

COMPUTER ASSOCIATES INTERNATIONAL INC

Form 10-Q/A

June 14, 2004

Table of Contents

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549
FORM 10-Q/A**

Quarterly Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934

For the quarterly period ended **September 30, 2003**
or

Transition Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934

For the transition period ended from _____ to _____

Commission File Number 1-9247

Computer Associates International, Inc.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

13-2857434

(I.R.S. Employer Identification Number)

One Computer Associates Plaza

Islandia, New York

(Address of principal executive offices)

11749

(Zip Code)

(631) 342-6000

(Registrant's telephone number, including area code)

Not applicable

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

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: Yes No

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Act): Yes No

EXPLANATORY NOTE

This Form 10-Q/A is being filed for the purpose of amending Items 1 and 2 of Part I and Item 6 of Part II of Form 10-Q to reflect adjustments to revenue for the three and six-month periods ended September 30, 2003. Refer to footnote A for further details regarding the restatement and certain other balance sheet reclassifications as of the

periods ending September 30, 2003 and March 31, 2003. The financial statements included in this form 10-Q/A have also been adjusted to reflect the disposition of the Company's subsidiary, ACCPAC International, Inc. (ACCPAC) as a discontinued operation for all periods presented. As a result of the completion of the internal investigation in April 2004 by the Audit Committee of the Board of Directors into accounting practices that were in place prior to the Company's adoption of its Business Model in October 2000, our independent registered public accounting firm was able to complete their review under Statement of Auditing Standards No. 100, Interim Financial Information (SAS 100) of the unaudited Consolidated Condensed Financial Statements for the quarterly periods ended September 30, 2003 and December 31, 2003. Based on the completion of their review, our independent registered public accounting firm issued their independent registered public accounting firm's SAS 100 review report, which is included herein.

All information in this Form 10-Q/A is as of September 30, 2003 and does not reflect any subsequent information or events other than the restatement of revenue, balance sheet reclassifications, and the classification of ACCPAC as a discontinued operation. Refer to the Company's Form 10-K for the fiscal year ended March 31, 2004, filed contemporaneously with this Form 10-Q/A, and our other filings with the Securities and Exchange Commission, for an update on the government investigation and other matters.

Except as described above, all other Items of the original filing made on October 22, 2003 are unaffected by the changes described above and have not been repeated in this Amendment.

Table of Contents

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

Title of Class	Shares Outstanding
Common Stock par value \$.10 per share	as of October 20, 2003 579,081,504

Table of Contents

PART I. FINANCIAL INFORMATION

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Computer Associates International, Inc.

We have reviewed the accompanying consolidated condensed balance sheet of Computer Associates International, Inc. and subsidiaries as of September 30, 2003, and the related consolidated condensed statements of operations for the three and six month periods ended September 30, 2003 and 2002, and the related consolidated condensed statement of cash flows for the six month periods ended September 30, 2003 and 2002. These consolidated condensed financial statements are the responsibility of the Company's management.

We conducted our review in accordance with standards established by the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the consolidated condensed financial statements referred to above for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with standards established by the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Computer Associates International, Inc. and subsidiaries as of March 31, 2003, and the related consolidated statements of operations, stockholders' equity, and cash flows for the year then ended (not presented herein); and in our report dated May 9, 2003, we expressed an unqualified opinion on those consolidated financial statements. As discussed in that report, effective April 1, 2002, the Company adopted the provisions of SFAS No. 142, *Goodwill and Other Intangible Assets*. In our opinion, the information set forth in the accompanying consolidated condensed balance sheet as of March 31, 2003, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

As discussed in Note A to the consolidated condensed financial statements, effective April 1, 2003, the Company adopted the fair value method of accounting provisions of Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation*, as amended by SFAS No. 148, *Accounting for Stock-Based Compensation- Transition and Disclosure- an amendment of SFAS 123*.

As discussed in Note A to the consolidated condensed financial statements, the Company has restated the consolidated condensed balance sheet at September 30, 2003, and the related consolidated condensed statements of operations and cash flows for the periods then ended.

/s/ KPMG LLP

New York, New York
June 7, 2004

Table of Contents**Item 1:**

COMPUTER ASSOCIATES INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED CONDENSED BALANCE SHEETS

(unaudited)
(in millions)

	September 30, 2003	March 31, 2003
	<u>(restated)</u>	
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 880	\$ 1,405
Marketable securities	96	91
Trade and installment accounts receivable, net	936	1,079
Deferred income taxes	186	287
Other current assets	82	117
Assets of discontinued operation	54	66
	<u> </u>	<u> </u>
TOTAL CURRENT ASSETS	2,234	3,045
Installment accounts receivable, due after one year, net	1,073	1,299
Property and equipment, net	643	662
Purchased software products, net	1,239	1,416
Goodwill, net	4,403	4,400
Other noncurrent assets, net	416	439
	<u> </u>	<u> </u>
TOTAL ASSETS	\$ 10,008	\$11,261
	<u> </u>	<u> </u>
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES		
Loans payable and current portion of long-term debt	\$ 2	\$ 828
Deferred subscription revenue (collected) current	842	923
Other current liabilities	1,132	1,213
Liabilities of discontinued operation	54	65
	<u> </u>	<u> </u>
TOTAL CURRENT LIABILITIES	2,030	3,029
Long-term debt, net of current portion	2,298	2,298
Deferred income taxes	851	1,047
Deferred subscription revenue (collected) noncurrent	213	173
Deferred maintenance revenue	249	324
Other noncurrent liabilities	29	27

	_____	_____
TOTAL LIABILITIES	5,670	6,898
Stockholders' equity	4,338	4,363
	_____	_____
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	\$ 10,008	\$ 11,261
	_____	_____

See Notes to the Consolidated Condensed Financial Statements.

Table of Contents**COMPUTER ASSOCIATES INTERNATIONAL, INC. AND SUBSIDIARIES****CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS**

(unaudited)

(in millions, except per share amounts)

	For the Three Months Ended September 30,		For the Six Months Ended September 30,	
	2003	2002	2003	2002
	(restated)		(restated)	
REVENUE				
Subscription revenue	\$ 473	\$ 343	\$ 920	\$ 657
Software fees and other	75	85	142	171
Maintenance	151	186	310	382
Financing fees	49	77	103	163
Professional services	55	60	114	125
TOTAL REVENUE	803	751	1,589	1,498
EXPENSES				
Amortization of capitalized software costs	117	117	233	235
Cost of professional services	52	59	107	118
Selling, general and administrative	317	333	638	673
Product development and enhancements	165	160	327	320
Commissions and royalties	55	58	107	117
Depreciation and amortization of other intangibles	34	35	67	68
Other gains/expenses, net	20	28	24	59
Shareholder litigation settlement	150		150	
TOTAL EXPENSES BEFORE INTEREST AND TAXES	910	790	1,653	1,590
Loss from continuing operations before interest and taxes	(107)	(39)	(64)	(92)
Interest expense, net	29	41	60	86
Loss from continuing operations before income taxes	(136)	(80)	(124)	(178)
Income taxes (benefit)	(46)	(27)	(42)	(61)
LOSS FROM CONTINUING OPERATIONS	(90)	(53)	(82)	(117)
Income from discontinued operation, net of income taxes		1		
NET LOSS	\$ (90)	\$ (52)	\$ (82)	\$ (117)

BASIC LOSS PER SHARE

Loss from continuing operations	\$ (.16)	\$ (.09)	\$ (.14)	\$ (.20)
Income from discontinued operation	.00	.00	.00	.00

Net loss	\$ (.16)	\$ (.09)	\$ (.14)	\$ (.20)

Basic weighted-average shares used in computation	579	573	579	576
---	-----	-----	-----	-----

DILUTED LOSS PER SHARE

Table of Contents

	For the Three Months Ended September 30,		For the Six Months Ended September 30,	
	2003	2002	2003	2002
	(restated)		(restated)	
Loss from continuing operations	\$(.16)	\$(.09)	\$(.14)	\$(.20)
Income from discontinued operation	.00	.00	.00	.00
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Net loss	<u>\$(.16)</u>	<u>\$(.09)</u>	<u>\$(.14)</u>	<u>\$(.20)</u>
	579	573	579	576

Diluted weighted-average shares used in computation
See Notes to the Consolidated Condensed Financial Statements.

COMPUTER ASSOCIATES INTERNATIONAL, INC. AND SUBSIDIARIES**CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS**

(unaudited)
(in millions)

	For the Six Months Ended September 30,	
	2003	2002
	(restated)	
OPERATING ACTIVITIES:		
Net loss	\$ (82)	\$ (117)
Income from discontinued operation, net of tax	<u> </u>	<u> </u>
Loss from continuing operations	(82)	(117)
Adjustments to reconcile loss from continuing operations to net cash provided by continuing operating activities:		
Depreciation and amortization	300	303
Provision for deferred income taxes	(104)	(111)
Compensation expense related to stock and pension plans	24	26
Decrease in noncurrent installment accounts receivable, net	223	188
Increase (decrease) in deferred subscription revenue (collected) noncurrent	35	(42)
Decrease in deferred maintenance revenue	(83)	(128)
Decrease in trade and current installment accounts receivable, net	196	433
Decrease in deferred subscription revenue (collected) current	(111)	(38)
(Gain) loss on sale of assets, net	(18)	2

Gain on early retirement of debt		(3)
Changes in other operating assets and liabilities, excluding effects of acquisitions and divestitures	(27)	(108)
	<u> </u>	<u> </u>
NET CASH PROVIDED BY CONTINUING OPERATING ACTIVITIES	353	405
INVESTING ACTIVITIES:		
Acquisitions of purchased software	(35)	(11)
Settlements of purchase accounting liabilities	(11)	(19)
Purchases of property and equipment, net	(15)	(9)
Proceeds from divestiture of assets	18	12
Purchases of marketable securities, net	(4)	(5)
Increase in capitalized software development costs and other	(20)	(20)
	<u> </u>	<u> </u>
NET CASH USED IN CONTINUING INVESTING ACTIVITIES	(67)	(52)
FINANCING ACTIVITIES:		
Debt repayments, net	(826)	(694)
Dividends paid	(23)	(23)
Exercises of common stock options and other	11	10
Purchases of treasury stock	(6)	(63)
	<u> </u>	<u> </u>

Table of Contents

	For the Six Months Ended September 30,	
	2003	2002
	<u> </u>	<u> </u>
	(restated)	
NET CASH USED IN CONTINUING FINANCING ACTIVITIES	(844)	(770)
DECREASE IN CASH AND CASH EQUIVALENTS BEFORE		
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(558)	(417)
Effect of exchange rate changes on cash and cash equivalents	33	18
	<u> </u>	<u> </u>
DECREASE IN CASH AND CASH EQUIVALENTS	(525)	(399)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	1,405	1,072
	<u> </u>	<u> </u>
CASH AND CASH EQUIVALENTS AT END OF PERIOD	<u>\$ 880</u>	<u>\$ 673</u>

See Notes to the Consolidated Condensed Financial Statements.

Table of Contents

COMPUTER ASSOCIATES INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

SEPTEMBER 30, 2003

NOTE A - BASIS OF PRESENTATION

The accompanying unaudited Consolidated Condensed Financial Statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. All such adjustments are of a normal recurring nature. The financial statements included in this Form 10-Q/A have been adjusted to reflect the disposition of the Company's subsidiary, ACCPAC International, Inc. (ACCPAC), as discontinued operations for all periods presented.

Operating results for the three and six months ended September 30, 2003 are not necessarily indicative of the results that may be expected for the fiscal year ending March 31, 2004. For further information, refer to the Consolidated Condensed Financial Statements and notes thereto included in the Annual Report on Form 10-K (Form 10-K) relating to Computer Associates International, Inc. and subsidiaries (the Company) for the fiscal year ended March 31, 2003.

Basis of Revenue Recognition: The Company derives revenue from licensing software products, providing customer technical support and providing professional services. The Company licenses to customers the right to use its software products pursuant to software license agreements. Since the Company recognizes subscription revenue from software license agreements evenly or ratably over the applicable license agreement term, the timing and amount of such revenue recognized during an accounting period is determined by the duration and license agreement value reflected in each software license agreement. Revenue from transactions completed through the Company's distributor, reseller and original equipment manufacturer partners is generally recognized when these partners sell the software products to their customers. This is commonly referred to as the sell-through method. For a detailed description of the Company's revenue recognition policy, refer to Note 1 to the Consolidated Financial Statements in the Form 10-K for fiscal year 2003.

