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

Form 10-K/A

(Mark One)

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

For the fiscal year ended December 31, 2001

or

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

Commission file number 0-20805

AROS CORPORATION

(Exact name of registrant as specified in its charter)

Delaware

*(State or other jurisdiction of
incorporation or organization)*

23-2476415

*(IRS Employer
Identification No.)*

**1160 Hayman Drive,
Crownsville, Maryland**

(Address of principal executive offices)

21032

(Zip Code)

Registrant's telephone number, including area code:

(410) 923-6106

Securities registered pursuant to Section 12(b) of the Act:

None

Securities registered pursuant to Section 12(g) of the Act:

Title of Class

Common Stock \$.01 par value per share

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

The aggregate market value of the voting common equity held by non-affiliates of the registrant as of March 29, 2002 was approximately \$814,197. The number of outstanding shares of the registrant's Common Stock as of that date was 8,966,966.

PART I

Item 1. Business

OVERVIEW

Aros Corporation (“Aros”, the “Company” or “we”), a Delaware corporation, was incorporated as APACHE Medical Systems, Inc. on September 1, 1987. We were a provider of clinically based decision support information systems and consulting services to the healthcare industry offering a comprehensive line of outcomes-based products and services, encompassing software, hardware, and related consulting and disease management services through two operating divisions: the APACHE Clinical Outcomes Division and the MetaContent Content and Coding Division.

The Clinical Outcomes Division provided clinically based decision support information systems, research and consulting services to the healthcare industry. On July 3, 2001, we sold our APACHE Clinical Outcomes Division (“Clinical Outcomes Division”), which accounted for substantially all of our assets, for cash to Cerner Corporation and changed our name from APACHE Medical Systems, Inc. to Aros Corporation. The Clinical Outcomes Division has been accounted for as discontinued operations for all periods presented.

The MetaContent Content and Coding Division provided consulting services in the clinical content and medical coding areas. We acquired MetaContent, Inc. (“MetaContent”), a company that develops and markets data management solutions for healthcare providers, on March 19, 2001 as part of a strategy to enter the medical coding business. On November 23, 2001, a founder and the sole employee of MetaContent, Inc. resigned. As a result, the Company has elected to discontinue all operations under the MetaContent Content and Coding Division, and has therefore written off the remaining net goodwill associated with the acquisition of MetaContent, Inc. and accounted for the results as discontinued operations.

Since the sale of assets to Cerner Corporation was completed on July 3, 2001, the Company continues to evaluate how best to utilize its remaining assets. The alternatives under consideration include moving the Company from its historical focus on clinical information systems to areas such as biotechnology, bio-informatics, medical coding or other healthcare related activities. In addition, the Company will evaluate any opportunity for a business combination that will maximize the stockholders’ investment, which may include combinations with companies outside of the Company’s traditional market. The Company has not precluded, if no suitable alternatives are found, the possibility of dissolution of the Company and distribution of net assets to its shareholders.

See Management’s Discussion and Analysis of Financial Conditions and Results of Operations for further discussion.

Employees

On July 3, 2001, all remaining full-time employees of the Clinical Outcomes Division were terminated and rehired by Cerner Corporation. As of December 31, 2001, there were no remaining employees with the Company.

Item 2. Properties

None.

Item 3. Legal Proceedings

The Company is a defendant from time to time in lawsuits incidental to its business. The Company is not currently subject to, and none of its properties are subject to, any material legal proceedings.

Item 4. Submission of Matters to a Vote of Security Holders

There were no matters that required a vote of security holders during the three months ended December 31, 2001.

PART II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters

Until February 12, 2001, the Company's common stock was traded on the Nasdaq SmallCap Market under the symbol AMSI. On February 13, 2001, the Company's common stock began trading on the OTC Bulletin Board under the symbol AMSI. On July 3, 2001, the ticker was changed to AROS. The following table sets forth, for the periods indicated, the range of high and low sale prices for the common stock as reported by the Nasdaq SmallCap Market and the OTC Bulletin Board.

	<u>High</u>	<u>Low</u>
Year Ended December 31, 2001		
First Quarter	\$0.53	\$0.14
Second Quarter	0.35	0.14
Third Quarter	0.34	0.06
Fourth Quarter	0.15	0.06
Year Ended December 31, 2000		
First Quarter	\$7.00	\$1.44
Second Quarter	3.50	0.88
Third Quarter	1.66	0.75
Fourth Quarter	1.00	0.09

As of March 7, 2002, the Company had 76 holders of record of its common stock.

The Company has never paid or declared any cash dividends and does not anticipate paying cash dividends on its common stock in the foreseeable future. The amount and timing of any future dividends will depend on the future business direction of the Company, general business conditions encountered by the Company, as well as the financial condition, earnings and capital requirements of the Company and such other factors as the Company's Board of Directors may deem relevant.

Item 6. Selected Financial Data

All periods have been reclassified to account for the operations of the Clinical Outcomes Division and the MetaContent Content and Coding Division as discontinued operations.

SELECTED CONSOLIDATED FINANCIAL DATA

	Year Ended December 31,				
	<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>	<u>1997</u>
	(In thousands, except per share data)				
Statement of Operations Data:					
Revenue:	\$ —	\$ —	\$ —	\$ —	\$ —
Expenses:					
General and administrative	2,688	5,912	6,304	7,367	12,870
Restructuring	24	276	—	—	—
Total expenses	<u>2,712</u>	<u>6,188</u>	<u>6,304</u>	<u>7,367</u>	<u>12,870</u>
Other income (expense):					
Interest income	107	216	321	477	859
Total other income (expense)	107	216	321	477	859
Loss from continuing operations	(2,605)	(5,972)	(5,983)	(6,890)	(12,011)
Discontinued operations					
Income from discontinued operations	1,286	1,179	7,334	3,697	(3,907)
Gain from sale of discontinued operations . . .	3,664	—	—	—	—
Loss on abandonment	(433)	—	—	—	—
	<u>4,517</u>	<u>1,179</u>	<u>7,334</u>	<u>3,697</u>	<u>(3,907)</u>
Net income (loss)	<u>\$ 1,912</u>	<u>\$ (4,793)</u>	<u>\$ 1,351</u>	<u>\$ (3,193)</u>	<u>\$ (15,918)</u>
Basic and diluted net income (loss) per share					
Continuing operations	\$ (0.30)	\$ (0.80)	\$ (0.82)	\$ (0.95)	\$ (1.66)
Discontinued operations	<u>\$ 0.53</u>	<u>\$ 0.16</u>	<u>\$ 1.00</u>	<u>\$ 0.51</u>	<u>\$ (0.54)</u>
Earnings per share	\$ 0.23	\$ (0.64)	\$ 0.18	\$ (0.44)	\$ (2.20)
Weighted average number of shares used for calculation of basic net income(loss) per share	<u>8,445</u>	<u>7,440</u>	<u>7,356</u>	<u>7,301</u>	<u>7,251</u>
Weighted average number of shares used for calculation of diluted net income(loss) per share	<u>8,445</u>	<u>7,440</u>	<u>7,356</u>	<u>7,301</u>	<u>7,251</u>

	December 31,				
	<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>	<u>1997</u>
	(In thousands)				
Balance Sheet Data:					
Cash and short-term investments	\$ 3,264	\$ 2,062	\$ 6,242	\$ 6,532	\$ 11,317
Working capital	3,031	550	5,118	3,802	6,983
Total assets	3,328	5,442	11,466	12,142	14,936
Total stockholders' equity	\$ 3,031	\$ 485	\$ 5,113	\$ 3,740	\$ 6,866

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

OVERVIEW

The Company believes that its Clinical Outcomes Division experienced material negative impact as a result of two key environmental factors, including: reductions in expenditures by hospitals stemming from the Balanced Budget Act's tightening of Medicare reimbursement; and a significant change in the buying patterns of large healthcare systems, with these buyers now preferring to do business with large companies offering integrated information system solutions, thus making substantial business expansion more difficult for small best-of-breed vendors like the Company's Clinical Outcomes Division. Additionally, the Company believes that, while a market for its Clinical Outcomes Division products and services exists, that market, and the business model required to address it are better and more profitably served by an organization engaged in a broader approach to the same market. Such an organization would allow for a sharing of corporate infrastructure, sales and marketing costs, development and support costs, and market knowledge across a wider array of products and services. As a consequence of this analysis, in September of 2000, the Company announced that it had engaged Allen & Company Incorporated to explore its strategic options, including sale of the Company. The Company also announced that it had initiated a restructuring plan designed to manage cost and conserve cash, which plan resulted in a net reduction in total employees from 69 at the end of 1999 to 24 by July 3, 2001.

During February 2001, the Company announced that it had entered into a nonbinding letter of intent for Cerner Corporation to acquire certain assets of the Company. The Company signed an agreement for the sale of assets to Cerner Corporation on April 7, 2001, subject to shareholder vote, which was obtained by the Company on June 11, 2001. On July 3, 2001, the Company concluded the sale of its Clinical Outcomes Division, which accounted for substantially all of the Company's assets, to Cerner Corporation. In connection with the sale, the Company received approximately \$3.7 million in cash and changed its name from APACHE Medical Systems, Inc. to Aros Corporation. In June of 2001, the Company began accounting for the Clinical Outcomes Division as a discontinued operation. Prior financial statements have been restated to reflect the discontinued operations for all periods presented.

On March 21, 2001, the Company acquired MetaContent, Inc., a Delaware corporation engaged in the business of providing consulting services in the clinical content and medical coding areas to the healthcare industry, whereby MetaContent, Inc. became a wholly owned subsidiary. The Company exchanged one million shares of its common stock and warrants to purchase one million shares of the Company's common stock at \$0.50 per share for all of the outstanding shares of MetaContent for a purchase price of \$611,000. The Company's Chairman and its financial advisor were two of the several owners of MetaContent and received 32.5% and 28% respectively, of the purchase price. MetaContent became the foundation for the Company's MetaContent and Coding Division, as part of a strategy to enter the medical coding business. On November 23, 2001, a founder and the sole employee of MetaContent, Inc. resigned employment with the Company. As a result, the Company has discontinued all operations under the MetaContent and Coding Division. The MetaContent and Coding Division has been accounted for as a discontinued operation in the 2001 financial statements.

Since the sale of assets to Cerner Corporation was completed on July 3, 2001, the Company continues to evaluate how best to utilize its remaining assets. The alternatives under consideration include moving the Company from its historical focus on clinical information systems to other areas involved with healthcare technology, administration and clinical applications. In addition, the Company will evaluate any opportunity for a business combination that will maximize the stockholders' investment, which may include combinations with companies outside of the Company's traditional market. The Company has not precluded, if no suitable alternatives are found, the possibility of dissolution of the Company and distribution of net assets to its shareholders. The Company has been advised that in order to avoid being deemed an "investment company" it must either engage in an operating business, either through the purchase or development of, or investment in an operating business, or it must dissolve and distribute its net assets to its shareholders within one year from the date of sale of substantially all of its assets to Cerner Corporation on July 3, 2001.

