I2 TECHNOLOGIES INC
Form 10-K
July 21, 2003
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

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

For the fiscal year ended December 31, 2002

or

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

For the transition period from __________ to __________

Commission file number 0-28030

i2 Technologies, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Delaware (State or other jurisdiction of incorporation or organization)	**75-2294945** (I.R.S. Employer Identification No.)
One i2 Place **11701 Luna Road** **Dallas, Texas** (Address of principal offices)	**75234** (Zip code)

Registrant s telephone number, including area code: **(469) 357-1000**

Securities registered pursuant to Section 12(b) of the Act: None

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

Common Stock, $0.00025 par value

Preferred Share Purchase Rights

(Title of Class)

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

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

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

As of June 30, 2003, the last business day of the registrant s most recently completed second fiscal quarter, the aggregate market value of the shares of Common Stock held by non-affiliates, based upon the closing price of the Common Stock as reported on the Pink Sheets, was approximately $295.4 million (affiliates being, for these purposes only, directors, executive officers and holders of more than 5% of the Registrant s Common Stock).

As of July 2, 2003, the Registrant had 432,853,021 outstanding shares of Common Stock.

i2 TECHNOLOGIES, INC.

ANNUAL REPORT ON FORM 10-K

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ITEM 1. BUSINESS

The disclosures set forth in this report are qualified by the sections captioned Forward-Looking Statements and Factors That May Affect Future Results in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations, of this report, and other cautionary statements set forth elsewhere in this report.

References in this report to the terms optimal and optimization and words to that effect are not necessarily intended to connote the mathematically optimal solution, but may connote near-optimal solutions, which reflect practical considerations such as customer requirements as to response time, precision of the results and other commercial factors.

Recent Events

Chronology

In our quarterly report on Form 10-Q for the quarter ended September 30, 2002, we disclosed that we and certain members of our Board of Directors had received a series of communications from two of our former officers containing a variety of allegations generally related to: accounting and revenue recognition; inadequate financial controls; and gross negligence or potential fraud in connection with product and customer problems, acquisitions, public disclosure and other management decisions. Our Board of Directors directed its Audit Committee to investigate the initial allegations received from one of these former officers in the fall of 2001 promptly after they were received. The Audit Committee, which is comprised solely of independent directors, engaged independent legal and accounting advisors to assist with the investigation. The Audit Committee completed the investigation and reported its findings to our board of directors in the third quarter of 2002. Based on the results of the Audit Committee s investigation, our Board of Directors concluded that there were no adjustments necessary to our consolidated financial statements, that there were no indications of material deficiencies in our financial controls and that the facts did not support the allegations concerning gross negligence or potential fraud.

In the fall of 2002, the two former officers brought additional information to the attention of the Audit Committee in respect of their prior allegations regarding revenue recognition. A review of this additional information was performed and, as a result of that review, management concluded that the revenue recognition allegations remained unsubstantiated by the additional information. Management reviewed its findings with the Audit Committee which directed management to review its findings with the independent accounting advisors engaged by the Audit Committee to investigate the initial allegations. In January 2003, this investigation turned up information that persuaded management and the Audit Committee that material adjustments to our previously issued financial statements might be required and that our consolidated financial statements for the years ended December 31, 2001 and 2000 should be re-audited. On January 27, 2003, we announced that the Audit Committee had engaged Deloitte & Touche LLP, our external auditors, to re-audit those consolidated financial statements, which had previously been audited by Arthur Andersen LLP. Additionally, we announced that the Securities and Exchange Commission (SEC) had commenced an informal inquiry into these matters.

On March 31, 2003, we announced that due to the ongoing re-audits of our 2001 and 2000 consolidated financial statements and our additional decision to re-audit our consolidated financial statements for the year ended December 31, 1999, it would be necessary for us to delay our filing of this 2002 annual report on Form 10-K until early June 2003. We also announced that the re-audits would result in material adjustments to our previously-reported consolidated financial statements and that we had received notice from the SEC that it had issued a formal order of investigation in connection with matters relating to the restatement of our consolidated financial results.

On May 13, 2003, we provided additional relevant information during our user conference which was publicly broadcast via webcast. During that webcast we stated that our consolidated financial statements for the year ended December 31, 1999 would not be re-audited, as previously disclosed, but that any revenue transactions in 1999 that could affect the year 2000 would be analyzed. We further stated that we believed we

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would be able to file our 2002 annual report on Form 10-K in June 2003. The substance of the webcast was filed as an exhibit to our Current Report on Form 8-K filed on May 16, 2003. We subsequently announced, on June 30, 2003, that we would file our annual report on Form 10-K in July 2003.

During the course of the re-audits, we determined that the accounting with respect to certain transactions was required to be adjusted. As a result, we have restated our consolidated financial statements for the years ended December 31, 2001 and 2000, for the first three quarters of 2002 and for each of the quarters in 2001 and 2000. We have also adjusted the preliminary consolidated financial statement information for the quarter ended December 31, 2002, which we announced in a January 27, 2003 press release. This press release was filed as an exhibit to our Current Report on Form 8-K on January 30, 2003. Any adjustments for the quarter ended December 31, 2002 are as compared to our preliminary consolidated financial statement information for the quarter ended December 31, 2002 or, with respect to the year ended December 31, 2002, the aggregate of our previously issued quarterly results for the periods ended March 31, 2002, June 30, 2002 and September 30, 2002 and the announced quarterly results for the period ended December 31, 2002. We have also restated on an unaudited basis our consolidated financial statements for the years ended December 31, 1999 and 1998.

In addition to our consolidated financial statements for the year ended December 31, 2002, this annual report on Form 10-K includes our restated consolidated financial statements for the years ended December 31, 2001 and 2000, as well as our restated consolidated financial data for the years ended December 31, 1999 and 1998. We also include our restated unaudited consolidated statement of operations for the first three quarters of 2002 and for each of the quarters in 2001 and 2000. Our quarterly reports on Form 10-Q for 2003 will contain our restated consolidated financial statements for the corresponding quarters of 2002.

We have not amended our previously-filed annual reports on Form 10-K or quarterly reports on Form 10-Q for the periods affected by the restatements or adjustments. For this reason, the consolidated financial statements and related consolidated financial information contained in such previously-filed reports should no longer be relied upon.

Financial Statement Adjustments

As noted above, we have determined the need to adjust the accounting with respect to certain transactions. The revenue adjustments that have been made mostly result in revenue being deferred and recognized in subsequent periods, although in certain situations the adjustments result in revenue reversals. The adjustments include amounts deferred and reversed as a result of our application of the principles of contract accounting and amounts reversed as a result of the presence of concurrent transactions. The net effect of these revenue adjustments is to increase total revenue by $385.8 million in 2002 and to decrease total revenue by $137.6 million, $477.0 million and $130.9 million in 2001, 2000 and 1999, respectively. We have also made certain deferrals and reversals to our expenses in connection with these revenue adjustments and have made certain other adjustments to our expenses. The net effect of these expense adjustments is to increase expense by $45.8 million in 2002 and to decrease expense by $195.6 million, $34.6 million and $5.4 million in 2001, 2000 and 1999, respectively. As a result of these adjustments to our revenues and expenses, we are also making certain income tax-related adjustments which increase our tax expense by $235.2 million and $25.6 million in 2002 and 2001, respectively, and which decrease our tax expense by $166.9 million, $51.5 million and $5.2 million in 2000, 1999 and 1998, respectively.

