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

FORM 10-Q

(Mark One)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2017

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE EXCHANGE ACT

For the transition period from _________ to _________

Commission file number 001-15757

IMAGEWARE SYSTEMS, INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	**33-0224167**
(State or Other Jurisdiction of Incorporation or Organization)	(IRS Employer Identification No.)

10815 Rancho Bernardo Rd., Suite 310
San Diego, CA 92127
(Address of Principal Executive Offices)

(858) 673-8600
(Registrant's Telephone Number, Including Area Code)

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

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

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

Large accelerated filer	[ ]	Accelerated filer	[X]
Non-accelerated filer	[ ]	Smaller reporting company	[ ]
		Emerging growth company	[ ]

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-12 of the Exchange Act). Yes [ ] No [X]

The number of shares of common stock, with $0.01 par value, outstanding on August 14, 2017 was 93,141,118.

IMAGEWARE SYSTEMS, INC.
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PART I

ITEM 1. FINANCIAL STATEMENTS

IMAGEWARE SYSTEMS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In Thousands, except for share and per share data)

	June 30, 2017	December 31, 2016
ASSETS	(Unaudited)	
Current Assets:		
Cash	$ 104	$ 1,586
Accounts receivable, net of allowance for doubtful accounts of $16 at June 30, 2017 and $1 at December 31, 2016.	332	287
Inventory, net	53	23
Other current assets	148	135
Total Current Assets	637	2,031
Property and equipment, net	62	93
Other assets	35	34
Intangible assets, net of accumulated amortization	100	106
Goodwill	3,416	3,416
Total Assets	**$ 4,250**	**$ 5,680**
LIABILITIES AND SHAREHOLDERS’ DEFICIT		
Current Liabilities:		
Accounts payable	$ 343	$ 425
Deferred revenue	608	1,045
Accrued expenses	1,237	1,047
Convertible lines of credit to related parties, net of discount	—	2,528
Total Current Liabilities	2,188	5,045
Convertible lines of credit to related parties, net of discount	5,687	—
Pension obligation	1,955	1,895
Total Liabilities	9,830	6,940
Shareholders’ Deficit:		
Preferred stock, authorized 4,000,000 shares:		
Series B Convertible Redeemable Preferred Stock, $0.01 par value; designated 750,000 shares, 389,400 shares issued, and 239,400 shares outstanding at June 30, 2017 and December 31, 2016; liquidation preference $607 at June 30, 2017 and December 31, 2016.	2	2
Series E Convertible Redeemable Preferred Stock, $0.01 par value; designated 12,000 shares, 12,000 shares issued and outstanding at June 30, 2017 and December 31, 2016; liquidation preference $12,000 at June 30, 2017 and December 31, 2016.	—	—
Series F Convertible Redeemable Preferred Stock, $0.01 par value; designated	—	—

2,000 shares, 2,000 shares issued and outstanding at June 30, 2017 and December 31, 2016; liquidation preference $2,000 at June 30, 2017 and December 31, 2016.		
Series G Convertible Redeemable Preferred Stock, $0.01 par value; designated 6,120 shares, 6,021 shares issued and outstanding at June 30, 2017 and December 31, 2016; liquidation preference $6,021 at June 30, 2017 and December 31, 2016.	—	—
Common Stock, $0.01 par value, 150,000,000 shares authorized; 93,147,822 and 91,853,499 shares issued at June 30, 2017 and December 31, 2016, respectively, 93,141,118 and 91,846,795 shares outstanding at June 30, 2017 and December 31, 2016, respectively.	930	917
Additional paid-in capital	158,236	156,195
Treasury stock, at cost 6,704 shares	(64)	(64)
Accumulated other comprehensive loss	(1,621)	(1,543)
Accumulated deficit	(163,063)	(156,767)
Total Shareholders' Deficit	(5,580)	(1,260)
Total Liabilities and Shareholders' Deficit	**$ 4,250**	**$ 5,680**

The accompanying notes are an integral part of these condensed consolidated financial statements.

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IMAGEWARE SYSTEMS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In Thousands, except share and per share amounts)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	**2016**	**2017**	**2016**
Revenue:				
Product	$ 407	$ 356	$ 680	$ 759
Maintenance	653	640	1,309	1,280
	1,060	996	1,989	2,039
Cost of revenue:				
Product	36	56	90	130
Maintenance	214	219	423	424
Gross profit	810	721	1,476	1,485
Operating expense:				
General and administrative	1,042	899	2,087	1,905
Sales and marketing	702	743	1,463	1,416
Research and development	1,479	1,318	2,943	2,631
Depreciation and amortization	17	35	38	70
	3,240	2,995	6,531	6,022
Loss from operations	(2,430)	(2,274)	(5,055)	(4,537)
Interest expense, net	164	36	264	46
Other income, net	(50)	(200)	(50)	(200)
Loss before income taxes	(2,544)	(2,110)	(5,269)	(4,383)

Income tax expense	3	4	7	6
Net loss	(2,547)	(2,114)	(5,276)	(4,389)
Preferred dividends	(514)	(309)	(1,021)	(657)
Net loss available to common shareholders	$ (3,061)	$ (2,423)	$ (6,297)	$ (5,046)
Basic and diluted loss per common share - see Note 3:				
Net loss	$ (0.03)	$ (0.02)	$ (0.06)	$ (0.05)
Preferred dividends	(0.00)	(0.01)	(0.01)	(0.00)
Basic and diluted loss per share available to common shareholders	$ (0.03)	$ (0.03)	$ (0.07)	$ (0.05)
Basic and diluted weighted-average shares outstanding	92,539,230	94,298,567	92,203,567	94,185,967

The accompanying notes are an integral part of these condensed consolidated financial statements.

IMAGEWARE SYSTEMS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(In Thousands)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	**2016**	**2017**	**2016**
Net loss	$ (2,547)	$ (2,114)	$ (5,276)	$ (4,389)
Other comprehensive income (loss):				
Foreign currency translation adjustment	(61)	23	(78)	(31)
Comprehensive loss	$ (2,608)	$ (2,091)	$ (5,354)	$ (4,420)

The accompanying notes are an integral part of these condensed consolidated financial statements.

IMAGEWARE SYSTEMS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands)
(Unaudited)

Six Months Ended

	June 30, 2017	June 30, 2016
Cash flows from operating activities		
Net loss	$ (5,276)	$ (4,389)
Adjustments to reconcile net loss to net cash used by operating activities:		
Depreciation and amortization	38	70
Amortization of debt issuance costs and beneficial conversion feature	97	37
Reduction in accrued expense from the expiration of statute of limitations	—	(200)
Provision for losses on accounts receivable	15	—
Stock-based compensation	550	565
Gain from sale of trademark	(50)	—
Change in assets and liabilities		
Accounts receivable	(60)	75
Inventory	(30)	(28)
Other assets	(21)	(73)
Accounts payable	(82)	—
Deferred revenue	(438)	(434)
Accrued expenses	192	(129)
Pension obligation	60	81
Total adjustments	271	(36)
Net cash used in operating activities	(5,005)	(4,425)
Cash flows from investing activities		
Purchase of property and equipment	(1)	(44)
Proceeds received from sale of trademark	50	—
Net cash used in investing activities	49	(44)
Cash flows from financing activities		
Proceeds from exercised stock options	227	—
Proceeds from lines of credit, net	3,350	1,500
Dividends paid	(25)	(25)
Net cash provided by financing activities	3,552	1,475
Effect of exchange rate changes on cash	(78)	(31)
Net decrease in cash	(1,482)	(3,025)
Cash at beginning of period	1,586	3,352
Cash at end of period	$ 104	$ 327
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ —	$ 1
Cash paid for income taxes	$ —	$ —
Summary of non-cash investing and financing activities:		
Beneficial conversion feature on convertible related party lines of credit	$ 281	$ 121
Stock dividend on Convertible Redeemable Preferred Stock	$ 996	$ 631

The accompanying notes are an integral part of these condensed consolidated financial statements.

IMAGEWARE SYSTEMS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1. ORGANIZATION AND DESCRIPTION OF BUSINESS

Overview

As used in this Quarterly Report, "we," "us," "our," "ImageWare," "ImageWare Systems," "Company" or "our Company" refers to ImageWare Systems, Inc. and all of its subsidiaries. ImageWare Systems, Inc. is incorporated in the state of Delaware. The Company is a pioneer and leader in the emerging market for biometrically enabled software-based identity management solutions. Using those human characteristics that are unique to us all, the Company creates software that provides a highly reliable indication of a person's identity. The Company's "flagship" product is the patented IWS Biometric Engine®. The Company's products are used to manage and issue secure credentials, including national IDs, passports, driver licenses and access control credentials. The Company's products also provide law enforcement with integrated mug shot, fingerprint LiveScan and investigative capabilities. The Company also provides comprehensive authentication security software using biometrics to secure physical and logical access to facilities or computer networks or internet sites. Biometric technology is now an integral part of all markets the Company addresses and all of the products are integrated into the IWS Biometric Engine.

Liquidity, Going Concern and Management's Plan

Historically, our principal sources of cash have included customer payments from the sale of our products, proceeds from the issuance of common and preferred stock and proceeds from the issuance of debt, including our Lines of Credit (defined below). Our principal uses of cash have included cash used in operations, product development, payments relating to purchases of property and equipment and repayments of borrowings. We expect that our principal uses of cash in the future will be for product development including customization of identity management products for enterprise and consumer applications, further development of intellectual property, development of Software-as-a-Service ("*SaaS*") capabilities for existing products as well as general working capital and capital expenditure requirements. Management expects that, as our revenues grow, our sales and marketing and research and development expenses will continue to grow, albeit at a slower rate and, as a result, we will need to generate significant net revenues to achieve and sustain income from operations.

Going Concern

At June 30, 2017, we had a working capital deficit of approximately $1,551,000. Our principal sources of liquidity at June 30, 2017 consisted of approximately $104,000 of cash and $332,000 of trade accounts receivable.

Considering our projected cash requirements, our available cash will be insufficient to satisfy our cash requirements for the next twelve months from the date of this filing. These factors raise substantial doubt about our ability to continue as a going concern. To address our working capital requirements, management will continue to seek additional equity and/or debt financing through the issuance of additional debt and/or equity securities prior to the end of the quarter ended September 30, 2017. There are currently no formal committed financing arrangements to support our projected cash shortfall, including commitments to purchase additional debt and/or equity securities, and no assurances can be given that we will be successful in raising additional debt and/or equity securities.

In view of the matters described in the preceding paragraph, recoverability of a major portion of the recorded asset amounts shown in the accompanying consolidated balance sheet is dependent upon continued operations of the Company, which, in turn, is dependent upon the Company's ability to continue to raise capital and generate positive cash flows from operations. However, the Company operates in markets that are emerging and highly competitive. There is no assurance that the Company will be able to obtain additional capital, operate at a profit or generate positive cash flows in the future.

These condensed consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts and classifications of liabilities that might be necessary should the Company be unable to continue as a going concern.

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NOTE 2. SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATION

Basis of Presentation

The accompanying condensed consolidated balance sheet as of December 31, 2016, which has been derived from audited financial statements, and the unaudited interim condensed consolidated financial statements have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America ("*GAAP*") and the rules and regulations of the Securities and Exchange Commission ("*SEC*") related to a quarterly report on Form 10-Q. Certain information and note disclosures normally included in annual financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to those rules and regulations, although the Company believes that the disclosures made are adequate to make the information not misleading. The interim financial statements reflect all adjustments, which, in the opinion of management, are necessary for a fair statement of the results for the periods presented. All such adjustments are of a normal and recurring nature. These unaudited condensed consolidated financial statements should be read in conjunction with the Company's audited financial statements for the year ended December 31, 2016, which are included in the Company's Annual Report on Form 10-K for the year ended December 31, 2016 that was filed with the SEC on March 30, 2017.

Operating results for the three and six months ended June 30, 2017 are not necessarily indicative of the results that may be expected for the year ended December 31, 2017, or any other future periods.

Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. The Company's wholly-owned subsidiaries are XImage Corporation, a California Corporation, ImageWare Systems ID Group, Inc. a Delaware corporation (formerly Imaging Technology Corporation), I.W. Systems Canada Company, a Nova Scotia unlimited liability company, ImageWare Digital Photography Systems, Inc., LLC a Nevada limited liability company (formerly Castleworks LLC), Digital Imaging International GmbH, a company formed under German laws and Image Ware Mexico S de RL de CV, a company formed under Mexican laws. All significant intercompany transactions and balances have been eliminated.