RESULTS OF OPERATIONS

2001 Compared to 2000

GENERAL AND ADMINISTRATIVE. General and administrative expenses decreased 55% to \$2.7 million from \$5.9 million in the prior year period. This decrease was due to a reduction in overall salaries and related personnel costs, as well as an overall reduction in general and administrative expenses due to the sale of the Clinical Outcomes Division to Cerner Corporation on July 3, 2001.

RESTRUCTURING. Restructuring charges decreased from \$1.4 million in 2000 to \$24,000 in 2001. As a result of the sale of assets to Cerner Corporation on July 3, 2001, the Company restated its financial results attributable to the Clinical Outcomes Division as discontinued operations. This restatement resulted in \$1.1 million of the restructuring charge recorded in 2000 being reclassified to discontinued operations. During the second quarter of 2001, we recognized additional restructuring charges of \$162,000 related to the termination of a Company officer. We recognized reductions in restructuring charges of \$138,000 as a result of sub-leasing part of our corporate office. The net result was an additional \$24,000 in restructuring charges. The following table summarizes the activity in 2001 related to the restructuring accrual:

	<u>Balance January 1, 2001</u>	<u>Additional Charges</u>	<u>Payments</u>	<u>Balance December 31, 2001</u>
		(In thousands)		
Severance costs	\$300	\$ 162	\$(462)	\$—
Excess rent	<u>295</u>	<u>(138)</u>	<u>(157)</u>	<u>—</u>
Total	<u>\$595(a)</u>	<u>\$ 24</u>	<u>\$(619)</u>	<u>\$—</u>

(a) \$274,000 of the \$595,000 restructuring accrual was reclassified to liabilities from discontinued operations in 2001.

OTHER INCOME (EXPENSE). Other income for 2001 decreased 50% to \$107,000 from \$216,000 in the prior year period. This decrease was attributed to a decrease in interest income related to changing the investment strategy from higher yielding short-term investments to lower yielding cash equivalents as well as the overall decrease in interest rates in 2001 as compared to 2000.

INCOME FROM DISCONTINUED OPERATIONS. Income from discontinued operations increased 9% to \$1.3 million in 2001 from \$1.2 million in the prior year period. This increase was due to several factors, including (1) a decrease in revenues generated by the Clinical Outcomes Division of \$4.3 million from \$6.7 million in 2000 to \$2.4 million in 2001. This was due to the Clinical Outcomes Division being discontinued in the first half of 2001 and the majority of the division's assets being sold in 2001. (2) Costs of sales related to the Clinical Outcomes Division decreased \$1.8 million from \$2.8 million in 2000 to \$1 million in 2001 due to the decrease in revenues. (3) Revenue from the MetaContent Content and Coding Division increased \$189,000 from \$0 in 2000 to \$189,000 in 2001. This division was acquired and discontinued in 2001. (4) Other expenses included in income from discontinued operations, including research & development, depreciation and restructuring decreased \$2.2 million in 2000 to \$350,000 in 2001.

GAIN FROM SALE OF DISCONTINUED OPERATIONS. The gain from the sale of discontinued operations increased to \$3.7 million in 2001 from \$0 in the prior year period. This increase was due to the sale of the Company's APACHE Clinical Outcomes Division, which accounted for substantially all of the Company's assets, to Cerner Corporation on July 3, 2001.

LOSS ON ABANDONMENT. The loss on abandonment increased to \$433,000 in 2001 from \$0 in the prior year period. This increase was due to the fact that on November 23, 2001, a founder and the sole employee of MetaContent, Inc. resigned employment with the Company. The Company has discontinued all operations under the MetaContent Content and Coding Division. The abandonment loss represents the

write off of goodwill from the MetaContent acquisition which management has determined was impaired by the decision to discontinue this business.

2000 Compared to 1999

GENERAL AND ADMINISTRATIVE. General and administrative expenses for 2000 decreased 6% to \$5.9 million from \$6.3 million in the prior year period. This decrease was due to reduction in personnel, travel, phone, and office supplies in 2000.

RESTRUCTURING. During the third and fourth quarters of 2000, the Company recognized restructuring charges of \$1.4 million primarily related to the Company's decision to revise its business strategy. The Company decided to focus on the development and selling of its Internet based products and no longer pursue the development and selling of certain products and strategic consulting services. As a result, the Company wrote-off the unamortized development costs and intangible assets associated with those products and its purchase of Health Research Network. In addition, the Company eliminated approximately 30 positions and took steps to downsize its corporate office. The revenue related to these discontinued products and the costs related to the eliminated positions and excess office rent was \$2.1 million and \$2.9 million, respectively, for the year ended December 31, 2000. As a result of the sale of assets to Cerner Corporation on July 3, 2001, the Company restated its financial statements to account for the Clinical Outcomes Division as discontinued operations. This restatement resulted in \$1.1 million of the restructuring charge being reclassified to discontinued operations.

The following table summarizes the activity in 2000 related to the restructuring accrual:

	<u>Restructuring Charges</u>	<u>Write-Offs</u>	<u>Payments</u>	<u>Balance December 31, 2000</u>
	(In thousands)			
Severance costs	\$ 411	\$ —	\$(111)	\$300
Development costs write-off	423	(423)	—	—
Intangibles write-off	260	(260)	—	—
Excess rent	<u>295</u>	<u>—</u>	<u>—</u>	<u>295</u>
Total	<u>\$1,389</u>	<u>\$(683)</u>	<u>\$(111)</u>	<u>\$595(a)</u>

(a) \$274,000 of the \$595,000 restructuring accrual was reclassified to liabilities from discontinued operations in 2001.

OTHER INCOME (EXPENSE). Other income for 2000 decreased 33% to \$216,000 from \$321,000 for 1999. This decrease was attributed to a decrease in interest income related to a decrease in short-term investments.

INCOME FROM DISCONTINUED OPERATIONS. Income from discontinued operations decreased 84% to \$1.2 million in 2000 from \$7.3 million in 1999. This decrease was due to a decrease in revenue from discontinued operations of \$5.4 million and an increase in costs from discontinued operations of \$783,000. Decreased revenue was primarily due to decrease in sales to new customers and the impact of one-time sales to existing customers in 1999. The increase in costs was primarily due to restructuring costs. There was no income tax benefit or expense associated with the discontinued operations due to the Company's net operating loss carryforward position.

QUARTERLY RESULTS

The following table sets forth certain unaudited quarterly financial data for fiscal 2001 and 2000. In the opinion of the Company's management, this unaudited information has been prepared on the same basis as the audited information included elsewhere in this annual report and includes all adjustments necessary to present fairly the information set forth therein. The amounts presented below have been adjusted from previously reported amounts to reflect the Clinical Outcomes Division and MetaContent Content and Coding Division as discontinued operations. The operating results for any quarter are not necessarily indicative of results for any future period:

	Fiscal Year 2001				Fiscal Year 2000			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Revenue.....	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Expenses:								
General and administrative ..	1,195	751	439	303	1,127	1,219	1,545	2,021
Restructuring charge	—	24	—	—	—	—	—	276
Total expenses	<u>1,195</u>	<u>775</u>	<u>439</u>	<u>303</u>	<u>1,127</u>	<u>1,219</u>	<u>1,545</u>	<u>2,297</u>
Total other income (expense)	26	35	32	14	76	64	34	42
(Loss) from continuing operations	<u>(1,169)</u>	<u>(740)</u>	<u>(407)</u>	<u>(289)</u>	<u>(1,051)</u>	<u>(1,155)</u>	<u>(1,511)</u>	<u>(2,255)</u>
Discontinued operations								
Income from discontinued operations	644	635	5	2	276	456	125	322
Gain from sale of discontinued operations	—	—	3,265	399	—	—	—	—
Loss on abandonment	—	—	—	(433)	—	—	—	—
Net income (loss)	<u>\$ (525)</u>	<u>\$ (105)</u>	<u>\$2,863</u>	<u>\$ (321)</u>	<u>\$ (775)</u>	<u>\$ (699)</u>	<u>\$ (1,386)</u>	<u>\$ (1,933)</u>
Basic and diluted net income (loss) per share								
Continuing operations	\$ (0.15)	\$ (0.08)	\$ (0.05)	\$ (0.04)	\$ (0.14)	\$ (0.16)	\$ (0.20)	\$ (0.30)
Discontinued operations.....	<u>\$ 0.08</u>	<u>\$ 0.07</u>	<u>\$ 0.38</u>	<u>\$ (0.00)</u>	<u>\$ 0.04</u>	<u>\$ 0.06</u>	<u>\$ 0.01</u>	<u>\$ 0.04</u>
Earnings per share	<u>\$ (0.07)</u>	<u>\$ (0.01)</u>	<u>\$ 0.33</u>	<u>\$ (0.04)</u>	<u>\$ (0.10)</u>	<u>\$ (0.10)</u>	<u>\$ (0.19)</u>	<u>\$ (0.26)</u>
Weighted average number of shares used for calculation of basic net income (loss) per share	<u>7,734</u>	<u>8,592</u>	<u>8,717</u>	<u>8,443</u>	<u>7,398</u>	<u>7,441</u>	<u>7,456</u>	<u>7,464</u>
Weighted average number of shares used for calculation of diluted net income (loss) per share	<u>7,734</u>	<u>8,592</u>	<u>8,717</u>	<u>8,443</u>	<u>7,398</u>	<u>7,441</u>	<u>7,456</u>	<u>7,464</u>

LIQUIDITY AND CAPITAL RESOURCES

At December 31, 2001, the Company has cash and cash equivalents of \$3.3 million representing an increase of \$1.2 million from the total \$2.1 million at December 31, 2000.

During 2001, the Company's operating activities used approximately \$2.6 million in cash. Cash used by operating activities in 2001 was composed primarily of the loss from continuing operations and payment of restructuring costs.

The Company's investing activities provided cash of approximately \$4.5 million in 2001. Cash acquired from investing activities was mainly from the proceeds from the sale of the Clinical Outcomes Division.

There was no cash effect from financing activities during 2001.

During 2001, the Company made no capital expenditures. As of December 31, 2001, the Company had a net working capital of \$3 million including cash and cash equivalents in the amount of \$3.3 million.

The Company anticipates that its cash and cash equivalents will be sufficient to meet its planned ongoing operating and working capital requirements for the next twelve months. Through December 31, 2001, the Company has incurred cumulative net operating losses of approximately \$43.6 million.

Our Clinical Outcomes Division, which included substantially all of our assets, provided clinically based decision support information systems, research and consulting services to the healthcare industry. On July 3, 2001, we sold our Clinical Outcomes Division for cash to Cerner Corporation. Proceeds from the sale of assets have been invested in money market and other cash accounts.