The statement of operations impact of all of these adjustments discussed above is to decrease our net loss by $104.8 million and $32.4 million in 2002 and 2001, respectively, increase our net loss by $275.5 million in 2000, decrease our net income by $74.0 million in 1999 and increase our net income by $5.2 million in 1998. Any adjustments for the quarter ended December 31, 2002 are as compared to our preliminary consolidated financial statement information for the quarter ended December 31, 2002 or, with respect to the year ended December 31, 2002, the aggregate of our previously issued quarterly results for the periods ended March 31, 2002, June 30, 2002 and September 30, 2002 and the announced quarterly results for the period ended December 31, 2002.

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The following tables summarize the statement of operations impact of these adjustments on our net income/loss for the periods indicated.

Restatement and Adjustment Impact on Net Income (Loss)

(in millions, except per share data)

	Quarter Ended March 31, 2002			Quarter Ended June 30, 2002			Quarter Ended September 30, 2002			Year Ended December 31, 2002
	(As Reported)	(Restated)	Difference	(As Reported)	(Restated)	Difference	(As Reported)	(Restated)	Difference	Difference*
Net Revenue adjustments	$ 168.4	$ 202.5	$ 34.1	$ 119.6	$ 162.5	$ 42.9	$ 114.6	$ 374.5	$ 259.9	$ 385.8
Expense adjustments, including operating expense and other income and expense	$ 222.7	$ 221.0	$ 1.7	$ 205.6	$ 205.7	$ (0.1)	$ 311.6	$ 338.3	$ (26.7)	$ (45.8)
Income tax adjustment	$ (19.6)	$ (6.3)	$ (13.3)	$ 671.4	$ 893.4	$ (222.0)	$ 2.1	$ 2.1	$ 0.0	$ (235.2)
Total effect on net income (loss) (increase) decrease	$ (34.8)	$ (12.2)	$ 22.6	$ (757.4)	$ (936.6)	$ (179.2)	$ (199.1)	$ 34.1	$ 233.2	$ 104.8
Effect on earnings per share										
Basic	$ (0.08)	$ (0.03)	$ 0.05	$ (1.77)	$ (2.18)	$ (0.41)	$ (0.46)	$ 0.08	$ 0.54	$ 0.24
Diluted	$ (0.08)	$ (0.03)	$ 0.05	$ (1.77)	$ (2.18)	$ (0.41)	$ (0.46)	$ 0.07	$ 0.53	$ 0.24

	Year Ended December 31, 2001			Year Ended December 31, 2000			Year Ended December 31, 1999			Year Ended December 31, 1998		
	(As Reported)	(Restated)	Difference	(As Reported)	(Restated)	Difference	(As Reported)	(Restated)	Difference	(As Reported)	(Restated)	Difference
Net Revenue adjustments	$ 1,012.9	$ 875.3	$ (137.6)	$ 1,149.5	$ 672.5	$ (477.0)	$ 583.0	$ 452.1	$ (130.9)	$ 371.2	$ 371.2	$ 0.0
Expense adjustments, including operating expense and other income and expense	$ 9,027.2	$ 8,831.6	$ 195.6	$ 2,865.8	$ 2,831.2	$ 34.6	$ 535.0	$ 529.6	$ 5.4	$ 348.7	$ 348.7	$ 0.0
Income tax adjustment	$ (263.0)	$ (237.4)	$ (25.6)	$ 35.7	$ (131.2)	$ 166.9	$ 24.6	$ (26.9)	$ 51.5	$ 17.3	$ 12.1	$ 5.2
Total effect on net income (loss) (increase) decrease	$ (7,751.3)	$ (7,718.9)	$ 32.4	$ (1,752.0)	$ (2,027.5)	$ (275.5)	$ 23.4	$ (50.6)	$ (74.0)	$ 5.2	$ 10.4	$ 5.2
Effect on earnings per share												
Basic	$ (18.68)	$ (18.61)	$ 0.07	$ (4.83)	$ (5.59)	$ (0.76)	$ 0.08	$ (0.15)	$ (0.23)	$ 0.02	$ 0.04	$ 0.02
Diluted	$ (18.68)	$ (18.61)	$ 0.07	$ (4.83)	$ (5.59)	$ (0.76)	$ 0.07	$ (0.15)	$ (0.22)	$ 0.02	$ 0.03	$ 0.01

* The differences for the year ended December 31, 2002, are a comparison of the aggregate of our previously issued quarterly results for the periods ended March 31, 2002, June 30, 2002 and September 30, 2002 and the announced quarterly results for the period ended December

31, 2002, and the restated consolidated financial results for the year ended December 31, 2002.

The following discussion provides additional information regarding these adjustments, including information with respect to the impact of these adjustments on our balance sheet.

Net Revenue Adjustments

Net Contract Revenue and Related Expense Adjustments

As a result of a comprehensive review of revenue recognition practices conducted by senior management simultaneously with the re-audits, which involved an extensive in-depth review and analysis of data and other information accumulated during the course of the re-audits from various sources within our company, we have changed the accounting for a number of transactions from revenue recognition under SOP 97-2, Software Revenue Recognition, to revenue recognition under SOP 81-1, Accounting for Certain Construction Type and Certain Production Type Contracts, referred to as contract accounting. This determination was made because we

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concluded that in some instances our services were essential to the functionality of certain software products we licensed and that contract accounting was therefore the appropriate accounting treatment for these transactions. We concluded that our services were essential to the functionality of certain software products we licensed for a variety of reasons, including (i) expansion of the use of such products into new industries and markets, (ii) communications with customers which established certain expectations inconsistent with the capabilities of products at the time of sale, (iii) significant performance and product-readiness issues related to certain products, and/or (iv) the requirement of significant customization, modifications or additions to products to meet the customers expectations or intended purposes.

Applying contract accounting to these transactions requires that the recognition of license, services and/or maintenance revenue for these transactions must be deferred and recognized in subsequent periods. The deferral and related revenue recognition is based on the applicability of either the percentage of completion method or the completed contract method of accounting. As discussed in more detail in *Note 1 Summary of Significant Accounting Policies* in the accompanying Notes to Consolidated Financial Statements, the percentage of completion method requires revenue to be recorded as the implementation is completed and the completed contract method requires revenue to be recorded only when we have satisfied all of our product and/or service delivery obligations to the customer.