Business Model: In October 2000, the Company announced the shift to its existing Business Model (the Business Model) that offers customers greater flexibility to change how they can use and license the Company's software products as their businesses change. Under the Business Model, customers can manage their costs more effectively by controlling the duration of their software license agreements. The Business Model also permits customers to change their software mix as their business and technology needs change. The Company believes its Business Model improves the predictability of its revenue streams, since the Company recognizes subscription revenue ratably over the life of each software license agreement. Under the Company's prior business model, and as is common practice in the software industry, license fees from a software license agreement was generally recorded up-front at the time the license agreement was signed and the software was delivered.

Statements of Cash Flows: Cash flows related to the discontinued operating activities of ACCPAC have been segregated on the Consolidated Condensed Statements of Cash Flows. For the six months ended September 30, 2003 and 2002, interest payments were \$77 million and \$105 million, respectively, and income taxes paid were \$172 million and \$87 million, respectively.

Cash Dividends: In May 2003, the Company's Board of Directors declared its regular, semi-annual cash dividend of \$.04 per share. The dividend totaled approximately \$23 million and was paid on July 7, 2003 to stockholders of record on June 19, 2003.

Table of Contents

COMPUTER ASSOCIATES INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
SEPTEMBER 30, 2003

Restatement of Revenue: This Form 10-Q/A reflects adjustments to revenue associated with a correction in the method of accounting for subscription revenue associated with Business Model contracts that replaced existing Business Model contracts and other miscellaneous minor adjustments. Previously, the remaining deferred subscription revenue balance associated with the contract that was being replaced was amortized over the term of the original contract. In accordance with SOP 97-2, Software Revenue Recognition, the correct, and revised, method amortizes the remaining deferred subscription revenue balance over the term of the new contract. The adjustments decreased revenue by \$5 million and \$8 million, and income taxes by \$2 million and \$3 million, for the three and six month periods ended September 30, 2003, respectively. These adjustments also increased deferred subscription revenue by approximately \$7 million at September 30, 2003. The impact of these adjustments are as follows:

	For the Three Months Ended September 30, 2003		For the Six Months Ended September 30, 2003	
	Previously Reported ⁽¹⁾	Restated	Previously Reported ⁽¹⁾	Restated
	(in millions, except per share amounts)			
Revenue	\$ 808	\$ 803	\$ 1,597	\$ 1,589
Loss from continuing operations	(87)	(90)	(77)	(82)
Basic loss from continuing operations per share	(0.15)	(0.16)	(0.13)	(0.14)
Diluted loss from continuing operations per share	(0.15)	(0.16)	(0.13)	(0.14)

⁽¹⁾ Excludes operating results of ACCPAC

NOTE B COMPREHENSIVE LOSS

Comprehensive loss includes unrealized gains (losses) on the Company's available-for-sale securities and foreign currency translation adjustments. The components of comprehensive loss, net of related tax, for the three and six month periods ended September 30, 2003 and 2002 are as follows:

	For the Three Months Ended September 30,		For the Six Months Ended September 30,	
	2003	2002	2003	2002
	(restated)		(restated)	
(in millions)				
Net loss	\$ (90)	\$ (52)	\$ (82)	\$ (117)
Unrealized gains (losses) on marketable securities, net of tax	(1)	(3)	1	(3)
Foreign currency translation adjustment	10	4	48	92

	—	—	—	—
Total comprehensive loss	\$ (81)	\$ (51)	\$ (33)	\$ (28)
	—	—	—	—

Table of Contents

COMPUTER ASSOCIATES INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
SEPTEMBER 30, 2003

NOTE C LOSS PER SHARE FROM CONTINUING OPERATIONS

Basic loss per share and diluted loss per share are computed by dividing loss from continuing operations by the weighted-average number of common shares outstanding for the period.

	For the Three Months Ended September 30,		For the Six Months Ended September 30,	
	2003	2002	2003	2002
	(restated)		(restated)	
	(in millions, except per share amounts)			
Loss from continuing operations ⁽¹⁾	\$ (90)	\$ (53)	\$ (82)	\$ (117)
	█	█	█	█
Diluted Loss Per Share from Continuing Operations				
Weighted-average shares outstanding and common share equivalents ⁽²⁾	579	573	579	576
Diluted loss per share from continuing operations	\$ (.16)	\$ (.09)	\$ (.14)	\$ (.20)
	█	█	█	█
Diluted Share Computation				
Weighted-average common shares outstanding	579	573	579	576
Weighted-average Convertible Senior Note shares outstanding				
Weighted-average stock options outstanding, net				
Weighted-average shareholder settlement shares (see Note I)				
	—	—	—	—
Weighted-average shares outstanding and common share equivalents ⁽²⁾	579	573	579	576
	█	█	█	█

(1) If the three and six month periods ended September 30, 2003 and 2002 had resulted in income from continuing operations and had the common share equivalents for the Convertible Senior Notes (27 million shares) issued in March 2002 and the 1.625% Convertible Senior Note (23 million shares) issued in December 2002 (collectively, the Notes) been dilutive, interest expense related to the Notes would have been added back to income from continuing operations to calculate diluted earnings per share from continuing operations. The related interest expense, net of tax, for the three and six month periods ended September 30, 2003 totaled approximately \$6 million and \$13 million, respectively, and for the three and six month periods ended September 30, 2002 totaled approximately \$6 million and \$11 million, respectively.

(2) Common share equivalents (the Notes, stock options and shareholder settlement shares) are not included since their effect would be antidilutive. If the three and six month periods ended September 30, 2003 and 2002 had

resulted in income from continuing operations and had the common share equivalents for the Notes been dilutive, the common share equivalents would have been added to the weighted-average common shares outstanding to calculate diluted earnings per share from continuing operations. The weighted-average shares outstanding and common share equivalents for the three and six month periods ended September 30, 2003 would have been 639 million and 635 million, respectively, and for the three and six month periods ended September 30, 2002 would have been 603 million and 606 million, respectively.

Table of Contents

COMPUTER ASSOCIATES INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
SEPTEMBER 30, 2003

NOTE D ACCOUNTING FOR STOCK BASED COMPENSATION

Prior to April 1, 2003, the Company accounted for its stock-based compensation plans under the recognition and measurement provisions of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB No. 25) and related interpretations.

Effective April 1, 2003, the Company adopted the fair value recognition provisions of SFAS No. 123, Accounting for Stock-Based Compensation, as amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure an amendment of FASB Statement No. 123. The Company selected the prospective method to transition to the fair value method of measuring stock-based compensation expense.

Under the prospective method, the Company recognizes compensation expense related to all stock awards granted after March 31, 2003 in the Consolidated Condensed Statements of Operations. The following table illustrates the pro forma effect on net loss and basic and dilutive loss per share as if the fair value method had been applied to all stock-based employee compensation in each period:

	For the Three Months Ended September 30,		For the Six Months Ended September 30,	
	2003	2002	2003	2002
	(restated)		(restated)	
	(in millions, except per share amounts)			
Net loss, as reported	\$ (90)	\$ (52)	\$ (82)	\$ (117)
Add:				
Stock-based employee compensation expense included in net loss, net of tax	2	1	3	1
Deduct:				
Total stock-based employee compensation expense determined under the fair value based method for all awards, net of tax	(23)	(26)	(46)	(49)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Pro forma net loss	<u>\$ (111)</u>	<u>\$ (77)</u>	<u>\$ (125)</u>	<u>\$ (165)</u>
Basic loss per share				
As reported	\$ (.16)	\$ (.09)	\$ (.14)	\$ (.20)
Pro forma	(.19)	(.13)	(.22)	(.29)
Diluted loss per share				
As reported	\$ (.16)	\$ (.09)	\$ (.14)	\$ (.20)
Pro forma	(.19)	(.13)	(.22)	(.29)

The compensation expense and pro forma net loss are not necessarily indicative of amounts to be included in future periods.

No options were granted in the second quarter of fiscal year 2004. The weighted-average estimated fair value at the date of grant for options granted in the first six months of fiscal year 2004 was \$12.32. Options covering 151,125 shares were granted in the first six months of fiscal year 2004. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model. The following weighted-average assumptions were used in determining the fair value of options granted in the first six months of fiscal year 2004: dividend yield of .35%; expected volatility factor of 67%; risk-free interest rate of 2.2%; and an expected life of 4.5 years, which is lower than the expected life used in prior year computations, due to a reduction in the average vesting period.

Table of Contents

COMPUTER ASSOCIATES INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
SEPTEMBER 30, 2003

The Company maintains a Year 2000 Employee Stock Purchase Plan (the Purchase Plan) for all eligible employees. The estimated fair value of the stock purchase rights under the Purchase Plan for the six month offering period commencing July 1, 2003 was \$7.02. The fair value is estimated on the first date of the offering period using the Black-Scholes option pricing model. The following weighted-average assumptions were used in determining the estimated fair value of stock purchase rights under the Purchase Plan granted for the offering period commencing July 1, 2003: dividend yield of .36%; expected volatility factor of 60%; risk-free interest rate of .96%; and an expected life of .5 years.

NOTE E ACCOUNTS RECEIVABLE

Net trade and installment accounts receivable consist of the following:

	September 30, 2003	March 31, 2003
	(in millions)	
Current:		
Billed accounts receivable	\$ 487	\$ 809
Unbilled amounts due within the next 12 months Business Model	1,350	1,284
Unbilled amounts due within the next 12 months prior business model	983	1,020
Less: Allowance for doubtful accounts	(145)	(159)
Net amounts expected to be collected	2,675	2,954
Less: Unearned revenue current	(1,739)	(1,875)
Net trade and installment accounts receivable current	\$ 936	\$ 1,079
Noncurrent:		
Unbilled amounts due beyond the next 12 months Business Model	\$ 1,277	\$ 1,210
Unbilled amounts due beyond the next 12 months prior business model	1,467	1,807
Less: Allowance for doubtful accounts	(69)	(85)
Net amounts expected to be collected	2,675	2,932
Less: Unearned revenue noncurrent	(1,602)	(1,633)
Net installment accounts receivable noncurrent	\$ 1,073	\$ 1,299

The components of unearned revenue consist of the following:

	September 30, 2003	March 31, 2003
	(in millions)	
Current:		
Unamortized discounts	\$ 147	\$ 185
Unearned maintenance	149	189
Deferred subscription revenue	924	688
Noncurrent deferred subscription revenue (uncollected) associated with unbilled amounts due within the next 12 months	494	780
Unearned professional services	25	33
	<u> </u>	<u> </u>
	\$1,739	\$ 1,875
	<u> </u>	<u> </u>
Noncurrent:		
Unamortized discounts	\$ 190	\$ 250
Unearned maintenance	135	173
Deferred subscription revenue	1,277	1,210
	<u> </u>	<u> </u>
	\$1,602	\$ 1,633
	<u> </u>	<u> </u>

Table of Contents

COMPUTER ASSOCIATES INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
SEPTEMBER 30, 2003

NOTE F IDENTIFIED INTANGIBLE ASSETS

In the table below, capitalized software includes both purchased and internally developed software costs; other identified intangible assets includes both purchased customer relationships and trademarks/trade name costs. Internally developed capitalized software costs and other identified intangible asset costs are included in Other noncurrent assets on the Consolidated Condensed Balance Sheets. The gross carrying amounts and accumulated amortization for identified intangible assets subject to amortization are as follows:

	At September 30, 2003		
	Gross Assets	Accumulated Amortization	Net Assets
	(in millions)		
Capitalized software:			
Purchased	\$4,519	\$ 3,280	\$1,239
Internally developed	412	276	136
Other	370	155	215
 Total	 \$5,301	 \$ 3,711	 \$1,590

	At March 31, 2003		
	Gross Assets	Accumulated Amortization	Net Assets
	(in millions)		
Capitalized software:			
Purchased	\$4,481	\$ 3,065	\$1,416
Internally developed	392	257	135
Other	370	136	234
 Total	 \$5,243	 \$ 3,458	 \$1,785

For the second quarters of fiscal years 2004 and 2003, amortization of capitalized software costs was \$117 million. Amortization of other identified intangible assets was \$9 million in the second quarters of fiscal years 2004 and 2003.

For the first six months of fiscal years 2004 and 2003, amortization of capitalized software costs was \$233 million and \$235 million, respectively, and amortization of other identified intangible assets was \$19 million in each period.