Since the sale of assets to Cerner Corporation was completed on July 3, 2001, the Company continues to evaluate how best to utilize its remaining assets. The alternatives under consideration include moving the Company from its historical focus on clinical information systems to other areas involved with healthcare technology, administration and clinical applications. In addition, the Company will evaluate any opportunity for a business combination that will maximize the stockholders' investment, which may include combinations with companies outside of the Company's traditional market. The Company has not precluded, if no suitable alternatives are found, the possibility of dissolution of the Company and distribution of net assets to its shareholders. The Company has been advised that in order to avoid being deemed an "investment company" it must either engage in an operating business, either through the purchase or development of, or investment in an operating business, or it must dissolve and distribute its net assets to its shareholders within one year from the date of sale of substantially all of its assets to Cerner Corporation on July 3, 2001. There can be no assurance that we will find a suitable new business focus, and if so, that we will be profitable in the future or that present capital will be sufficient to fund our ongoing operations. If additional financing is required to fund operations, there can be no assurance that such financing can be obtained or obtained on terms we find acceptable.

The Company does not believe the impact of inflation has significantly affected the Company's operations.

CRITICAL ACCOUNTING POLICIES

The Company's accounting policies are more fully described in Note 2 of Notes to Consolidated Financial Statements. As disclosed in Note 2 of Notes to Consolidated Financial Statements, the preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions about future events that affect the amounts reported in the financial statements and accompanying notes. Future events and their effects cannot be determined with absolute certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results inevitably will differ from those estimates, and such differences may be material to the financial statements.

The most significant accounting estimates inherent in the preparation of the Company's financial statements related to its continuing operations include estimates associated with its pension plan, income tax valuation allowance and the identification of any contingent liabilities. The most significant accounting estimates related to the discontinued operations include determination of contract completion for purposes of revenue recognition, recoverability of capitalized software costs, recoverability of goodwill and the collectibility of accounts receivable. Various assumptions and other factors underlie the determination of these significant estimates. The process of determining significant estimates is fact specific and takes into account factors such as historical experience, current and expected economic conditions, product mix, and in some cases, actuarial techniques. The Company constantly re-evaluates these significant factors and

makes adjustments where facts and circumstances dictate. Historically, actual results have not significantly deviated from those determined using the estimates described above.

SAFE HARBOR FOR FORWARD-LOOKING STATEMENTS

Statements in this filing, which are not historical facts, are forward-looking statements under provisions of the Private Securities Litigation Reform Act of 1995. All forward-looking statements involve risks and uncertainties. We wish to caution readers that the following important factors, among others, in some cases have affected, and in the future could affect our actual results and could cause our actual results in fiscal 2002 and beyond to differ materially from those expressed in any forward-looking statements made by us or on our behalf.

Important factors that could cause actual results to differ materially include but are not limited to our having sufficient sales and timely collections to meet cash requirements and achieve profitability, our ability to correctly estimate and address our Year 2002 costs and liabilities, our ability to attract and retain key employees, our ability to timely develop new products and enhance existing products, the success of our strategy to concentrate our new product offerings associated with our limited operating history in the medical coding business, our ability to obtain additional working capital, risks inherent in our acquisition strategy, our ability to compete in the competitive and rapidly evolving healthcare information technology industry, the success of our marketing and consulting efforts, the occurrence of certain operating hazards and uninsured risks, our ability to protect proprietary information and to obtain necessary licenses on commercially reasonable terms, our ability to comply with and adopt products and services to potential regulatory changes, the impact of governmental regulations, changes in technology, marketing risks and one time events on our business and our ability to adapt to economic, political and regulatory conditions affecting the healthcare industry.

Our quarterly revenues and operating results have varied significantly in the past and are likely to vary from quarter to quarter in the future. Quarterly revenues and operating results may fluctuate as a result of a variety of factors, including our relatively long sales cycle, variable customer demand for our products and services, changes in our product mix and the timing and relative prices of product sales, loss of our customers due to consolidation in the healthcare industry, changes in customer budgets, our investments in marketing or other corporate resources, acquisitions of other companies or assets, the timing of new product introductions and enhancements by us and our competitors, changes in distribution channels, sales and marketing promotional activities and trade shows and general economic conditions. Further, due to the relatively fixed nature of most of our costs, which primarily include personnel costs as well as facilities costs, any unanticipated shortfall in revenue in any fiscal quarter would have an adverse effect on our results of operations in that quarter. Accordingly, our operating results for any particular quarterly period may not necessarily be indicative of results for future periods.

Item 7a. Quantitative and Qualitative Disclosures About Market Risk

The Company is exposed to certain financial market risks, the most predominate being fluctuations in interest rates; however, the Company does not believe that it is currently exposed to material financial market risks. The Company maintains all of its cash and cash equivalents with one financial institution, which, at times, may exceed federally insured amounts.

Proceeds from the sale of assets have been invested in money market and other cash accounts.

Item 8. Financial Statements and Supplementary Data

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AND FINANCIAL STATEMENT SCHEDULE**

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All other financial statement schedules have been omitted because they are not applicable or because the required information is otherwise furnished.

REPORT OF INDEPENDENT AUDITORS

Board of Directors
Aros Corporation

We have audited the accompanying consolidated balance sheets of Aros Corporation as of December 31, 2001 and 2000, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2001. Our audits also included the financial statement schedule listed in the Index at Item 14(a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Aros Corporation, at December 31, 2001 and 2000, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

ERNST & YOUNG LLP

Baltimore, Maryland
March 7, 2002

AROS CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS

	<u>Years Ended December 31,</u>		
	<u>2001</u>	<u>2000</u>	<u>1999</u>
	(In thousands, except per share data)		
Revenue:	\$ —	\$ —	\$ —
Expenses:			
General and administrative	2,688	5,912	6,304
Restructuring charge	<u>24</u>	<u>276</u>	<u>—</u>
Total expenses	<u>2,712</u>	<u>6,188</u>	<u>6,304</u>
Other income (expense):			
Interest income	<u>107</u>	<u>216</u>	<u>321</u>
Total other income (expense)	<u>107</u>	<u>216</u>	<u>321</u>
Loss from continuing operations	(2,605)	(5,972)	(5,983)
Discontinued operations:			
Income from discontinued operations	1,286	1,179	7,334
Gain from sale of discontinued operations	3,664	—	—
Loss on abandonment	<u>(433)</u>	<u>—</u>	<u>—</u>
	<u>4,517</u>	<u>1,179</u>	<u>7,334</u>
Net income (loss)	<u>\$ 1,912</u>	<u>\$ (4,793)</u>	<u>\$ 1,351</u>
Basic and diluted net income (loss) per share			
Continuing operations	\$ (0.30)	\$ (0.80)	\$ (0.82)
Discontinued operations	<u>\$ 0.53</u>	<u>\$ 0.16</u>	<u>\$ 1.00</u>
Net income (loss) per share	<u>\$ 0.23</u>	<u>\$ (0.64)</u>	<u>\$ 0.18</u>
Weighted average number of shares used for calculation of basic net income (loss) per share	<u>8,445</u>	<u>7,440</u>	<u>7,356</u>
Weighted average number of shares used for calculation of diluted net income (loss) per share	<u>8,445</u>	<u>7,440</u>	<u>7,356</u>

See accompanying Notes to Consolidated Financial Statements.

AROS CORPORATION
CONSOLIDATED BALANCE SHEETS

	December 31	
	2001	2000
	(In thousands, except share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 3,264	\$ 1,420
Short-term investments	—	642
Prepaid expenses and other	49	42
Assets from discontinued operations	15	3,338
Total current assets	3,328	5,442
Total assets	\$ 3,328	\$ 5,442
LIABILITIES AND STOCKHOLDER'S EQUITY		
Current liabilities:		
Account payable	\$ 30	\$ 19
Restructuring cost	—	321
Accrued expenses	144	12
Liabilities from discontinued operations	123	4,540
Total current liabilities	297	4,892
Deferred rent benefit	—	65
Total liabilities	297	4,957
Stockholders' equity:		
Common stock, \$.01 par value, 30,000,000 authorized shares at December 31, 2001 and 2000, 8,985,081 and 7,485,081 shares issued at December 31, 2001 and 2000, respectively; 8,966,966 and 7,466,966 shares outstanding at December 31, 2001 and 2000, respectively	90	75
Additional capital	46,608	45,954
Accumulated other comprehensive income	(34)	1
Accumulated deficit	(43,633)	(45,545)
Total stockholders' equity	3,031	485
Total liabilities and stockholders' equity	\$ 3,328	\$ 5,442

See accompanying Notes to Consolidated Financial Statements.

AROS CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
Years ended December 31, 2001, 2000 and 1999

	<u>Common Stock</u>		<u>Additional Capital</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Deferred Compensation</u>	<u>Accumulated Deficit</u>	<u>Total</u>	<u>Comprehensive Income (Loss)</u>
	<u>Shares</u>	<u>Amount</u>						
Balance at December 31, 1998	7,330,473	\$73	\$45,770	\$ —	\$ —	\$(42,103)	\$3,740	<u>\$(3,193)</u>
Exercise of common stock options	12,600	—	12	—	—	—	12	—
Issuance of common stock under Employee Stock Purchase Plan	38,912	1	36	—	—	—	37	—
Unrealized loss on available for- sale securities	—	—	—	(27)	—	—	(27)	(27)
Net income	—	—	—	—	—	1,351	1,351	1,351
Balance at December 31, 1999	7,381,985	74	45,818	(27)	—	(40,752)	5,113	<u>\$ 1,324</u>
Issuance of common stock under Employee Stock Purchase Plan	26,435	—	23	—	—	—	23	—
Exercise of common stock options	76,661	1	142	—	—	—	143	—
Treasury stock purchase	(18,115)	—	(29)	—	—	—	(29)	—
Unrealized gain on available for- sale securities	—	—	—	28	—	—	28	28
Net loss	—	—	—	—	—	(4,793)	(4,793)	(4,793)
Balance at December 31, 2000	7,466,966	75	45,954	1	—	(45,545)	485	<u>\$(4,765)</u>
Issuance of common stock	1,000,000	10	320	—	—	—	330	—
Issuance of warrants	—	—	240	—	—	—	240	—
Issuance of common stock options	—	—	21	—	—	—	21	—
Issuance of restricted common shares	500,000	5	73	—	(78)	—	—	—
Deferred compensation expense	—	—	—	—	78	—	78	—
Unrealized loss	—	—	—	(1)	—	—	(1)	(1)
Minimum pension liability	—	—	—	(34)	—	—	(34)	(34)
Net income	—	—	—	—	—	1,912	1,912	1,912
Balance at December 31, 2001	<u>8,966,966</u>	<u>\$90</u>	<u>\$46,608</u>	<u>\$(34)</u>	<u>\$ —</u>	<u>\$(43,633)</u>	<u>\$3,031</u>	<u>\$ 1,877</u>

See accompanying Notes to Consolidated Financial Statements.