Use of Estimates

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ("*U.S. GAAP*") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenue and expense during the reporting period. Significant estimates include the evaluation of our ability to continue as a going concern, the allowance for doubtful accounts receivable, inventory carrying values, deferred tax asset valuation allowances, accounting for loss contingencies, recoverability of goodwill and acquired intangible assets and amortization periods, assumptions used in the Black-Scholes model to calculate the fair value of share based payments, revenue and cost of revenues recognized under the percentage of completion method and assumptions used in the application of fair value methodologies to calculate the fair value of pension assets and obligations. Actual results could differ from estimates.

Accounts Receivable

In the normal course of business, the Company extends credit without collateral requirements to its customers that satisfy pre-defined credit criteria. Accounts receivable are recorded net of an allowance for doubtful accounts. Accounts receivable are considered delinquent when the due date on the invoice has passed. The Company records its allowance for doubtful accounts based upon its assessment of various factors. The Company considers historical experience, the age of the accounts receivable balances, the credit quality of its customers, current economic conditions and other factors that may affect customers' ability to pay to determine the level of allowance required. Accounts receivable are written off against the allowance for doubtful accounts when all collection efforts by the Company have been unsuccessful.

Inventories

Finished goods inventories are stated at the lower of cost, determined using the average cost method, or market. See Note 4, "*Inventory*," below.

Fair Value of Financial Instruments

For certain of the Company's financial instruments, including accounts receivable, accounts payable, accrued expenses, deferred revenues and lines of credit payable to related parties, the carrying amounts approximate fair value due to their relatively short maturities.

Revenue Recognition

The Company recognizes revenue from the following major revenue sources:

- Long-term fixed-price contracts involving significant customization
- Fixed-price contracts involving minimal customization
- Software licensing
- Sales of computer hardware and identification media
- Post-contract customer support (" *PCS*")

The Company's revenue recognition policies are consistent with GAAP including the Financial Accounting Standards Board ("*FASB*"), Accounting Standards Codification ("*ASC*") 985-605, *Software Revenue Recognition*, ASC 605-35, *Revenue Recognition, Construction-Type and Production-Type Contracts*, SEC Staff Accounting Bulletin 104, and ASC 605-25, *Revenue Recognition, Multiple Element Arrangements*. Accordingly, the Company recognizes revenue when all of the following criteria are met: (i) persuasive evidence that an arrangement exists, (ii) delivery has occurred or services have been rendered, (iii) the fee is fixed or determinable and (iv) collectability is reasonably assured.

The Company recognizes revenue and profit as work progresses on long-term, fixed-price contracts involving significant amounts of hardware and software customization using the percentage of completion method based on costs incurred to date, compared to total estimated costs upon completion. The primary components of costs incurred are third party software and direct labor cost including fringe benefits. Revenue recognized in excess of amounts billed are classified as current assets under "Costs and estimated earnings in excess of billings on uncompleted contracts". Amounts billed to customers in excess of revenue recognized are classified as current liabilities under "Billings in excess of costs and estimated earnings on uncompleted contracts". Revenue from contracts for which the Company cannot reliably estimate total costs, or there are not significant amounts of customization, are recognized upon completion. For contracts that require significant amounts of customization that the Company accounts for under the completed contract method of revenue recognition, the Company defers revenue recognition until customer acceptance is received. For contracts containing either extended or dependent payment terms, revenue recognition is deferred until such time as payment has been received by the Company. The Company also generates non-recurring revenue from the licensing of its software. Software license revenue is recognized upon the execution of a license agreement, upon deliverance, when fees are fixed and determinable, when collectability is probable and when all other significant obligations have been fulfilled. The Company also generates revenue from the sale of computer hardware and identification media. Revenue for these items is recognized upon delivery of these products to the customer. The Company's revenue from periodic maintenance agreements is generally recognized ratably over the respective maintenance periods provided no significant obligations remain and collectability of the related receivable is probable. Amounts collected in advance for maintenance services are included in current liabilities under "Deferred revenue". Sales tax collected from customers is excluded from revenue.

Customer Concentration

For the three months ended June 30, 2017, one customer accounted for approximately 17% or $184,000 of our total revenue and had trade receivables at June 30, 2017of $0. For the six months ended June 30, 2017, one customer accounted for approximately 19% or $368,000 of our total revenue and had trade receivables at June 30, 2017of $0.

For the three months ended June 30, 2016, two customers accounted for approximately 31% or $313,000 of our total revenue and had trade receivables at June 30, 2016 of $0. For the six months ended June 30, 2016, two customers accounted for approximately 32% or $644,000 of our total revenue and had trade receivables at June 30, 2016 of $53,000.

Recently Issued Accounting Standards

From time to time, new accounting pronouncements are issued by the Financial Accounting Standards Board (the "*FASB*"), or other standard setting bodies, which are adopted by us as of the specified effective date. Unless otherwise discussed, the Company's management believes the impact of recently issued standards not yet effective will not have a material impact on the Company's consolidated financial statements upon adoption.

FASB ASU No. 2014-09. In May 2014, FASB issued Accounting Standards Update ("*ASU*") No. 2014-09, *Revenue from Contracts with Customers*, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. ASU No. 2014-09 will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. In July 2015, the FASB finalized a one-year deferral of the effective date of the new standard. For public entities, the deferral results in the new revenue standard being effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Calendar year-end public companies are therefore required to apply the revenue guidance beginning in their 2018 interim and annual financial statements. The standard permits the use of either the retrospective or cumulative effect transition method. We currently anticipate adopting the standard using the cumulative effect transition method during the first fiscal quarter in 2018.

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FASB ASU No. 2016-01. In January 2016, the FASB issued ASU 2016-01, "*Financial Instruments—Overall - Recognition and Measurement of Financial Assets and Financial Liabilities".* The amendments in this ASU address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments and apply to all entities that hold financial assets or owe financial liabilities. The amendments in this ASU also simplify the impairment assessment of equity investments without readily determinable fair values by requiring assessment for impairment qualitatively at each reporting period. That impairment assessment is similar to the qualitative assessment for long-lived assets, goodwill, and indefinite-lived intangible assets. This ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, with earlier application permitted for financial statements that have not been issued. An entity should apply the amendments by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. We plan to adopt the provisions of this ASU for our fiscal year beginning January 1, 2018 and are currently evaluating the impact the adoption of this new accounting standard will have on our consolidated financial statements.

FASB ASU No. 2016-02. In February 2016, the FASB issued ASU No. 2016-02, "*Leases".* This guidance will result in key changes to lease accounting and will aim to bring leases onto balance sheets to give investors, lenders, and other financial statement users a more comprehensive view of a company's long-term financial obligations as well as the assets it owns versus leases. The new leasing standard will be effective for fiscal years beginning after December 15, 2018, and for interim periods within those fiscal years. The Company is currently evaluating the impact this guidance will have on our consolidated financial statements and anticipates commencement of adoption planning in the first fiscal quarter of 2019.

FASB ASU No. 2016-08. In March 2016, the FASB issued Accounting Standards Update No. 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)* ("*ASU 2016-08*"). ASU 2016-08 clarifies the implementation guidance on principal versus agent considerations. The guidance includes indicators to assist an entity in determining whether it controls a specified good or service before it is transferred to the customers. This guidance is effective for fiscal years beginning after December 15, 2017 including interim periods within those fiscal years. The Company is currently assessing the impact that adopting this new accounting standard will have on its consolidated financial statements and footnote disclosures.

FASB ASU No. 2016-10. In April 2016, the FASB issued Accounting Standards Update No. 2016-10, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing* ("*ASU 2016-10*"). ASU 2016-10 provides further implementation guidance on identifying performance obligations and also improves the operability and understandability of the licensing implementation guidance. This guidance is effective for fiscal years beginning after December 15, 2017 including interim periods within those fiscal years. The Company is currently assessing the impact that adopting this new accounting standard will have on its consolidated financial statements and footnote disclosures.

FASB ASU No. 2016-13. In June 2016, the FASB issued Accounting Standard Update No. 2016-13, F*inancial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.* ASU No. 2016-13 changes the impairment model for most financial assets and certain other instruments. For trade and other receivables, held-to-maturity debt securities, loans and other instruments, entities will be required to use a new forward-looking "expected loss" model that will replace today's "incurred loss" model and generally will result in the earlier recognition of allowances for losses. For available-for-sale debt securities with unrealized losses, entities will measure credit losses in a manner similar to current practice, except that the losses will be recognized as an allowance. This guidance is effective for fiscal years beginning after December 15, 2019 including interim periods within those fiscal years. The Company is currently evaluating the potential impact of adoption of this standard on its consolidated financial statements.

FASB ASU No. 2016-15. In August 2016, the FASB issued Accounting Standards Update No. 2016-15, *Statement of Cash Flows (Topic 230) Classification of Certain Cash Receipts and Cash Payments.* ASU 2016-15 eliminates the diversity in practice related to the classification of certain cash receipts and payments for debt prepayment or extinguishment costs, the maturing of a zero-coupon bond, the settlement of contingent liabilities arising from a business combination, proceeds from insurance settlements, distributions from certain equity method investees and beneficial interests obtained in a financial asset securitization. ASU 2016-15 designates the appropriate cash flow classification, including requirements to allocate certain components of these cash receipts and payments among operating, investing and financing activities. This guidance is effective for fiscal years beginning after December 15, 2017 including interim periods within those fiscal years. The retrospective transition method, requiring adjustment to all comparative periods presented, is required unless it is impracticable for some of the amendments, in which case those amendments would be prospectively as of the earliest date practicable. The Company is currently assessing the impact that adopting this new accounting standard will have on its consolidated financial statements and footnote disclosures.

FASB ASU No. 2017-04. In January 2017, the FASB issued ASU No. 2017-04, *Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment.* The amendments of this ASU eliminate step 2 from the goodwill impairment test. The annual, or interim test is performed by comparing the fair value of a reporting unit with its carrying amount. The amendments of this ASU also eliminate the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and if it fails that qualitative test, to perform step 2 of the goodwill impairment test. ASU No. 2017-04 is effective for fiscal years beginning after December 15, 2019. The Company is currently evaluating the potential impact of adoption of this standard on its consolidated financial statements.

FASB ASU No. 2017-09. In May 2017, the FASB issued ASU No. 2017-09, "*Scope of Modification Accounting*", to reduce diversity in practice and provide clarity regarding existing guidance in ASC 718, "*Stock Compensation*". The amendments in this updated guidance clarify that an entity should apply modification accounting in response to a change in the terms and conditions of an entity's share-based payment awards unless three newly specified criteria are met. This guidance is effective for fiscal years beginning after December 15, 2017, including interim periods within that reporting period. Early adoption is permitted. The Company is currently evaluating the potential impact of this updated guidance on its consolidated financial statements.

FASB ASU No. 2017-11. In July 2017, the FASB issued ASU No 2017-11, "*Earnings Per Share (Topic 260); Distinguishing Liabilities from Equity (Topic 480); Derivatives and Hedging (Topic 815): (Part I) Accounting for Certain Financial Instruments with Down Round Features, (Part II) Replacement of the Indefinite Deferral*". The ASU applies to issuers of financial instruments with down-round features. It amends (1) the classification of such instruments as liabilities or equity by revising the guidance in ASC 815 on the evaluation of whether instruments or embedded features with down-round provisions must be accounted for as derivative instruments and (2) the guidance on recognition and measurement of the value transferred upon the trigger of a down-round feature for equity-classified instruments by revising ASC 260. The ASU is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. For all other organizations, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted. The Company is currently evaluating the potential impact of this updated guidance on its consolidated financial statements.

NOTE 3. NET LOSS PER COMMON SHARE

Basic loss per common share is calculated by dividing net loss available to common shareholders for the period by the weighted-average number of common shares outstanding during the period. Diluted loss per common share is calculated by dividing net loss available to common shareholders for the period by the weighted-average number of common shares outstanding during the period, adjusted to include, if dilutive, potential dilutive shares consisting of convertible preferred stock, convertible related party lines of credit, stock options and warrants, calculated using the treasury stock and if-converted methods. For diluted loss per share calculation purposes, the net loss available to common shareholders is adjusted to add back any preferred stock dividends and any interest on convertible debt reflected in the condensed consolidated statement of operations for the respective periods.

