-in puts, all of which were combined into one compound instrument that is carried at fair value as a derivative liability. Changes in the fair value of the compound derivative liability are recorded within income each period.

Conversions and Repayments – Our preferred stock and convertible debentures are convertible into shares of our common stock. Upon conversion of any of the convertible financial instruments in which the compound embedded derivative is bifurcated, the carrying amount of the debt, including any unamortized premium or discount, and the related derivative instrument liability are credited to the capital accounts upon conversion to reflect the stock issued and no gain or loss is recognized. For instruments that are recorded in their entirety at the fair value of the hybrid instrument, the fair value of the hybrid instrument converted is credited to the capital accounts upon conversion to reflect the stock issued and no gain or loss is recognized. Beginning in April 2013, the trading market price of our common stock (and the conversion price) was less than its par value. We are limited to issuing shares of common stock at no less than the par value, and all shares of our common stock issued in those conversions were issued at par value. However, the methodology used to estimate the number of shares of convertible debentures and preferred stock converted during this time are based upon the value received for the shares issued, with the difference between that value and the par value recorded as a deemed dividend.

The following table provides a summary of the preferred stock conversions that have occurred since inception and the number of common shares issued upon conversion.

	Preferred shares issued	Preferred shares converted	Preferred shares remaining	Common shares issued
	(in thousands)			
Series C Preferred Stock	22	17	5	314,619
Series D Preferred Stock	25	22	3	245,162

The outstanding principal and accrued interest for the debentures as of December 31, 2013 is reflected in the following table in addition to the principal and interest converted since inception and the number of common shares issued upon conversion.

	Outstanding principal and accrued interest at December 31, 2013	Principal and accrued interest converted since inception	Common Shares issued
	(in thousands)		
Debentures	$42,811	$ 11,747	4,403,415

Warrants – YA Global holds warrants to purchase shares of our common stock that were issued in connection with the convertible debentures and the Series C and Series D preferred stock. The warrants are exercisable at a fixed exercise price which, from time to time, has been reduced due to anti-dilution provisions when we have entered into subsequent financing arrangements with a lower price. The exercise prices may be reset again in the future if we subsequently issue stock or enter into a financing arrangement with a lower price. In addition, upon each adjustment in the exercise price, the number of warrant shares issuable is adjusted to the number of shares determined by multiplying the warrant exercise price in effect prior to the adjustment by the number of warrant shares issuable prior to the adjustment divided by the warrant exercise price resulting from the adjustment.

The warrants issued to YA Global do not meet all of the established criteria for equity classification in ASC 815-40, *Derivatives and Hedging – Contracts in Entity's Own Equity,* and accordingly, are recorded as derivative liabilities at fair value. Changes in the fair value of the warrants are charged or credited to income each period.

Effective February 1, 2013, 1.4 billion of the 1.9 billion warrants held by YA Global were cancelled and the remaining 500 million had their exercise price reduced to $0.0001 per share. These changes resulted in a decrease in fair value of the warrants of approximately $1.6 million during the first quarter of 2013 as reflected in the Gain from change in fair value of derivative liabilities - warrants.

Fair value disclosures for Series C and D Bifurcated Embedded Derivative Instruments – For financings in which the embedded derivative instruments are bifurcated and recorded separately, the compound embedded derivative instruments are valued using a Monte Carlo Simulation methodology because that model embodies certain relevant assumptions (including, but not limited to, interest rate risk, credit risk, and conversion/redemption privileges) that are necessary to value these complex derivatives.

The conversion price in each of the convertible debentures is subject to adjustment for down-round, anti-dilution protection. Accordingly, if we sell common stock or common share indexed financial instruments below the stated or variable conversion price of the debenture, the conversion price adjusts to that lower amount.

The assumptions included in the calculations are highly subjective and subject to interpretation. Assumptions used as of December, 2013 included exercise estimates/behaviors and the following other significant estimates: (i) Preferred Stock: remaining term of 1.59 years, equivalent volatility range of 203% to 206%, stated dividend of 8%, equivalent credit-risk adjusted rate of 13.0% and conversion price of $0.000194. Equivalent amounts reflect the net results of multiple modeling simulations that the Monte Carlo Simulation methodology applies to underlying assumptions.

Due to the variability of the conversion prices, fluctuations in the trading market price of our common stock may result in significant variations to the calculated conversion price. For each debenture, we analyze the ratio of the conversion price (as calculated based on the percentage of VWAP for the appropriate look-back period) to the trading market price for a period of time equal to the term of the debenture to determine the average ratio for the term of the note. Each quarter, the ratio in effect on the date of the valuation is compared with the average ratio over the term of the debenture to determine if the calculated conversion price is representative of past trends or if it is considered unrepresentative due to a large fluctuation in the common stock price over a short period of time. If the calculated conversion price results in a ratio that deviates significantly from the average ratio over the term of the agreement, the average ratio of the conversion price to the trading market price is then multiplied by the current trading market price to determine the variable conversion price for use in the fair value calculations. This variable conversion price is then compared with the fixed conversion price and, as required by the terms of the debentures, the lower of the two amounts is used as the conversion price in the Monte Carlo Simulation model used for valuation purposes. On December 31, 2013, the fixed conversion price for each of the debentures was equal to or higher than the calculated variable conversion price. Accordingly, the variable conversion price was used in the Monte Carlo Simulation model. This analysis is performed each quarter to determine if the calculated conversion price is reasonable for purposes of determining the fair value of the embedded conversion features (for instruments recorded under ASC 815-15-25-1) or the fair value of the hybrid instrument (for instruments recorded under ASC 815-15-25-4).