AROS CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
	2001	2000	1999
	(In thousands)		
Cash flows from operating activities			
Loss from continuing operations	\$(2,605)	\$(5,972)	\$(5,983)
Adjustments to reconcile loss from continuing operations to net cash used in operating activities:			
Depreciation and amortization	—	—	—
Stock compensation expense	99	—	—
Changes in operating assets and liabilities:			
Prepaid expenses and other	(7)	145	158
Accounts payable	11	19	—
Restructuring cost	(321)	321	—
Accrued expenses	74	12	—
Deferred rent benefit	(65)	60	(57)
Income from discontinued operations	4,517	1,179	7,334
Gain from sale of discontinued operations	(3,664)	—	—
Loss on abandonment	433	—	—
Liabilities from discontinued operations	(4,451)	(1,808)	(1,992)
Assets from discontinued operations	<u>3,363</u>	<u>1,699</u>	<u>228</u>
Net cash used in operating activities	(2,616)	(4,345)	(312)
Cash flows from investing activities			
Cash assumed in acquisition	128	—	—
Redemption (purchase) of short-term investments	641	434	(75)
Proceeds from sale of assets	<u>3,691</u>	<u>—</u>	<u>—</u>
Net cash provided by (used in) investing activities	4,460	434	(75)
Cash flows from financing activities			
Proceeds from issuance of common stock upon exercise of options ...	—	143	12
Proceeds from issuance of stock under employee stock purchase plan	—	23	37
Purchase of treasury stock	<u>—</u>	<u>(29)</u>	<u>—</u>
Net cash provided by financing activities	—	137	49
Net increase (decrease) in cash and cash equivalents	1,844	(3,774)	(338)
Cash and cash equivalents at beginning of year	<u>1,420</u>	<u>5,194</u>	<u>5,532</u>
Cash and cash equivalents at end of year	<u><u>\$ 3,264</u></u>	<u><u>\$ 1,420</u></u>	<u><u>\$ 5,194</u></u>

See accompanying Notes to Consolidated Financial Statements.

AROS CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2001 and 2000

(1) NATURE OF THE BUSINESS

Aros Corporation (“Aros” or the “Company”), a Delaware corporation, was incorporated as APACHE Medical Systems, Inc. on September 1, 1987. The Company was a provider of clinically based decision support information systems and consulting services to the healthcare industry offering a comprehensive line of outcomes-based products and services, encompassing software, hardware, and related consulting and disease management services through two operating divisions: the APACHE Clinical Outcomes Division and the MetaContent Content and Coding Division.

The Clinical Outcomes Division provided clinically based decision support information systems, research and consulting services to the healthcare industry. On July 3, 2001, the Company sold the Clinical Outcomes Division, which accounted for substantially all of the Company’s assets, for \$3.7 million in cash to Cerner Corporation and changed the Company name from APACHE Medical Systems, Inc. to Aros Corporation. The Clinical Outcomes Division has been accounted for as discontinued operations and the financial statements have been reclassified accordingly. As a result, the Company’s fixed assets, operating and capital leases and capitalized software costs were sold or have been classified as discontinued operations.

The MetaContent Content and Coding Division provided consulting services in the clinical content and medical coding areas. MetaContent, Inc. (“MetaContent”), a company that developed and marketed data management solutions for healthcare providers, was acquired on March 19, 2001 as part of a strategy to enter the medical coding business, whereby MetaContent became the Company’s wholly owned subsidiary. The Company exchanged one million shares of common stock and warrants to purchase one million shares of common stock at \$0.50 per share for all of the outstanding shares of MetaContent. The total purchase price of \$611,000, comprised of \$570,000 common stock and warrants and \$41,000 in costs associated with the purchase. The chairman of the Company’s Board of Directors and a financial advisor received, for their interests in MetaContent, 32.5% and 28%, respectively, of the common stock and warrant consideration component of the purchase price. The acquisition was accounted for using the purchase method of accounting, resulting in net assets assumed of \$111,000 and goodwill totaling \$500,000. Results of operations of MetaContent are included in the accompanying financial statements beginning on the date of acquisition. On November 23, 2001, a founder and the sole employee of MetaContent, Inc. resigned. As a result, the Company has elected to discontinue all operations under the MetaContent Content and Coding Division, has written off the remaining net goodwill of \$432,642 associated with the acquisition of MetaContent as an asset impairment and the results have been classified as discontinued operations.

Summary operating results of discontinued operations are as follows:

	Apache Clinical Outcomes Division Year Ended December 31,			Metacontent Content and Coding Division Year Ended December 31,		
	<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>
Revenue	\$2,355	\$6,660	\$12,023	\$189	\$—	\$—
Costs and expenses	<u>1,195</u>	<u>5,481</u>	<u>4,689</u>	<u>63</u>	<u>—</u>	<u>—</u>
Net income from discontinued operations	<u>\$1,160</u>	<u>\$1,179</u>	<u>\$ 7,334</u>	<u>\$126</u>	<u>\$—</u>	<u>\$—</u>

Liabilities related to discontinued operations of \$123,000 at December 31, 2001 consist of liabilities to be held that were part of the APACHE Clinical Outcomes Division not purchased by Cerner. These liabilities are for the pension plan liability of the discontinued business.

AROS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The assets from discontinued operations of \$15,000 at December 31, 2001 include assets to be held of which \$13,000 was a part of the APACHE Clinical Outcomes Division not purchased by Cerner and \$2,000 were a part of the MetaContent Content and Coding Division. These assets to be held are accounts receivable related to the discontinued businesses.

Revenues and net income from discontinued operations for Clinical Outcomes Division from the measurement date, June 11, 2001 to December 31, 2001 were \$116,000 and \$109,000, respectively. Revenues and net income from discontinued operations for MetaContent Content and Coding Division from the measurement date, November 23, 2001 to December 31, 2001 were \$0 and \$0, respectively.

Since the sale of assets to Cerner Corporation was completed on July 3, 2001, the Company continues to evaluate how best to utilize its remaining assets. The alternatives under consideration include moving the Company from its historical focus on clinical information systems to areas such as biotechnology, bio-informatics, medical coding or other healthcare related activities. In addition, the Company has not precluded, if no suitable alternatives are found, the possibility of dissolution of the Company and distribution of net assets to its shareholders.

Through December 31, 2001, the Company has incurred cumulative net operating losses of approximately \$43.6 million. There can be no assurance that a suitable new business focus will be found, and if one is found, that the Company will be profitable in the future or that present capital will be sufficient to fund ongoing operations. If additional financing is required to fund operations, there can be no assurance that such financing can be obtained or obtained on acceptable terms.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation and Use of Estimates

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ from those estimates.

Cash Equivalents

The Company considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. As of December 31, 2001, cash equivalents consisted of money market instruments. Cash equivalents are carried at lower of cost or market. The Company maintains all of its cash and cash equivalents at one financial institution, which, at times, may exceed federally insured amounts.

Income Taxes

The Company accounts for income taxes using the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

AROS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Employee Stock Options

The Company accounts for its stock-based compensation in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, (“APB 25”), using the intrinsic value method. Stock-based compensation related to options granted to non-employees is accounted for using the fair value method in accordance with the Statement of Financial Accounting Standard No. 123, Accounting for Stock-Based Compensation, (“SFAS 123”).

Reclassification

Certain amounts have been reclassified from prior years to conform to the current year presentation.

Policies Related to Discontinued Operations

The following accounting policies were followed for the discontinued operations of the APACHE Clinical Outcomes Division and MetaContent Content and Coding Division prior to their disposition.

Revenue Recognition

Revenues for sales of systems and products were recognized at delivery. For systems where services were critical to the functionality of the system, revenue was recognized using contract accounting. Systems support fees were recognized ratably over the period of performance. Professional services revenue was recognized as these services were provided and was generally billed on a time and material basis. Professional services did not involve significant customization, modification or production of the licensed software. Amounts received prior to the performance of service or completions of a milestone were deferred. Revenue recognized for work performed for which billings had not been presented to customers was recorded as unbilled.

Cost of Operations

Cost of operations consisted primarily of personnel costs, costs of media, production manuals, telephone support, third party equipment, licenses, software and other direct costs related to providing systems, support, and professional services.

Furniture and Equipment

Furniture and equipment are stated at cost. All furniture and equipment is included in assets from discontinued operations at December 31, 2000. There is no furniture and equipment at December 31, 2001. Depreciation and amortization was calculated on the straight-line basis over the estimated useful lives of the assets ranging from 3 to 7 years. Depreciation and amortization expense included in discontinued operations was \$145,000, \$365,000 and \$518,000 for the years ended December 31, 2001, 2000 and 1999 respectively.

Software Capitalization

The Company accounted for software development costs in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 86 “Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed.” The Company capitalized certain software development costs subsequent to the establishment of technological feasibility of its products. Technological feasibility was established generally upon completion of a working model of a product. Costs incurred prior to technological feasibility were expensed. Research and development expenses included in discontinued operations were \$87,000, \$659,000 and \$701,000 for the years ended December 31, 2001, 2000 and 1999 respectively. Amortization of capitalized costs began when products were available for general release to customers and was computed

AROS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

on a product-by-product basis in the amount which is the greater of (a) the ratio that current revenues bore to the total of the current and future anticipated revenues, or (b) the straight-line method over the remaining estimated economic life of the product, not to exceed five years. Such costs are reflected in discontinued operations. The Company capitalized approximately \$275,000, \$593,000, and \$501,000 in software development costs during 2001, 2000, and 1998, respectively. Amortization of software development costs included in discontinued operations approximated \$117,000, \$378,000, and \$196,000, in 2001, 2000, and 1999, respectively. In the fourth quarter of 2000, the Company wrote-off, as part of its restructuring charge included in discontinued operations, \$423,000 of capitalized software development costs related to certain non-Internet products.

Other

Interest expense included in discontinued operations was \$9,000, \$39,000, and \$30,000 for the years ended December 31, 2001, 2000 and 1999 respectively.

(3) RESTRUCTURING

During the third and fourth quarters of 2000, the Company recognized restructuring charges of \$1.4 million primarily related to the Company's decision to revise its business strategy. The Company decided to focus on the development and selling of its Internet based products and no longer pursue the development and selling of certain products and strategic consulting services. As a result, the Company wrote-off the unamortized development costs and intangible assets associated with those products and its purchase of Health Research Network. In addition, the Company eliminated approximately 30 positions and took steps to downsize its corporate office. The revenue related to these discontinued products and the costs related to the eliminated positions and excess office rent was \$2.1 million and \$2.9 million, respectively, for the year ended December 31, 2000. As a result of the sale of assets to Cerner Corporation on July 3, 2001, the Company restated its financial results attributable to the APACHE Clinical Outcomes Division as discontinued operations. This restatement resulted in the Company reclassifying \$1.1 million of the restructuring charge to discontinued operations.