We do not have fair value for our license revenue as a result of our varied discounting practices. Accordingly, under SOP 97-2 we have recognized revenue under the residual method as described in *Note 1 Summary of Significant Accounting Policies* in the accompanying Notes to Consolidated Financial Statements, which has prevented us from allocating license revenue among the individual products licensed to a customer. As a result, if a determination is made that our services are essential to the functionality of any single software product or group of products licensed to a customer as part of a larger bundle of our software products, then the license, services and/or maintenance revenue associated with the entire bundle must be accounted for in accordance with SOP 81-1. This is so even if the software product for which our services are essential has not been implemented by the customer. As a result of this treatment, in numerous situations we have deferred all license, maintenance and/or services revenue associated with transactions in which our customers have implemented many parts of a software bundle and have paid us in full.

In these situations, we have deferred license, services and/or maintenance revenue because the customer retains the license right to the non-implemented software product for which our services have been deemed to be essential. Once payment from the customer is received, these amounts remain on the balance sheet as deferred revenue until an event occurs to allow revenue to be recognized under SOP 81-1. There are a limited number of transactions that remain in deferred revenue at December 31, 2002 in which certain non-implemented software products for which services are essential are no longer being licensed by us. In these cases, we believe it is unlikely that the customer will implement these software products, although most are using other products and services from us. While we will attempt to resolve these situations with the customers involved in order to enable recognition of the deferred revenue in question, we cannot predict how successful we will be in doing so.

As a result of the use of contract accounting, our total revenues increased by $401.5 million in 2002 and decreased by $103.2 million, $406.4 million and $124.3 million in 2001, 2000 and 1999, respectively. We have also deferred certain contract costs associated with the use of contract accounting. As a result of these expense adjustments, our operating expense increased by $58.7 million in 2002 and decreased by $31.3 million, $34.1 million and $7.6 million in 2001, 2000 and 1999, respectively. As a further result of these adjustments as well as the revenue adjustments described below, deferred revenue increased by $210.0 million, $558.6 million, $383.1 million and $99.6 million at December 31, 2002, 2001, 2000 and 1999, respectively. Prepaid contract expense increased by $14.3 million, $72.9 million, $41.6 million and $7.6 million at December 31, 2002, 2001, 2000 and 1999, respectively. This deferred contract revenue and cost may be recognized in future periods only when and if we are able to arrange with our customers to terminate our residual service obligations, as described above.

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Revenue and Expense Reversals   Contract Accounting

With respect to certain transactions that are now being accounted for under contract accounting rules, we were not paid all amounts due to us or we incurred transaction-related settlement expenses. In each of these cases we have reversed revenue equal to the amount of such payment shortfall and/or settlement expense. In the aggregate, we have reversed $83.2 million of revenue. These payment shortfalls and settlement expenses, formerly recorded as bad debt or customer litigation expenses, have also been reversed. These revenue reversal adjustments decreased revenue by $0.7 million, $20.9 million, $55.0 million and $6.6 million in 2002, 2001, 2000 and 1999, respectively. The expense reversal adjustments decreased operating expense by $14.5 million, $57.8 million, $8.3 million and $0.3 million in 2002, 2001, 2000 and 1999, respectively.

Revenue and Expense Reversals   Concurrent Transactions

We have also identified four transactions which were concluded at or about the same time as other arrangements with the same customers and with respect to which we have been unable to determine that we had paid or received   fair value   for the products or services involved. See *Note 1   Summary of Significant Accounting Policies* in the accompanying Notes to Consolidated Financial Statements for a discussion regarding our accounting policy for concurrent transactions.

The principal transaction was our license of software to International Business Machines Corporation (IBM) in the first quarter of 2000. See *Note 3   Business Combinations* in the accompanying Notes to Consolidated Financial Statements. The concurrent arrangements with IBM included (i) our license of certain software from IBM, (ii) our purchase of certain software from IBM, (iii) the issuance of common stock to IBM, (iv) the amendment of a marketing agreement between us and IBM, and (v) the entry into a patent cross-license agreement between us and IBM (which included a related release and covenant not to sue).

The original accounting treatment, applied in accordance with the advice of our former auditor, was based on recording two separate transactions: (i) a license of software to IBM and (ii) an issuance of common stock to IBM in consideration for a purchase of certain business assets, a license of certain software and the entry into a patent cross-license agreement. This accounting treatment resulted in the recognition of license revenue on a subscription basis over a four-year recognition period, $38.5 million of which had been recognized at December 31, 2002. We have determined that our license of software to IBM and the concurrent arrangements with IBM should be accounted for as a single transaction. As a result, the fixed license revenue of $60 million from IBM associated with this transaction has been recorded as an offset against the value of the assets received from IBM. The cumulative statement of operations impact through December 31, 2002 was a $38.5 million reversal of license revenue and a $62.7 million reversal of expense. The balance sheet impact at December 31, 2002 was an increase to intangibles and goodwill of $2.6 million and a decrease in deferred revenue of $18.5 million.

The cumulative amount of the revenue reversals as a result of the IBM transaction and the other three transactions involving substantially concurrent arrangements was $44.1 million as of December 31, 2002. The year-by-year impact of these revenue reversals is to decrease revenue by $15.0 million, $13.5 million and $15.6 million for 2002, 2001 and 2000, respectively. The year-by-year impact of the associated expense reversals is to increase expense by $1.6 million in 2002, decrease expense by $79.8 million in 2001 and increase expense by $10.0 million in 2000. The balance sheet impact of these reversals was a decrease in deferred revenue of $18.5 million, $33.2 million, and $37.0 million at December 31, 2002, 2001 and 2000, respectively.

Other Expense Adjustments

We have also identified several accrued expense items for which we have made adjustments to the amount of the liability, the timing of recording the liability or the timing of releasing the liability. These adjustments related to our accrued compensation and related expenses, including the accruals related to vacation, employee health plans and potential bonus payouts. Finally, the original accounting treatment with respect to certain business combinations, applied in accordance with the advice of our former auditor, has been modified. As a result, we are adjusting the allocation of purchase price on certain acquisitions and the related amortization of intangibles and goodwill. The net effect of the expense adjustments associated with these various kinds of

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adjustments is to increase operating expenses by $0.2 million in 2002, to decrease operating expenses by $26.6 million and $2.2 million in 2001 and 2000, respectively, and to increase operating expenses by $2.2 million in 1999. These adjustments also decreased our accrued liabilities by $20.0 million, $23.0 million and $13.4 million at December 31, 2002, 2001 and 2000, respectively, and increased our accrued liabilities by $0.3 million, at December 31, 1999.

Income Tax Adjustments

As a result of these adjustments to our revenues and expenses, we are also making certain income tax-related adjustments. For 2002, our income tax expense increased by $235.2 million. For 2001, we decreased our previously recorded tax benefit by $25.6 million. For 2000, 1999 and 1998, our income tax expense decreased by $166.9 million, $51.5 million and $5.2 million, respectively. Despite these adjustments, there was no impact to our previously announced balance sheet at December 31, 2002 due to the fact that, in the second quarter of 2002, we recorded a full valuation allowance on our deferred tax asset which reduced the value to zero. Our deferred tax assets increased by $230.8 million, $225.1 million, $58.1 million and $5.2 million at December 31, 2001, 2000, 1999 and 1998, respectively.