The table below presents the computation of basic and diluted loss per share:

(Amounts in thousands except share and per share amounts)	**Three Months Ended June 30,**		**Six Months Ended June 30,**	
	2017	**2016**	**2017**	**2016**
Numerator for basic and diluted loss per share:				
Net loss	$ (2,547)	$ (2,114)	$ (5,276)	$ (4,389)
Preferred dividends	(514)	(309)	(1,021)	(657)
Net loss available to common shareholders	$ (3,061)	$ (2,423)	$ (6,297)	$ (5,046)
Denominator for basic and dilutive loss per share – weighted-average shares outstanding	92,539,230	94,298,567	92,203,567	94,185,967
Net loss	$ (0.03)	$ (0.02)	$ (0.06)	$ (0.05)
Preferred dividends	(0.00)	(0.01)	(0.01)	(0.00)
Basic and diluted loss per share available to common shareholders	$ (0.03)	$ (0.03)	$ (0.07)	$ (0.05)

The following potential dilutive securities have been excluded from the computations of diluted weighted-average shares outstanding as their effect would have been antidilutive:

Potential Dilutive securities	**Three and Six Months Ended June 30,**	
	2017	**2016**
Related party lines of credit	5,016,236	1,209,635
Convertible redeemable preferred stock	11,709,151	6,361,818
Stock options	6,171,555	5,582,136
Warrants	175,000	450,000
Total potential dilutive securities	23,071,942	13,603,589

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NOTE 4. SELECT BALANCE SHEET DETAILS

Inventory

Inventories of $53,000 as of June 30, 2017 were comprised of work in process of $47,000 representing direct labor costs on in-process projects and finished goods of $6,000 net of reserves for obsolete and slow-moving items of $3,000.

Inventories of $23,000 as of December 31, 2016 were comprised of work in process of $19,000 representing direct labor costs on in-process projects and finished goods of $4,000 net of reserves for obsolete and slow-moving items of $3,000.

Intangible Assets

The carrying amounts of the Company's patent intangible assets were $100,000 and $106,000 as of June 30, 2017 and December 31, 2016, respectively, which includes accumulated amortization of $560,000 and $554,000 as of June 30, 2017 and December 31, 2016, respectively. Amortization expense for patent intangible assets was $3,000 and $6,000 for the three and six months ended June 30, 2017 and 2016, respectively. Patent intangible assets are being amortized on a straight-line basis over their remaining life of approximately 9.0 years.

The estimated acquired intangible amortization expense for the next five fiscal years is as follows:

Fiscal Year Ended December 31,	**Estimated Amortization Expense ($ in thousands)**
2017 (six months)	$ 6
2018	12
2019	12
2020	12
2021	12
Thereafter	46
Totals	$ 100

Goodwill

The Company annually, or more frequently if events or circumstances indicate a need, tests the carrying amount of goodwill for impairment. A two-step impairment test is used to first identify potential goodwill impairment and then measure the amount of goodwill impairment loss, if any. The first step was conducted by determining and comparing the fair value, employing the market approach, of the Company's reporting unit to the carrying value of the reporting unit. The Company continues to have only one reporting unit, Identity Management. Based on the results of this impairment test, the Company determined that its goodwill was not impaired as of June 30, 2017 and December 31, 2016.

NOTE 5. LINES OF CREDIT WITH RELATED PARTIES

Outstanding lines of credit consist of the following:

($ in thousands)	**June 30, 2017**	**December 31, 2016**
Lines of Credit		
8% convertible lines of credit. Face value of advances under lines of credit $6,000 and $2,650 at June 30, 2017 and December 31, 2016, respectively. Discount on advances under lines of credit is $313 at June 30, 2017 and $122 at December 31, 2016. Maturity date is December 31, 2018.	$ 5,687	$ 2,528

Total lines of credit to related parties	5,687	2,528
Less current portion	(—)	(2,528)
Long-term lines of credit to related parties	$ 5,687	$ —

Lines of Credit

In March 2013, the Company and Neal Goldman, a member of the Company’s Board of Directors (“*Goldman*”), entered into a line of credit (the “*Goldman Line of Credit*”) with available borrowings of up to $2.5 million. In March 2014, the Goldman Line of Credit’s borrowing was increased to an aggregate total of $3.5 million (the “*Amendment*”). Pursuant to the terms and conditions of the Amendment, Goldman had the right to convert up to $2.5 million of the outstanding balance of the Goldman Line of Credit into shares of the Company's Common Stock for $0.95 per share. Any remaining outstanding balance was convertible into shares of the Company's Common Stock for $2.25 per share.

As consideration for the initial Goldman Line of Credit, the Company issued a warrant to Goldman, exercisable for 1,052,632 shares of the Company’s Common Stock (the "*Line of Credit Warrant*"). The Goldman Line of Credit Warrant had a term of two years from the date of issuance and an exercise price of $0.95 per share. As consideration for entering into the Amendment, the Company issued to Goldman a second warrant, exercisable for 177,778 shares of the Company’s Common Stock (the “*Amendment Warrant*”). The Amendment Warrant expired on March 27, 2015 and had an exercise price of $2.25 per share.

The Company estimated the fair value of the Line of Credit Warrant using the Black-Scholes option pricing model using the following assumptions: term of two years, a risk-free interest rate of 2.58%, a dividend yield of 0%, and volatility of 79%. The Company recorded the fair value of the Line of Credit Warrant as a deferred financing fee of approximately $580,000 to be amortized over the life of the Goldman Line of Credit. The Company estimated the fair value of the Amendment Warrant using the Black-Scholes option pricing model using the following assumptions: term on one year, a risk-free interest rate of 2.58%, a dividend yield of 0% and volatility of 74%. The Company recorded the fair value of the Amendment Warrant as an additional deferred financing fee of approximately $127,000 to be amortized over the life of the Goldman Line of Credit.

During the three and six months ended June 30, 2017, the Company recorded an aggregate of approximately $2,000 and $7,000, respectively in deferred financing fee amortization expense. During the three and six months ended June 30, 2016, the Company recorded an aggregate of approximately $12,000 and $24,000, respectively in deferred financing fee amortization expense. Such expense is recorded as a component of interest expense in the Company’s condensed consolidated statements of operations.

In April 2014, the Company and Goldman entered into a further amendment to the Goldman Line of Credit to decrease the available borrowings to $3.0 million (the “*Second Amendment*”). Contemporaneous with the execution of the Second Amendment, the Company entered into a new unsecured line of credit with Charles Crocker, a member of the Company’s Board of Directors (“*Crocker*”), with available borrowings of up to $500,000 (the “*Crocker LOC*”), which amount was convertible into shares of the Company’s Common Stock for $2.25 per share. As a result of these amendments, total available borrowings under the Lines of Credit available to the Company remained unchanged at a total of $3.5 million. In connection with the Second Amendment, Goldman assigned and transferred to Crocker one-half of the Amendment Warrant.

In December 2014, the Company and Goldman entered into a further amendment to the Goldman Line of Credit to increase the available borrowing to $5.0 million and extend the maturity date of the Goldman Line of Credit to March 27, 2017 (the “*Third Amendment*”). Also, as a result of the Third Amendment, Goldman had the right to convert up to $2.5 million outstanding principal, plus any accrued but unpaid interest ("*Outstanding Balance*") into shares of the Company's Common Stock for $0.95 per share, the next $500,000 Outstanding Balance into shares of Common Stock for $2.25 per share and any remaining outstanding balance thereafter into shares of Common Stock for $2.30 per share. The Third Amendment also modified the definition of a "Qualified Financing" to mean a debt or equity financing resulting in gross proceeds to the Company of at least $5.0 million.

In February 2015, as a result of the Series E Financing, the Company issued 1,978 shares of Series E Preferred to Goldman to satisfy $1,950,000 in principal borrowings under the Goldman Line of Credit plus approximately $28,000 in accrued interest. As a result of the Series E Financing, the Company's borrowing capacity under the Goldman Line of Credit was reduced to $3,050,000 with the maturity date unchanged and the Crocker LOC was terminated in accordance with its terms.

In March 2016, the Company and Goldman entered into a fourth amendment to the Goldman Line of Credit (the "*Fourth Amendment*") solely to (i) increase available borrowings to $5.0 million; (ii) extend the maturity date to June 30, 2017, and (iii) provide for the conversion of the outstanding balance due under the terms of the Goldman Line of Credit into that number of fully paid and non-assessable shares of the Company's Common Stock as is equal to the quotient obtained by dividing the outstanding balance by $1.25.

Contemporaneous with the execution of the Fourth Amendment, the Company entered into a new $500K Line of Credit (the "*New Crocker LOC*") with available borrowings of up to $500,000 with Crocker, which replaced the original Crocker LOC that terminated as a result of the consummation of the Series E Financing. Similar to the Fourth Amendment, the New Crocker LOC with Crocker originally matured on June 30, 2017, and provides for the conversion of the outstanding balance due under the terms of the New Crocker LOC into that number of fully paid and non-assessable shares of the Company's Common Stock as is equal to the quotient obtained by dividing the outstanding balance by $1.25.

On December 27, 2016, in connection with the consummation of the Series G Financing, the Company and Holder agreed to enter into the Fifth Amendment (the "*Line of Credit Amendment*") to the Goldman Line of Credit to provide the Company with the ability to borrow up to $5.5 million under the terms of the Goldman Line of Credit. In addition, the Maturity Date, as defined in the Goldman Line of Credit was amended to be December 31, 2017. The Line of Credit Amendment was executed on January 23, 2017.

In addition, on January 23, 2017, the Company and Crocker amended the New Crocker LOC to extend the maturity date thereof to December 31, 2017. No other amendments were made to the New Crocker LOC.

On May 10, 2017, Goldman and Crocker agreed to further extend the maturity dates of Lines of Credit to December 31, 2018.

As the aforementioned amendments to the Lines of Credit resulted in an increase to the borrowing capacity of the Lines of Credit, the Company adjusted the amortization period of any remaining unamortized deferred costs and note discounts to the term of the new arrangement.

The Company evaluated the Lines of Credit and determined that the instruments contain a contingent beneficial conversion feature, i.e. an embedded conversion right that enables the holder to obtain the underlying Common Stock at a price below market value. The beneficial conversion feature is contingent as the terms of the conversion do not permit the Company to compute the number of shares that the holder would receive if the contingent event occurs (i.e. future borrowings under the Line of Credit). The Company has considered the accounting for this contingent beneficial conversion feature using the guidance in ASC 470, Debt. The guidance in ASC 470 states that a contingent beneficial conversion feature in an instrument shall not be recognized in earnings until the contingency is resolved. The beneficial conversion features of future borrowings under the Line of Credit will be measured using the intrinsic value calculated at the date the contingency is resolved using the conversion price and trading value of the Company's Common Stock at the date the Lines of Credit were issued (commitment date). Pursuant to borrowings made during the 2015 year, the Company recognized approximately $146,000 in beneficial conversion feature as debt discount. As a result of the retirement of all amounts outstanding under the Lines of Credit in 2015, the Company recognized all remaining unamortized debt discount of approximately $385,000 as a component of interest expense during the three months ended March 31, 2015. The Company incurred borrowings of $2,650,000 during the year ended December 31, 2016 and incurred borrowings of $3,350,000 during the six months ended June 30, 2017. As a result of these borrowings under the Lines of Credit, the Company recorded approximately $220,000 in debt discount attributable to the beneficial conversion feature during the year ended December 31, 2016 and recorded approximately $281,000 in debt discount attributable to beneficial conversion feature during the six months ended June 30, 2017. During the three and six months ended June 30, 2017, the Company accreted approximately $55,000 and $90,000, respectively, of debt discount. During the three and six months ended June 30, 2016, the Company accreted approximately $12,000 of the note discount. Such expense is recorded as a component of interest expense in the Company's condensed consolidated statements of operations.

NOTE 6. EQUITY

The Company's Articles of Incorporation, as amended, authorize the issuance of two classes of stock to be designated "Common Stock" and "Preferred Stock". The Preferred Stock may be divided into such number of series and with the rights, preferences, privileges and restrictions as the Board of Directors may determine.