The following table summarizes the activity in 2000 related to the restructuring accrual:

	Restructuring Charge	Write-Offs	Payments	Balance December 31, 2000
	(In thousands)			
Severance costs	\$ 411	\$ —	\$(111)	\$300
Development costs write-off	423	(423)	—	—
Intangibles write-off	260	(260)	—	—
Excess rent	295	—	—	295
Total	<u>\$1,389</u>	<u>\$(683)</u>	<u>\$(111)</u>	<u>\$595(a)</u>

(a) \$274,000 of the \$595,000 restructuring accrual was reclassified to discontinued operations in 2001.

AROS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The following table summarizes the activity in 2001 related to the restructuring accrual:

	<u>Balance</u> <u>January 1, 2001</u>	<u>Additional</u> <u>Charges</u>	<u>Payments</u>	<u>Balance</u> <u>December 31, 2001</u>
	(In thousands)			
Severance costs	\$300	\$162	\$(462)	\$—
Excess rent	<u>295</u>	<u>(138)</u>	<u>(157)</u>	<u>—</u>
Total	<u>\$595(a)</u>	<u>\$ 24</u>	<u>\$(619)</u>	<u>\$—</u>

(a) \$274,000 of the \$595,000 restructuring accrual was reclassified to discontinued operations in 2001.

(4) ACCRUED EXPENSES

Accrued expenses consist of the following (in thousands):

	<u>December 31,</u>	
	<u>2001</u>	<u>2000</u>
Accrued professional fees	\$106	\$—
Other accrued expenses	<u>38</u>	<u>12</u>
	<u>\$144</u>	<u>\$12</u>

(5) INCOME TAXES

The Company had no provision for income taxes in 2001, 2000 or 1999 as a result of its net losses for income tax purposes. The difference between the tax provision and the amount that would be computed by applying the statutory federal income tax rate to income before taxes is attributable to the following (in thousands):

	<u>2001</u>	<u>2000</u>	<u>1999</u>
Federal tax at 34% statutory rate	\$ 650	\$(1,630)	\$ 459
Permanent items	194	4	10
State taxes, net of federal benefit	88	(189)	64
Change in valuation allowance	(932)	1,827	(520)
Other	<u>—</u>	<u>(12)</u>	<u>(13)</u>
Total	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

AROS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The approximate tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2001 and 2000 are as follows (in thousands):

	<u>2001</u>	<u>2000</u>
Deferred tax liabilities:		
Capitalized software development costs	\$ —	\$ (221)
Gross deferred tax liabilities	—	(221)
Deferred tax assets:		
Accrued vacation	—	6
Accrued bonuses	—	25
Allowance for doubtful accounts	—	66
Accrued licensing fees	—	3
Deferred rent benefit	—	25
Tax basis of equipment in excess of book value	—	6
Intangible assets	—	874
Other accruals	—	460
Net operating loss carryforwards	<u>15,153</u>	<u>14,841</u>
Gross deferred tax assets	<u>15,153</u>	<u>16,306</u>
Net deferred tax assets before valuation allowance	<u>15,153</u>	<u>16,085</u>
Less valuation allowance	<u>(15,153)</u>	<u>(16,085)</u>
Net deferred tax assets	<u>\$ —</u>	<u>\$ —</u>

The Company has a net operating loss carryforward for income tax reporting purposes at December 31, 2001, of approximately \$39.2 million, which expires beginning in 2003. The Company's ability to use the carryforwards is subject to limitations resulting from changes in ownership, as defined by the Internal Revenue Code. Lack of future earnings, a change in the ownership of the Company, or the application of the alternative minimum tax rules could adversely affect the Company's ability to utilize the net operating loss carryforwards.

(6) STOCKHOLDERS' EQUITY

Restricted Stock

During the first quarter of 2001, the Company granted to Gerald E. Bisbee, Jr., Ph.D., the Company's Chairman of the Board, 500,000 shares of restricted stock which fully vest on December 31, 2001. Compensation expense of \$78,000 was recognized over the vesting period.

Stock Options

The Company has an Employee Stock Option Plan (the Plan) that provides up to 2,700,000 options to be issued to employees, and non-employees (other than non-employee directors) of the Company. The Company granted 169,500 options to employees during 2001 and 105,000 options to non-employees during 2001. The exercise prices of the granted options were equal to the fair value of the Company's stock on the date of grant. The Company recognized \$21,000 in expense during 2001 related to the options granted to non-employees. All options are subject to forfeiture until vested, and unexercised options expire on the tenth anniversary of the year granted. Vesting is generally over five years. All employee stock options

AROS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

issued by the Company have been granted with exercise prices equal to or greater than the fair market value of the common stock on the date of grant; accordingly, the Company has recorded no compensation expense related to such grants. At December 31, 2001, options for 2,333,245 shares were available for grant under the Plan. The Company has reserved 2,700,000 shares of common stock for issuance under the Plan.

In April 1996, the Company adopted its Non-Employee Director Option Plan (the Director Option Plan), pursuant to which non-employee directors of the Company will be granted an option to purchase 2,500 shares of common stock on January 1, of each calendar year for each year of service. The exercise price of such options shall be at the fair market value of the Company's common stock on the date of grant. Options become fully vested and exercisable on the December 31, immediately following the date on which the option is granted. Stock options granted under the Director Option Plan may not be transferred other than by will or by the laws of descent and distribution. The Board of Directors may terminate the Director Option Plan at any time. Upon the occurrence of a Change of Control, as defined in the Director Option Plan, all outstanding unvested options under the Director Option Plan immediately vest. As of December 31, 2001, 52,500 shares were outstanding under the Director Option Plan. At December 31, 2001 options for 17,500 shares were available for grant under the Director Option Plan. The Company has reserved 70,000 shares of common stock for issuance under the Director Option Plan.

In May 1999, the Company adopted its Non-Employee Director Supplemental Stock Option Plan (the Director Supplemental Option Plan) that provides up to 500,000 options to be issued to the Directors of the Company as amended. The exercise price of such options shall not be less than the fair market value of the Company's common stock on the date of grant. The Board of Directors may terminate the Director Supplemental Option Plan at any time. Upon occurrence of a Change in Control as defined in the Director Supplemental Option Plan, all outstanding unvested options under the Director Supplemental Option Plan vest immediately. As of December 31, 2001, options for 292,000 shares were outstanding under the Director Supplemental Option Plan. At December 31, 2001, options for 208,000 shares were available for grant under the Director Supplemental Option Plan. The Company has reserved 500,000 shares of common stock for issuance under the Director Supplemental Option Plan.

The following is a summary of the Company's option transactions for the years ending December 31, 2001, 2000 and 1999:

	Shares	Weighted Average Exercise Price
Outstanding, December 31, 1998	2,424,678	\$3.11
Granted	687,100	1.03
Forfeited	(105,230)	1.70
Exercised	(12,600)	.94
Outstanding, December 31, 1999	2,993,948	\$2.62
Granted	221,700	1.24
Forfeited	(1,657,689)	1.42
Exercised	(76,661)	1.84
Outstanding, December 31, 2000	1,481,298	\$3.81
Granted	429,500	.20
Forfeited	(764,530)	1.10
Exercised	—	—
Outstanding, December 31, 2001	1,146,268	\$4.26

AROS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The following table summarizes information regarding stock options outstanding at December 31, 2001:

<u>Range of Exercise Prices</u>	<u>Options Outstanding</u>			<u>Options Exercisable</u>	
	<u>Number Outstanding</u>	<u>Average Remaining Contractual Life</u>	<u>Weighted Average Exercise Price</u>	<u>Number Exercisable</u>	<u>Weighted Average Exercise Price</u>
\$0.00 – \$ 0.99	352,733	6.70	\$ 0.32	307,733	\$ 0.35
\$1.00 – \$ 1.99	193,000	1.90	\$ 1.43	193,000	\$ 1.43
\$2.00 – \$ 5.99	215,674	1.10	\$ 3.53	215,674	\$ 3.53
\$6.00 – \$ 8.99	236,084	4.60	\$ 7.91	236,084	\$ 7.91
\$9.00 – \$13.00	<u>148,777</u>	4.20	\$12.57	<u>148,777</u>	\$12.57
	<u>1,146,268</u>			<u>1,101,268</u>	

The Company applies APB 25 in accounting for its stock based compensation plans. Compensation expense recognized in the statements of operations for stock-based compensation was \$99,000, \$0 and \$0 for years ended December 31, 2001, 2000 and 1999, respectively. Had the Company determined compensation cost based on the fair value at the grant date for these plans under SFAS 123, the Company's net income (loss) would have been adjusted to the pro forma amounts indicated below:

	<u>Year Ended December 31,</u>		
	<u>2001</u>	<u>2000</u>	<u>1999</u>
	(In thousands except per share data)		
Net income (loss)			
As reported	\$1,912	\$(4,793)	\$1,351
Pro forma	1,477	(5,728)	667
Net income (loss) per share			
As reported	\$ 0.23	\$ (.64)	\$.18
Pro forma	0.17	(.77)	.09

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions: January 1, 2001 through December 31, 2001 — expected dividend yield of 0%, risk free interest rate of 4.58%, expected volatility factor of 124.54% and an expected life of 5 years; January 1, 2000 through December 31, 2000 — expected dividend yield of 0%, risk-free interest rate of 5.5%, expected volatility factor of 124.54%, and an expected life of 6 years; January 1, 1999 through December 31, 1999 — expected dividend yield of 0%, risk-free interest rate of 5.86%, expected volatility factor of 202.34%, and an expected life of 6 years.

The effect of applying SFAS 123 on 2001, 2000, 1999 pro forma net income (loss) as stated above is not necessarily indicative of the effects in reported net income (loss) for future years due to, among other things, the vesting period of the stock options and the fair value of additional stock options in future years.

Stock Warrants

In connection with the purchase of MetaContent, the Company exchanged one million shares of its common stock and warrants to purchase one million shares of the Company's common stock at \$0.50 per share for all of the outstanding shares of MetaContent. A value of \$240,000 was ascribed to the warrants. The warrants expire March 19, 2011.

AROS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Employee Stock Purchase Plan

Effective May 1, 1996, the Company adopted an Employee Stock Purchase Plan (the Purchase Plan). A total of 210,000 shares of common stock are available for purchase under the Purchase Plan. The Purchase Plan permits eligible employees to purchase common stock through payroll deductions, which may not exceed 8% of an employee's base compensation, including commissions, bonuses and overtime, at a price equal to 85% of the fair market value of the common stock at the beginning of each offering period or the end of a three month purchase period, whichever is lower. The Board of Directors has the authority to amend or terminate the Purchase Plan provided no such action may adversely affect the rights of any participant.

The Employee Stock Purchase Plan was terminated on December 31, 2001.