Based on the identified intangible assets recorded through September 30, 2003, annual amortization expense is expected to be as follows:

	Year Ended March 31,					
	2004	2005	2006	2007	2008	2009
	(in millions)					
Capitalized software:						
Purchased	\$422	\$394	\$369	\$256	\$ 7	\$ 1
Internally developed	40	40	32	24	14	5
Other	42	42	39	23	23	23
	—	—	—	—	—	—
Total	\$504	\$476	\$440	\$303	\$44	\$29

Table of Contents

COMPUTER ASSOCIATES INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
SEPTEMBER 30, 2003

NOTE G RECLASSIFICATIONS

Gains and losses attributable to sales of fixed assets, foreign currency exchange rate fluctuations, and certain other infrequent events have been reclassified from Selling, general & administrative to Other gains/expenses on the Consolidated Condensed Statements of Operations. The components of Other gains/expenses are as follows:

	For the Three Months Ended September 30,		For the Six Months Ended September 30,	
	2003	2002	2003	2002
	(in millions)			
(Gain)/loss attributable to sale of fixed assets	\$	\$ 2	\$(18)	\$ 2
Expenses attributable to fluctuations in foreign currency exchange rates		14	14	45
Expenses attributable to legal settlements	20	2	28	2
Payment to Ranger Governance Ltd.	—	10	—	10
	\$ 20	\$ 28	\$ 24	\$ 59

Approximately \$14 million of deferred revenue at March 31, 2003 related to the Company's indirect business (distributors, resellers, and value-added resellers) has been reclassified to Billed accounts receivable from Allowance for doubtful accounts within Note E to the Consolidated Condensed Financial Statements to conform to the September 30, 2003 presentation. As a result of this reclassification, the Company reclassified \$5 million of deferred income taxes at March 31, 2003, from deferred income taxes current, to deferred income taxes noncurrent, on the Consolidated Balance Sheets.

Approximately \$72 million of deferred tax assets at March 31, 2003 has been reclassified from Other noncurrent assets to Deferred income taxes on the Consolidated Condensed Balance Sheets to conform to the September 30, 2003 presentation.

Approximately \$18 million of a noncurrent reserve at March 31, 2003 has been reclassified from Other noncurrent assets to Other current liabilities on the Consolidated Balance Sheets to conform to the September 30, 2003 presentation.

Approximately \$494 million and \$780 million of noncurrent deferred subscription revenue (uncollected) associated with amounts due from customers within the next 12 months at September 30, 2003 and March 31, 2003, respectively,

have been reclassified from unearned revenue noncurrent (a component of net installment accounts receivable noncurrent) to unearned revenue current (a component of net trade and installment accounts receivable current) on the Consolidated Balance Sheet and within Note A. As a result of this reclassification, the Company reclassified \$185 million and \$291 million of a deferred tax liability at September 30, 2003 and March 31, 2003, respectively, from deferred income taxes current to deferred income taxes noncurrent, on the Consolidated Balance Sheets.

Upon adoption of SFAS No. 142, assembled workforce no longer met the definition of an identifiable intangible asset. As a result, the noncurrent deferred tax liability of \$35 million at both September 30, 2003 and March 31, 2003 associated with the assembled workforce asset was eliminated through a reduction in the carrying amount of goodwill.

Approximately \$21 million and \$16 million of certain unclaimed funds at September 30, 2003 and March 31, 2003, respectively, have been reclassified from Allowance for doubtful accounts (a component of net trade and installment accounts receivable current) to Other current liabilities on the Consolidated Balance Sheets. As a result of this reclassification, the Company reclassified \$8 million and \$6 million of deferred income taxes at September 30, 2003 and March 31, 2003, respectively, from deferred income taxes current, to deferred income taxes noncurrent, on the Consolidated Balance Sheets.

Table of Contents

COMPUTER ASSOCIATES INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
SEPTEMBER 30, 2003

Approximately \$9 million and \$8 million of certain international pension liabilities at September 30, 2003 and March 31, 2003, respectively, have been reclassified from Other current liabilities to Other noncurrent liabilities on the Consolidated Balance Sheets.

NOTE H ACQUISITIONS AND DIVESTITURES

In December 2003, the Company entered into a definitive agreement to sell its 90 percent ownership of ACCPAC to The Sage Group, plc. (Sage) based on a \$110 million aggregate cash price for all the outstanding equity interests of ACCPAC including options and change of control payments for certain officers and managers. ACCPAC specializes in accounting, customer relationship management, human resources, warehouse management, manufacturing, electronic data interchange, and point-of-sale software for small and medium-sized businesses. The sale of ACCPAC was completed in the fourth quarter of fiscal year 2004. Pursuant to SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, the assets and liabilities of ACCPAC are recorded at their carrying values and have been classified as a discontinued operation held for sale on the Consolidated Condensed Balance Sheets.

Approximately 600 employees were transferred to Sage as part of the transaction. The sale completes the Company's multi-year effort to exit the business applications market. For the three and six month periods ended September 30, 2003, ACCPAC generated total revenue of \$25 million and \$49 million, respectively and there was no net income for either period. For the three and six month periods ended September 30, 2002, ACCPAC generated total revenue of \$21 million and \$39 million, respectively. ACCPAC had net income of \$1 million for the three months ended September 30, 2002 and had no net income for the six month period ended September 30, 2002.

In October 2002, the Company completed the divestiture of its banking products group, the remaining interBiz product group, to a third party. Proceeds from the divestiture totaled approximately \$8 million, which was received in the quarter ended December 31, 2002. The banking products group generated approximately \$10 million of revenue and \$6 million of direct expenses for the first six months of fiscal year 2003. As part of the transaction, net billed and unbilled accounts receivable and net deferred subscription revenue were reduced by approximately \$12 million and \$18 million, respectively. Approximately 80 employees were transferred to the acquirer as part of this transaction.

The Company acquired PLATINUM *technology* International, *inc.* and Sterling Software, Inc. in May 1999 and March 2000, respectively. The Company also acquired several smaller businesses prior to fiscal year 2000. The Company has not completed any acquisitions since March 2000 that would have generated additional acquisition-related liabilities. Accrued acquisition-related costs and changes in these accruals were as follows:

	Duplicate Facilities & Other Costs	Employee Costs
	<hr/>	<hr/>
	(in millions)	
Balance at March 31, 2002:	\$ 135	\$ 34
Settlements	(43)	(10)
Adjustments	(18)	(1)
	<hr/>	<hr/>

Balance at March 31, 2003:	\$ 74	\$ 23
Settlements	(5)	(6)
	<u> </u>	<u> </u>
Balance at September 30, 2003:	\$ 69	\$ 17
	<u> </u>	<u> </u>

Table of Contents

**COMPUTER ASSOCIATES INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
SEPTEMBER 30, 2003**

The duplicate facilities and other costs relate to operating leases which expire at various times through 2010, negotiated buyouts of operating lease commitments, taxes, and other contractual liabilities. The employee costs consist of involuntary termination benefits. The adjustments, which reduced the corresponding liability and related goodwill asset accounts, were recorded when obligations were settled at amounts less than originally estimated. The remaining liability balances are included in Other current liabilities on the Consolidated Condensed Balance Sheets.

NOTE I SHAREHOLDER LITIGATION SETTLEMENT

In August 2003, the Company announced plans to settle all outstanding litigation related to past accounting issues. Included in the settlement are both shareholder and ERISA (Employee Retirement Income Security Act of 1974, as amended) class-action suits and related derivative litigation. As part of the settlement and upon approval by the United States District Court for the Eastern District of New York, the Company will issue to the shareholder classes a total of up to 5.7 million shares (settlement shares) of the Company's common stock. If the Company's share price is below \$23.43 at the time of distribution of the settlement shares, up to 2.2 million of the 5.7 million shares would be payable in cash at that price or a maximum of \$51.546 million in cash. In that case, the stock portion of the settlement would be reduced to no less than 3.5 million shares. On August 22, 2003, the Company established an initial estimate for the value of the shareholder litigation settlement of approximately \$144 million. The estimated value was based on the Company's NYSE closing share price of \$25.00 on that date and certain administrative costs associated with the settlement. The Company updated the estimated value of the settlement based on the Company's NYSE closing share price of \$26.11 as of September 30, 2003. The estimated value of the settlement as of September 30, 2003 was \$150 million and the related liability was reflected in Other current liabilities on the Consolidated Condensed Balance Sheets. Until the settlement shares are issued, the projected impact will be reviewed quarterly and the expense adjusted accordingly. Refer to Part II, Item 1. Legal Proceedings of the Form 10-Q filed with the Securities and Exchange Commission on October 22, 2003 (the Original Filing) for additional information.

NOTE J RECENT ACCOUNTING PRONOUNCEMENTS

In November 2002, the EITF reached a consensus on Issue No. 00-21, Revenue Arrangements with Multiple Deliverables. Issue 00-21 provides guidance on how to account for arrangements that involve the delivery or performance of multiple products, services and/or rights to use assets. The provisions of Issue 00-21 apply to revenue arrangements entered into in fiscal periods beginning after June 15, 2003 but do not supersede existing authoritative guidance, including SOP 97-2. The adoption of Issue 00-21 did not have an impact on the Company's financial statements.

In January 2003, the FASB issued Interpretation No. 46, Consolidation of Variable Interest Entities. Interpretation No. 46 clarifies the application of Accounting Research Bulletin No. 51 and applies immediately to any variable interest entities created after January 31, 2003 and to variable interest entities in which an interest is obtained after that date. This Interpretation is applicable to the Company in the quarter ending December 31, 2003, for interests acquired in variable interest entities prior to February 1, 2003. This Interpretation requires variable interest entities to be consolidated if the equity investment at risk is not sufficient to permit an entity to finance its activities without support from other parties or the equity investors lack specified characteristics. The adoption of this Interpretation will not have a material impact on the Company's financial statements.

In April 2003, the FASB issued SFAS No. 149, Amendment of SFAS No. 133 on Derivative Instruments and Hedging Activities. SFAS No. 149 amends and clarifies accounting for derivative instruments, including certain derivative

instruments embedded in other contracts, and for hedging activities under SFAS No. 133. In particular, this Statement clarifies under what circumstances a contract with an initial net

Table of Contents

**COMPUTER ASSOCIATES INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
SEPTEMBER 30, 2003**

investment meets the characteristic of a derivative. It also clarifies when a derivative contains a financing component that warrants special reporting in the statement of cash flows. SFAS No. 149 is generally effective for contracts entered into or modified after June 30, 2003 and did not have an impact on the Company's financial statements.

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. SFAS No. 150 establishes standards for how a company classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify certain financial instruments as a liability (or as an asset in some circumstances). SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of SFAS No. 150 did not have an impact on the Company's financial statements.

NOTE K SUBSEQUENT EVENT

On October 8, 2003, the Company announced actions that were taken in response to the preliminary results of an independent inquiry being conducted by the Audit Committee of the Board of Directors.

As previously reported, the Company has been responding to a joint investigation by the United States Attorney's Office for the Eastern District of New York and the Northeast Regional Office of the Securities and Exchange Commission. The investigation concerns accounting practices that were in place prior to the Company's adoption of its Business Model in October 2000.

In response to the investigation, the Board of Directors authorized the Audit Committee to conduct an independent investigation into the timing of revenue recognition by the Company.

Although the Audit Committee investigation is continuing, the Audit Committee has determined that certain revenues were prematurely recognized in the fiscal year ended March 31, 2000. The Audit Committee found that in fiscal year 2000 a number of software license agreements appear to have been signed after the end of the quarter in which revenues associated with such agreements had been recognized. Those revenues should have been recognized in the quarter in which the software license agreements were signed. The Audit Committee has not yet quantified the revenue prematurely recognized. However, through October 21, 2003, the Audit Committee has found no evidence to suggest that the software license agreements and the revenues and cash flows associated with those software license agreements were not genuine.

Following the Audit Committee's report and at its recommendation, the Company asked for and received the resignations of three executives who oversaw the relevant financial operations during the period in question, including the Company's Chief Financial Officer (CFO). The Company is currently conducting an external search for a new CFO. In the interim, Douglas E. Robinson, Senior Vice President, Finance, will serve as CFO.

The Audit Committee's continuing review will include an examination of whether restatement of prior period financial statements is required under GAAP.

Table of Contents

Item 2:

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS**

This Form 10-Q/A contains certain forward-looking statements and information relating to the Company that are based on the beliefs and assumptions made by management as well as information currently available to management. When used in this document, the words anticipate, believe, estimate, expect, and similar expressions, are intended to identify forward-looking statements. Such statements reflect our current views with respect to future events and are subject to certain risks, uncertainties, and assumptions, some of which are described below in the section Risk Factors. Should one or more of these risks or uncertainties occur, or should our assumptions prove incorrect, actual results may vary materially from those described herein as anticipated, believed, estimated, or expected. We do not intend to update these forward-looking statements except as may be required by law.

QUARTERLY UPDATE

In August 2003, we announced plans to settle all outstanding litigation related to past accounting issues. Included in the settlement are both shareholder and ERISA class-action suits and related derivative litigation. As part of the settlement and upon approval by the United States District Court for the Eastern District of New York, we will issue to the shareholder classes a total of up to 5.7 million shares (settlement shares) of our common stock. In anticipation of a final settlement, we recorded a pre-tax expense in the quarter ended September 30, 2003 of approximately \$150 million. The pre-tax expense is based on our NYSE closing share price of \$26.11 on September 30, 2003 and certain administrative costs associated with the settlement. Until the settlement shares are issued, the projected impact will be reviewed quarterly and the expense adjusted accordingly. Refer to Note I Shareholder Litigation Settlement and Part II, Item 1. Legal Proceedings of the Original Filing for additional information.

