

Applications Environment (\$755,000)

Q. Why is the annual recurring cost for the Microsoft Licensing Agreement being treated as capital?

A. The Company's 3-year Microsoft Enterprise Agreement entered into in 2002 ensures the right to use and avail of all upgrades to Microsoft Office products covered under the Company's previous Microsoft Enterprise Agreement, which expired in April 2002. The Microsoft Enterprise Agreement also entitles the Company to use and avail of upgrades to existing installed Microsoft applications not previously available under the Microsoft Enterprise Agreement.

The purchase and right to use additional Microsoft applications is also included under this Agreement. These products were not available under the previous Microsoft Enterprise Agreement.

This 3-year Microsoft Enterprise Agreement entitles the Company to install Microsoft products as needed throughout the 3-year contract period. It also entitles the Company to continuous upgrades of Microsoft Office products and upgrades of all other products covered under the Agreement.

In the absence of this Agreement, the Company would be required to separately purchase all software and software upgrades. Because the terms of the Agreement enable continuous software additions and upgrades to software currently in production, it extends overall software life. It is therefore appropriate to treat the costs as a capital expenditure.

The additional cost of day-to-day Microsoft software maintenance and support is charged to the Company on a per incident basis. The Company's cost of software maintenance and support is treated as an operating expense.