(7) OTHER COMPREHENSIVE INCOME

The accumulated balances in other comprehensive income at December 31 follow (in thousands):

	<u>2001</u>	<u>2000</u>
Unrealized gain on available for-sale securities	\$—	\$1
Minimum pension liability	<u>34</u>	<u>—</u>
	<u>\$34</u>	<u>\$1</u>

(8) EARNINGS (LOSS) PER SHARE (EPS)

The following table sets forth the computation of basic and diluted earnings (loss) per share for the years ended December 31, 2001, 2000, and 1999 (in thousands, except per share data):

	<u>2001</u>	<u>2000</u>	<u>1999</u>
Loss from continuing operations available to common shareholders	\$(2,581)	\$(5,972)	\$(5,983)
Income from discontinued operations available to common shareholders	<u>4,493</u>	<u>1,179</u>	<u>7,334</u>
Net income (loss)	\$ 1,912	\$(4,793)	\$ 1,351
Weighted average shares outstanding	8,445	7,440	7,356
Basic earnings (loss) per share			
Continuing operations	\$ (0.30)	\$ (0.80)	\$ (0.82)
Discontinued operations	<u>0.53</u>	<u>0.16</u>	<u>\$ 1.00</u>
	<u>\$ 0.23</u>	<u>\$ (0.64)</u>	<u>\$ 0.18</u>
Loss from continuing operations available to common shareholders	\$(2,581)	\$(5,972)	\$(5,983)
Income from discontinued operations available to common shareholders	<u>4,493</u>	<u>1,179</u>	<u>7,334</u>

AROS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

	<u>2001</u>	<u>2000</u>	<u>1999</u>
Net income (loss)	\$ 1,912	\$(4,793)	\$ 1,351
Weighted average shares outstanding	8,445	7,440	7,356
Effect of dilutive securities:			
Employee stock options	—	—	—
Adjusted weighted average shares	8,445	7,440	7,356
Diluted earnings (loss) per share	<u>\$ 0.23</u>	<u>\$ (0.64)</u>	<u>\$ 0.18</u>

Options to purchase 1,146,268 and 1,481,298 shares of common stock were outstanding at December 31, 2001 and 2000, respectively, but were not included in the computation of diluted EPS because the options' weighted average exercise price was greater than the average market price of the common shares and the affect of including such shares would be anti-dilutive to the per share amount.

The Company has 1,459,722 and 477,205 warrants outstanding at December 31, 2001 and 2000, respectively, that were not included in the computation of diluted EPS because the warrants' weighted average exercise price was greater than the average market price of the common shares and the affect of including such shares would be anti-dilutive to the per share amount.

(9) EMPLOYEE BENEFIT PLANS

The Company sponsors a profit sharing plan ("Plan") intended to qualify under Section 401(k) of the Internal Revenue Code. All employees are eligible to participate in the Plan after three months of service. Employees may contribute a portion of their salary to the Plan, subject to annual limitations imposed by the Internal Revenue Code. The Company may make matching or discretionary contributions to the Plan at the discretion of the Board of Directors, but has made no such contribution to date. Employer contributions generally vest over seven years. As of July 3, 2001, all contributions to the Plan were discontinued. The Company is in the process of terminating the Plan.

The Company sponsors a defined benefit pension plan ("Pension Plan") covering all former employees of National Health Advisors, a subsidiary of the Company acquired in 1997. The Pension Plan was amended to freeze benefit accruals and the entry of new participants effective October 31, 1997. The sale of the Company's APACHE Clinical Outcomes Division in 2001 resulted in the termination of all remaining participants in the Pension Plan thereby constituting a further curtailment. During 2001, all unamortized actuarial losses were also recognized and a curtailment gain of \$89,765 was recorded.

The benefits under the Pension Plan are based on final average compensation and are offset by each employee's interest in the Company's profit sharing plan. The Company's funding policy is to contribute annually an amount that can be deducted for federal income tax purposes and meets minimum funding standards, using an actuarial cost method and assumptions which are different from those used for financial reporting.

AROS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The Company's pension expense is as follows (in thousands):

	<u>2001</u>	<u>2000</u>	<u>1999</u>
Service cost	\$ —	\$ 10	\$ 9
Interest cost	14	16	13
Expected return on plan assets	(24)	(19)	(17)
Amortization of prior service costs	—	19	19
Recognized net actuarial loss (gain)	(21)	(12)	(9)
Curtailment gain	<u>(81)</u>	<u>—</u>	<u>—</u>
	<u>\$ (112)</u>	<u>\$ 14</u>	<u>\$ 15</u>

Rollforwards of the benefit obligation, fair value of plan assets and a reconciliation of the pension plan's funded status at November 30, the measurement date, and significant assumptions follow (in thousands):

	<u>2001</u>	<u>2000</u>
CHANGE IN BENEFIT OBLIGATION		
Beginning of the year	\$ 190	\$ 211
Service cost	—	10
Interest cost	14	16
Plan changes and other		
Curtailment	(8)	—
Actuarial loss (gain)	<u>143</u>	<u>(47)</u>
End of the year	<u>\$ 339</u>	<u>\$ 190</u>
CHANGE IN FAIR VALUE OF ASSETS		
Beginning of the year	\$ 315	\$ 254
Actual return on plan assets	(100)	48
Employer contributions	<u>2</u>	<u>13</u>
End of the year	<u>\$ 217</u>	<u>\$ 315</u>
RECONCILIATION OF FUNDED STATUS		
(Under)/over funded status	\$(122)	\$ 125
Unrecognized net actuarial loss (gain)	<u>—</u>	<u>(327)</u>
Accrued pension cost	<u>\$(122)</u>	<u>\$(202)</u>
SIGNIFICANT ASSUMPTIONS:		
Discount rate	6.26%	7.50%
Expected return on plan assets	6.26%	7.50%
Rate of compensation increase	5.00%	5.00%

(10) SUPPLEMENTAL CASH FLOW INFORMATION

Cash paid for interest was approximately \$9,000, \$41,000, and \$30,000 for the years ended December 31, 2001, 2000 and 1999, respectively.

AROS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(11) FAIR VALUE OF FINANCIAL INSTRUMENTS

Financial instruments included in current assets and current liabilities, which include cash and cash equivalents, accounts payable and accrued expenses, approximate fair value.

(12) SUBSEQUENT EVENTS

None.

SCHEDULE II — VALUATION AND QUALIFYING ACCOUNTS

<u>Description</u>	<u>Balance at Beginning of Period</u>	<u>Additions Charged to Costs and Expenses</u>	<u>Deductions</u>	<u>Balance at End of Period</u>
Allowance for doubtful accounts receivable				
1999	\$514,293	\$ 91,708	\$ 75,311	\$530,690
2000	530,690	86,494	444,272	172,912
2001	172,912	111,096	284,008	—

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

PART III

Item 10. Directors and Executive Officers of the Registrant

Executive Officers of the Registrant

The following persons are or have served as executive officers or directors of the Company during the year ended December 31, 2001:

<u>Names</u>	<u>Age</u>	<u>Position</u>
Gerald E. Bisbee, Jr., Ph.D.(3)	58	Secretary, President and Chief Executive Officer
Violet L. Shaffer(1)	53	President and Chief Operating Officer
Karen C. Miller(2)	42	Vice President, Finance and CFO
Alan W. Baldwin(4)	64	Director
William R. Lewis(5)	59	Director

- (1) Violet L. Shaffer, 53, served as Chief Operating Officer of the Company from September 2000 to July 3, 2001, and President of the Company effective January 1, 2001 to July 3, 2001. Previously she was Vice President of Marketing for the Company since September 1997. Prior to joining the Company, from January 1997 through September 1997, Ms. Shaffer served as President and Chief Executive Officer of Competitive Advantage Services, Inc. Ms. Shaffer served as Vice President of Business Development for Nichols Research Corporation and of HealthGate Data Corporation, an entity partially owned by Nichols, from September 1995 through December 1996.
- (2) Karen C. Miller, 42, served as Vice President of Finance and Chief Financial Officer of the Company from October 1998 to June 30, 2001. From 1997 to 1998, Ms. Miller served as Controller of the Per-Se Technologies Division of Medaphis Corporation, now Per-Se Technologies, Inc. Prior to assuming this role, Ms. Miller was Chief Financial Officer, Vice President of Finance and Controller of Health Data Sciences Corporation, a company she co-founded in 1983 that was acquired by Medaphis in 1996.
- (3) Gerald E. Bisbee, Jr., Ph.D., 57, has been acting as Secretary, President and Chief Executive Officer since July 3, 2001, President and Chief Executive Officer until December 31, 1997, Chairman of the Board from 1989 through November 5, 1997, and December 22, 2000 to present, and director since 1989. Dr. Bisbee is presently Chairman, President and Chief Executive Officer of ReGen Biologics, Inc., which conducts research and development, manufacturing and marketing of tissue engineering, biological and other orthopedic products and services. Before joining us as Chairman and Chief Executive Officer in December 1989, Dr. Bisbee was the Chairman and Chief Executive Officer of the Sequel Corporation, which he joined in 1988 and engineered the merger with the Hanger Orthopedic Group, Inc. He founded and managed the Health Care Group of the Corporate Finance Department of Kidder, Peabody & Co., leaving to join Sequel in 1988. From 1978 until moving to

Kidder, Peabody in 1984, he was President of the Hospital Research and Educational Trust, a new venture and product development company affiliated with the American Hospital Association. Dr. Bisbee also managed the Yale University Health Services, which included a 22,000-member health maintenance organization. He is a director of Cerner Corporation and HealthGate Data Corporation. Dr. Bisbee received his B.A. from North Central College, his M.B.A. from the Wharton School of the University of Pennsylvania and his Ph.D. from Yale University, where his dissertation was instrumental in the development of Diagnosis Related Groups.

- (4) Alan W. Baldwin, 64, has been a Director since 2000. Mr. Baldwin is presently Chief Executive Officer of Alcore, Inc., subsidiary of MC Guild Corporation, and is also a director of MedGrup, a medical coding company, Scindo Networks, Inc., a broadband communications provider and as director of Advanced Technical Products, Inc, an advanced composite materials company. Before joining us, Mr. Baldwin served during 2000 as the chief executive officer of CopperGlass Broadband Solutions, Inc, managing the acquisition of fiber-optic component manufacturing companies and in 1999 as the chief executive officer of Mediappraise (now Performaworks), an internet-based management performance measurement company. In 1998 Mr. Baldwin served as founder and president of Wren Associates, Ltd., a management consulting firm. From March 1994 through October 1997, he served as Chairman and Chief Executive Officer of Lunn Industries, Inc., a publicly traded composite material company, where he developed a detailed turn-around and recovery plan and supervised the restructuring of the company. Mr. Baldwin is a graduate of the United States Military Academy at West Point, New York and received his Masters Degree in engineering and mathematics from the University of Alabama.
- (5) William R. Lewis, 59, has been a Director since 2000. Mr. Lewis has been an independent financial and management consultant since 1993, assisting various corporations and investment groups. From October 1999 to March 2000 he served as interim Chief Financial Officer of Fomex International, Inc., a publicly traded manufacturing company. From February to November 1998 Mr. Lewis served as Chief Financial Officer of Vlasic Foods International Inc., a food products manufacturer, where he established its financial functions, investment banking relationships and negotiated a \$750 million dollar bank financing agreement. From 1996 to 1998 in association with Allen & Company Mr. Lewis has served as an independent financial consultant advising companies on among other things corporate restructuring and financing. Mr. Lewis is a graduate of Dartmouth College and received his M.B.A. from Columbia University.