Net Income / Stockholders Equity

The statement of operations impact of the adjustments described above is to decrease our net loss by $104.8 million and $32.4 million in 2002 and 2001, respectively, increase our net loss by $275.5 million in 2000, decrease our net income by $74.0 million in 1999 and increase our net income by $5.2 million in 1998. The balance sheet impact of these adjustments is to decrease our stockholders equity by $204.7 million, $310.4 million, $328.2 million and $65.4 million at December 31, 2002, 2001, 2000 and 1999, respectively, and increase our stockholders equity by $6.7 million in 1998.

Our restated consolidated financial statements for the years ended December 31, 2001 and 2000 are included elsewhere in this annual report on Form 10-K. See *Note 2 Restatement* in the accompanying Notes to Consolidated Financial Statements for additional information on the effect of these adjustments on our previously-reported consolidated statement of operations for the years ended December 31, 2001 and 2000 and our previously-reported consolidated balance sheet at December 31, 2001. See Selected Consolidated Financial Data for additional information on the effect of these adjustments on our previously-reported unaudited consolidated statements of operations for the first three quarters of 2002 and for each of the quarters in 2001 and 2000.

Cumulative Restatement and Adjustment Impact

In sum, the cumulative impact of the revenue adjustments is to reduce revenue by $359.7 million, which is comprised of $127.3 million of revenue that has been reversed and $232.4 million of revenue that has been deferred and may be recognized in the future. The cumulative impact to net loss of the revenue and expense adjustments is to increase our net loss by $207.1 million. To the extent that revenue that has been deferred is subsequently recognized, it will reduce the impact of the adjustments to net income. The following table summarizes the cumulative statement of operations impact of these adjustments on our net income/loss for the periods indicated.

Cumulative Restatement and Adjustment Impact on Net Income (Loss)

(in millions)

		For the Years Ended December 31, 2002, 2001, 2000, 1999 and 1998**
Cumulative net revenue deferrals	$	(232.4)
Cumulative net revenue reversals	$	(127.3)
Total cumulative and revenue adjustments	$	(359.7)
Cumulative expense adjustments, including operating expense and other income and expense	$	189.8
Cumulative income tax adjustments	$	(37.2)
Cumulative total increase in net loss	$	(207.1)

** The cumulative impact represents the sum of the Difference columns set forth above for the years ended December 31, 2002, 2001, 2000, 1999 and 1998.

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Securities and Exchange Commission and Internal Investigations

As previously disclosed, our Board of Directors had directed our Audit Committee to conduct an internal investigation of certain allegations made during the fall of 2001 by a former officer relating to revenue recognition and financial reporting, among other things. In November 2002, we reported to the SEC and in our third quarter Form 10-Q the results of that investigation, as well as certain new, related allegations (discussed above) made during the fall of 2002 by the former officer and another former officer. Thereafter, the staff of the SEC opened an informal inquiry into these allegations and other matters relating to our financial reporting. On or about March 26, 2003, we were advised that the SEC had issued a formal order of investigation to determine whether there have been violations of the federal securities laws by us and/or others involved with us in connection with matters relating to the restatement of our consolidated financial statements.

In response to the allegations received in the fall of 2002, our Audit Committee asked its independent legal and accounting advisors to conduct a further investigation into the actions of our officers and employees in connection with the circumstances necessitating the restatement of our consolidated financial statements. Based on the results of this investigation, taking all relevant factors into consideration and exercising its business judgment, the Audit Committee has advised the Board of Directors that it has no present intention to recommend the replacement of any members of senior management. Nevertheless, in light of the nature and extent of the restatement, the Audit Committee directed management to review the company s internal systems, controls and procedures, a process management had already commenced, and to develop and implement a remedial plan to ensure that the circumstances causing the need to restate our financial statements do not occur again. In response to this request, management has completed a review of the company s revenue recognition practices that focused on:

- our revenue recognition policies and procedures, including related product release management and price list practices;
- the adequacy of the training we have and will provide regarding these policies and procedures, including specifically programs designed to educate our sales, services and development employees;
- our product development and release management policies and practices;
- our license transaction review and sign-off policies and procedures, with specific emphasis on participation by finance and accounting, sales and development, legal, senior management and our external auditors;
- our post-transaction review procedures, including our review of product issues, implementation projects and non-billable services hours; and
- the role of internal audit, including its participation in the revenue recognition process.

Work has begun on developing a remedial plan incorporating senior management s recommendations for enhancements to our control processes and procedures. See Item 14 Controls and Procedures. Proposed or completed enhancements to our control processes and procedures include: increased review of the facts and circumstances surrounding our transactions, implementations and products; expansion of our transaction sign-off procedures to include certain field personnel; enhanced training with respect to revenue recognition policies and procedures for our field personnel and personnel in our services and development organizations; modification of the incentive compensation structure of certain field personnel to eliminate compensation based upon recognized revenue; expansion of our quarterly sign-off procedures; enhanced release management review and approval processes; enhancement of our post-transaction monitoring of implementations; expansion of the responsibilities of our internal audit team; enhanced analysis and support for the accounting used when recording business acquisition transactions; and enhanced analysis and support for our accrued liability accounts. With the assistance of our advisors we continue to consider further actions, including without limitation actions to address the material weaknesses identified by our auditors to the extent not already addressed, and to improve the effectiveness of our control processes and procedures.

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Based on the results of its investigation, the Audit Committee has also directed that management review the company s recently adopted code of ethics and establish a comprehensive compliance program, requiring, among other things, periodic written confirmations from every officer and employee of the company of compliance with our code of ethics and internal policies and procedures. The Audit Committee charter provides for its continuing oversight of the changes made by management and for monitoring management s progress in implementing and maintaining these new initiatives.

The results of the Audit Committee s investigation have been reported to the SEC in connection with the SEC s formal investigation. We intend to continue to fully cooperate with the SEC as it moves forward in its investigation.

Listing Matters

As a result of our inability to timely file this annual report on Form 10-K, our common stock was delisted from The NASDAQ Stock Market effective at the opening of the market on May 9, 2003. While we have since initiated an appeal with the NASDAQ Listing and Hearing Review Council, there can be no assurance as to whether the appeal process will lead to a different result. We do not expect to hear the results of our appeal until September 2003.

If our appeal is unsuccessful, we intend to re-apply to the NASDAQ National Market once we can satisfy NASDAQ s initial listing requirements, which include, among other things, a minimum bid price requirement of $5 per share. There can be no assurance that our common stock will satisfy the minimum bid price requirement or that our common stock will otherwise be approved for listing.

Our common stock is currently quoted in the over-the-counter Pink Sheets under the OTC symbol ITWO. However, soon after the filing of this annual report on Form 10-K and our quarterly report on Form 10-Q for the quarter ended March 31, 2003, we believe that our common stock will begin trading on the OTC Bulletin Board under the symbol ITWO.