Also in August 2003, we announced that we reached an agreement with The Canopy Group and Center 7 to settle all litigation between the parties for \$40 million, which was paid in the quarter ended September 30, 2003. The settlement was approved by the United States District Court for the District of Utah, Central Division, on August 12, 2003. In addition to amounts previously expensed in relation to this litigation, we recorded a pre-tax expense in the quarter ended September 30, 2003 of \$20 million, which was included in Other gains/expenses on the Consolidated Condensed Statements of Operations. Refer to Part II, Item 1. Legal Proceedings of the Original Filing for additional information.

In October 2003, we announced actions that were taken in response to the preliminary results of an independent investigation being conducted by the Audit Committee of the Board of Directors. Although the Audit Committee investigation is continuing, the Audit Committee determined that an as-yet unquantified amount of revenue was prematurely recognized in the fiscal year ending March 31, 2000. Based on the Audit Committee's recommendation, we asked for and received the resignations of three executives who oversaw the relevant financial operations during the period in question, including our CFO. We are currently conducting an external search for a new CFO. In the interim, Douglas E. Robinson, Senior Vice President, Finance, will serve as CFO. Refer to Note K Subsequent Event and Part II, Item 1. Legal Proceedings of the Original Filing for additional information.

In October 2003, due primarily to the ongoing independent investigation by the Audit Committee, Moody's Investor Services (Moody's) announced that it lowered our senior unsecured rating to Baa3 from Baa2 and our

short-term rating for commercial paper to Prime-3 from Prime-2. These ratings are under review for possible further downgrade. Also in October 2003, Standard & Poor's Rating Services (Standard & Poor's) announced that it placed our BBB+ senior unsecured rating and our A-2 commercial paper rating on CreditWatch with negative implications. Refer to the Liquidity and Capital Resources section of this Form 10-Q/A for additional information.

Table of Contents

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS**

CA World, our annual conference and exhibition, was held July 13 - 17 in Las Vegas, Nevada. CA World provides educational sessions on and demonstrations of the latest CA technology. During CA World 2003, we announced several new products, including our enterprise security management solution, *eTrust* Security Command Center. *eTrust* Security Command Center enables customers to manage their entire security operations, including security products from other companies, from a single location. We also announced new channel initiatives to expand opportunities for reseller partners. These initiatives include improved demand creation, increased partner profit margins and expanded program support.

In October 2003, the Board of Directors declared its regular semi-annual cash dividend of \$.04 per share. The dividend will be paid on January 7, 2004 to stockholders of record on December 22, 2003.

PERFORMANCE INDICATORS

The following is a summary of some of the quantitative performance indicators (as defined below) that may be used to assess our financial results and condition on a continuing operating basis:

	For the Three Months Ended Sept. 30,			
	2003 (restated)	2002	Change	Percent Change
	(dollars in millions)			
Subscription revenue	\$ 473	\$ 343	\$ 130	38%
Total revenue	\$ 803	\$ 751	\$ 52	7%
Subscription revenue as a percent of total revenue	59%	46%		28%
New deferred subscription revenue	\$ 405	\$ 394	\$ 11	3%
Weighted-average license agreement duration in years	2.70	2.80	(.10)	(4%)
Cash from continuing operations	\$ 184	\$ 206	\$ (22)	(11%)
Loss from continuing operations, net of tax	\$ (90)	\$ (53)	\$ (37)	70%
	For the Six Months Ended Sept. 30,			
	2003 (restated)	2002	Change	Percent Change
	(dollars in millions)			
Subscription revenue	\$ 920	\$ 657	\$ 263	40%
Total revenue	\$ 1,589	\$ 1,498	\$ 91	6%
Subscription revenue as a percent of total revenue	58%	44%		32%
New deferred subscription revenue	\$ 792	\$ 716	\$ 76	11%
Weighted-average license agreement duration in years	2.80	2.80		

Edgar Filing: COMPUTER ASSOCIATES INTERNATIONAL INC - Form 10-Q/A

Cash from continuing operations	\$ 353	\$ 405	\$ (52)	(13%)
Loss from continuing operations, net of tax	\$ (82)	\$ (117)	\$ 35	(30%)

	<u>Sept. 30, 2003</u>	<u>March 31, 2003</u>	<u>Change</u>	<u>Percent Change</u>
	(dollars in millions)			
Total debt	\$2,300	\$3,126	\$(826)	(26%)

Definitions of performance indicators are as follows:

Subscription Revenue Subscription revenue is the ratable revenue recognized in a period from amounts previously recorded as deferred subscription revenue. The larger the ratio of subscription revenue to total revenue, the more predictable our revenue streams become. If weighted-average life remains constant, an increase in deferred subscription revenue will result in an increase in subscription revenue. Therefore, since we expect an increase in deferred subscription revenue for the remainder of fiscal year 2004, we also expect subscription revenue to continue to increase for that period.

Table of Contents

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS**

Total Revenue Total revenue is the sum of all revenue line items. Although subscription revenue continues to increase, certain other revenue line items in our Consolidated Condensed Statements of Operations are decreasing. As we noted in our previous filings, these decreases are generally expected. We expected decreases in Maintenance and Financing fees, as described in further detail below. Software fees and other and Professional services decreased as well. For a more complete description of the reasons for changes in each revenue line item, refer to the Results of Operations section of this Form 10-Q/A.

New Deferred Subscription Revenue New deferred subscription revenue represents the total undiscounted incremental value (license agreement value) of all new software licenses sold in the current period by our direct sales force. New deferred subscription revenue excludes the value associated with maintenance-only agreements as well as professional services arrangements. New deferred subscription revenue is what we expect to collect over time from our customers. This amount is recognized as subscription revenue ratably over the applicable software license term. These license agreements represent committed payments from customers over periods generally up to three years.

The contribution to revenue from the new deferred subscription revenue applicable to any single license agreement is relatively small, since revenue is recognized ratably over the applicable license agreement term. We believe this allows us to balance the importance of recording new deferred subscription revenue from any single transaction with the importance of seeking to enter into transactions on acceptable business terms.

Weighted-Average License Agreement Duration in Years The weighted-average license agreement duration in years represents the sum of the duration of all software licenses executed during a period, weighted by the contract value of each individual software license. We believe that shorter license agreement durations increase the value customers receive from our software licenses because it enables them to vary their software mix as their needs change. We also believe this flexibility improves our customer relationships and encourages us to be more accountable to each of our customers, which in turn may lead to increased future sales opportunities.

Cash From Continuing Operations Cash from operations shown on our Consolidated Condensed Statements of Cash Flows represents the excess of cash collected from billings to our customers over cash paid for expenses to run our business. This amount represents what is available to pay for equipment, technology, and other investing activities, to repay debt, pay dividends, repurchase stock, and for other financing purposes. We believe this is an important performance indicator since cash generation over the long term is essential to maintaining a healthy business and providing funds to help fuel growth. We believe generating consistent cash from operations is an indication that we are achieving a high level of customer satisfaction with our products and are appropriately managing our expenses. Cash from operations decreased \$22 million in the quarter ended September 30, 2003 from the comparable prior fiscal year period primarily due to an increase in cash paid for income taxes (\$21 million) and legal settlements (\$36 million). This was partially offset by a reduction in cash paid for interest (\$8 million) and an overall improvement in accounts receivable.

Loss from Continuing Operations, Net of Tax Under our Business Model, revenue is generally deferred and recognized ratably over the applicable license agreement term. Under the prior business model, license revenue was generally recognized up-front. However, costs continue to be recorded as expenses as incurred. As a result we have generally experienced net losses in each quarter since the transition to our Business Model. Included in the second quarter's loss from continuing operations is a \$100 million after-tax expense related to the announced plans to settle all outstanding shareholder and ERISA class-action suits and related derivative litigation involving past accounting issues. Also included in this quarter's loss from continuing operations is a \$13 million after-tax expense related to our settlement of litigation with The Canopy Group and Center 7. For a more complete description of these settlement

expenses, refer to Note I Shareholder Litigation Settlement and Part II, Item 1. Legal Proceedings of the Original Filing for additional information.

Total Debt Total debt includes the current and long term portions of our debt obligations. We have made a strategic decision to reduce our overall debt level and achieved our current fiscal year objective of an \$826 million reduction during the six month period ended September 30, 2003.

Table of Contents**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS**

Refer to the discussion of our Results of Operations, Outlook, Liquidity and Capital Resources, and Risk Factors herein and the Notes to the Consolidated Condensed Financial Statements in this Form 10-Q/A for further descriptions of the items discussed in this section.

RESULTS OF OPERATIONS

This Form 10-Q/A reflects adjustments to revenue associated with a correction in the method of accounting for subscription revenue associated with Business Model contracts that replaced existing Business Model contracts and other miscellaneous minor adjustments. Previously, the remaining deferred subscription revenue balance associated with the contract that was being replaced was amortized over the term of the original contract. In accordance with SOP 97-2, Software Reserve Recognition, the correct, and revised, method amortizes the remaining deferred subscription revenue balance over the term of the new contract. The adjustments decreased revenue by \$5 million and \$8 million, and income taxes by \$2 million and \$3 million, for the three and six month periods ended September 30, 2003, respectively. These adjustments also increased deferred subscription revenue by approximately \$7 million at September 30, 2003.

The following table presents the percentage of total revenue and the percentage of period-over-period dollar change for the line items in our Consolidated Condensed Statements of Operations for the three and six month periods ended September 30, 2003 and 2002. These comparisons of financial results are not necessarily indicative of future results.

	For the Three Months Ended September 30,			For the Six Months Ended September 30,		
	Percentage of Total Revenue		Percentage of Dollar Change	Percentage of Total Revenue		Percentage of Dollar Change
	2003 (restated)	2002	2003/ 2002	2003 (restated)	2002	2003/ 2002
Revenue						
Subscription revenue	59%	46%	38%	58%	44%	40%
Software fees and other	9%	11%	(12%)	9%	11%	(17%)
Maintenance	19%	25%	(19%)	20%	26%	(19%)
Financing fees	6%	10%	(36%)	6%	11%	(37%)
Professional services	7%	8%	(8%)	7%	8%	(9%)
Total revenue	100%	100%	7%	100%	100%	6%
Expenses						
Amortization of capitalized software costs	15%	16%	0%	15%	16%	(1%)
Cost of professional services	6%	8%	(12%)	7%	8%	(9%)
Selling, general and administrative	39%	44%	(5%)	40%	45%	(5%)
Product development and enhancements	21%	21%	3%	21%	21%	2%
Commissions and royalties	7%	8%	(5%)	7%	8%	(9%)

Edgar Filing: COMPUTER ASSOCIATES INTERNATIONAL INC - Form 10-Q/A

Depreciation and amortization of other intangibles	4%	5%	(3%)	4%	5%	(1%)
Other gains/expenses, net	2%	4%	NM	2%	4%	NM
Shareholder litigation settlement	19%		NM	9%		NM
Total operating expenses	113%	105%	NM	104%	106%	NM
Interest expense, net	4%	5%	(29%)	4%	6%	(30%)

NM Not Meaningful

Note: amounts may not add due to rounding

Table of Contents

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS**

Revenue:

Total Revenue

Total revenue for the quarter ended September 30, 2003 increased \$52 million, or 7%, from the prior year comparable quarter to \$803 million. This increase was primarily due to the transition to our Business Model that began in the third quarter of fiscal year 2001. This transition resulted in an increase in subscription revenue from the prior year comparable period, partially offset by an expected decrease in maintenance and financing fees, as described below. Software fees and other and professional services revenue decreased for the second quarter as described below. In addition, there was a positive impact to revenue of \$31 million compared to the prior fiscal year quarter due to fluctuations in foreign currency exchange rates, primarily associated with the strengthening of both the Euro and the British Pound versus the U.S. dollar. This foreign exchange rate impact was partially offset by the impact of the sale of our banking products group in October 2002, which had contributed \$5 million of revenue in the second quarter of fiscal year 2003. Cautious capital spending by many of our existing and potential customers associated with weak conditions in the overall economy and the IT industry adversely impacted revenue in the second quarter of fiscal year 2004.