Series B Convertible Redeemable Preferred Stock

The Company had 239,400 shares of Series B Convertible Redeemable Preferred Stock ("*Series B Preferred*") outstanding as of June 30, 2017 and December 31, 2016. At June 30, 2017 and December 31, 2016, the Company had cumulative undeclared dividends of approximately $8,000. There were no conversions of Series B Preferred into Common Stock during the six months ended June 30, 2017 and 2016.

Series E Convertible Redeemable Preferred Stock

On January 29, 2015, the Company filed the Certificate of Designations of the Series E Preferred Stock with the Delaware Secretary of State, designating 12,000 shares of the Company's preferred stock, par value $0.01 per share, as Series E Preferred. Shares of Series E Preferred accrue dividends at a rate of 8% per annum if the Company chooses to pay accrued dividends in cash, and 10% per annum if the Company chooses to pay accrued dividends in shares of Common Stock. Each share of Series E Preferred has a liquidation preference of $1,000 per share and is convertible, at the option of the holder, into that number of shares of the Company's Common Stock equal to the Liquidation Preference, divided by $1.90. The Series E Preferred shall be subordinate to and rank junior to the Company's Series B Preferred and all indebtedness of the Company. Each holder of the Series E Preferred is entitled to vote on all matters, together with the holders of Common Stock, on an as converted basis.

Any time after the six-month period following the issuance date, in the event the arithmetic average of the closing sales price of the Company's Common Stock is or was at least $2.85 for twenty (20) consecutive trading days, the Company may redeem all or a portion of the Series E Preferred outstanding upon thirty (30) calendar day's prior written notice (the "*Company's Redemption Notice*") in cash at a price per share of Series E Preferred equal to 110% of the liquidation preference amount plus all accrued and unpaid dividends. Also, simultaneous with the occurrence of a change of control transaction, the Company, at its option, shall have the right to redeem all or a portion of the outstanding Series E Preferred in cash at a price per share of Series E Preferred equal to 110% of the liquidation preference amount plus all accrued and unpaid dividends.

In February 2015, the Company consummated a registered direct offering conducted without an underwriter or placement agent. In connection therewith, the Company issued 12,000 shares of Series E Preferred to certain investors at a price of $1,000 per share, with each share convertible into 526.32 shares of the Company's Common Stock at $1.90 per share.

On December 29, 2016, the Company filed Amendment No. 1 to the Certificate of Designations, Preferences and Rights of the Series E Convertible Preferred Stock (the "*Series E Amendment*") with the Delaware Division of Corporations. The Series E Amendment made the following changes to the Certificate of Designations, Preferences and Rights of the Series E Convertible Preferred Stock: (i) the Company may only make dividend payments in cash received from positive cash flow from operations; (ii) beginning on July 1, 2017, in the event the Company pays accrued dividend payments in shares of Common Stock for more than four consecutive quarterly periods, holders of shares of Series E Preferred will have the right to immediately appoint two designees to the Company's Board of Directors (the "*Director Appointment Provision*"); (iii) dividend payments incurred on December 31, 2016 and March 31, 2017 may be paid in shares of Common Stock, without triggering the Director Appointment Provision; and (iv) the term Permitted Indebtedness (as defined in the Series E Certificate of Designations) was revised to cover permitted borrowings of up to $6.0 million.

The Company had 12,000 shares of Series E Preferred outstanding as of June 30, 2017 and December 31, 2016, respectively. At June 30, 2017 and December 31, 2016, the Company had cumulative undeclared dividends of $0. There were no conversions of Series E Preferred into Common Stock during the six months ended June 30, 2017 and 2016. The Company issued the holders of Series E Preferred 301,720 shares of Common Stock on June 30, 2017 as payment of dividends due on that date. For the six months ended June 30, 2017, the Company has issued the holders of Series E Preferred 584,437 shares of Common Stock as payment of dividends due. With the payment of the quarterly dividends due June 30, 2017 to the holders of Series E Preferred in shares of Common Stock, the Director Appointment Provision became effective as of that date.

Series F Convertible Redeemable Preferred Stock

In September 2016, we filed the Certificate of Designations, Preferences, and Rights of the Series F Convertible Preferred Stock (the "*Certificate of Designations*") with the Delaware Division of Corporations, designating 2,000 shares of our preferred stock as Series F Convertible Redeemable Preferred Stock ("*Series F Preferred*"). Shares of Series F Preferred rank junior to shares of Series B Preferred and Series E Preferred, as well as our existing indebtedness, and accrue dividends at a rate of 10% per annum, payable on a quarterly basis in shares of Common Stock.

Each share of Series F Preferred has a liquidation preference of $1,000 per share ("*Liquidation Preference*"), and is convertible, at the option of the holder, into that number of shares of the Company's Common Stock equal to the Series F Liquidation Preference, divided by $1.50 (the "*Series F Conversion Shares*").

Any time after the six-month period following the issuance date, in the event the arithmetic average of the closing sales price of the Company's Common Stock is or was at least $2.50 for twenty (20) consecutive trading days, the Company may redeem all or a portion of the Series F Preferred outstanding upon thirty (30) calendar days prior written notice in cash at a price per share of Series F Preferred equal to 110% of the Series F Liquidation Preference, plus all accrued and unpaid dividends. Also, simultaneous with the occurrence of a Change of Control transaction (as defined in the Certificate of Designations), the Company, at its option, shall have the right to redeem all or a portion of the outstanding Series F Preferred in cash at a price per share of Series F Preferred equal to 110% of the Liquidation Preference Amount plus all accrued and unpaid dividends.

In September 2016, the Company offered and sold 2,000 shares of Series F Preferred for $1,000 per share (the "*Series F Financing*"), resulting in gross proceeds to the Company of $2,000,000 net of issuance costs of approximately $21,000.

The Company had 2,000 shares of Series F Preferred outstanding as of June 30, 2017 and December 31, 2016. At June 30, 2017 and December 31, 2016, the Company had cumulative undeclared dividends of $0. There were no conversions of Series F Preferred into Common Stock during the six months ended June 30, 2017 and 2016. The Company issued the holders of Series F Preferred 49,749 shares of Common Stock on June 30, 2017 as payment of dividends due on that date. For the six months ended June 30, 2017, the Company has issued the holders of Series F Preferred 96,716 shares of Common Stock as payment of dividends due.

Series G Convertible Redeemable Preferred Stock

In December 27, 2016, the Company filed the Certificate of Designations, Preferences, and Rights of the Series G Convertible Preferred Stock with the Delaware Division of Corporations, designating 6,120 shares of the Company's preferred stock, par value $0.01 per share, as Series G Convertible Preferred Stock ("*Series G Preferred*"). Shares of Series G Preferred rank junior to the Company's Series B Preferred, Series E Preferred, Series F Preferred as well as the Company's existing indebtedness, and accrue dividends at a rate of 10% per annum, payable on a quarterly basis in shares of the Company's common stock, par value $0.01 per share. Each share of Series G Preferred has a liquidation preference of $1,000 per share ("*Series G Liquidation Preference*"), and is convertible, at the option of the holder, into that number of shares of the Company's Common Stock equal to the Series G Liquidation Preference, divided by $1.50.

Any time after the six-month period following the issuance date, in the event the arithmetic average of the closing sales price of the Company's Common Stock is or was at least $2.50 for twenty (20) consecutive trading days, the Company may redeem all or a portion of the Series G Preferred outstanding upon thirty (30) calendar days prior written notice in cash at a price per share of Series G Preferred equal to 110% of the Series G Liquidation Preference, plus all accrued and unpaid dividends. Also, simultaneous with the occurrence of a Change of Control transaction (as defined in the Certificate of Designations), the Company, at its option, shall have the right to redeem all or a portion of the outstanding Series G Preferred in cash at a price per share of Series G Preferred equal to 110% of the Liquidation Preference Amount plus all accrued and unpaid dividends.

On December 29, 2016, the Company accepted subscription forms from certain accredited investors to purchase a total of 1,625 shares of Series G Preferred for $1,000 per share (the "*Series G Financing*"), resulting in gross proceeds to the Company of $1,625,000, net of issuance cost of approximately $11,000. In addition, the Company also received executed exchange agreements from the Investors pursuant to which the Company exchanged an aggregate total of 3,383,830 shares of common stock held by the Investors for an aggregate total of 4,396 shares of Series G Preferred.

The Company had 6,021 shares of Series G Preferred outstanding as of June 30, 2017 and December 31, 2016. At June 30, 2017 and December 31, 2016, the Company had cumulative undeclared dividends of $0. There were no conversions of Series G Preferred into Common Stock during the six months ended June 30, 2017 and 2016. The Company issued the holders of Series G Preferred 149,773 shares of Common Stock on June 30, 2017 as payment of dividends due on that date. For the six months ended June 30, 2017, the Company has issued the holders of Series G Preferred 291,170 shares of Common Stock as payment of dividends due.

Common Stock

The following table summarizes Common Stock activity for the six months ended June 30, 2017:

	Common Stock
Shares outstanding at December 31, 2016	91,846,795
Shares issued as payment of stock dividend on Series E Preferred	584,437
Shares issued as payment of stock dividend on Series F Preferred	96,716
Shares issued as payment of stock dividend on Series G Preferred	291,170
Shares issued pursuant to option exercises	322,000
Shares outstanding at June 30, 2017	93,141,118

Warrants

The following table summarizes warrant activity for the following periods:

	Warrants	Weighted-Average Exercise Price
Balance at December 31, 2016	175,000	$ 0.84
Granted	—	—
Expired / Canceled	—	—
Exercised	—	
Balance at June 30, 2017	175,000	$ 0.84

As of June 30, 2017, warrants to purchase 175,000 shares of Common Stock at prices ranging from $0.80 to $1.10 were outstanding. There were 25,000 warrants exercisable as of June 30, 2017 which expire on September 1, 2017. There are 150,000 warrants which will become exercisable only upon the attainment of specified events. The intrinsic value of warrants outstanding at June 30, 2017 was approximately $30,000.

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Stock-Based Compensation

The 1999 Plan was adopted by the Company's Board of Directors on December 17, 1999. Under the terms of the 1999 Plan, the Company could, originally, issue up to 350,000 non-qualified or incentive stock options to purchase Common Stock of the Company. During the year ended December 31, 2014, the Company subsequently amended and restated the 1999 Plan whereby it increased the share reserve for issuance to approximately 7.0 million shares of the Company's Common Stock. The 1999 Plan prohibits the grant of stock option or stock appreciation right awards with an exercise price less than fair market value of Common Stock on the date of grant. The 1999 Plan also generally prohibits the "re-pricing" of stock options or stock appreciation rights, although awards may be bought-out for a payment in cash or the Company's stock. The 1999 Plan permits the grant of stock based awards other than stock options, including the grant of "full value" awards such as restricted stock, stock units and performance shares. The 1999 Plan permits the qualification of awards under the plan (payable in either stock or cash) as "performance-based compensation" within the meaning of Section 162(m) of the Internal Revenue Code. The number of options issued and outstanding and the number of options remaining available for future issuance are shown in the table below. On July 1, 2014, the Company began soliciting written consents from its shareholders to approve an amendment to the Company's 1999 Stock Option Plan to increase the number of shares authorized for issuance thereunder from approximately 4.0 million to approximately 7.0 million (the "*Amendment*"). As of July 21, 2014, the Company had received written consents approving the Amendment from over 50% of the Company's stockholders. As such, the Amendment was approved. The number of authorized shares available under the plan for issuance at June 30, 2017 was 6,240,781. The number of available shares under the plan for issuance at June 30, 2017 was 69,226.

The Company estimates the fair value of its stock options using a Black-Scholes option-valuation model, consistent with the provisions of ASC No. 718, *Compensation – Stock Compensation*. The fair value of stock options granted is recognized to expense over the requisite service period. Stock-based compensation expense is reported in general and administrative, sales and marketing, engineering and customer service expense based upon the departments to which substantially all of the associated employees report and credited to additional paid-in capital. Stock-based compensation expense related to equity options was approximately $240,000 and $480,000 for the three and six months ended June 30, 2017, respectively. Stock-based compensation expense related to equity options was approximately $233,000 and $475,000 for the three and six months ended June 30, 2016, respectively. Stock-based compensation expense related to options to purchase shares of the Company's Common Stock issued to certain members of the Company's Board of Directors in return for their service (disclosed more fully below) was approximately $35,000 and $70,000 for the three and six months ended June 30, 2017, respectively. Stock-based compensation expense related to options to purchase shares of the Company's Common Stock issued to certain members of the Company's Board of Directors in return for their service was approximately $46,000 and $90,000 for the three and six months ended June 30, 2016, respectively.