Debt and Real Estate Update

On April 7, 2003, we announced that the indenture governing our $350 million of convertible subordinated notes due in December 2006 requires us to deliver our annual and quarterly filings with the SEC to the indenture trustee within 15 days after the date such periodic filings are due to be filed with the SEC, and that the indenture contains a 60-day cure period for covenant non-compliance. In the event that we were unable to cure such non-compliance within the 60-day cure period, we would then be in default under the convertible subordinated notes. The cure period commences upon delivery of notice of non-compliance to us. To date, we have not received notice of non-compliance from the trustee or the debt holders. With the filing of this annual report on Form 10-K and our quarterly report on Form 10-Q for the quarter ended March 31, 2003 (and the delivery of such filings to the indenture trustee), we believe that we will cure our non-compliance with the reporting covenants in the indenture. While we have not yet filed our quarterly report on Form 10-Q for the quarter ended March 31, 2003, management believes that we will be able to file such report promptly after the filing of this annual report on Form 10-K. Additionally, management believes subsequent quarterly reports on Form 10-Q during the year ending December 31, 2003 will be filed (and copies delivered to the indenture trustee) within the timeframes required in the indenture. See Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources and Factors that May Affect Future Results.

As of May 15, 2003, we entered into a termination agreement with the owner of Two Colinas Crossing, a building in Dallas, Texas, that we vacated in January 2003 as part of our restructuring. This lease, originally scheduled to expire in October 2011, would have required us to pay approximately $37.7 million through the lease s original date of termination. In consideration for the early termination of the lease, we paid approximately $7.6 million in cash and issued a $6.8 million non-negotiable promissory note. The senior note bears interest at a rate of 5.25% per annum, payable semi-annually in arrears, and matures on December 15, 2006.

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On June 6, 2003, we prepaid the $60.9 million convertible promissory note issued by us in connection with the acquisition of Trade Service Corporation and EC-Content, Inc. We paid $59.2 million in cash to the holder of the senior note as payment and satisfaction in full of the principal amount of, and all accrued interest under, the note and our remaining obligations under the acquisition agreement. The note bore interest at a rate of 7.5% per annum and was scheduled to mature on September 23, 2003. The amount paid in settlement of the note and our remaining obligations under the acquisition agreement represented approximately a 5.5% discount to principal and interest accrued under the note as of the payoff date.

Our Company

We are a provider of enterprise supply chain management solutions, including various supply chain software and service offerings. We operate our business in one business segment. Supply chain management is the set of processes, technology and expertise involved in managing supply, demand and fulfillment throughout divisions within a company and with its customers, suppliers and partners. The goals of our solutions include increasing supply chain efficiency and enhancing customer and supplier relationships by managing variability, reducing complexity, improving operational visibility, increasing operating velocity and integrating planning and execution. Our offerings help customers maximize efficiency in relation to spend, production, revenue and profit, fulfillment and logistics performance. Our application software is often bundled with other offerings including content and services we provide such as business optimization and technical consulting, training, solution maintenance, content management, software upgrades and development.

Globally, we have over 1,000 customers in a variety of industries including:

- Technology
  - Computer & Electronics
  - Telecommunications Equipment and Service
  - Semiconductor
  - Consumer Electronics & Consumer Durables
  - Contract Manufacturers
- Automotive and Industrial
  - Automotive OEMs
  - Suppliers

- Industrial Manufacturers

Process Industries

- Consumer Packaged Goods
- Pharmaceuticals
- Energy & Chemicals
- Metals
- Paper

Consumer Goods & Retail

- Retailers
- Consumer Packaged Goods
- Soft Goods (Textiles/Apparel & Footwear)

Siemens AG accounted for 10.5% of total revenue in 2002. No other individual customer accounted for more than 10% of our total revenues during 2002.

i2 was founded in 1988 and incorporated in Delaware in 1989. Our executive offices are located at One i2 Place, 11701 Luna Road, Dallas, Texas 75234, and our telephone number is (469) 357-1000.

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2002 Developments

Sanjiv Sidhu, our co-founder and Chairman, assumed the additional titles Chief Executive Officer and President in April 2002. At the same time, Shigeru Sam Nakane was named Chief Operating Officer and joined Pallab Chatterjee, President, Solutions Operations; William Beecher, Executive Vice President and Chief Financial Officer; and Hiten Varia, Chief Customer Officer on the Executive Management Committee. Robert Donohoo was appointed Senior Vice President and General Counsel and joined the Executive Management Committee in August 2002.

Industry Background

Today s increasingly competitive business environment has led many companies in diverse industries to seek greater operating efficiency while improving flexibility and responsiveness to changing market conditions. In addition to facing higher competitive standards with respect to meeting customer demands for product quality, variety and price, businesses also recognize the need to improve asset utilization, reduce the cost of goods, reduce inventories, shorten lead times and reduce the cost of fulfilling orders. Furthermore, a company s extended supply chain may span multiple continents, requiring suppliers in one part of the world to collaborate with a plant in another to serve customers in yet a third location. These forces are prompting companies to collaborate with a broad range of suppliers and customers to improve efficiencies across multi-enterprise supply chains.

In the past, companies have sought to address the changing business environment by investing in enterprise resource planning (ERP) systems and first-generation electronic commerce systems; however, these systems do not provide both the forward visibility across divisions or enterprises and the high-speed decision-support capabilities that we believe are necessary to quickly plan and execute decisions. To increase competitiveness, we believe many companies are looking for solutions that can be integrated with their existing systems to provide tools for managing the variability in their supply chains, allowing them to monitor changes in key areas, weigh tradeoffs for fast and accurate decision-making and execute their plans across the critical processes in their supply chains.

The growth of the Internet and the proliferation of software applications have accelerated many companies efforts to increase efficiencies by leveraging platform-independent information technology. We believe this platform independence has prompted demands for a dynamic, open and integrated environment among customers, suppliers and designers. In response to these evolving market forces, many companies have sought to re-engineer their business processes to reduce manufacturing cycle times, shift from mass production to order-driven manufacturing, increase the use of outsourcing and share information more readily with vendors and customers.

Integration has become an increasingly important issue for enterprises to lower costs and realize value from their diverse environment of applications and distributed systems. Customers seek integration at several levels business process, applications, user interface, data and technology. A wide variety of companies are pursuing the integration market opportunity, including ERP companies, leading Independent Software Vendors (ISVs), Enterprise Application Integration (EAI) vendors, Systems Integrators (SIs) and other information technology (IT) services organizations, but no single company has demonstrated a complete solution to the various requirements sought by customers. Web service-based applications appear promising, but to date are immature, incomplete and limited by competing technology standards and protocols.

Leading software and technology companies are developing offshore (global) workforces, in part to take advantage of the technical talent and lower costs of human resources in India, China and other locations. This has led many companies to start up their own offshore operations or outsource some activities to Offshore IT Services (OIS) firms. While many of these efforts focus on run and maintain activities, development activities are increasingly involved as well.