Total revenue for the six months ended September 30, 2003 increased \$91 million, or 6%, from the prior year comparable period to \$1.589 billion. Consistent with and for the same reasons as the increase in total revenue for the second quarter of fiscal year 2004 as compared with the second quarter of fiscal year 2003, the increase was primarily due to the transition to our Business Model. For the six months ended September 30, 2003, there was a positive impact to revenue of \$70 million compared to the prior fiscal year period due to fluctuations in foreign currency exchange rates, primarily associated with the strengthening of both the Euro and the British Pound versus the U.S. dollar. This foreign exchange rate impact was partially offset by the impact of the sale of our banking products group in October 2002, which had contributed \$10 million of revenue in the comparable six month period of the prior fiscal year.

Subscription Revenue

Subscription revenue for the quarter ended September 30, 2003 increased \$130 million, or 38%, from the comparable prior year quarter to \$473 million. Subscription revenue represents the ratable portion of revenue recognized during the quarter on software license agreements executed under our Business Model. The increase is primarily due to the transition to our Business Model in the third quarter of fiscal year 2001. The three month period ended September 30, 2003 included subscription revenue earned from licenses that were completed during the past 12 months, which did not contribute to the revenue of the prior fiscal year quarter. For the quarters ended September 30, 2003 and 2002, we added new deferred subscription revenue of \$405 million and \$394 million, respectively. The approximate duration of licenses executed under our Business Model in the quarters ended September 30, 2003 and 2002 had a weighted-average of 2.70 years and 2.80 years, respectively. Annualized deferred subscription revenue represents the total value of all new software license agreements signed during a period divided by the weighted-average duration of all such license agreements recorded during the same period. Annualized deferred subscription revenue increased approximately \$9 million, or 6%, for the quarter ended September 30, 2003 over the comparable prior year quarter to \$150 million.

Subscription revenue for the six months ended September 30, 2003 increased \$263 million, or 40%, from the comparable prior year period to \$920 million. The increase for the six month period is attributable to the same factors as described above for the second quarter increase. Annualized deferred subscription revenue increased approximately

\$27 million, or 11%, for the six month period ended September 30, 2003 over the comparable prior year period to approximately \$283 million.

Table of Contents

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS**

Software Fees and Other

Software fees and other primarily consists of royalties and revenue related to distribution and original equipment manufacturer (OEM) partners. Revenue related to distribution partners and OEMs is sometimes referred to as our indirect or channel business. Such revenue decreased during the second quarter by \$10 million, or 12%, from the comparable prior year quarter to \$75 million. The decrease was primarily due to a difficult economic and competitive environment and associated pricing pressures as well as our focus on the reorganization of our channel business. The quantification of the impact each of these factors had on the decrease in software fees and other revenue is not readily determinable.

Software fees and other for the six months ended September 30, 2003 decreased \$29 million, or 17%, from the comparable prior year period to \$142 million. The decrease for the six month period is attributable to the same factors as described above for the second quarter decrease.

Maintenance

As expected, maintenance revenue for the quarter ended September 30, 2003 decreased \$35 million, or 19%, to \$151 million from the comparable prior year quarter. This decrease in maintenance revenue is attributable to additional license agreements signed under our Business Model, where maintenance revenue, bundled along with license revenue, is reported in Subscription revenue on the Consolidated Condensed Statements of Operations. The combined maintenance and license revenue on these types of license agreements is recognized on a monthly basis ratably over the term of the agreement. The decrease is partially offset by new maintenance revenue earned from customers who elect optional maintenance at the expiration of their non-term-based license agreements and maintenance earned from our indirect business. Maintenance revenue from our indirect business for the quarter ended September 30, 2003 increased \$5 million, or 42%, to \$17 million from the comparable prior year quarter.

Maintenance revenue for the six months ended September 30, 2003 decreased \$72 million, or 19%, from the comparable prior year period to \$310 million. The decrease for the six month period is attributable to the same factors as described above for the second quarter decrease. Maintenance revenue from our indirect business for the six months ended September 30, 2003 increased \$10 million, or 45%, from the comparable prior year period to \$32 million.

Financing Fees

Financing fees result from the discounting to present value of product sales with extended payment terms under our prior business model, which required up-front revenue recognition. This discount initially reduced the related installment accounts receivable, and was referred to as unamortized discounts. The related unamortized discount is amortized over the life of the applicable license agreement and is reported as financing fees. Under our Business Model, unamortized discounts are no longer recorded, since we no longer recognize the present value of license revenue when license agreements are signed. As expected, for the quarter ended September 30, 2003, these fees decreased \$28 million, or 36%, from the comparable prior year quarter to \$49 million.

Financing fees for the six months ended September 30, 2003 decreased \$60 million, or 37%, from the comparable prior year period to \$103 million. The decrease for the six month period is attributable to the same factors as described above for the second quarter decrease.

Professional Services

Professional services revenue for the quarter ended September 30, 2003 decreased \$5 million, or 8%, from the prior year comparable quarter to \$55 million as a result of the weak spending environment that affected the IT service sector in general, which we expect to continue for the remainder of fiscal year 2004. The decrease was also a result of our shift in focus to professional services engagements that are centered around our products. Quantification of the impact that each of these factors had on the decrease in professional services revenue is not readily determinable.

Table of Contents**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS**

Professional services revenue for the six months ended September 30, 2003 decreased \$11 million, or 9%, from the prior year comparable period to \$114 million as a result of the same factors as described above for the second quarter decrease.

Total Revenue by Geography

The following table presents the amount of revenue earned from the North American and international geographic regions and corresponding percentage changes for the three and six month periods ended September 30, 2003 and 2002. These comparisons of financial results are not necessarily indicative of future results.

	Three Months Ended September 30,			Six Months Ended September 30,		
	2003	2002	(dollars in millions) Change	2003	2002	Change
North American	\$463	\$478	(3%)	\$ 924	\$ 951	(3%)
International	340	273	25%	665	547	22%
	<u>\$803</u>	<u>\$751</u>	7%	<u>\$1,589</u>	<u>\$1,498</u>	6%

The increase in international revenue in the three and six month periods ended September 30, 2003 compared with the prior fiscal year comparable periods was attributable to our European business. The increase was also a result of a positive impact to revenue from fluctuations in foreign currency exchange rates of \$31 million and \$70 million for the three and six month periods ended September 30, 2003, respectively. The increase in both periods is primarily associated with the strengthening of both the Euro and the British Pound versus the U.S. dollar.

Price changes did not have a material impact on the three and six month periods ended September 30, 2003 or on the comparable prior fiscal year periods. Barring any significant, unforeseen economic, industry, or Company changes, we believe international revenue will continue to remain at approximately 40% of total revenue for fiscal year 2004.

Expenses:**Amortization of Capitalized Software Costs**

Amortization of capitalized software costs consists of the amortization of both purchased software and internally generated capitalized software development costs. Internally generated capitalized software development costs are related to new products and significant enhancements to existing software products that have reached the technological feasibility stage. Amortization of capitalized software costs for the quarter ended September 30, 2003 was consistent with the comparable prior year quarter.

Amortization of capitalized software costs for the six months ended September 30, 2003 decreased \$2 million, or 1%, from the comparable prior year period to \$233 million. The decrease for the six month period was due to certain purchased software assets becoming fully amortized.

Cost of Professional Services

Cost of professional services consists primarily of the personnel-related costs associated with providing professional services and training to customers. Cost of professional services for the quarter ended September 30, 2003 decreased \$7 million, or 12%, from the comparable prior year quarter to \$52 million. This decrease was due primarily to a reduction in professional service engagements and related personnel costs.

Cost of professional services for the six months ended September 30, 2003 decreased \$11 million, or 9%, from the comparable prior year period to \$107 million. The decrease for the six month period is attributable to the same factors as described above for the second quarter decrease.

Table of Contents

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS**

Selling, General and Administrative (SG&A)

SG&A expenses for the quarter ended September 30, 2003 decreased \$16 million, or 5%, from the comparable prior year quarter to \$317 million. The decrease was primarily attributable to a reduction in bad debt expense of \$27 million as a result of a declining installment accounts receivable balance related to the prior business model. The decrease in bad debt expense was partially offset by an increase in personnel related costs.

SG&A expenses for the six month period ended September 30, 2003 decreased \$35 million, or 5%, compared to the prior fiscal year period to \$638 million. The decrease was primarily attributable to a reduction in bad debt expense of \$58 million, partially offset by a \$15 million expense for severance and other termination benefits in connection with the reorganization of the U.S. channel sales organization and the creation of CA Technology Services in April 2003 and an increase in personnel related costs.

Product Development and Enhancements

For the quarter ended September 30, 2003, product development and enhancement expenditures, also referred to as research and development, increased \$5 million, or 3%, from the comparable prior year quarter to \$165 million. As a percentage of operating expenses (Total expenses before interest and taxes excluding the impact of Other gains/expenses and Shareholder litigation settlement), net research and development expenditures increased to approximately 22% in the quarter ended September 30, 2003 from approximately 21% in the prior fiscal year comparable quarter. This increase resulted from our continued focus on and investment in product development and enhancements for emerging technologies such as wireless, Web services and on-demand computing, as well as a broadening of our enterprise product offerings, while other operating expenses declined.

Product development and enhancement expenditures for the six month period ended September 30, 2003, increased \$7 million, or 2%, from the comparable prior year period to \$327 million. As a percentage of operating expenses, net research and development expenditures increased to approximately 22% in the six month period ended September 30, 2003 from approximately 21% in the prior fiscal year comparable period. This increase is attributable to the same factors as described above for the second quarter increase.

Commissions and Royalties

Commissions and royalties for the second quarter of fiscal year 2004 decreased \$3 million, or 5%, from the comparable prior year quarter to \$55 million. This decrease was primarily due to a reduction in royalties to third parties as we continue to invest internally on product development and enhancements.

Commissions and royalties for the six months ended September 30, 2003 decreased \$10 million, or 9%, from the comparable prior year period to \$107 million. The decrease for the six month period is also primarily attributable to a reduction in royalties to third parties.

Depreciation and Amortization of Other Intangibles

Depreciation and amortization of other intangible assets for the second quarter of fiscal year 2004 decreased \$1 million, or 3%, from the comparable prior year period to \$34 million. The decrease was primarily attributable to certain assets becoming fully depreciated/amortized.

Depreciation and amortization of other intangible assets for the six months ended September 30, 2003 decreased \$1 million, or 1% from the comparable prior year period to \$67 million. The decrease was attributable to the same factors as described above for the second quarter decrease.

Other Gains/Expenses

Other gains/expenses of \$20 million in the quarter ended September 30, 2003 includes the expense related to the settlement of litigation with The Canopy Group and Center 7. Refer to Part II, Item 1. Legal Proceedings of the Original Filing for additional information. There was no impact related to foreign currency exchange rate fluctuations in the quarter ended September 30, 2003. Other gains/expenses of \$28 million in the prior year comparable quarter includes expenses of \$14 million related to foreign currency exchange rate fluctuations, a \$10 million payment to Ranger Governance Ltd. (Ranger) in relation to

Table of Contents

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS**

extending a non-compete agreement and reaching a standstill agreement, a \$2 million expense related to certain legal proceedings, and a \$2 million loss on the sale of certain fixed assets.

Other gains/expenses of \$24 million for the six months ended September 30, 2003 includes the \$20 million expense recorded in the second quarter of fiscal year 2004 and a \$5 million expense recorded in the first quarter of fiscal year 2004 for the settlement of litigation with The Canopy Group and Center 7. The previously accrued expenses related to The Canopy Group and Center 7 represented management's best estimate of the settlement amount at that time. Other gains/expenses for the six months ended September 30, 2003 also includes a \$14 million expense related to foreign currency exchange rate fluctuations, a \$3 million expense related to certain legal proceedings, partially offset by an \$18 million net gain on the sale of certain fixed assets. Other gains/expenses of \$59 million in the prior year comparable period includes a \$45 million expense related to foreign currency exchange rate fluctuations, a \$10 million payment to Ranger, a \$2 million expense related to certain legal proceedings, and a \$2 million loss on the sale of certain fixed assets.

Shareholder Litigation Settlement

In August 2003, we announced plans to settle all outstanding litigation related to past accounting issues. Included in the settlement are both shareholder and ERISA class-action suits and related derivative litigation. As part of the settlement and upon approval by the United States District Court for the Eastern District of New York, we will issue to the shareholder classes a total of up to 5.7 million shares of our common stock. In anticipation of a final settlement, we recorded an expense in the quarter ended September 30, 2003 of approximately \$150 million. The expense is based on our NYSE closing share price of \$26.11 on September 30, 2003 and certain administrative costs associated with the settlement. Until the settlement shares are issued, the projected impact will be reviewed quarterly and the expense adjusted accordingly. Refer to Note I Shareholder Litigation Settlement and Part II, Item 1. Legal Proceedings of the Original Filing for additional information.