ASC No. 718 requires the use of a valuation model to calculate the fair value of stock-based awards. The Company has elected to use the Black-Scholes option-valuation model, which incorporates various assumptions including volatility, expected life, and interest rates. The Company is required to make various assumptions in the application of the Black-Scholes option-valuation model. The Company has determined that the best measure of expected volatility is based on the historical weekly volatility of the Company's Common Stock. Historical volatility factors utilized in the Company's Black-Scholes computations for the six months ended June 30, 2017 and 2016 ranged from 58% to 121%. The Company has elected to estimate the expected life of an award based upon the SEC approved "simplified method" noted under the provisions of Staff Accounting Bulletin No. 110. The expected term used by the Company during the six months ended June 30, 2017 and 2016 was 5.17 years. The difference between the actual historical expected life and the simplified method was immaterial. The interest rate used is the risk-free interest rate and is based upon U.S. Treasury rates appropriate for the expected term. Interest rates used in the Company's Black-Scholes calculations for the six months ended June 30, 2017 and 2016 was 2.6%. Dividend yield is zero, as the Company does not expect to declare any dividends on the Company's Common Stock in the foreseeable future.

In addition to the key assumptions used in the Black-Scholes model, the estimated forfeiture rate at the time of valuation is a critical assumption. The Company has estimated an annualized forfeiture rate of approximately 0% for corporate officers, 4.1% for members of the Board of Directors and 6.0% for all other employees. The Company reviews the expected forfeiture rate annually to determine if that percent is still reasonable based on historical experience.

A summary of the activity under the Company's stock option plans is as follows:

	Options	**Weighted-Average Exercise Price**
Balance at December 31, 2016	6,506,843	$ 1.21
Granted	35,000	$ 1.05
Expired/Cancelled	(48,288)	$ 2.01
Exercised	(322,000)	$ 0.71
Balance at June 30, 2017	6,171,555	$ 1.22

The intrinsic value of options exercisable at June 30, 2017 was approximately $568,000. The aggregate intrinsic value for all options outstanding as of June 30, 2017 was approximately $568,000. The weighted-average grant-date per share fair value of options granted during the six months ended June 30, 2017 was $0.53. At June 30, 2017, the total remaining unrecognized compensation cost related to unvested stock options amounted to approximately $1,328,000 which will be recognized over a weighted-average period of 1.9 years.

In September 2016, the Company issued an aggregate of 168,000 options to purchase shares of the Company's Common Stock to certain members of the Company's Board of Directors in return for their service from January 1, 2017 through December 31, 2017. Such options will vest at the rate of 14,000 options per month on the last day of each month during the 2017 year. The options have an exercise price of $1.37 per share and a term of 10 years. The Company began recognition of compensation based on the grant-date fair value ratably over the 2017 requisite service period.

In May 2016, the Company issued an aggregate of 16,000 options to purchase shares of the Company's Common Stock to a new member of the Company's Board of Directors in return for their service from May 2016 through December 31, 2016. Such options vest at the rate of 2,000 options per month on the last day of each month during the 2016 year. The options have an exercise price of $1.29 per share and a term of 10 years. Pursuant to this issuance, the Company recorded compensation based on the grant-date fair value ratably over the 2016 requisite service period.

In September 2015, the Company issued an aggregate of 144,000 options to purchase shares of the Company's Common Stock to certain members of the Company's Board of Directors in return for their service from January 1, 2016 through December 31, 2016. Such options vest at the rate of 12,000 options per month on the last day of each month during the 2016 year. The options have an exercise price of $1.73 per share and a term of 10 years. Pursuant to this issuance, the Company recorded compensation based on the grant-date fair value ratably over the 2016 requisite service period.

Stock-based compensation related to equity options, including options granted to certain members of the Company's Board of Directors, has been classified as follows in the accompanying condensed consolidated statements of operations (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	**2016**	**2017**	**2016**
Cost of revenue	$ 5	$ 5	$ 10	$ 10
General and administrative	165	172	329	346
Sales and marketing	55	54	110	109
Research and development	50	49	101	100
Total	$ 275	$ 280	$ 550	$ 565

NOTE 7. FAIR VALUE ACCOUNTING

The Company accounts for fair value measurements in accordance with ASC 820, "*Fair Value Measurements and Disclosures*," which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements.

ASC 820 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under ASC 820 are described below:

Level 1 Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2 Applies to assets or liabilities for which there are inputs other than quoted prices included within Level 1 that are observable for the asset or liability such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical assets or liabilities in markets with insufficient volume or infrequent transactions (less active markets); or model-derived valuations in which significant inputs are observable or can be derived principally from, or corroborated by, observable market data.

Level 3 Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (supported by little or no market activity).

The following table sets forth the Company's financial assets and liabilities measured at fair value by level within the fair value hierarchy. As required by ASC 820, assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

	Fair Value at June 30, 2017			
($ in thousands)	**Total**	**Level 1**	**Level 2**	**Level 3**
Assets:				
Pension assets	$ 1,789	$ 1,789	$ —	$ —
Totals	$ 1,789	$ 1,789	$ —	$ —

	Fair Value at December 31, 2016			
($ in thousands)	**Total**	**Level 1**	**Level 2**	**Level 3**
Assets:				
Pension assets	$ 1,645	$ 1,645	$ —	$ —
Totals	$ 1,645	$ 1,645	$ —	$ —

NOTE 8. RELATED PARTY TRANSACTIONS

The Company has certain Lines of Credit extended by certain members of the Company's Board of Directors. For a more detailed discussion of the Company's Lines of Credit, see Note 5 - Lines of Credit. As of June 30, 2017, the Company had borrowed $5,500,000 under the terms of the Goldman LOC and $500,000 under the terms of the New Crocker LOC.

Each of Messrs. Goldman and Crocker are members of the Board of Directors of the Company.

NOTE 9. CONTINGENT LIABILITIES

Employment Agreements

The Company has employment agreements with its Chief Executive Officer, its Senior Vice President of Administration and Chief Financial Officer, and its Chief Technical Officer. The Company may terminate the agreements with or without cause. Subject to the conditions and other limitations set forth in each respective employment agreement, each executive will be entitled to the following severance benefits if the Company terminates the executive's employment without cause or in the event of an involuntary termination (as defined in the employment agreements) by the Company or by the executive:

Under the terms of the agreement, the Chief Executive Officer will be entitled to the following severance benefits if we terminate his employment without cause or in the event of an involuntary termination: (i) a lump sum cash payment equal to twenty-four months' base salary; (ii) continuation of fringe benefits and medical insurance for a period of three years; and (iii) immediate vesting of 50% of outstanding stock options and restricted stock awards. In the event that the Chief Executive Officer's employment is terminated within six months prior to or thirteen months following a change of control (as defined in the employment agreements), the Chief Executive Officer is entitled to the severance benefits described above, except that 100% of the Chief Executive Officer's outstanding stock options and restricted stock awards will immediately vest.

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Under the terms of the employment agreements with our Senior Vice President of Administration and Chief Financial Officer, this executive will be entitled to the following severance benefits if we terminate their employment without cause or in the event of an involuntary termination: (i) a lump sum cash payment equal to six months of base salary; (ii) continuation of their fringe benefits and medical insurance for a period of six months; and (iii) immediate vesting of 50% of their outstanding stock options and restricted stock awards. In the event that their employment is terminated within six months prior to or thirteen months following a change of control (as defined in the employment agreements), they are entitled to the severance benefits described above, except that 100% of their outstanding stock options and restricted stock awards will immediately vest.

Under the terms of the employment agreement with our Chief Technical Officer, this executive will be entitled to the following severance benefits if we terminate his employment without cause or in the event of an involuntary termination: (i) a lump sum cash payment equal to six months of base salary; and (ii) continuation of their fringe benefits and medical insurance for a period of six months. In the event that his employment is terminated within six months prior to or thirteen months following a change of control (as defined in the employment agreements), he is entitled to the severance benefits described above, except that 100% of his outstanding stock options and restricted stock awards will immediately vest.

Effective October 20, 2016, the employment agreements for the Company's Chief Executive Officer, Chief Financial Officer and Chief Technical Officer were amended to extend the term of each executive officer's employment agreement until December 31, 2017.

Litigation

There is no action, suit, proceeding, inquiry or investigation before or by any court, public board, government agency, self-regulatory organization or body pending or, to the knowledge of the executive officers of the Company or any of our subsidiaries, threatened against or affecting the Company, our Common Stock, any of our subsidiaries or of the Company's or our subsidiaries' officers or directors in their capacities as such, in which an adverse decision could have a material adverse effect.

Leases

The Company's corporate headquarters are located in San Diego, California where we occupy 9,927 square feet of office space. This facility is leased through October 2017 at a cost of approximately $18,000 per month. In addition to our corporate headquarters, we also occupied the following spaces at June 30, 2017:

- 1,508 square feet in Ottawa, Province of Ontario, Canada, at a cost of approximately $3,000 per month until the expiration of the lease on March 31, 2021. This lease was renewed in April 2016 for a five-year period ending on March 31, 2021. Renewal terms were substantially unchanged from the existing lease;

- 8,045 square feet in Portland, Oregon, at a cost of approximately $16,000 per month until the expiration of the lease on October 31, 2018; and

- 304 square feet of office space in Mexico City, Mexico, at a cost of approximately $3,000 per month until November 30, 2017.

At June 30, 2017, future minimum lease payments are as follows:

($ in thousands)		
2017 (six months)	$	208
2018		203
2019		35
2020		35
2021		9
Total	$	490

Rental expense incurred under operating leases for the six months ended June 30, 2017 and 2016 was approximately $256,000 and $242,000, respectively.

NOTE 10. SUBSEQUENT EVENTS

Subsequent to June 30, 2017, the Company received an aggregate of $875,000 from Goldman and S. James Miller, the Company's Chief Executive Officer, to provide for the Company's short-term working capital requirements.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All forward-looking statements included in this report are based on information available to us as of the date hereof and we assume no obligation to update any forward-looking statements. Forward-looking statements involve known or unknown risks, uncertainties and other factors, which may cause our actual results, performance or achievements, or industry results to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences *include but are not limited to those items discussed under "Risk Factors" in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2016, and in Item 1A of Part II of this Quarterly Report on Form 10-Q.*

The following discussion of the financial condition and results of operations should be read in conjunction with the condensed consolidated financial statements included elsewhere within this Quarterly Report. Fluctuations in annual and quarterly results may occur as a result of factors affecting demand for our products such as the timing of new product introductions by us and by our competitors and our customers' political and budgetary constraints. Due to such fluctuations, historical results and percentage relationships are not necessarily indicative of the operating results for any future period.

Overview

The Company is a pioneer and leader in the emerging market for biometrically enabled software-based identity management solutions. Using those human characteristics that are unique to us all, we create software that provides a highly reliable indication of a person's identity. Our "flagship" product is our patented IWS Biometric Engine®. Scalable for small city business or worldwide deployment, our IWS Biometric Engine is a multi-biometric software platform that is hardware and algorithm independent, enabling the enrollment and management of unlimited population sizes. It allows a user to utilize one or more biometrics on a seamlessly integrated platform. Our products are used to manage and issue secure credentials, including national IDs, passports, driver licenses and access control credentials. Our products also provide law enforcement with integrated mug shot, LiveScan fingerprint and investigative capabilities. We also provide comprehensive authentication security software using biometrics to secure physical and logical access to facilities or computer networks or Internet sites. Biometric technology is now an integral part of all markets we address and all of our products are integrated into the IWS Biometric Engine.

Critical Accounting Policies and Estimates

The discussion and analysis of our consolidated financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America ("*GAAP*"). The preparation of these consolidated financial statements in accordance with GAAP requires us to utilize accounting policies and make certain estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingencies as of the date of the consolidated financial statements and the reported amounts of revenues and expenses during a fiscal period. The Securities and Exchange Commission ("*SEC*") considers an accounting policy to be critical if it is important to a company's financial condition and results of operations, and if it requires significant judgment and estimates on the part of management in its application.