Item 11. Executive Compensation

EXECUTIVE COMPENSATION

The following table summarizes, for the last three fiscal years, the compensation paid to or earned by Violet Shaffer who was our Chief Operating Officer from September 2000 to July 3, 2001 and our President from January 2001 to July 3, 2001, Gerald Bisbee became our Secretary, President and Chief Executive Officer as of July 3, 2001, and our executive officers serving as executive officers through July 3, 2001.

<u>Name and Principal Position</u>	<u>Annual Compensation</u>			<u>Long Term Compensation Awards</u>	
	<u>Year</u>	<u>Salary(\$)</u>	<u>Bonus(\$)</u>	<u>Number of Securities Underlying Options(#)</u>	<u>All Other Compensation(\$)</u>
Gerald E. Bisbee, Jr. Secretary, President and Chief Executive Officer(1)	2001	\$ —	\$ —	—	\$ —
	2000	—	—	—	—
	1999	—	—	—	—
Donald W. Seymour(2) Vice President of National Health Advisors	2001	\$ —	\$ —	—	\$ 58,181(3)
	2000	154,500	40,725	—	—
	1999	154,500	91,575	8,000	—
Karen C. Miller(4) Vice President, Finance and Chief Financial Officer	2001	\$137,641	\$18,250(5)	50,000	\$109,500(6)
	2000	130,295	56,500	20,000	—
	1999	128,000	45,000	18,000	—
Violet Shaffer(7) President and Chief Operating Officer	2001	\$ 81,004	\$ —	25,000	\$ —
	2000	133,295	20,000	20,000	—
	1999	128,295	—	8,000	—

- (1) We employed Mr. Bisbee on July 3, 2001 as Secretary, President and Chief Executive Officer. He has been on the board of directors since 1989.
- (2) On June 2, 1997, we merged with NHA, and Mr. Seymour became our employee. Mr. Seymour served as our Vice President from July 1, 1999 to January 3, 2001.
- (3) Mr. Seymour was given 12 weeks severance in conjunction with his employee agreement at resignation on January 3, 2001.
- (4) Ms. Miller commenced employment with us on October 1, 1998. She has served as our Vice President of Finance and Chief Financial Officer from October 1998 to June 30, 2001.
- (5) Ms. Miller was paid a bonus of \$18,250 in conjunction with her employee agreement at her resignation on June 30, 2001.
- (6) Ms. Miller was paid nine months severance of \$109,500 in conjunction with her employee agreement. Half was paid at her resignation on June 30, 2001 and the remaining amount was paid October 2, 2001.
- (7) Ms. Shaffer commenced employment with us on September 22, 1997. She served as Vice President, Marketing from January 1998 to September 2000. She has served as Chief Operating Officer since September 2000 and as President from January 2001 to July 3, 2001.

OPTION GRANTS IN 2001

The following table shows information with respect to grants of options to the indicated executive officers for the fiscal year ended December 31, 2001. The options were granted under our Employee Stock Option Plan.

<u>Name</u>	<u>Number of Securities Underlying Options Granted</u>	<u>Individual Grants</u>		<u>Expiration Date</u>	<u>Potential Realizable Value at Assumed Annual Rate of Stock Price Appreciation for Option Term (1)</u>	
		<u>% of Total Options Granted to Employees in 2001</u>	<u>Exercise Price (\$/Sh) (2)</u>		<u>5% (\$)</u>	<u>10% (\$)</u>
Gerald E. Bisbee, Jr. Secretary, President and Chief Executive Officer	0	0	n/a	n/a	n/a	n/a
Donald W. Seymour Vice President of National Health Advisors	0	0	n/a	n/a	n/a	n/a
Karen C. Miller Vice President, Finance and Chief Financial Officer	50,000(3)	25.06	0.16	09/28/2001	n/a	n/a
Violet Shaffer President and Chief Operating Officer	25,000(4)	12.53	0.16	10/02/2001	n/a	n/a

- (1) Amounts reflect certain assumed rates of appreciation set forth in the Securities and Exchange Commission's executive compensation disclosure rules. Actual gains, if any, on stock options exercised, will depend on future performance of our common stock. No assurance can be given that the amounts reflected in these columns will be achieved.
- (2) We grant options at the fair market value on the date of grant, which means the average of the highest and lowest quoted selling prices for the shares on the date of grant.
- (3) Ms. Miller's options were granted on March 7, 2001 and expired 90 days from her resignation on June 30, 2001.
- (4) Ms. Shaffer's options were granted on March 7, 2001 and expired 90 days from her termination on July 3, 2001.

AGGREGATE OPTION EXERCISES IN 2001 AND 2001 YEAR-END OPTION VALUES

The following table provides information regarding stock options held by the indicated executive officers as of December 31, 2001.

<u>Name</u>	<u>Number of Shares Acquired On Exercise</u>	<u>Value Realized</u>	<u>Number of Securities Underlying Unexercised Options at Fiscal Year-End (#)</u>		<u>Value of Unexercised In-the-Money Options at Fiscal Year-End (\$) (1)</u>	
			<u>Exercisable</u>	<u>Unexercisable</u>	<u>Exercisable</u>	<u>Unexercisable</u>
Gerald Bisbee, Jr.	—	\$—	—	—	—	\$—
Donald W. Seymour ..	—	—	—	—	—	—
Karen C. Miller	—	—	—	—	—	—
Violet Shaffer	—	—	—	—	—	—

- (1) Value is calculated by subtracting the exercise price per share from the last reported market price at December 31, 2000 and multiplying the result by the number of shares subject to the option.

Executive Employment Contracts

In the second quarter of 1999 we renegotiated an employment agreement with Donald Seymour, our former Vice President. The initial term of Mr. Seymour's agreement began on July 1, 1999 and was to end on January 31, 2000, automatically renewable for one year terms. On December 27, 2000 we entered into an agreement and general release with Mr. Seymour providing that he would resign his employment effective January 3, 2001. In exchange for his resignation, we agreed to pay Mr. Seymour severance pay equal to the amount of his current salary prorated for a period of twelve (12) weeks thereafter. We also agreed to provide Mr. Seymour with certain benefits through January 31, 2000 and provide health insurance benefits through March 31, 2001.

In September 1998 we entered into an employment agreement with Karen C. Miller naming her as Vice President, Finance and Chief Financial Officer. The term of the agreement began on October 1, 1998. On July 28, 2000, we entered into an additional employment agreement with Ms. Miller renewing her employment. The term of the agreement began on July 28, 2000 and was to end on October 1, 2002. In February 2001 we entered into a letter agreement with Ms. Miller providing that in the event of her termination for any reason or her resignation on June 30, 2001, we would pay her salary plus benefits for a period of nine months after her termination plus a prorated amount of her bonus. In the event that Ms. Miller resigned prior to June 30, 2001, we would pay her salary plus benefits for a period of three months after her termination. In the event of her termination without cause or her resignation on any date with appropriate notice, we agreed to accelerate any incentive stock options that would have vested in the three months after the effective date of Ms. Miller's termination or resignation to her effective termination or resignation date, and any of her vested incentive stock options must be exercised within a period ending three months after her effective termination or resignation date. Upon the termination of her employment contract due to a change in control, Ms. Miller's incentive stock options would have accelerated and vested upon the date of her termination. Ms. Miller resigned on June 30, 2001.

In April 1998 we entered into an employment agreement with Violet Shaffer naming her as Vice President, Marketing. We agreed that her term of employment would be effective as January 1, 1998 and would end on December 31, 1998. In September 2000 we entered into another employment agreement with Ms. Shaffer naming her as Chief Operating Officer. The initial term of the agreement began on September 20, 2000 and was to end on September 20, 2002. Upon the termination of her employment without cause or upon a change in control, or a change in leadership that she notified us that she finds unacceptable, we would pay her salary and benefits for a period of nine (9) months thereafter. In the event of her termination without cause, we would accelerate any incentive stock options that would have vested in the three months after the effective date of Ms. Shaffer's termination or resignation to her effective termination date, and any of her vested incentive stock options must be exercised within a period ending three months after her effective termination date. Upon the termination of her employment contract due to a change in control, Ms. Shaffer's incentive stock options would have accelerated and vested upon the date of her termination. In December of 2001 the Board elected her to be our President and Chief Operating Officer effective January 1, 2001. Ms. Shaffer was terminated on July 3, 2001.

Item 12. Security Ownership of Certain Beneficial Owners and Management

The following table sets forth certain information regarding the beneficial ownership of the shares of our common stock as of April 30, 2002 by:

- each person we know to beneficially own more than 5% of our common stock,
- each director and nominee for director,
- each of our executive officers named in the Summary Compensation Table under "Executive Compensation," and
- all of our directors, nominees for director and executive officers as a group.

The number of shares of common stock outstanding on April 30, 2002 was 8,966,966 shares. Except as noted, all information with respect to beneficial ownership has been furnished by the respective director or officer or is based on filings with the Securities and Exchange Commission. Unless otherwise indicated below, the persons named below have sole voting and investment power with respect to the number of shares set forth opposite their names. Beneficial ownership of the common stock has been determined for this purpose in accordance with the Securities Exchange Act of 1934, as amended, which provides, among other things, that a person is deemed to be the beneficial owner of the common stock if that person, directly or indirectly, has or shares voting power or investment power in respect of such stock or has the right to acquire such ownership within sixty days. Accordingly, the amounts shown in the table do not purport to represent beneficial ownership for any purpose other than compliance with Securities and Exchange Commission reporting requirements. Further, beneficial ownership as determined in this manner does not necessarily bear on the economic incidence of ownership of the common stock. Unless otherwise indicated below, the address of those identified in the table is Aros Corporation, 1290 Bay Dale Drive, PMB 351, Arnold, MD 21012.

