

## Management's Discussion and Analysis of Financial Condition and Results of Operations

On an on-going basis, the Company evaluates its estimates. The most significant estimates relate to the allowance for doubtful accounts, reserve for warranties, reserves for employee benefits, income taxes, depreciation of fixed assets and long-lived assets, contingencies and litigation and the recognition of revenue and profits based on the percentage of completion method of accounting for certain fixed-bid contracts. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. The actual amounts will differ from the estimates used in the preparation of the accompanying financial statements.

Most of the Company's IT development centers, including a substantial majority of its employees are located in India. As a result, the Company may be subject to certain risks associated with international operations, including risks associated with foreign currency exchange rate fluctuations and risks associated with the application and imposition of protective legislation and regulations relating to import and export or otherwise resulting from foreign policy or the variability of foreign economic conditions. To date, the Company has not engaged in any hedging transactions to mitigate its risks relating to exchange rate fluctuations. Additional risks associated with international operations include difficulties in enforcing intellectual property rights, the burdens of complying with a wide variety of foreign laws, potentially adverse tax consequences, tariffs, quotas and other barriers.

The Company believes the following critical accounting policies affect its more significant judgments and estimates used in the preparation of its consolidated financial statements:

**Revenue Recognition.** The Company's services are entered into on either a time-and-materials or fixed-price basis. Revenues related to time-and-material contracts are recognized as the service is performed. Revenues related to fixed-price contracts that provide for application development services or that provide for a combination of application development and application management services are recognized as the service is performed using the percentage-of-completion method of accounting, under which the sales value of performance is recognized on the basis of the percentage that each contract's cost to date bears to the total estimated cost. Revenues related to fixed-priced contracts that provide solely for application management services are recognized on a straight-line basis or as services are rendered or transactions processed in accordance with contract terms. Expenses are recorded as incurred over the contract period.

In November 2002, the Emerging Issues Task Force (EITF) reached a consensus in EITF 00-21 "Revenue Arrangements with Multiple Deliverables". The consensus, which is effective for contracts entered into in fiscal periods beginning after June 15, 2003, requires that a Company evaluate all deliverables in an arrangement to determine whether they represent separate units of accounting. That evaluation must be performed at the inception of the arrangement and as each item in the arrangement is delivered. Arrangement consideration should be then allocated among the separate

units of accounting based on their relative fair values. EITF 00-21 indicates that the best evidence of fair value is the price of a deliverable when it is regularly sold on a stand-alone basis. Fair value evidence often consists of entity-specific or vendor-specific objective evidence of fair value.

The Company enters into contracts that could be considered arrangements with multiple deliverables. These contracts are primarily long-term fixed-bid contracts that provide both application maintenance and application development services. As indicated above and in Note 2 to the Consolidated Financial Statements, the Company accounts for such contracts using percentage of completion accounting. The Company is currently evaluating the prospective impact of EITF 00-21 on the Company's results of operations related to contracts entered into after June 15, 2003.

Fixed-price contracts are cancelable subject to a specified notice period. All services provided by the Company through the date of cancellation are due and payable under the contract terms. The Company issues invoices related to fixed price contracts based upon achievement of milestones during a project or other contractual terms. Differences between the timing of billings, based upon contract milestones or other contractual terms, and the recognition of revenue, based upon the percentage-of-completion method of accounting, are recognized as either unbilled or deferred revenue. Estimates are subject to adjustment as a project progresses to reflect changes in expected completion costs. The cumulative impact of any revision in estimates is reflected in the financial reporting period in which the change in estimate becomes known and any anticipated losses on contracts are recognized immediately. A reserve for warranty provisions under such contracts, which generally exist for ninety days past contract completion, is estimated and accrued during the contract period.

Revenues related to services performed without a signed agreement or work order are not recognized until there is evidence of an arrangement, such as when agreements or work orders are signed or payment is received; however the cost related to the performance of such work is recognized in the period the services are rendered. Such revenue is recognized when, and if, evidence of an arrangement is obtained,

**Foreign Currency Translation.** The assets and liabilities of the Company's Canadian and European subsidiaries are translated into U.S. dollars from local currencies at current exchange rates and revenues and expenses are translated from local currencies at average monthly exchange rates. The resulting translation adjustments are recorded in a separate component of stockholders' equity. For the Company's Indian subsidiary ("CTS India"), the functional currency is the U.S. dollar, since its sales are made primarily in the United States, the sales price is predominantly in U.S. dollars and there is a high volume of intercompany transactions denominated in U.S. dollars between CTS India and its U.S. affiliates. Non-monetary assets and liabilities are translated at historical exchange rates, while monetary assets and liabilities are translated at current exchange rates. The resulting gain (loss) is included in other income.

**Allowance for Doubtful Accounts.** The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its