Significant estimates include the evaluation of our ability to continue as a going concern, the allowance for doubtful accounts receivable, inventory carrying values, deferred tax asset valuation allowances, accounting for loss contingencies, recoverability of goodwill and acquired intangible assets and amortization periods, assumptions used in the Black-Scholes model to calculate the fair value of share based payments, assumptions used in the application of fair value methodologies to calculate the fair value of derivative liabilities, revenue and cost of revenues recognized under the percentage of completion method and assumptions used in the application of fair value methodologies to calculate the fair value of pension assets and obligations.

Critical accounting policies are those that, in management's view, are most important in the portrayal of our financial condition and results of operations. Management believes there have been no material changes during the six months ended June 30, 2017 to the critical accounting policies discussed in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of our Annual Report on Form 10-K for the year ended December 31, 2016.

Results of Operations

This management's discussion and analysis of financial condition and results of operations should be read in conjunction with the condensed consolidated financial statements and related notes contained elsewhere in this Quarterly Report.

Comparison of the Three Months Ended June 30, 2017 to the Three Months Ended June 30, 2016

Product Revenue

Net Product Revenue (dollars in thousands)	Three Months Ended June 30, 2017	Three Months Ended June 30, 2016	$ Change	% Change
Software and royalties	$ 319	$ 284	$ 35	12%
Percentage of total net product revenue	78%	80%		
Hardware and consumables	$ 39	$ 23	$ 16	70%
Percentage of total net product revenue	10%	6%		
Services	$ 49	$ 49	$ —	0%
Percentage of total net product revenue	12%	14%		
Total net product revenue	$ 407	$ 356	$ 51	14%

Software and royalty revenue increased 12% or approximately $35,000 during the three months ended June 30, 2017 as compared to the corresponding period in 2016. This increase is attributable to higher sales of law enforcement project related revenue of approximately $15,000 and higher royalty revenue of approximately $47,000 offset by lower sales of boxed identity management software sold through our distribution channel of approximately $22,000 and lower identification project related revenue of approximately $5,000.

Revenue from the sale of hardware and consumables increased approximately $16,000 during the three months ended June 30, 2017 as compared to the corresponding period in 2016. This increase resulted from higher sales of hardware and consumables in project solutions.

Services revenue is comprised primarily of software integration services, system installation services and customer training. Such revenue was approximately $49,000 during the three months ended June 30, 2017 and 2016.

We believe that the period-to-period fluctuations of identity management software revenue in project-oriented solutions are largely due to the timing of government procurement with respect to the various programs we are pursuing. Although no assurances can be given, based on management's current visibility into the timing of potential government procurements and potential partnerships and current pilot programs, we believe that we will see an increase in government procurement and implementations with respect to identity management initiatives during 2017; however, government procurement initiatives, implementations and pilots are frequently delayed and extended, as was the case in the year ended December 31, 2016, and we cannot predict the timing of such initiatives.

During the quarter ended June 30, 2017, we continued to accelerate our efforts to move the Biometric Engine into cloud and mobile markets, and expanded our end-user market into non-government sectors including commercial, consumer and healthcare applications. In November 2016, we introduced our new GoVerifyID Enterprise suite for customers that want to add biometric identity verification to their Microsoft infrastructure. While we anticipated results from these initiatives during the 2016 fiscal year, many of those initiatives were delayed to 2017. As a result, we anticipate that we will see positive developments from these efforts beginning in the second half of 2017, which management believes should help us to begin to smooth out our period-to-period fluctuations in revenue and enable us to provide better visibility into the timing of future revenues.

Maintenance Revenue

Maintenance Revenue	**Three Months Ended June 30,**			
(dollars in thousands)	**2017**	**2016**	**% Change**	**% Change**
Total maintenance revenue	$ 653	$ 640	$ 13	2%

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Maintenance revenue was approximately $653,000 for the three months ended June 30, 2017, as compared to approximately $640,000 for the corresponding period in 2016. Identity management maintenance revenue generated from identification software solutions was approximately $308,000 for the three months ended June 30, 2017 as compared to approximately $294,000 during the comparable period in 2016. Law enforcement maintenance revenue was approximately $345,000 and $346,000 for the three months ended June 30, 2017 and 2016, respectively. The increase of $14,000 in identification software solutions for the three months ended June 30, 2017 as compared to the corresponding period of 2016 reflects the expansion of our installed base.

We anticipate growth of our maintenance revenue through the retention of existing customers combined with the expansion of our installed base resulting from the completion of project-oriented work; however, we cannot predict the timing of this anticipated growth.

Cost of Product Revenue

	Three Months Ended June 30,			
Cost of Product Revenue:	**2017**	**2016**	**$ Change**	**% Change**
(dollars in thousands)				
Software and royalties	$ 6	$ 26	$ (20)	(77)%
Percentage of software and royalty product revenue	2%	9%		
Hardware and consumables	$ 18	$ 22	$ (4)	(18)%
Percentage of hardware and consumables product revenue	46%	96%		
Services	$ 12	$ 8	$ 4	50%
Percentage of services product revenue	24%	16%		
Total product cost of revenue	$ 36	$ 56	$ (20)	(36)%
Percentage of total product revenue	9%	16%		

The cost of software and royalty product revenue decreased approximately $20,000 for the three months ended June 30, 2017 as compared to the corresponding period in 2016. This decrease results primarily from lower personnel expenses allocated to software project implementation. In addition to changes in costs of software and royalty product revenue caused by revenue level fluctuations, costs of products can vary as a percentage of product revenue from period to period depending upon level of software customization and third-party software license content included in product sales during a given period.

The cost of hardware and consumable product revenue decreased approximately $4,000 for the three months ended June 30, 2017 as compared to the corresponding period in 2016 despite higher hardware and consumable revenue due primarily to certain hardware costs being previously expensed due to recoverability concerns.

The cost of services revenue increased approximately $4,000 during the three months ended June 30, 2017 as compared to the corresponding period in 2016 due to the composition of labor resources utilized in the completion of the service element. In addition to changes in costs of services product revenue caused by revenue level fluctuations, costs of services can vary as a percentage of service revenue from period to period depending upon both the level and complexity of professional service resources utilized in the completion of the service element.

Cost of Maintenance Revenue

Maintenance cost of revenue	**Three Months Ended June 30,**			
(dollars in thousands)	**2017**	**2016**	**$ Change**	**% Change**
Total maintenance cost of revenue	$ 214	$ 219	(5)	(2)%
Percentage of total maintenance revenue	33%	34%		

Cost of maintenance revenue decreased approximately $5,000 during the three months ended June 30, 2017 as compared to the corresponding period in 2016. This decrease, despite maintenance revenues increasing approximately $13,000 during the same period is due primarily to the composition of engineering resources used in the provision of maintenance services.

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Product Gross Profit

Product gross profit	**Three Months Ended June 30,**			
	2017	**2016**	**$ Change**	**% Change**
(dollars in thousands)				
Software and royalties	$ 313	$ 258	$ 55	21%
Percentage of software and royalty product revenue	98%	91%		
Hardware and consumables	$ 21	$ 1	$ 20	2000%
Percentage of hardware and consumables product revenue	54%	4%		
Services	$ 37	$ 41	$ (4)	(10)%
Percentage of services product revenue	76%	84%		
Total product gross profit	$ 371	$ 300	$ 71	24%
Percentage of total product revenue	91%	84%		

Software and royalty gross profit increased 21% or approximately $55,000 for the three months ended June 30, 2017 from the corresponding period in 2016 due primarily to higher software and royalty revenue of approximately $35,000 combined with lower software and royalty cost of revenues of $20,000 for the same period. In addition to changes in costs of software and royalty product revenue caused by revenue level fluctuations, costs of products can vary as a percentage of product revenue from period to period depending upon level of software customization and third -party software license content included in product sales during a given period.

Hardware and consumables gross profit increased approximately $20,000 for the three months ended June 30, 2017 as compared to the corresponding period in 2016 due to higher hardware and consumable revenue of approximately $16,000 combined with lower cost of hardware and consumables product revenue of approximately $4,000 for the three months ended June 30, 2017 as compared to the corresponding period in 2016.

Services gross profit decreased approximately $4,000 for the three months ended June 30, 2017 as compared to the corresponding period in 2016 due to higher costs of service revenue of approximately $4,000 for the three months ended June 30, 2017 as compared to the corresponding period in 2016.

Maintenance Gross Profit

Maintenance gross profit	**Three Months Ended June 30,**			
(dollars in thousands)	**2017**	**2016**	**$ Change**	**% Change**
Total maintenance gross profit	$ 439	$ 421	$ 18	4%
Percentage of total maintenance revenue	67%	66%		

Gross profit related to maintenance revenue increased 4% or approximately $18,000 for the three months ended June 30, 2017 as compared to the corresponding period in 2016. This increase is due to higher maintenance revenue of approximately $13,000 combined with lower cost of maintenance revenue of approximately $5,000.

Operating Expense

	Three Months Ended June 30,			
Operating expense (dollars in thousands)	**2017**	**2016**	**$ Change**	**% Change**
General and administrative	$ 1,042	$ 899	$ 143	16%
Percentage of total net revenue	98%	90%		
Sales and marketing	$ 702	$ 743	$ (41)	(6)%
Percentage of total net revenue	66%	75%		
Research and development	$ 1,479	$ 1,318	$ 161	12%
Percentage of total net revenue	140%	132%		
Depreciation and amortization	$ 17	$ 35	$ (18)	(51)%
Percentage of total net revenue	2%	4%		

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General and Administrative Expense

General and administrative expense is comprised primarily of salaries and other employee-related costs for executive, financial, and other infrastructure personnel. General legal, accounting and consulting services, insurance, occupancy and communication costs are also included with general and administrative expense. The dollar increase of approximately $143,000 during the three months ended June 30, 2017 as compared to the corresponding period in 2016 is comprised of the following major components:

- Increase in personnel related expense of approximately $21,000 due to increased salaries from headcount increases of approximately $6,000 and higher health insurances and 401(k) plan employer contributions of approximately $15,000.

- Decreases in professional services of approximately $35,000 which includes lower Board of Director fees of approximately $11,000, lower auditing fees of approximately $18,000, lower patent-related expense of approximately $9,000 offset by higher legal fees of approximately $3,000.

- Increase in travel, insurances, licenses, dues, rent, and office related costs of approximately $26,000.

- Increase in investment banking fees and financing expenses of approximately $131,000.

We continue to focus our efforts on achieving additional future operating efficiencies by reviewing and improving upon existing business processes and evaluating our cost structure. We believe these efforts will allow us to continue to gradually decrease our level of general and administrative expense expressed as a percentage of total revenue.

Sales and Marketing

Sales and marketing expense consists primarily of the salaries, commissions, other incentive compensation, employee benefits and travel expense of our sales, marketing, and business development functions. The dollar decrease of approximately $41,000 during the three months ended June 30, 2017 as compared to the corresponding period in 2016 is primarily comprised of the following major components:

- Increase in personnel related expense of approximately $2,000 driven primarily by higher employee medical insurances.

- Decrease in contractor and contract services of approximately $40,000 resulting from decreased utilization of certain sales consultants offset by increased marketing dues and subscription expenses.

- Increase in travel, trade show expense and office related expense of approximately $20,000.

- Decrease in our Mexico sales office expenses and other of approximately $23,000.

Research and Development

Research and development expense consists primarily of salaries, employee benefits and outside contractors for new product development, product enhancements, custom integration work and related facility costs. Such expense increased approximately $161,000 for the three months ended June 30, 2017 as compared to the corresponding period in 2016 due primarily to the following major components:

- Decrease in personnel related expense of approximately $13,000.

- Increase in contractor fees and contract services of approximately $144,000 for services related to the accelerated development of mobile identity management applications.

- Increase in office related expense and engineering tools and supplies of approximately $30,000.

Our level of expenditures in research and development reflects our belief that to maintain our competitive position in markets characterized by rapid rates of technological advancement, we must continue to invest significant resources in new systems and software development as well as continue to enhance existing products.

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Depreciation and Amortization

During the three months ended June 30, 2017 and 2016, depreciation and amortization expense was approximately $17,000 and $35,000, respectively. The relatively small amount of depreciation and amortization reflects the relatively small property and equipment carrying value.

Interest Expense, Net

For the three months ended June 30, 2017, we recognized interest expense of approximately $165,000 and interest income of approximately $1,000. For the three months ended June 30, 2016, we recognized interest expense of approximately $36,000 and interest income of approximately $0. Interest expense for the three months ended June 30, 2017 is comprised of approximately $3,000 of amortization expense of deferred financing fees related to the Goldman LOC, interest expense of approximately $107,000 of coupon interest on debt outstanding under the Lines of Credit, and approximately $55,000 related to the amortization of beneficial conversion feature related to the Lines of Credit.