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Development of the i2 Solution

Advanced Planning and Scheduling. We have offered an expanding set of supply chain management solutions since the company was founded nearly 15 years ago. Our founders, Sanjiv Sidhu and Ken Sharma, sought to expand enterprise application software beyond traditional ERP systems, which were basically transaction accounting and processing systems that did not consider production constraints or offer more sophisticated monitoring, decision-support and execution capabilities. We took the first step beyond ERP with the development of an advanced planning and scheduling application that took into account actual constraints to improve the flow of materials within a factory. That solution, i2 Factory Planner, has assisted many of our customers in improving the efficiency and profitability of their factories while reducing their materials and inventory costs.

Supply Chain Planning/Supply Chain Management. Our applications evolved into solutions for supply chain planning that encompassed constraint-based planning and scheduling for multiple factories, distribution centers and warehouses. With the addition of supply chain design and execution capabilities for logistics, demand planning and fulfillment, we became a leader in enterprise solutions for supply chain management.

Supplier Relationship Management. We continued to expand our product base by applying our solutions for the extended supply chain to the supplier relationship processes and functions. To facilitate cost-effective sourcing and product design, we acquired and developed technologies that help customers to more efficiently source, negotiate the pricing of and procure materials and components from suppliers, thereby enabling them to make design decisions while cognizant of the effect on the supply chain of existing products and the total product portfolio.

Fulfillment and Revenue Management. Our distributed order execution technology has enabled us to develop planning and execution solutions, such as service parts management. We continue to invest in this technology, which provides a scalable and flexible toolkit for creating new solutions and helps customers to leverage transaction processing, visibility and event management capabilities. We have also invested in solutions that help customers optimize merchandising, revenue and pricing.

Products

Our solutions bundles of software products, technology services and/or content are designed to help customers address various supply chain problems and opportunities, including:

- Linking certain aspects of planning and decision-making to execution of such plans and the monitoring of changing conditions across the supply chain;
- Improving current business processes, return on assets, profitability and customer service levels;
- Increasing market share;
- Enhancing their competitive advantage; and

Delivering on their promises to their customers.

Our primary products are contained in the following suites: Production Optimization, Spend Optimization, Revenue and Profit Optimization, Fulfillment Optimization and Logistics Optimization. These suites are complemented by our content, technology and services offerings that together form customer solutions.

Production Optimization: The i2 Production Optimization suite helps businesses coordinate the production and distribution of goods and materials through the supply chain, to product delivery and to the customer. This suite of products can provide multi-enterprise visibility, collaboration, decision-support and execution capabilities. Using i2 Production Optimization, a business may estimate future demand for its products to help planners to more accurately estimate future supply needs. As a result, businesses can make better decisions about how much of what products to make, when to make them, and what parts to pull through the chain to make those products. Our Production Optimization products include the i2 Six Supply Chain Management (SCM) suite featuring solutions such as Demand Planner, Demand Fulfillment, Demand Manager, Factory Planner, Supply Chain Planner and various Scheduling products.

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Spend Optimization: The Spend Optimization suite helps companies and their suppliers collaborate on sourcing and procurement for supply management. This suite bridges product development, sourcing, supply planning and procurement across the supply chain, providing the ability to create, execute and sustain global sourcing strategies. i2 Spend Optimization provides decision-support and optimization tools that are designed to help companies improve decision-making on supplies and the parts to use in products. During product development, these products can help to optimize designs by considering sourcing and supply chain constraints, as well as allowing design collaboration when outsourcing manufacturing or custom parts. During procurement, Spend Optimization helps companies to define sourcing strategies to reduce supply risks and costs, negotiate terms and streamline the requisitioning and buying of materials. Our Spend Optimization products include the i2 Six Supplier Relationship Management (SRM) suite featuring solutions such as Catalog Management, Product Sourcing, Contracts Management, Strategic Sourcing, Negotiate, and Procurement.

Revenue and Profit Optimization: The Revenue and Profit Optimization suite helps businesses manage their revenues with merchandising, planning and pricing tools. This suite provides tools to plan merchandising strategies, to manage markdowns and promotions pricing, and to optimize price quoting. Using these products, companies can begin to optimize their revenues by selling products at prices set by sophisticated analytic products. Our Revenue and Profit Optimization products include Markdown Optimizer and Merchandise Planner.

Fulfillment Optimization: The Fulfillment Optimization suite helps businesses integrate planning and execution in fulfillment solutions, such as Service Parts Management and Vendor Managed Inventory. This suite provides tools to stage inventory, plan replenishment, manage orders and provide visibility to lower fulfillment costs, improve on-time delivery performance and enhance customer satisfaction. The Distributed Order Execution solution that is the backbone of i2 s Fulfillment Optimization suite provides transaction processing, visibility, event management, integration and workflow capabilities. Our Fulfillment Optimization products include solutions such as Distributed Order Management, Replenishment Planner, Service Budget Optimizer and Service Parts Planner.

Logistics Optimization: The i2 Logistics Optimization suite helps businesses optimize the flow of goods between suppliers, enterprise supply chain locations and customers. This suite of products provides integrated products for planning and executing transportation and distribution activities, as well as tools for strategic supply chain design and transportation modeling. Using i2 Logistics Optimization, a business can procure, plan, execute and monitor freight movements across multiple modes, borders and enterprises. As a result, businesses can make better decisions about where and how to ship products, reducing their transportation costs while executing supply chain plans and achieving customer service objectives. Our Logistics Optimization products include the i2 Six Transportation and Distribution Management (TDM) suite featuring products such as Supply Chain Strategist, Transportation Bid Collaboration, Transportation Planner, Transportation Modeler, Transportation Manager and Warehouse Manager.

Content: Content is information about items and suppliers that can be used to describe, search, compare, buy, sell or select an item. The i2 Content solution consists of content management software, content services and reference content. Our content management software provides publication, subscription, management and syndication functionality for enterprises and helps identify parts or services that match both technical and price criteria and the delivery of content services via the Internet. Additionally, our content management software provides a standards-based method for content exchange and collaboration among trading partners. Content services provided with i2 Content include legacy data conversion services and custom content creation capabilities that help enterprises to access needed part, component and supplier data. Our reference content contains part, component and item-specific records as well as technical and pricing information about available products.

Integration: Integration links our products with the customer s IT environment, especially to ERP and legacy operational systems. Our integration tools are designed to enable customers to integrate data, systems and processes, and are based on a combination of internally-developed software and third-party software.

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Product Development

We focus our ongoing product development efforts on meeting the requests of, and delivering on our commitments to, our current customers, enhancing our solutions and the underlying technology across our products, and developing or enhancing products that will enable us to enter new markets. In order to address customer recommendations, we have developed a User Enhancement Voting Process in collaboration with the i2 User Group. This process allows customers to provide input so that our solutions evolve to meet our customers business challenges and opportunities. In addition, we invest in solutions that help us more fully complete our solution offerings and enable cross-product workflows. We have focused much of our discretionary investments into products and technologies that we anticipate will be important and differentiated in the future, such as our Distributed Order Execution platform. We maintain our primary development centers in North America and India. Research and development expenses totalled $173.1 million in 2002, $288.9 million in 2001 and $218.5 million in 2000.