Net Interest Expense

Net interest expense for the second quarter of fiscal year 2004 decreased \$12 million, or 29%, as compared to the prior fiscal year second quarter to \$29 million. Of the change, \$13 million was due to the decrease in average debt outstanding and \$1 million was due to the decrease in the weighted-average interest rate, partially offset by a \$2 million gain related to the early retirement of a portion of outstanding debt in the prior fiscal year second quarter.

Net interest expense for the first six months of fiscal year 2004 decreased \$26 million, or 30%, as compared to the prior fiscal year comparable period to \$60 million. Of the change, \$22 million was due to the decrease in average debt outstanding and \$7 million was due to the decrease in the weighted-average interest rate, partially offset by a \$3 million gain related to the early retirement of a portion of outstanding debt in the comparable prior fiscal year period.

Operating Margins:

For the second quarter of fiscal year 2004, our pre-tax loss from continuing operations was \$136 million as compared to a pre-tax loss from continuing operations of \$80 million in the prior year comparable quarter. The increase in pre-tax loss from continuing operations in the quarter ended September 30, 2003 as compared to the prior fiscal year second quarter was primarily related to the shareholder litigation settlement expense of \$150 million, partially offset by increased revenue as noted above. On a year to date basis, our pre-tax loss from continuing operations was

\$124 million as compared to \$178 million in the comparable prior fiscal year period. The reduction in pre-tax loss from continuing operations for the six months ended September 30, 2003 as compared to the comparable prior year period is primarily due to an increase in revenue as noted above, partially offset by the shareholder litigation settlement expense of \$150 million.

Our effective tax benefit rate from continuing operations was 34% for the quarters ended September 30, 2003 and 2002, and for the six month periods ended September 30, 2003 and 2002.

Table of Contents**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS****OUTLOOK** *(as originally reported)*

This outlook for the remainder of fiscal year 2004 contains certain forward looking statements and information relating to us that are based on the beliefs and assumptions made by management, as well as information currently available to management. Should business conditions change or should our assumptions prove incorrect, actual results may vary materially from those described below. We do not intend to update these forward looking statements except as may be required by law.

The outlook for the overall economy and the IT environment continues to be difficult to predict. The outlook for our full fiscal year 2004 results is largely based on the assumption that there will be limited to modest improvement in the current economic and IT environments. We also believe that customers will continue to be cautious with their technology purchases. Our outlook for the third quarter of fiscal year 2004 is to generate revenue in the range of \$825 million to \$845 million and diluted earnings per share in the range of \$.02 to \$.04. Our outlook for the full fiscal year 2004 is to generate revenue in the range of \$3.3 billion to \$3.4 billion and diluted loss per share in the range of \$.09 to \$.04.

LIQUIDITY AND CAPITAL RESOURCES

Cash, cash equivalents and marketable securities totaled \$976 million at September 30, 2003, an increase of \$117 million from the June 30, 2003 balance of \$859 million. Cash generated from continuing operations for the quarters ended September 30, 2003 and 2002 was \$184 million and \$206 million, respectively. In the quarter ended September 30, 2003, we paid approximately \$36 million more in legal settlements than the comparable prior year quarter. In addition, we used existing cash balances at June 30, 2003 and cash from continuing operations to purchase approximately \$2 million in treasury stock and to repay less than \$1 million in outstanding debt during the quarter ended September 30, 2003.

For the six months ended September 30, 2003, cash, cash equivalents and marketable securities had a net decrease of approximately \$520 million from March 31, 2003. Cash generated from continuing operations for the six month periods ended September 30, 2003 and 2002 was \$353 million and \$405 million, respectively. Cash paid for income taxes for the six months ended September 30, 2003 increased \$85 million from the prior year comparable period. Cash paid for interest for the six months ended September 30, 2003 decreased \$28 million from the prior year comparable period. The increase in taxes paid during the six month period ended September 30, 2003 is primarily the result of the timing of estimated tax payments. We used existing cash balances at March 31, 2003 and cash from continuing operations to repay approximately \$826 million in outstanding debt and to purchase approximately \$6 million in treasury stock during the first six months of fiscal year 2004.

As of September 30, 2003 and March 31, 2003, our debt arrangements consisted of the following:

	September 30, 2003	March 31, 2003
	Maximum Outstanding Available Balance	Maximum Outstanding Available Balance
Debt Arrangements:		

	(in millions)		
1999 Revolving Credit Facility	\$	\$400	\$ 350
2002 Revolving Credit Facility	470	440	
Commercial Paper	400	400	
6.770% Senior Notes due April 2003			64
6.250% Senior Notes due April 2003			412
6.375% Senior Notes due April 2005		825	825
5.000% Convertible Senior Notes due March 2007		660	660
6.500% Senior Notes due April 2008		350	350
1.625% Convertible Senior Notes due December 2009		460	460
International line of credit	5	3	
Other		5	5
Total		\$2,300	\$ 3,126

Table of Contents

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS**

1999 Revolving Credit Facility

The four-year revolving credit facility (the 1999 Revolving Credit Facility) expired on May 30, 2003. During the first quarter of fiscal year 2004, we fully repaid the \$350 million balance that was drawn under the 1999 Revolving Credit Facility at March 31, 2003.

2002 Revolving Credit Facility

On December 31, 2002, we entered into an unsecured, bank revolving credit facility (the 2002 Revolving Credit Facility). The maximum amount that may be outstanding at any time under the 2002 Revolving Credit Facility is \$470 million. In the six month period ended September 30, 2003, the 2002 Revolving Credit Facility was increased by \$30 million. The 2002 Revolving Credit Facility expires January 31, 2005, and no amount was drawn as of September 30, 2003. The interest rates on the 2002 Revolving Credit Facility are determined based on a ratings grid, which applies a margin to the prevailing London InterBank Offered Rate (LIBOR). We capitalized the initial transaction fees associated with the 2002 Revolving Credit Facility, which totaled approximately \$6 million. We are amortizing these fees over the term of the 2002 Revolving Credit Facility in Interest expense, net on the Consolidated Condensed Statements of Operations.

Commercial Paper

As of September 30, 2003, there were no borrowings outstanding under our \$400 million commercial paper (CP) program. We expect any future outstanding borrowings under the CP program to be supported by cash and marketable securities on hand and undrawn amounts available under the 2002 Revolving Credit Facility.

Fiscal Year 1997 Senior Notes

In fiscal year 1997, \$320 million of unsecured 6.77% Senior Notes were issued in a private transaction pursuant to an exemption from registration under the Securities Act of 1933. The 6.77% Senior Notes called for annual repayments of \$64 million each April, commencing in April 1999 with final payment in April 2003. The \$64 million balance of the 6.77% Senior Notes was repaid in April 2003.

Fiscal Year 1999 Senior Notes

In fiscal year 1999, we issued \$1.750 billion of unsecured Senior Notes in a transaction pursuant to Rule 144A under the Securities Act of 1933 (Rule 144A). Amounts borrowed, rates, and maturities for each issue were \$575 million at 6.25% due April 15, 2003, \$825 million at 6.375% due April 15, 2005, and \$350 million at 6.5% due April 15, 2008. During the first quarter of fiscal year 2004, we repaid the \$412 million remaining balance of the 6.25% Senior Notes. As of September 30, 2003, \$825 million and \$350 million of our 6.375% and 6.5% Senior Notes, respectively, remained outstanding.

5% Convertible Senior Notes

In fiscal year 2002, we issued \$660 million of unsecured 5% Convertible Senior Notes (5% Notes), due March 15, 2007, in a transaction pursuant to Rule 144A. The 5% Notes are senior unsecured indebtedness and rank equally with all existing senior unsecured indebtedness. Concurrent with the issuance of the 5% Notes, we entered into call spread repurchase option transactions to partially mitigate potential dilution from conversion of the 5% Notes. For further

information, refer to Note 6 to the Consolidated Financial Statements included in our Form 10-K for the fiscal year ended March 31, 2003.

1.625% Convertible Senior Notes

In fiscal year 2003, we issued \$460 million of unsecured 1.625% Convertible Senior Notes (1.625% Notes), due December 15, 2009, in a transaction pursuant to Rule 144A. The 1.625% Notes are senior unsecured indebtedness and rank equally with all existing senior unsecured indebtedness. Concurrent with the issuance of the 1.625% Notes, we entered into call spread repurchase option transactions to partially mitigate potential

Table of Contents

dilution from conversion of the 1.625% Notes. For further information, refer to Note 6 to the Consolidated Financial Statements in our Annual Report on Form 10-K for the fiscal year ended March 31, 2003.

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS**

International Line of Credit

An unsecured and uncommitted multi-currency line of credit is available to meet short-term working capital needs for subsidiaries operating outside the United States. This line totals \$5 million, and less than \$1 million was drawn under this credit line as of September 30, 2003.

Other Matters

In August 2003, we announced plans to settle all outstanding litigation related to past accounting issues. Included in the settlement are both shareholder and ERISA class-action suits and related derivative litigation. As part of the settlement and upon approval by the United States District Court for the Eastern District of New York, we will issue to the shareholder classes a total of up to 5.7 million shares of our common stock. Plaintiffs' attorney fees will be covered by this stock issuance. If our share price is below \$23.43 per share at the time of distribution, up to 2.2 million of the 5.7 million shares would be payable in cash at that price or a maximum of \$51.546 million in cash. In that case, the stock portion of the settlement would be reduced to no less than 3.5 million shares. In anticipation of a final settlement, we recorded a pre-tax expense in the quarter ended September 30, 2003 of approximately \$150 million. The pre-tax expense is based on our NYSE closing share price of \$26.11 on September 30, 2003 and certain administrative costs associated with the settlement.

On October 9, 2003, due primarily to the ongoing independent investigation by the Audit Committee, Moody's announced that it lowered our senior unsecured rating to Baa3 from Baa2 and our short-term rating for commercial paper to Prime-3 from Prime-2. These ratings are under review for possible further downgrade. Also on October 9, 2003, Standard & Poor's announced that it placed our BBB+ senior unsecured rating and our A-2 commercial paper rating on CreditWatch with negative implications. As a result of the downgrade by Moody's, we will pay additional facility fees of approximately \$0.6 million annually under the 2002 Revolving Credit Facility and, should we choose to borrow in the future under the 2002 Revolving Credit Facility, our cost of borrowing would be higher. This, or any other future downgrade, could also affect our ability to obtain additional financing in the future and may affect the terms of any such financing.

Peak borrowings under all debt facilities during the second quarter of fiscal year 2004 totaled approximately \$2.3 billion, with a weighted-average interest rate of 5.16%. Peak borrowings under all debt facilities during the first six months of fiscal year 2004 totaled approximately \$3.126 billion, with a weighted-average interest rate of 5.02%.

As of September 30, 2003, the cumulative number of shares purchased under our various open market common stock repurchase programs since fiscal year 1991 was 179 million, including less than 1 million shares purchased in the second quarter of fiscal year 2004. The remaining number of shares authorized for repurchase is approximately 21 million.

Capital resource requirements as of September 30, 2003 consisted of lease obligations for office space, equipment, mortgage or loan obligations, and amounts due as a result of product and company acquisitions.

It is expected that existing cash, cash equivalents, marketable securities, the availability of borrowings under existing and renewable credit lines, and cash expected to be provided from operations will be sufficient to meet ongoing cash

requirements. We expect our long-standing history of providing extended payment terms to our customers to continue.

Table of Contents

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS**

CRITICAL ACCOUNTING POLICIES AND BUSINESS PRACTICES

Note 1 to the Consolidated Financial Statements included in our Form 10-K for the fiscal year ended March 31, 2003 contains a summary of the significant accounting policies that we use. Many of these accounting policies involve complex situations and require a high degree of judgment, either in the application and interpretation of existing accounting literature or in the development of estimates that impact our financial statements. The following items are the critical accounting policies and business practices that are important to the portrayal of our financial condition and results of operations.

Basis of Revenue Recognition

We generate revenue from the following primary sources: (1) licensing software products, (2) providing customer technical support (also referred to as maintenance), and (3) providing professional services, such as consulting and education.

We recognize revenue pursuant to the requirements of Statement of Position 97-2 Software Revenue Recognition, (SOP 97-2) issued by the American Institute of Certified Public Accountants as amended by SOP 98-9 Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions. While these statements substantially govern the basis for software licensing revenue recognition, we believe that we exercise appropriate judgment in applying criteria set forth in these SOPs.

In accordance with SOP 97-2, we begin to recognize revenue from the licensing of our software products when all of the following criteria are met: (1) we have entered into a legally binding agreement with a customer; (2) we deliver the products; (3) license agreement terms are deemed fixed or determinable and free of contingencies or uncertainties that may alter the agreement such that it may not be complete and final; and (4) collection is probable. After these criteria are met, we recognize revenue ratably over the applicable license term.