Other Income

For the three months ended June 30, 2017, we recognized $50,000 of other income from the sale of one of the Company's non-utilized trademarks. Other income for the three months ended June 30, 2016 is comprised of approximately $200,000 from the write off of certain accrued expense due to the expiration of the legal statute of limitations on such liabilities.

Comparison of the Six Months Ended June 30, 2017 to the Six Months Ended June 30, 2016

Product Revenue

Net Product Revenue (dollars in thousands)	**Six Months Ended June 30, 2017**	**Six Months Ended June 30, 2016**	**$ Change**	**% Change**
Software and royalties	$ 508	$ 502	$ 6	1%
Percentage of total net product revenue	74%	66%		
Hardware and consumables	$ 86	$ 54	$ 32	59%
Percentage of total net product revenue	13%	7%		
Services	$ 86	$ 203	$ (117)	(58)%
Percentage of total net product revenue	13%	27%		
Total net product revenue	$ 680	$ 759	$ (79)	(10)%

Software and royalty revenue increased 1% or approximately $6,000 during the six months ended June 30, 2017 as compared to the corresponding period in 2016. This increase is attributable to higher sales of boxed identity management software sold through our distribution channel of approximately $8,000, higher sales of law enforcement project related revenue of approximately $7,000 offset by lower identification project related revenue of approximately $4,000 and lower royalty revenue of approximately $5,000.

Revenue from the sale of hardware and consumables increased approximately $32,000 during the six months ended June 30, 2017 as compared to the corresponding period in 2016. This increase resulted from higher sales of hardware and consumables in project solutions.

Services revenue is comprised primarily of software integration services, system installation services and customer training. Such revenue decreased approximately $117,000 during the six months ended June 30, 2017 as compared to the corresponding period in 2016, due primarily to the completion of the service element in certain identity management project solutions in the 2016 period.

We believe that the period-to-period fluctuations of identity management software revenue in project-oriented solutions are largely due to the timing of government procurement with respect to the various programs we are pursuing. Although no assurances can be given, based on management's current visibility into the timing of potential government procurements and potential partnerships and current pilot programs, we believe that we will see an increase in government procurement and implementations with respect to identity management initiatives during 2017; however, government procurement initiatives, implementations and pilots are frequently delayed and extended, as was the case in the year ended December 31, 2016, and we cannot predict the timing of such initiatives.

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During the six months ended June 30, 2017, we continued to accelerate our efforts to move the Biometric Engine into cloud and mobile markets, and expanded our end-user market into non-government sectors including commercial, consumer and healthcare applications. In November 2016, we introduced our new GoVerifyID Enterprise suite for customers that want to add biometric identity verification to their Microsoft infrastructure. While we anticipated results from these initiatives during the 2016 fiscal year, many of those initiatives were delayed to 2017. As a result, we anticipate that we will see positive developments from these efforts beginning in the second half of 2017, which management believes should help us to begin to smooth out our period-to-period fluctuations in revenue and enable us to provide better visibility into the timing of future revenues.

Maintenance Revenue

Maintenance Revenue	**Six Months Ended June 30,**			
(dollars in thousands)	**2017**	**2016**	**$ Change**	**% Change**
Total maintenance revenue	$ 1,309	$ 1,280	$ 29	2%

Maintenance revenue was approximately $1,309,000 for the six months ended June 30, 2017, as compared to approximately $1,280,000 for the corresponding period in 2016. Identity management maintenance revenue generated from identification software solutions was approximately $613,000 for the six months ended June 30, 2017 as compared to approximately $583,000 during the comparable period in 2016. Law enforcement maintenance revenue was approximately $696,000 for the six months ended June 30, 2017 as compared to approximately $697,000 during the comparable period in 2016. The increase of $30,000 in identification software solutions reflects the completion of certain projects and an increase to our installed base.

We anticipate growth of our maintenance revenue through the retention of existing customers combined with the expansion of our installed base resulting from the completion of project-oriented work; however, we cannot predict the timing of this anticipated growth.

Cost of Product Revenue

Cost of Product Revenue: (dollars in thousands)	Six Months Ended June 30, 2017	Six Months Ended June 30, 2016	$ Change	% Change
Software and royalties	$ 17	$ 51	$ (34)	(67)%
Percentage of software and royalty product revenue	3%	10%		
Hardware and consumables	$ 55	$ 29	$ 26	90%
Percentage of hardware and consumables product revenue	64%	54%		
Services	$ 18	$ 50	$ (32)	(64)%
Percentage of services product revenue	21%	25%		
Total product cost of revenue	$ 90	$ 130	$ (40)	(31)%
Percentage of total product revenue	13%	17%		

The cost of software and royalty product revenue decreased approximately $34,000 for the six months ended June 30, 2017 and 2016. This decrease results primarily from lower personnel expenses allocated to software project implementation. In addition to changes in costs of software and royalty product revenue caused by revenue level fluctuations, costs of products can vary as a percentage of product revenue from period to period depending upon level of software customization and third-party software license content included in product sales during a given period.

The increase in the cost of product revenue for our hardware and consumable sales of approximately $26,000 for the six months ended June 30, 2017 as compared to the corresponding period in 2016 reflects higher hardware and consumables product revenue of approximately $32,000 for the six months ended June 30, 2017 as compared to the corresponding period in 2016.

The cost of services revenue decreased approximately $32,000 during the six months ended June 30, 2017 as compared to the corresponding period in 2016 due to lower services revenue of approximately $117,000 in the 2017 period. In addition to changes in costs of services product revenue caused by revenue level fluctuations, costs of services can vary as a percentage of service revenue from period to period depending upon both the level and complexity of professional service resources utilized in the completion of the service element.

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Cost of Maintenance Revenue

Maintenance cost of revenue (dollars in thousands)	Six Months Ended June 30, 2017	Six Months Ended June 30, 2016	$ Change	% Change
Total maintenance cost of revenue	$ 423	$ 424 $	$ (1)	0%

Percentage of total maintenance revenue	32%	33%

Cost of maintenance revenue decreased approximately $1,000 during the six months ended June 30, 2017 as compared to the corresponding period in 2016. This decrease, despite maintenance revenues increasing approximately $29,000 during the same period is due primarily to the composition of engineering resources used in the provision of maintenance services.

Product Gross Profit

Product gross profit (dollars in thousands)	**Six Months Ended June 30, 2017**	**2016**	**$ Change**	**% Change**
Software and royalties	$ 491	$ 451	$ 40	9%
Percentage of software and royalty product revenue	97%	90%		
Hardware and consumables	$ 30	$ 25	$ 5	20%
Percentage of hardware and consumables product revenue	35%	46%		
Services	$ 68	$ 153	$ (85)	(56)%
Percentage of services product revenue	79%	75%		
Total product gross profit	$ 589	$ 629	$ (40)	(6)%
Percentage of total product revenue	87%	83%		

Software and royalty gross profit increased 9% or approximately $40,000 for the six months ended June 30, 2017 from the corresponding period in 2016 due primarily to higher software and royalty revenue of approximately $6,000 combined with lower cost of software and royalty revenue of approximately $34,000. In addition to changes in costs of software and royalty product revenue caused by revenue level fluctuations, costs of products can vary as a percentage of product revenue from period to period depending upon level of software customization and third party software license content included in product sales during a given period.

Services gross profit decreased approximately $85,000 for the six months ended June 30, 2017 as compared to the corresponding period in 2016 due to lower service revenue of approximately $117,000 combined with lower cost of service revenue of approximately $32,000 for the six months ended June 30, 2017 as compared to the corresponding period in 2016.

Maintenance Gross Profit

Maintenance gross profit (dollars in thousands)	**Six Months Ended June 30, 2017**	**2016**	**$ Change**	**% Change**
Total maintenance gross profit	$ 886	$ 856	$ 30	4%
Percentage of total maintenance revenue	68%	67%		

Gross profit related to maintenance revenue increased 4% or approximately $30,000 for the six months ended June 30, 2017 as compared to the same period ended June 30, 2016. This increase is due to higher maintenance revenue of approximately $29,000 combined with lower cost of maintenance revenue of approximately $1,000.

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Operating Expense

Operating expense (dollars in thousands)	Six Months Ended June 30, 2017		Six Months Ended June 30, 2016		$ Change		% Change
General and administrative	$	2,087	$	1,905	$	182	10%
Percentage of total net revenue		105%		93%			
Sales and marketing	$	1,463	$	1,416	$	47	3%
Percentage of total net revenue		74%		69%			
Research and development	$	2,943	$	2,631	$	312	12%
Percentage of total net revenue		148%		129%			
Depreciation and amortization	$	38	$	70	$	(32)	(46)%
Percentage of total net revenue		2%		3%			

General and Administrative Expense

General and administrative expense is comprised primarily of salaries and other employee-related costs for executive, financial, and other infrastructure personnel. General legal, accounting and consulting services, insurance, occupancy and communication costs are also included with general and administrative expense. The dollar increase of approximately $182,000 during six months ended June 30, 2017 as compared to the corresponding period in 2016 is comprised of the following major components:

- Increase in personnel related expense of approximately $51,000 due to increased salaries from headcount increases of approximately $95,000, higher 401(k) plan employer contributions of approximately $5,000 offset by lower pension expense of our foreign sales office of approximately $49,000.

- Increase in stock-based compensation expense of approximately $3,000.

- Increases in professional services of approximately $63,000 which includes decreases in Board of Director fees of approximately $20,000, lower auditing fees of approximately $70,000, lower patent expenses of approximately $1,000 offset by higher legal expense of approximately $14,000, higher contractor fees of approximately $9,000 and higher investor relations and financing fees of approximately $131,000.

- Increase in travel, insurances, licenses, dues, rent, and office related costs of approximately $65,000.

We continue to focus our efforts on achieving additional future operating efficiencies by reviewing and improving upon existing business processes and evaluating our cost structure. We believe these efforts will allow us to continue to gradually decrease our level of general and administrative expense expressed as a percentage of total revenue.

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Sales and Marketing

Sales and marketing expense consists primarily of the salaries, commissions, other incentive compensation, employee benefits and travel expense of our sales, marketing, and business development functions. The dollar increase of approximately $47,000 during the six months ended June 30, 2017 as compared to the corresponding period in 2016 is primarily comprised of the following major components:

- Increase in personnel related expense of approximately $25,000 driven primarily by higher salaries and employee health insurance.

- Decrease in professional services of approximately $34,000 resulting from lower utilization of certain consultants.

- Increase in advertising, travel and trade show expense and office related expense of approximately $79,000.

- Increase in due and subscription expense of approximately $22,000.

- Decrease in foreign sales office expense and other of approximately $45,000.

Research and Development

Research and development expense consists primarily of salaries, employee benefits and outside contractors for new product development, product enhancements, custom integration work and related facility costs. Such expense increased approximately $312,000 for the six months ended June 30, 2017 as compared to the corresponding period in 2016 due primarily to the following major components:

- Increase in personnel related expense of approximately $18,000.

- Increase in contractor fees and contract services of approximately $246,000 for services related to the accelerated development of mobile identity applications.

- Increase in office related expense, engineering tools and supplies and travel of approximately of approximately $48,000.

Our level of expenditures in research and development reflects our belief that to maintain our competitive position in markets characterized by rapid rates of technological advancement, we must continue to invest significant resources in new systems and software development as well as continue to enhance existing products.

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Depreciation and Amortization

During the six months ended June 30, 2017 and 2016, depreciation and amortization expense was approximately $38,000 and $70,000, respectively. The relatively small amount of depreciation and amortization is a reflection of the relatively small property and equipment carrying value.

Interest Expense, Net

For the six months ended June 30, 2017, we recognized interest expense of approximately $266,000 and interest income of approximately $2,000. For the six months ended June 30, 2016, we recognized interest expense of approximately $48,000 and interest income of approximately $2,000. Interest expense for the six months ended June 30, 2017 is comprised of approximately $8,000 of amortization expense of deferred financing fees related to the Lines of Credit, interest expense of approximately $168,000 of coupon interest on debt outstanding under the Lines of Credit, and approximately $90,000 related to the amortization of beneficial conversion feature related to the Lines of Credit. Interest expense for the six months ended June 30, 2016 is comprised of approximately $12,000 of coupon interest on debt outstanding under our Line of Credit, approximately $24,000 in deferred financing fee amortization related to our Line of Credit and approximately $12,000 related to the amortization of beneficial conversion feature related to our Line of Credit.