We conducted a product rationalization effort in 2002, during which we assessed our product portfolio with the goal of making the best use of development funds. We examined historical economic performance, quality, market potential, customer commitments, and the fit with our overall strategy. Products with functionality overlap were consolidated and a few products were phased out (made unavailable for future customer sales). During these efforts, we worked to ensure that we had adequate resources to maintain and meet existing customer commitments, including providing customer support.

Our Solution Operations activities are primarily conducted in North America and India and are organized into Solutions Business Units (SBUs). Most SBU management, product management and product marketing employees are based in North America, but many development and services teams are based in India. The India location offers many benefits to i2, including centralization of development efforts and cost structure advantages. Our India-based Solutions Center provides services such as upgrades, implementations and development services that heavily leverage other organizations based in India. We also provide content and data services out of India.

Our Solution Operations organization has embarked on several strategic initiatives to improve processes and performance in those areas, including Total Quality Management (TQM), customer satisfaction and productization.

Customer Service and Support

We maintain a technical support team that operates through our global service and support centers. Our customer service and support activities consist of the following:

Consulting. We offer our customers on-site consulting services aimed at assisting in the implementation of our products and services and integration with the customers existing systems. We and our customers also use third-party consulting firms.

Training. We offer education and training programs for our customers and third-party implementation providers with classes offered at our offices or at customer locations. We also offer web-based and self-paced learning programs. These classes focus on the fundamental principles of our software products as well as their implementation and use.

Maintenance and Product Updates. We provide ongoing support services for our product suites. Maintenance contracts are typically sold to customers at the time of the initial license and may be renewed for additional periods. Our maintenance agreements with our customers provide the right to receive most product updates and enhancements to the products purchased by the customer, as well as telephone and online support. Our support services are packaged into three tiers (silver, gold and platinum), which offer customers the ability to choose the level of service they desire.

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Development Services. We offer some customers custom development of our applications. These development service arrangements are generally entered into when we believe that the modifications or additions to the software can be utilized by multiple customers.

Sales and Marketing

We sell our software and services through a direct customer facing organization that is augmented by other sales channels, including systems consulting and integration firms and other industry-related partners. Our direct customer facing organization consists of account representatives and client managers that are supported by a team of personnel that includes solution and industry specialists.

We currently have joint marketing agreements with software vendors and other industry-related businesses. Additionally, we have alliances with top global and regional systems consulting and integration firms, including Accenture, A. T. Kearney, Cap Gemini Ernst & Young, EDS, IBM Global Services, Tata Consulting Services and webMethods, among others. These joint marketing agreements and alliances generally provide the vendors with non-exclusive rights to market our products and access our marketing materials and product training. By using these indirect sales channels, we seek to capitalize on the installed base of other companies and obtain favorable product recommendations from the business partners, thereby increasing the market coverage of our products.

International Operations

We have international offices in Australia, Belgium, Canada, China, Finland, France, Germany, India, Japan, Korea, Malaysia, Netherlands, Singapore, South Africa, Spain, Taiwan and the United Kingdom. Total assets related to our international operations accounted for 21% and 13% of our total consolidated assets as of December 31, 2002 and 2001. International revenue totalled $202.1 million, or 22% of total revenue, in 2002; $383.9 million, or 44% of total revenue, in 2001; and $365.8 million, or 54% of total revenue, in 2000. See *Note 15 Segment Information, International Operations and Customer Concentrations* in the accompanying Notes to Consolidated Financial Statements.

Competition

The markets in which we operate are highly competitive. Our competitors are diverse and offer a variety of solutions targeting various segments of the extended supply chain as well as the enterprise as a whole. Some competitors compete with suites of applications, while most offer solutions designed specifically to target particular functions or industries. We believe our principal competitors are as follows:

ERP Software Vendors. These include companies such as Oracle, SAP and PeopleSoft, who have added or are attempting to add capabilities for supply chain planning or collaboration to their transaction system products.

Other Software Vendors. These include companies such as Adexa and Manugistics who compete principally with our production, logistics and fulfilment optimization products; companies such as Agile and Ariba who compete principally with our supplier relationship management applications; and companies such as Trilogy and Yantra who compete principally with our fulfilment, revenue and profit optimization products.

Custom and Offshore Development. We also compete with independent developers of enterprise application software, particularly entities in countries with relatively low wage structures, as well as internal development efforts by corporate information technology departments.

Proprietary Rights and Licenses

We regard our trademarks, copyrights, patents, trade secrets, technology and other proprietary rights as critical to our business. To protect our proprietary rights, we primarily rely on a combination of copyright, patent, trademark and trade secret laws, confidentiality procedures and contractual provisions. We license our software products in object code (machine-readable) format to customers under license agreements and we generally do not sell or otherwise transfer title of our software products to our customers. Our non-exclusive license agreements generally allow the use of our software products solely by the customer for specified purposes without the right to sublicense or transfer our software products.

Trademarks are important to our business as we use them in our marketing and promotional activities as well as with the delivery of our software products. Our registered trademarks include i2, RHYTHM, PLANET, TRADEMATRIX and GLOBAL SUPPLY CHAIN MANAGEMENT. Other trademarks of i2 include POWERING THE BOTTOM LINE.

We hold a number of U.S. patents that predominantly relate to planning, scheduling optimization, demand fulfilment, collaboration, e-commerce and data management and reporting. These patents expire at various times through 2021. We also depend on trade secrets and proprietary know-how for certain unpatented aspects of our business. To protect our proprietary information, we enter into confidentiality agreements with our employees, consultants and licensees, and generally control access to and distribution of our proprietary information. We sublicense some software that we license from third parties and incorporate in, or license in conjunction with, our products.

Employees

As of July 2, 2003, we had approximately 2,600 full-time employees, including approximately 1,250 employees primarily engaged in research and development activities primarily located in India and the U.S. and approximately 300 employees primarily engaged in sales and marketing activities. Our future success depends in significant part upon the continued service of our key technical, sales and managerial personnel and our ability to attract and retain highly qualified technical, sales and managerial personnel. Except for employees represented by a Worker s Council in Germany, none of our employees is represented by a collective bargaining agreement and we have never experienced a work stoppage. We believe employee relations are good.

Available Information

Under the Securities Exchange Act of 1934, we are required to file annual, quarterly and special reports, proxy statements and other information with the SEC. You may read and copy any document we file with the SEC at the SEC s Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information about the public reference room. The SEC maintains a web site at http://www.sec.gov that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. We file electronically with the SEC.

We make available, free of charge, through our investor relations web site, our reports on Forms 10-K, 10-Q and 8-K, and amendments to those reports, as soon as reasonably practicable after they are filed with the SEC. The address for our investor relations web site is http://www.i2.com/investor.