Beginning in October 2000, we began entering into software license agreements that include flexible contractual provisions that, among other things, allow customers to receive unspecified future software products for no additional fee. These agreements generally combine the right to use the software product with maintenance for the term of the agreement. Under these agreements, and pursuant to SOP 97-2, we are required to recognize revenue ratably over the term of the license agreement beginning upon completion of the four SOP 97-2 recognition criteria noted above. Prior to October 2000, our license agreements did not include flexible contractual provisions consistent with post October 2000 license agreements. Thus, once all four of the above noted revenue recognition criteria were met, software license fees were recognized as revenue up-front and the maintenance fees were deferred and subsequently recognized as revenue over the term of the license.

Our software licenses generally do not include acceptance provisions. An acceptance provision generally allows a customer to test the software for a defined period of time before the customer commits to licensing the software. If a license agreement includes an acceptance provision, we do not record deferred subscription revenue or recognize revenue until the earlier of the receipt of a written customer acceptance or, if not notified by the customer to cancel the license agreement, the expiration of the acceptance period.

Maintenance revenue is derived from two primary sources: (1) combined license and maintenance agreements recorded under our prior business model and (2) standalone maintenance agreements recorded under both our prior

business model and our Business Model.

Under our prior business model, maintenance and license fees were generally combined into a single license agreement. The maintenance portion, which was generally optional to the customer, was deferred and amortized ratably into revenue over the initial license agreement term. Many of these license agreements have not reached the end of their initial terms and, therefore, continue to generate maintenance revenue through amortization. This amortization is recorded in Maintenance on the Consolidated Condensed

Table of Contents

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS**

Statements of Operations. This maintenance deferral was determined using its fair value based on annual, fixed maintenance renewal rates stated in the agreement. Since we no longer record license agreements under our prior business model, the amount of maintenance deferred as well as the amount of maintenance revenue recognized from such agreements will continue to decrease. For license agreements entered into under our Business Model, maintenance and license fees continue to be combined; however, the maintenance is no longer optional on an annual basis but rather is inclusive and committed for the entire term. We recognize such combined fees in Subscription revenue on the Consolidated Condensed Statements of Operations.

Under both our prior business model and our Business Model, we record maintenance revenue earned from customers who elect optional maintenance for their non-term-based license agreements. Maintenance revenue from such renewals is recognized over the term of the renewal agreement and is recorded in Maintenance on the Consolidated Condensed Statements of Operations.

Revenue recognition from professional service arrangements begins when all four of the SOP 97-2 revenue recognition criteria as discussed above are met and as the services are performed. If it is not probable that a project will be completed or the payment will be received, revenue is deferred until the uncertainty is removed.

Revenue from sales to distributors, resellers, and value-added resellers (indirect business) is generally recognized when all four of the SOP 97-2 revenue recognition criteria noted above are met and when these entities sell the software products to their customers. This is commonly referred to as the sell-through method.

We have an established business practice of offering installment payment options to customers and have a history of successfully collecting substantially all amounts due under such agreements. We assess the probability of collection based on a number of factors, including past transaction history with the customer and the credit-worthiness of the customer. If, in our judgment, collection of a fee is not probable, we will not record deferred subscription revenue or recognize revenue until the uncertainty is removed, which is generally upon receipt of cash.

Our standard licensing agreements include a product warranty provision for all products. Such warranties are accounted for in accordance with SFAS No. 5, Accounting for Contingencies. The likelihood that we would be required to make refunds to customers under such provisions is considered remote.

Under the terms of substantially all of our license agreements, we have agreed to indemnify customers for costs and damages arising from claims against such customers based on, among other things, allegations that our software product infringes the intellectual property rights of a third party. In most cases, in the event of an infringement claim, we retain the right to (i) procure for the customer the right to continue using the software product; (ii) replace or modify the software product to eliminate the infringement while providing substantially equivalent functionality; or (iii) if neither (i) nor (ii) can be reasonably achieved, we may terminate the license agreement and refund to the customer a pro-rata portion of the fees paid. The indemnification usually is limited to the amount paid by the customer. Such indemnification provisions are accounted for in accordance with SFAS No. 5. The likelihood that we would be required to make refunds to customers under such provisions is considered to be remote.

Accounts Receivable

As detailed in the table included in Note E Accounts Receivable of this Form 10-Q/A, net trade and installment accounts receivable, after accounting for unearned revenue and the allowance for doubtful accounts, was \$2.009 billion.

The allowance for doubtful accounts is a valuation account used to reserve for potential impairment of accounts receivable on the balance sheet. It reflects an accounting estimate of unidentified losses in the accounts receivable portfolio resulting from the expectations of not collecting all of these amounts in full.

Table of Contents

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS**

The valuation allowance relates to two components of receivables: (a) specifically identified receivables that are evaluated individually for impairment; and (b) all other receivables.

A specific receivable is reviewed for impairment when, based on current information and events, we do not expect to collect fully amounts due according to the contractual terms of the receivable agreement. Factors considered in assessing collectibility include a customer's extended delinquency, requests for restructuring, and filing for bankruptcy. A specific allowance is provided based on the difference between the carrying value of the receivable and the amounts estimated to be collected.

We review the adequacy of the general allowance for doubtful accounts attributable to the remaining pool of accounts receivable by performing various analytical procedures and considering our history of collections of long-term software agreements, as well as the overall economic environment. A 10% change in the estimated default rate used to calculate the general allowance for doubtful accounts would have an approximate \$7 million effect on the balance of the allowance for doubtful accounts as of September 30, 2003.

We expect the allowance for doubtful accounts to continue to decline as net installment accounts receivable under the prior business model are billed and collected. Under our Business Model, amounts due from customers are offset by deferred subscription revenue (unearned revenue) related to these amounts, resulting in little or no net installment accounts receivable carrying value on the balance sheet. Therefore, less of an allowance for doubtful accounts is required. Our allowance for doubtful accounts as a percentage of accounts receivable, net of unearned revenue, for fiscal year 2003 and for the first six months of fiscal year 2004 has approximated 10.5%.

Deferred Tax Assets

When we prepare our financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. We record this amount as a provision for our taxes in accordance with SFAS No. 109, Accounting for Income Taxes. This process requires us to estimate our actual current tax liability in each jurisdiction, estimate differences resulting from differing treatment of items for financial statement purposes versus tax return purposes (known as temporary differences), which result in deferred tax assets and liabilities, and assess the likelihood that our deferred tax assets will be recovered from future taxable income. If we believe that recovery is not likely, we establish a valuation allowance. We have recognized, as a deferred tax asset, a portion of the tax benefits connected with losses related to operations that are expected to result in a future tax benefit. This recognition assumes we will be able to generate sufficient future taxable income so that the carryforward of these losses will be realized. The factors that we consider in assessing the likelihood of realization include the forecast of future taxable income and available tax planning strategies that could be implemented to realize the deferred tax assets. Deferred tax assets are primarily a result of acquisition expenses, such as duplicate facility costs, employee severance and other costs, foreign net operating losses (NOLs), and the recognition of subscription revenue pursuant to our Business Model. The NOLs generally expire between 2004 and 2014. Future results may vary from these estimates. At this time it is not practicable to determine if we will need to increase the valuation allowance or if such future valuations will have a material impact on our financial statements.

Goodwill, Capitalized Software Products, and Other Intangible Assets

SFAS No. 142 requires an impairment-only approach to accounting for goodwill. As a result of various acquisitions completed under the purchase method, goodwill constitutes a significant portion of our total assets. The SFAS No. 142 goodwill impairment model is a two-step process for impairment testing of goodwill, which is performed

annually, absent indicators of impairment. We have elected to perform our annual analysis during the fourth quarter of our fiscal year. No indicators of impairment were identified during the first six months of fiscal year 2004.

Table of Contents

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS**

The carrying value of capitalized software products, both purchased software and internally developed software, and other intangible assets, are reviewed on a regular basis for the existence of internal and external facts or circumstances that may suggest impairment. Such facts and circumstances considered include an assessment of the net realizable value for capitalized software products and the future recoverability of cost for other intangible assets as of the balance sheet date. It is not possible for us to predict the likelihood of any possible future impairments or, if such an impairment were to occur, the magnitude thereof.

Accounting for Stock-Based Compensation

Prior to April 1, 2003, we accounted for our stock-based compensation plans under the recognition and measurement provisions of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB No. 25) and related interpretations. Effective April 1, 2003, we adopted the fair value recognition provisions of SFAS No. 123, Accounting for Stock-Based Compensation, as amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure an amendment of FASB Statement No. 123. We now recognize compensation expense related to all option awards granted after March 31, 2003 in Selling, General and Administrative on the Consolidated Condensed Statements of Operations.

We have historically used the Black-Scholes option-pricing model to determine the estimated fair value of each option grant. The Black-Scholes model includes assumptions regarding dividend yields, expected volatility, expected lives, and risk-free interest rates. These assumptions reflect our best estimates, but these items involve uncertainties based on market conditions generally outside of our control. As a result, if other assumptions had been used in the current period, stock-based compensation expense could have been materially impacted. Furthermore, if management uses different assumptions in future periods, stock-based compensation expense could be materially impacted in future years.

Legal Contingencies

We are currently involved in various legal proceedings and claims. Periodically, we review the status of each significant matter and assess our potential financial exposure. If the potential loss from any legal proceeding or claim is considered probable and the amount can be reasonably estimated, we accrue a liability for the estimated loss. Significant judgment is required in both the determination of probability and the determination as to whether an exposure is reasonably estimable. Due to the uncertainties related to these matters, accruals are based only on the best information available at the time. As additional information becomes available, we reassess the potential liability related to our pending litigation and claims and may revise our estimates. Such revisions could have a material impact on our results of operations and financial condition. Refer to Part II, Item 1. Legal Proceedings of the Original Filing for a description of our material legal proceedings.

Table of Contents

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS**

RISK FACTORS

Current and potential stockholders should consider carefully the risk factors described below. Any of these factors, or others, many of which are beyond our control, could negatively affect our revenue, profitability, and cash flow in the future.

Operating results and revenue are subject to fluctuations caused by many factors.

Quarterly and annual results of operations are affected by a number of factors, including those listed below, which in turn could adversely affect our revenue, profitability, and cash flow in the future.

Demand for products and services;

Length of sales cycle;

Customer implementation of our products;

Magnitude of price and product competition;

Introduction of new hardware;

General economic conditions in countries in which customers do a substantial amount of business;

Customer budgets for hardware and software;

Ability to develop and introduce new or enhanced versions of our products;

Changes in foreign currency exchange rates;

Ability to control costs;

The size of licensing transactions;

Reorganizations of the sales and technical services forces;

Litigation, government and internal investigations, and settlement of litigation;

Ability to retain and attract qualified personnel; and

Reaction of customers to our Business Model.

Any of the foregoing factors, among others, may cause our operating expenses to be disproportionately high or cause our revenue and operating results to fluctuate. As a consequence, our business, financial condition, operating results, and cash flow could be adversely affected.

The success of our international operations is subject to many factors.

International revenue has historically represented a significant percentage of our total worldwide revenue. Continued success in selling our products outside of the United States will depend on a variety of factors, including:

Reorganizations of the sales and technical services forces;

Fluctuations in foreign exchange currency rates;

Staffing key managerial positions;

General economic conditions in foreign countries;

Political instability; and

Trade restrictions such as tariffs, duties, or other controls affecting foreign operations.

Increases in tariffs, the imposition of trade restrictions, or other factors could adversely affect our business, financial condition, operating results, and cash flow.

Table of Contents

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS**

We could be subject to fines, penalties, or other sanctions as a result of a joint inquiry by the SEC and U.S. Attorney's Office.

As previously reported, we have been cooperating with an ongoing joint inquiry being conducted by the staff of the Northeast Regional Office of the Securities and Exchange Commission and the United States Attorney's Office for the Eastern District of New York concerning certain of our accounting practices. See Part II, Item 1. Legal Proceedings of the Original Filing for additional information. Although we are unable at this point to predict the scope or outcome of this inquiry, it is possible that it could result in the institution of administrative, civil injunctive or criminal proceedings, the imposition of fines and penalties, suspensions or debarments from government contracts, and/or other remedies and sanctions. The conduct of these proceedings could negatively impact our stock price. In addition, we expect to continue to incur expenses associated with responding to these agencies, regardless of the outcome, and the efforts and attention of our management team may be diverted from normal business operations. This could adversely affect our business, financial condition, operating results, and cash flow.

The Audit Committee's internal investigation is continuing.