Other Income

For the six months ended June 30, 2017, we recognized $50,000 of other income from the sale of one of the Company's non-utilized trademarks. Other income for the six months ended June 30, 2016 is comprised of approximately $200,000 from the write off of certain accrued expense due to the expiration of the legal statute of limitations on such liabilities.

LIQUIDITY AND CAPITAL RESOURCES AND GOING CONCERN

Historically, our principal sources of cash have included customer payments from the sale of our products, proceeds from the issuance of common and preferred stock and proceeds from the issuance of debt, including our Lines of Credit. Our principal uses of cash have included cash used in operations, payments relating to purchases of property and equipment and repayments of borrowings. We expect that our principal uses of cash in the future will be for product development including customization of identity management products for enterprise and consumer applications, further development of intellectual property, development of Software-as-a-Service ("*SaaS*") capabilities for existing products as well as general working capital and capital expenditure requirements. We expect that, as our revenue grows, our sales and marketing and research and development expense will continue to grow, albeit at a slower rate and, as a result, we will need to generate significant net revenue to achieve and sustain income from operations.

At June 30, 2017, our principal sources of liquidity consisted of cash of $104,000 and accounts receivable, net of $332,000. As of June 30, 2017, we had negative working capital of $1,551,000. We have a history of recurring losses, and as of June 30, 2017, we have incurred a cumulative net loss of approximately $163,063,000.

Subsequent to June 30, 2017, the Company received $875,000 from Goldman and S. James Miller, the Company's Chief Executive Officer, to provide for the Company's short-term working capital requirements. While no assurances can be given, the Company is currently seeking additional working capital from third parties to meet it's working capital requirements through December 31, 2017 ("*Pending Financing*"), and such Pending Financing may result in the issuance of debt or equity securities. Messrs. Goldman and Miller currently intend to roll their respective investments into the Pending Financing, on the same terms and conditions offered by such third parties, and agreed to by independent members of our Board of Directors. As of the date of this report, the Company has not received any commitments from third parties regarding the Pending Financing, and any such terms may result in dilution to the Company's stockholders, and such dilution may be material.

Lines of Credit

On March 9, 2016, the Company and Goldman entered into the fourth amendment (the "*Fourth Amendment*") to the convertible promissory note and line of credit previously issued by the Company to Goldman on March 27, 2013 (the "*Goldman LOC*"). The Fourth Amendment (i) provides the Company with the ability to borrow up to $5.0 million under the terms of the Goldman LOC; (ii) permits Goldman to convert the outstanding principal, plus any accrued but unpaid interest due under the Goldman LOC (the "*Outstanding Balance*"), into shares of the Company's Common Stock for $1.25 per share; and (iii) extends the maturity date of the Goldman LOC to June 30, 2017.

In addition, on March 9, 2016, the Company and Charles Crocker, also a director of the Company ("*Crocker*"), entered into a new line of credit and promissory note (the "*New Crocker LOC*"), in the principal amount of $500,000. The New Crocker LOC accrues interest at a rate of 8% per annum, and matures on the earlier to occur of June 30, 2017 or such date that the Company consummates a debt and/or equity financing resulting in net proceeds to the Company of at least $3.5 million. All outstanding amounts due under the terms of the New Crocker LOC are convertible into shares of the Company's Common Stock at $1.25 per share.

On December 27, 2016, in connection with the consummation of the Series G Financing, the Company and Holder agreed to enter into the Fifth Amendment (the "*Line of Credit Amendment*") to the Goldman Line of Credit to provide the Company with the ability to borrow up to $5.5 million under the terms of the Goldman Line of Credit. In addition, the Maturity Date, as defined in the Goldman Line of Credit was amended to be December 31, 2017. The Line of Credit Amendment was executed on January 23, 2017.

In addition, on January 23, 2017, the Company and Crocker amended the New Crocker LOC to extend the maturity date thereof to December 31, 2017. No other amendments were made to the New Crocker LOC.

On May 10, 2017, Goldman and Crocker agreed to further extend the maturity dates of the Lines of Credit to December 31, 2018.

As of June 30, 2017, we have aggregate borrowings outstanding under our Lines of Credit of $6,000,000 and related accrued unpaid interest of approximately $270,000. These amounts are due on December 31, 2018.

Going Concern

At June 30, 2017, we had a working capital deficit of approximately $1,551,000. Our principal sources of liquidity at June 30, 2017 consisted of approximately $0.1 million of cash and $0.3 million of trade accounts receivable.

Considering our projected cash requirements, our available cash will be insufficient to satisfy our cash requirements for the next twelve months from the date of this filing. These factors raise substantial doubt about our ability to continue as a going concern. To address our working capital requirements, management will access available borrowings under our existing Lines of Credit, and will continue to seek additional equity and/or debt financing through the issuance of additional debt and/or equity securities prior to the end of the quarter ended June 30, 2017. There are currently no formal committed financing arrangements to support our projected cash shortfall, including commitments to purchase additional debt and/or equity securities, and no assurances can be given that we will be successful in raising additional debt and/or equity securities.

In view of the matters described in the preceding paragraph, recoverability of a major portion of the recorded asset amounts shown in the accompanying consolidated balance sheet is dependent upon continued operations of the Company, which, in turn, is dependent upon the Company's ability to continue to raise capital and generate positive cash flows from operations. However, the Company operates in markets that are emerging and highly competitive. There is no assurance that the Company will be able to obtain additional capital, operate at a profit or generate positive cash flows in the future.

These condensed consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts and classifications of liabilities that might be necessary should the Company be unable to continue as a going concern.

Operating Activities

We used net cash of $5,005,000 in operating activities for the six months ended June 30, 2017 as compared to net cash used of $4,425,000 during the comparable period in 2016. During the six months ended June 30, 2017, net cash used in operating activities consisted of net loss of $5,276,000 and a decrease in working capital and other assets and liabilities of $379,000. Those amounts were offset by $650,000 of non-cash costs including $550,000 in stock based compensation, $97,000 in debt issuance cost amortization and beneficial conversion feature amortization, $38,000 in depreciation and amortization, $15,000 in provision for losses on accounts receivables offset by gains from the sale of a trademark of $50,000. During the six months ended June 30, 2017, we used cash of $111,000 to fund increases in current assets and used cash of $268,000 through reductions in current liabilities and deferred revenue, excluding debt.

We used net cash of $4,425,000 in operating activities for the six months ended June 30, 2016 as compared to net cash used of $4,136,000 during the comparable period in 2015. During the six months ended June 30, 2016, net cash used in operating activities consisted of net loss of $4,389,000 and a decrease in working capital and other assets and liabilities of $508,000. Those amounts were offset by $472,000 of non-cash costs including $565,000 in stock based compensation, $37,000 in debt issuance cost amortization and beneficial conversion feature amortization, $70,000 in depreciation and amortization, offset by $200,000 from the write off of accrued expense due to the expiration of the legal statute of limitations on such liabilities. During the six months ended June 30, 2016, we used cash of $26,000 to fund increases in current assets and used cash of $482,000 through reductions in current liabilities and deferred revenue, excluding debt.

Investing Activities

Net cash generated from investing activities was $49,000 for the six months ended June 30, 2017 as compared to $44,000 used in the six months ended June 30, 2016. For the six months ended June 30, 2017, we generated cash of $50,000 from the sale of one of our non-utilized trademarks and used cash to fund capital expenditures of computer equipment, software and furniture and fixtures of approximately $1,000. For the six months ended June 30, 2016, we used cash to fund capital expenditures of computer equipment, software and furniture and fixtures of approximately $44,000.

Financing Activities

During the six months ended June 30, 2017 and 2016, the Company received $3,350,000 and $1,500,000, respectively, from borrowings under the Lines of Credit. Also during the six months ended June 30, 2017, the Company received approximately $227,000 from the exercise of 322,000 options resulting in the issuance of 322,000 shares of Common Stock.

Debt

At June 30, 2017, the Company had $6,000,000 in outstanding debt under the terms of the Lines of Credit, and $270,000 in accrued but unpaid interest, as compared to $1,500,000 in outstanding debt and $12,000 in related accrued but unpaid interest at June 30, 2016.

Contractual Obligations

Total contractual obligations and commercial commitments as of June 30, 2017 are summarized in the following table (in thousands):

	Payment Due by Year				
	Total	**Less than 1 Year**	**1-3 Years**	**3-5 Years**	**More than 5 Years**
Operating lease obligations	$ 490	208	273	9	—
Lines of credit payable to related parties	$ 6,270	—	6,270	—	—
Total	$ 6,760	208	6,543	9	—

Real Property Leases

Our corporate headquarters are located in San Diego, California where we occupy 9,927 square feet of office space. This facility is leased through October 2017 at a cost of approximately $18,000 per month. In addition to our corporate headquarters, we also occupied the following spaces at June 30, 2017:

- 1,508 square feet in Ottawa, Province of Ontario, Canada, at a cost of approximately $3,000 per month until the expiration of the lease on March 31, 2021. This lease was renewed in April 2016 for a five-year period ending on March 31, 2021. Renewal terms were substantially unchanged from the existing lease;

- 8,045 square feet in Portland, Oregon, at a cost of approximately $16,000 per month until the expiration of the lease on October 31, 2018; and

- 425 square feet of office space in Mexico City, Mexico, at a cost of approximately $3,000 per month, on a month-to-month basis until terminated by either party.

At June 30, 2017, future minimum lease payments are as follows:

($ in thousands)	
2017 (nine months)	$ 208
2018	$ 203
2019	$ 35
2020	$ 35
2021	$ 9
Total	$ 490

Off-Balance Sheet Arrangements

At June 30, 2017, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance, special purpose or variable interest entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. In addition, we did not engage in trading activities involving non-exchange traded contracts. As a result, we are not exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in such relationships. We do not have relationships and transactions with persons or entities that derive benefits from their non-independent relationship with us or our related parties except as disclosed elsewhere in this Quarterly Report.

Recently Issued Accounting Standards

Please refer to the section "Recently Issued Accounting Standards" in Note 2 of our Notes to the Condensed Consolidated Financial Statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Each of our contracts requires payment in U.S. dollars. We therefore do not engage in hedging transactions to reduce our exposure to changes in currency exchange rates, although in the event any future contracts are denominated in a foreign currency, we may do so in the future. As a result, our financial results are not affected by factors such as changes in foreign currency exchange rates.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of the design and operations of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as of June 30, 2017. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed in the reports submitted under the Securities and Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, including to ensure that information required to be disclosed by the Company is accumulated and communicated to management, including the principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Controls Over Financial Reporting

The Company's Chief Executive Officer and Chief Financial Officer have determined that there have been no changes, in the Company's internal control over financial reporting during the period covered by this report identified in connection with the evaluation described in the above paragraph that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II

ITEM 1. LEGAL PROCEEDINGS

None.

ITEM 1A. RISK FACTORS

Our results of operations and financial condition are subject to numerous risks and uncertainties described in our Annual Report on Form 10K for our fiscal year ended December 31, 2016, filed on March 31, 2017, including our need to raise additional capital to continue as a going concern. You should carefully consider these risk factors in conjunction with the other information contained in this Quarterly Report. Should any of these risks materialize, our business, financial condition and future prospects could be negatively impacted. As of August 14, 2017, there have been no material changes to the disclosures made in the above referenced Form 10-K.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

(a)	EXHIBITS
31.1	Certification of the Principal Executive Officer pursuant to Rule 13a-14(a) and 15d-14(a)
31.2	Certification of the Principal Financial and Accounting Officer pursuant to Rule 13a-14(a) and 15d-14(a)
32.1	Certification by the Principal Executive Officer and Principal Financial and Accounting Officer pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Linkbase
101.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase

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SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: August 14, 2017

IMAGEWARE SYTEMS, INC

By: /s/ S. James Miller

S. James Miller
Chief Executive Officer, Chairman and Director
(Principal Executive Officer)

Date: August 14, 2017

By: /s/ Wayne Wetherell

Wayne Wetherell
Chief Financial Officer
(Principal Financial and Accounting Officer)