The following table reflects the face value of the instruments, their amortized carrying value and the fair value of the separately-recognized compound embedded derivative, as well the number of common shares into which the instruments are convertible as of December 31, 2013 and 2012.

December 31, 2013 (Restated)

	Face Value (in thousands)	Carrying Value	Embedded Conversion Feature	Common Stock Shares
Series C Preferred Stock	$4,816	$ 4,816	$ 276	24,823,015
Series D Preferred Stock	348	348	20	1,794,330
Total	$5,164	$ 5,164	$ 296	26,617,345

December 31, 2012

	Face Value (in thousands)	Carrying Value	Accrued Interest	Embedded Conversion Feature	Common Stock Shares
Series C Preferred Stock	$4,840	$ 4,840	$ -	$ 1,988	923,953
Series D Preferred Stock	348	348	-	143	66,457
Total	$5,188	$ 5,188	$ -	$ 2,131	990,410
Debentures:					
2006	$53	$ 53	$ 7	16	11,871

The terms of the embedded conversion features in the convertible instruments presented above provide for variable conversion rates that are indexed to our quoted common stock price. As a result, the number of indexed shares is subject to continuous fluctuation. For presentation purposes, the number of shares of common stock into which the embedded conversion feature of the Series C and Series D preferred stock was convertible as of December 31, 2013 and 2012 was calculated as face value plus assumed dividends (if declared), divided by the lesser of the fixed rate or the calculated variable conversion price using the 125 day look-back period.

Changes in the fair value of derivative instrument liabilities related to the bifurcated embedded derivative features of convertible instruments not carried at fair value are reported as Loss from Change in Fair Value of Derivative Liability – Series C and Series D Preferred Stock and Debentures in the accompanying consolidated statements of operations.

Gain (loss) from change in fair value of derivative liability – Series C and D Preferred Stock and debentures

	Year ended December 31,	
	2013	2012 (Restated)
	(in thousands)	
Series C Preferred Stock	$1,712	$(2,066)
Series D Preferred Stock	123	(1,286)
Debentures:		
2006	6	(3,005)
2008	-	(1,350)
2009	-	(484)
2010	-	(34)
2011	-	(4,825)
2012	-	15
Gain (loss) from change in fair value of derivative liability	$1,841	$(13,035)

Hybrid Financial Instruments Carried at Fair Value – At inception, the March 2007, August 2007, April 2008, May 2008 and April 2012 convertible debentures were recorded in their entirety at fair value as hybrid instruments in accordance with ASC 815-15-25-4 with subsequent changes in fair value charged or credited to income each period. As of May 25, 2012, we elected the fair value option for all other convertible debentures held by YA Global upon a re-measurement date that was triggered by significant modifications of the financial instruments. The convertible debentures continued to be recorded in their entirety at fair value upon their consolidation into six Consolidated Debentures effective July 1, 2013.

Because these debentures are carried in their entirety at fair value, the value of the embedded conversion feature is embodied in those fair values. We estimate the fair value of the hybrid instrument as the present value of the cash flows of the instrument, using a risk-adjusted interest rate, enhanced by the value of the conversion option, valued using a Monte Carlo model. This method was considered by our management to be the most appropriate method of encompassing the credit risk and exercise behavior that a market participant would consider when valuing the hybrid financial instrument. Inputs used to value the hybrid instruments as of December 31, 2013 included: (i) present value of future cash flows for the debentures using an effective market interest rate of 13.0%, (ii) remaining term of 1.59 years, (iii) equivalent volatility range of 203% to 209% and anti-dilution adjusted conversion prices ranging from $0.00018 - $0.00019.

The following table reflects the face value of the financial instruments, the fair value of the hybrid financial instrument and the number of common shares into which the instruments are convertible as of December 31, 2013 and 2012.

December 31, 2013	Face Value	Fair Value	Common Stock Shares
	(in thousands) (Restated)		
Debentures:			
2006	$1,962	$2,008	819,019
2007	839	533	216,720
2008	2,047	1,905	779,294
2009	134	151	61,563
2011	852	854	348,437
2012	972	1,392	568,305
2013	34,211	31,407	12,826,301
Total	$41,017	$38,250	15,619,639

December 31, 2012	Face Value	Fair Value	Common Stock Shares
	(in thousands)		
Debentures:			
2006	$6,180	$14,758	5,196,283
2007	6,856	17,172	6,098,480
2008	6,468	15,492	5,487,497
2009	1,644	3,565	1,243,390
2010	3,806	7,178	2,512,724
2011	1,954	3,080	1,084,237
2012	1,979	3,047	1,073,527
Total	$28,887	$64,292	22,696,138

Changes in the fair value of convertible instruments that are carried in their entirety at fair value are reported as Gain (loss) from change in fair value of hybrid financial instruments in the accompanying consolidated statements of operations. The changes in fair value of these hybrid financial instruments were as follows:

Gain from change in fair value of hybrid financial instruments

	Year ended December 31,	
	2013	2012
	(in thousands)	
	(Restated)	
2006	$11,604	$2,680
2007	16,381	798
2008	13,291	5,433
2009	2,113	708
2010	7,177	1,858
2011	1,748	840
2012	1,321	771
2013	(31,826)	-
	21,809	13,088
Less: Day-one loss from debenture financings	-	(1,162)
Gain from changes in fair value of hybrid instruments	$21,809	$11,926