<u>Name of Beneficial Owner</u>	<u>Shares Beneficially Owned</u>	<u>Percentage Beneficially Owned</u>
Gerald E. Bisbee, Jr., Ph.D.(1)	1,286,830	13.65%
Allen & Company Incorporated(2)	890,107	9.60%
Caremark, Inc.(3)	732,269	8.16%
Timothy McNamara(4)	650,000	7.00%
Edwards Lifesciences LLC(5)	573,346	6.39%
Karen C. Miller	0	*
Alan W. Baldwin(6)	90,000	*
William R. Lewis(7)	90,000	*
Donald W. Seymour	0	*
Violet L. Shaffer	2,620	*
All Directors, Nominees and Executive Officers as a Group (five persons)(8)	1,469,450	15.83%

* Represents less than 1% of our outstanding common stock

- (1) Includes 136,830 shares of our common stock issuable upon exercise of vested options, 325,000 shares of our common stock issuable upon exercise of vested warrants and a 500,000 share grant, a portion of which we may repurchase if Dr. Bisbee terminates his relationship with us prior to a certain date. The address of Dr. Bisbee is 110 Wellesley Drive, New Canaan, CT 06840.
- (2) Includes 280,000 shares of common stock issuable upon exercise of vested warrants. The address of Allen & Company Incorporated is 711 Fifth Avenue, 9th Floor, New York, NY 10022.
- (3) Stock ownership is based on a Schedule 13G filed on May 18, 1998. Caremark, Inc. is a subsidiary of MedPartners, Inc. The address of Caremark, Inc., is 2215 Sanders Road, Suite 400, Northbrook, IL 60062.
- (4) Includes 325,000 shares of common stock issuable upon exercise of vested warrants. The address of Mr. McNamara is 7339 East Byers Ave., Denver, CO 80230.
- (5) Includes 573,346 shares previously owned by Baxter Healthcare Corporation, which transferred all of its shares to Edwards Lifesciences LLC on March 31, 2000 as part of a spin-off of Edwards Lifesciences Corporation and its subsidiaries by Baxter International Inc., parent of Baxter Healthcare Corporation. The address of Edwards Lifesciences LLC is One Edwards Way, Irvine, CA 92614.
- (6) Includes 90,000 shares of our common stock issuable upon exercise of vested options able to be exercised within 60 days of April 30, 2002.

- (7) Includes 90,000 shares of our common stock issuable upon exercise of vested options able to be exercised within 60 days of April 30, 2002.
- (8) Includes 136,830, 90,000, 90,000, 0 and 2,620 shares of our common stock, which Dr. Bisbee, Mr. Baldwin, Mr. Lewis, Ms. Miller and Ms. Shaffer, respectively, may acquire pursuant to outstanding options within 60 days of April 23, 2002. Also includes 325,000 shares of our common stock, which Dr. Bisbee may acquire pursuant to outstanding warrants within 60 days of April 30, 2002.

Item 13. Certain Relationships and Related Transactions

Director Compensation

Directors are entitled to reimbursement of expenses for attending each meeting of the Board and each meeting of any committee. In addition, effective January 1, 2001, Messrs. Baldwin and Lewis will receive \$2,500 per quarter as compensation for their services on the Board.

Our directors who are not also our employees are eligible to participate in our Non-Employee Director Stock Option Plan. The Chairman of the Board administers this plan along with other directors, if any, selected by the Chairman. Pursuant to this plan our non-employee directors receive options to purchase 2,500 shares of our common stock in January of each year. The exercise price of the options is to be no less than the fair market value of our common stock on the date of grant. Stock options granted under this plan have a term of 10 years and are not exercisable during the first 12 months following grant. We have reserved 70,000 shares of our common stock for issuance under this plan. The plan may be terminated by the Board at any time. Upon the occurrence of a Change of Control, as defined in the plan, all outstanding unvested options under the Director Option Plan immediately vest.

Non-employee directors are entitled to stock option grants under our Non-Employee Director Supplemental Stock Option Plan, which became effective as of January 1, 1999. Pursuant to this plan, 250,000 shares of our common stock are issuable to individuals who are non-employee members of the Board on the date of the grant.

During the first quarter of 2001, the Company granted to Gerald E. Bisbee, Jr., Ph.D., the Company's Chairman of the Board, 500,000 shares of restricted stock. The Company has an option to repurchase certain amounts of such grant by certain dates, with the Company's right to purchase any shares of such grant to expire by December 31, 2001. Dr. Bisbee received \$150,000 for services rendered in connection with the sale of assets to Cerner Corporation.

PART IV

Item 14. Exhibits, Financial Statement Schedules, and Reports on Form 8-K

- (a) List of documents filed as part of this report.
 - 1. The consolidated financial statement required by Part IV, Item 14 is included in Part II, Item 8.
 - 2. The financial statement schedules required by Part IV, Item 14 are included in Part II, Item 8.
- (b) Reports on Form 8-K.

During the quarter ended December 31, 2001, Aros did not file any current reports on Form 8-K.

(c) Exhibits

<u>EXHIBIT NO.</u>	<u>DESCRIPTION</u>
2.1	Agreement and Plan of Merger among the Company, NHA Acquisition Corporation, National Health Advisors, Ltd., Scott A. Mason and Donald W. Seymour dated as of June 2, 1997(5)
2.2	Agreement and Plan of Merger among the Company and MetaContent, Inc. dated as of March 21, 2001(15)
2.3	Asset Purchase Agreement between Cerner Corporation and the Company dated as of April 7, 2001(16)
2.4	Amendment No. 1 to Asset Purchase Agreement by and between Cerner Corporation and the Company dated as of June 11, 2001(16)
3.1	Amended and Restated Certificate of Incorporation(5)
3.2	Amended and Restated By-Laws(13)
3.3	Certificate of Amendment to the Certificate of Incorporation(19)
3.4	Rights Agreement between the Company and First Chicago Trust Company of New York, dated as of May 6, 1997(3)
3.5	APACHE Medical Systems, Inc. Employee Stock Option Plan(5)
3.6	APACHE Medical Systems, Inc. Employee Stock Option Plan, Amended and Restated Effective May 12, 1999(9)
3.7	APACHE Medical Systems, Inc. Non-Employee Director Option Plan(5)
3.8	Registration Agreement between the Company and Certain Stockholders, dated December 28, 1995(2)
3.9	Form of Warrant Agreement relating to warrants issued in 1995(2)
3.10	Nonqualified Stock Option Agreement between the Company and The Cleveland Clinic Foundation, dated August 19, 1994(2)
3.11	Registration Agreement between the Company and each of Iowa Health Centers, P.C. d/b/a Iowa Heart Center, P.C., Mercy Hospital Medical Center, Mark A. Tannenbaum, M.D. and Iowa Heart Institute dated January 7, 1997(1)
3.12	Nonqualified Stock Option Agreements between the Company and each of Iowa Health Centers, P.C. d/b/a Iowa Heart Center, P.C., Mercy Hospital Medical Center and Mark A. Tannenbaum, M.D., dated January 7, 1997(4)
3.13	Nonqualified Stock Option Agreement between the Company and William A. Knaus, M.D., dated May 29, 1997(5)
3.14	Form of Nonqualified Director Stock Option Agreement(6)
3.15	APACHE Medical Systems, Inc. Employee Stock Option Plan, Amended and Restated February 23, 1998, including forms of Incentive Stock Option Agreement and Nonqualified Stock Option Agreement(6)
3.16	APACHE Medical Systems, Inc. Non-Employee Director Supplemental Stock Option Plan, Amended and Restated effective May 12, 1999(9)
3.17	APACHE Medical Systems, Inc. Non-Employee Director Supplemental Stock Option Plan, Amended and Restated effective January 1, 2000(3)
3.18	APACHE Medical Systems, Inc. Non-Employee Director Supplemental Stock Option Plan, Amended and Restated effective December 9, 2000(13)
4.1	Specimen Common Stock Certificate(2)
10.1	Settlement Agreement and General Release by and between Cerner Corporation and the Company dated as of November 5, 2001

EXHIBIT NO.DESCRIPTION

23.1 Consent of Ernst Young LLP(13)

- (1) Incorporated herein by reference to the Company's Current Report on Form 8-K filed on January 14, 1997 (File No. 0-20805)
- (2) Incorporated herein by reference to the Company's Registration Statement on Form S-1 (File No. 333-04106)
- (3) Incorporated herein by reference to the Company's Current Report on Form 8-K filed on June 4, 1997 (File No. 0-20805)
- (4) Incorporated herein by reference to the Company's Report on Form 10-Q for the quarter ended March 31, 1997 (File No. 0-20805)
- (5) Incorporated herein by reference to the Company's Report on Form 10-Q for the quarter ended June 30, 1997 (File No. 0-20805)
- (6) Incorporated herein by reference to the Company's Report on Form 10-K for the year ended December 31, 1997 (File No. 0-20805)
- (7) Incorporated herein by reference to the Company's Report on Form 10-Q for the quarter ended June 30, 1998 (File No. 0-20805)
- (8) Incorporated herein by reference to the Company's Report on Form 10-K for the year ended December 31, 1998 (File No. 0-20805)
- (9) Incorporated herein by reference to the Company's Report on Form 10-Q for the quarter ended March 31, 1999 (File No. 0-20805)
- (10) Incorporated herein by reference to the Company's Report on Form 10-Q for the quarter ended September 30, 1999 (File No. 0-20805)
- (11) Incorporated herein by reference to the Company's Report on Form 10-K for the year ended December 31, 1999 (File No. 0-20805)
- (12) Incorporated herein by reference to the Company's Report on Form 10-Q for the quarter ended June 30, 2000 (File No. 0-20805)
- (13) Incorporated herein by reference to the Company's Report on Form 10-K for the year ended December 31, 2000 (File No. 0-20805)
- (14) Incorporated herein by reference to the Company's Definitive Proxy Statement filed pursuant to Schedule 14A on May 1, 2001 (File No. 0-20805)
- (15) Incorporated herein by reference to the Company's Report on Form 10-Q/A for the quarter ended March 31, 2001 (File No. 0-20805)
- (16) Incorporated herein by reference to the Company's Report on Form 8-K dated April 12, 2001 (File No. 0-20805)
- (17) Incorporated herein by reference to the Company's Current Report on Form 8-K filed on July 18, 2001 (File No. 0-20805)
- (18) Incorporated herein by reference to the Company's Current Report on Form 8-K/A filed on September 17, 2001 (File No. 0-20805)
- (19) Incorporated herein by reference to the Company's Report on Form 10-Q for the quarter ended June 30, 2001 (File No. 000-20805)
- (20) Incorporated herein by reference to the Company's Report on Form 10-Q for the quarter ended September 30, 2001 (File No. 000-20805)

(d) Financial Statement Schedules

Not applicable.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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, on April 1, 2002.

APACHE MEDICAL SYSTEMS, INC.

By: /s/ GERALD E. BISBEE, JR., PH.D.
Gerald E. Bisbee, Jr.
President

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below on April 1, 2002 by the following persons on behalf of the Registrant in the capacities indicated.

<u>Signature</u>	<u>Capacity</u>
<u>/s/ GERALD E. BISBEE, JR., PH.D.</u> Gerald E. Bisbee, Jr., Ph.D.	President, Director and Chairman of the Board
<u>/s/ WILLIAM R. LEWIS</u> William R. Lewis	Director
<u>/s/ ALAN W. BALDWIN</u> Alan W. Baldwin	Director

**AROS CORPORATION
BOARD OF DIRECTORS**

**Gerald E. Bisbee, Jr., Ph.D.
President, Chairman &
Chief Executive Officer
ReGen Biologics, Inc.**

**William R. Lewis
Financial Consultant**

**Alan W. Baldwin
Chief Executive Officer
Alcore Inc.**