As discussed herein, in response to the joint inquiry referred to above, the Audit Committee of our Board of Directors is conducting an internal investigation into the timing of revenue recognition by the Company. See Note K

Subsequent Event and Part II, Item 1. Legal Proceedings of the Original Filing for additional information. We cannot predict the timing or possible outcome of this investigation; however, the outcome of the investigation could have an adverse effect on our stock price, could result in the restatement of prior period financial statements and could adversely affect our business, financial condition, operating results, and cash flow.

Certain software is licensed from third parties.

Some of our products contain software licensed from third parties. Some of these licenses may not be available to us in the future on terms that are acceptable or allow our products to remain competitive. The loss of these licenses or the ability to maintain any of them on commercially acceptable terms could delay development of future products or enhancement of existing products. This could adversely affect our business, financial condition, operating results, and cash flow.

Our products must remain compatible with ever-changing operating environments.

IBM, HP, Sun Microsystems, and Microsoft are the largest suppliers of systems and computing software and, in most cases, are the manufacturers of the computer hardware systems used by most of our customers. Historically, these operating system developers have modified or introduced new operating systems, systems software, and computer hardware. Such new products could in the future incorporate features that perform functions currently performed by our products or could require substantial modification of our products to maintain compatibility with these companies hardware or software. Although we have to date been able to adapt our products and our business to changes introduced by hardware manufacturers and system software developers, there can be no assurance that we will be able to do so in the future. Failure to adapt our products in a timely manner to such changes or customer decisions to forego the use of our products in favor of those with comparable functionality contained either in the hardware or operating system could have a material adverse effect on our business, financial condition, operating results, and cash flow.

We have a significant amount of debt.

As of September 30, 2003, we had approximately \$2.3 billion of debt outstanding, consisting of unsecured fixed-rate senior note obligations, convertible senior notes, and unsecured multi-currency credit facilities. We expect that existing cash, cash equivalents, marketable securities, cash provided from operations, and our bank credit facilities will be sufficient to meet ongoing cash requirements. Failure to generate sufficient cash as our debt becomes due or to renew credit lines prior to their expiration may adversely affect our business, financial condition, operating results, and cash flow.

Table of Contents

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS**

The Company's credit ratings have been downgraded and could be downgraded further.

As discussed herein, our Moody's credit rating was recently downgraded. Moody's, Standard & Poor's, or any other credit rating agency may further downgrade or take other negative action with respect to our credit ratings in the future. If our credit ratings are further downgraded or other negative action is taken, we would be required to, among other things, pay additional facility fees and interest under our credit agreements. Any downgrades could affect our ability to obtain additional financing in the future and may affect the terms of any such financing. This could have a material adverse effect on our business, financial condition, operating results, and cash flow.

The computer software business is highly competitive.

The market in which we compete is marked by rapid and substantial technological change, the steady emergence of new companies and products, evolving industry standards, and changing customer needs. We compete with many established companies in the markets we serve, and some of these companies may have substantially greater financial, marketing and technological resources, larger distribution capabilities, earlier access to customers, and greater opportunity to address customers' various information technology requirements than us. We also compete with many smaller, less established companies that may be able to focus more effectively on specific product segments or markets. Historically, we have competed primarily on the basis of our products' features and performance. As product pricing becomes a more important criterion for our customers, we may experience increased competition from certain, low-price competitors. To remain competitive, we must develop new products and continue to enhance existing products. We may be unsuccessful in our ability to develop new releases or new products that meet the needs of our customers in light of competitive alternatives available in the market. In addition, the introduction of new products or versions of existing products may not meet with customer acceptance or may be delayed. Our inability to bring new products and enhancements to existing products to the market in a timely manner or the failure of these products to achieve market acceptance could have a material adverse effect on our business, financial condition, operating results, and cash flow.

Customers are still adapting to our Business Model.

Our Business Model affords customers greater flexibility in licensing transactions. For example, under our Business Model, we offer software licenses on a month-to-month or other short-term basis in order to allow customers the opportunity to try our software products without committing to a multi-year license obligation. Transactions such as these increase the risk that customers will not fully implement our software and will not enter into a long-term relationship with us. This effect could be diminished if customers elect cost certainty by committing to longer license agreement periods. Additionally, customer preference for payment (upfront, annual or monthly installments) could impact the amount of cash generated from operations in any period. This could adversely affect our business, financial condition, operating results, and cash flow.

Failure to protect our intellectual property rights would weaken our competitive position.

Our future success is dependent upon our proprietary technology. We protect our proprietary information through the use of patent, copyright, trademark, trade secret laws, confidentiality procedures, and contractual provisions. Notwithstanding our efforts to protect our proprietary rights, policing unauthorized use or copying of our proprietary information is difficult. Unauthorized use or copying occurs from time to time and litigation to enforce intellectual property rights could result in significant costs and diversion of resources. Moreover, the laws of some foreign jurisdictions do not afford the same degree of protection to our proprietary rights as do the laws of the United States.

For example, shrink-wrap or click-on licenses may be unenforceable in whole or in part in some jurisdictions in which we operate. In addition, patents we have obtained may be circumvented, challenged, invalidated, or designed around by other companies. Our inability to adequately protect our intellectual property for these or other reasons could adversely affect our business, financial condition, operating results, and cash flow.

Table of Contents

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS**

Changes to compensation of our sales organization.

We update our compensation plan for the sales organization annually. These plans are intended to align with our Business Model objectives of providing customer flexibility and satisfaction. The compensation plan may encourage behavior not anticipated or intended as it is implemented, which could adversely affect our business, financial condition, operating results, and cash flow.

We may become dependent upon large transactions.

We have historically been dependent upon large-dollar enterprise transactions with individual customers. As a result of the flexibility afforded by our Business Model, we anticipate that there will be fewer of these transactions in the future. There can be no assurances, however, that we will not be reliant on large-dollar enterprise transactions in the future, and the failure to close such transactions could adversely affect our business, financial condition, operating results, and cash flow.

Customer decisions are influenced by general economic conditions.

Our products are designed to improve the productivity and efficiency of our customers' information processing resources. In a recessionary environment, our products are often a reasonable economic alternative for customers faced with the prospect of incurring expenditures to increase their existing information processing resources. However, a general slowdown in the world economy or a particular region could cause customers to delay or forgo decisions to license new products or upgrades to their existing environments and this could adversely affect our business, financial condition, operating results, and cash flow.

Third-party microcode could impact product development.

We anticipate ongoing use of microcode or firmware provided by hardware manufacturers. Microcode and firmware are essentially software programs in hardware form and are therefore less flexible than other types of software. We believe that such continued use will not have a significant impact on our operations and that our products will remain compatible with any changes to such code. However, there can be no assurance that future technological developments involving such microcode will not have an adverse impact on our business, financial condition, operating results, and cash flow.

The software business is marked by easy entry and large, entrenched businesses.

Many companies with whom we compete, including IBM, Sun Microsystems, HP, and other large computer manufacturers, have substantial resources, a larger installed base of customers in any particular market niche, as well as the ability to develop and market software programs similar to and competitive with the products offered by us. Additionally, these producers can bundle hardware, software, and services together, which is a disadvantage for us since we do not provide hardware and have far fewer services offerings. Competitive products are also offered by numerous independent software companies that specialize in specific aspects of the highly fragmented software industry. Some, like Microsoft, Oracle, and SAP, are the leading developers and vendors in their specialized markets. In addition, new companies enter the market on a frequent and regular basis, offering products that compete with those offered by us. Increased competition also results from consolidation of existing companies within the industry. Additionally, many customers historically have developed their own products that compete with those offered by us. Competition from any of these sources can result in price reductions, or displacement of our products, which could

have a material adverse effect on our business, financial condition, operating results, and cash flow.

Table of Contents

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS**

Future product development is dependent upon access to third-party operating systems.

In the past, licensees using proprietary operating systems were furnished with source code, which makes the operating system generally understandable to programmers, and object code, which directly controls the hardware and other technical documentation. Since the availability of source code facilitated the development of systems and applications software, which must interface with the operating systems, independent software vendors such as us were able to develop and market compatible software. Microsoft, IBM, and other vendors have a policy of restricting the use or availability of the source code for some of their operating systems. To date, this policy has not had a material effect on us. Some companies, however, may adopt more restrictive policies in the future or impose unfavorable terms and conditions for such access. These restrictions may, in the future, result in higher research and development costs for us in connection with the enhancement and modification of our existing products and the development of new products. Although we do not expect that such restrictions will have this adverse effect, there can be no assurances that such restrictions or other restrictions will not have a material adverse effect on our business, financial condition, operating results, and cash flow.

The markets for some or all of our key product areas may not grow.

We have identified six product areas: enterprise management; security; storage; portal and business intelligence; application life cycle management; and data management and application development. Some or all of these areas may not grow, may decline in growth, or customers may decline or forgo use of products in some or all of these product areas. This is particularly true in newly emerging areas, such as portal and business intelligence. A decline in these product areas could result in decreased demand for our products, which would adversely impact our business, financial condition, operating results, and cash flow.

Third parties could claim that our products infringe their intellectual property rights.

From time to time we receive notices from third parties claiming infringement of various forms of their intellectual property. Investigation of these claims, whether with or without merit, can be expensive and could affect development, marketing, or shipment of our products. As the number of software patents issued increases, it is likely that additional claims, with or without merit, will be asserted. Defending against such claims is time consuming and could result in significant litigation expense or settlement with unfavorable terms that could adversely affect our business, financial condition, operating results, and cash flow.

Fluctuations in foreign currencies could result in transaction losses.

Most of the revenue and expenses of our foreign subsidiaries are denominated in local currencies. Due to the substantial volatility of currency exchange rates, it is not possible to predict the effect of exchange rate fluctuations on our future operating results. Given the relatively long sales cycle that is typical for many of our products, foreign currency fluctuations could result in substantial changes in the foreign currency impact on these transactions. Additionally, fluctuations of the exchange rate of foreign currencies against the U.S. dollar can affect our revenue within those markets, all of which may adversely impact our business, financial condition, operating results, and cash flow.

Acts of terrorism or war may adversely affect our business.

Acts of terrorism, acts of war, and other unforeseen events may cause damage or disruption to our properties, business, employees, suppliers, distributors, resellers, and customers, which could have an adverse effect on our business, financial condition, operating results, and cash flow. Such events may also result in an economic slowdown in the United States or elsewhere, which could adversely affect our business, financial condition, operating results, and cash flow.

Table of Contents

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS**

Our stock price may continue to be volatile.

Our stock price is subject to significant fluctuations in response to variations in quarterly operating results, the gain or loss of significant license agreements, changes in earnings estimates by analysts, announcements of technological innovations or new products by us or our competitors, changes in domestic and international economic and business conditions, general conditions in the software and computer industries, and other events or factors. In addition, the stock market in general has experienced extreme price and volume fluctuations that have affected the market price of many companies in industries that are similar or related to those in which we operate and that have been unrelated to the operating performance of these companies. These market fluctuations have in the past adversely affected and may continue to adversely affect the market price of our common stock.

Potential European Union tariffs or United States Congressional action in connection with the extraterritorial income regime could adversely affect our business.

The World Trade Organization (WTO) recently authorized sanctions against the United States for operating the extraterritorial income regime. This regime relates to a provision in the United States Tax Code providing tax incentives on products manufactured in the United States and exported for sale. The WTO has ruled the regime to be an illegal export subsidy and has now authorized the European Union (EU) to impose tariffs on certain United States-made products imported into the EU. EU officials have indicated that they will not raise tariffs provided that the United States shows substantial progress and a commitment to act within the next year. We cannot be certain, however, what impact the potential EU tariffs could have on the software industry or the economy in general. Additionally, we cannot be certain that any legislation replacing the extraterritorial income regime will continue to provide us with the level of tax incentives received under the existing regime. We currently save approximately \$12 million per year in United States federal income tax under the current extraterritorial income regime.

PART II. OTHER INFORMATION

Item 6:

EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits:

15.1 Accountants' acknowledgement

31.1 Certification of the CEO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2 Certification of the CFO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.1 Certification of the CEO pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.2 Certification of the CFO pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(b) Reports on Form 8-K:

The Registrant furnished a Report on Form 8-K dated July 23, 2003 to report an event under Items 7 and 9.

The Registrant filed a Report on Form 8-K dated August 13, 2003 to report an event under Items 5 and 7.

The Registrant filed a Report on Form 8-K dated August 26, 2003 to report an event under Items 5 and 7.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

COMPUTER ASSOCIATES INTERNATIONAL, INC.

Dated: June 14, 2004

By: /s/ Kenneth D. Cron
Kenneth D. Cron
Interim Chief Executive Officer

Dated: June 14, 2004

By: /s/ Jeff Clarke
Jeff Clarke
Chief Operating Officer and
Chief Financial Officer

Dated: June 14, 2004

By: /s/ Douglas E. Robinson
Douglas E. Robinson
Senior Vice President and Controller
Principal Accounting Officer

38