ITEM 2. PROPERTIES

Our primary offices are located in Dallas, Texas, and are held under lease contracts that expire at various dates through 2011. These facilities house our executive and primary administrative offices as well as sales, marketing, research and development and consulting personnel. We also lease space for our other offices in the U.S., Australia, Belgium, Canada, China, Finland, France, Germany, India, Japan, Korea, Malaysia, Netherlands, Singapore, South Africa, Spain, Taiwan and the United Kingdom primarily to provide sales, customer support, consulting services and research and development activities. We consider our properties to be suitable and adequate for our present needs and do not anticipate leasing additional properties at this time.

ITEM 3. LEGAL PROCEEDINGS

Securities and Exchange Commission Investigation

On or about March 26, 2003, we were advised that the SEC had issued a formal order of investigation to determine whether there have been violations of the federal securities laws by the company and/or others involved with the company in connection with matters relating to the restatement of our consolidated financial results. As previously disclosed, our Board of Directors had directed our Audit Committee to conduct an internal investigation of certain allegations made during the fall of 2001 by a former officer relating to revenue recognition and financial reporting, among other things. In November 2002, we reported to the SEC and in our third quarter 10-Q the results of that investigation, as well as certain new related allegations made during the fall of 2002 by the former officer and another former officer. Thereafter, the staff of the SEC opened an informal inquiry into these allegations and other matters relating to our financial reporting prior to the issuance of the formal order of investigation by the SEC. We continue to be in discussions with the SEC and intend to continue to fully cooperate with the SEC.

Class Action and Derivative Litigation

Beginning in March 2001, a number of purported class action complaints were filed in the United States District Court for the Northern District of Texas (Dallas Division) against the company and certain of our officers and directors. The cases have been consolidated, and in August 2001 plaintiffs filed a consolidated amended complaint. The consolidated amended complaint alleges that we and certain of our officers violated the federal securities laws, specifically Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, by making purportedly false and misleading statements concerning the characteristics and implementation of certain of our software products. The consolidated amended complaint seeks unspecified damages on behalf of a purported class of purchasers of our common stock during the period from May 4, 2000 to February 26, 2001. We continue to vigorously defend against this lawsuit. Based on the stage of the litigation, it is not possible to estimate the amount or range of possible loss that might result from an adverse judgment or a settlement of this matter.

In April 2001, a purported shareholder derivative lawsuit was filed in Dallas County, Texas, against certain of our officers and directors, naming the company as a nominal defendant. The suit claims that certain of our officers and directors breached their fiduciary duties to the company and our stockholders by: (i) selling shares of our common stock while in possession of material adverse non-public information regarding our business and prospects, and (ii) disseminating inaccurate information regarding our business and prospects to the market and/or failing to correct such inaccurate information. As stated, the complaint is derivative in nature and does not seek relief from the company. However, we have entered into indemnification agreements in the ordinary course of business with certain of the defendant officers and directors and may be obligated throughout the pendency of this action to advance payment of legal fees and costs incurred by the defendants pursuant to our obligations under the indemnification agreements and/or applicable Delaware law. This suit has since been removed to the United States District Court for the Northern District of Texas (Dallas Division). We filed a motion to dismiss the action on February 19, 2002 and the motion was granted on October 8, 2002. Plaintiffs filed an appeal of the decision on October 15, 2002. Based on the stage of the litigation, it is not possible to estimate the amount or range of possible loss that might result from an adverse judgment or a settlement of this matter.

Restatement Class Action Litigation and Derivative Litigation

Beginning in April 2003, a number of purported shareholder class action complaints were filed in the United States District Court for the Northern District of Texas (Dallas Division) against the company and certain of our current and former officers and directors. The complaints bring claims under the federal securities laws, specifically Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, relating to our announcements that we would re-audit certain of our consolidated financial statements and that there would be material adjustments to our financial statements. Specifically, these actions allege that we issued a series of false or misleading statements to the market during the class period that failed to disclose that (i) we had materially overstated our

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revenue by improperly recognizing revenue on certain customer contracts; (ii) we lacked adequate internal controls and were therefore unable to ascertain our true financial condition; and (iii) as a result of the foregoing, our financial statements issued during the class period were materially false and misleading. Plaintiffs contend that such statements caused our stock price to be artificially inflated. The complaints seek unspecified damages on behalf of a purported class of purchasers of our common stock during the period from April 18, 2000 to January 24, 2003. We continue to vigorously defend against these lawsuits. Based on the stage of the litigation, it is not possible to estimate the amount or range of possible loss that might result from an adverse judgment or a settlement of this matter.

In April and May 2003, two purported shareholder derivative lawsuits were filed in the United States District Court for the Northern District of Texas (Dallas Division) against certain of our officers and directors, naming the company as a nominal defendant. The suits claim that certain of our officers and directors breached their fiduciary duties to the company and our stockholders by: (i) causing the company to improperly recognize revenue in violation of generally accepted accounting principles to artificially inflate our stock price in order to complete acquisitions in which our stock was used as consideration, and (ii) selling shares of the company s common stock while in possession of material adverse non-public information regarding our financial statements and securing personal loans using our allegedly artificially inflated stock price. As stated, the complaints are derivative in nature and do not seek relief from the company. However, the company has entered into indemnification agreements in the ordinary course of business with certain of the defendant officers and directors and may be obligated throughout the pendency of these actions to advance payment of legal fees and costs incurred by the defendants pursuant to our obligations under the indemnification agreements and/or applicable Delaware law. Based on the stage of the litigation, it is not possible to estimate the amount or range of possible loss that might result from an adverse judgment or a settlement of these matters.

In May 2003, a purported shareholder derivative lawsuit was filed in the United States District Court for the Northern District of Texas (Dallas Division) against our current Chief Executive Officer, Chief Financial Officer and directors, naming the company as a nominal defendant. The suit claims that our Chief Executive Officer and Chief Financial Officer violated section 304 of the Sarbanes-Oxley Act of 2003 and seeks to recover from them (a) bonuses and equity-based compensation, and (b) profits realized from sales of securities of the company. The suit also names our current directors for failing to seek recovery of the aforementioned bonuses, equity-based compensation and trading profits. As stated, the complaint is derivative in nature and does not seek relief from the company. However, we have entered into indemnification agreements in the ordinary course of business with our Chief Executive Officer, Chief Financial Officer and directors and we may be obligated throughout the pendency of this action to advance payment of legal fees and costs incurred by the defendants pursuant to our obligations under the indemnification agreements and/or applicable Delaware law. Based on the stage of the litigation, it is not possible to estimate the amount or range of possible loss that might result from an adverse judgment or a settlement of this matter.

Other Litigation

We are subject to various other claims and legal actions, including claims and legal actions from former employees and certain customers. We have accrued for estimated losses in the accompanying consolidated financial statements for those matters where we believe the likelihood of an adverse outcome is probable and the amount of the loss is reasonably estimable.

The adverse resolution of any one or more of the matters described in this Item 3, over and above the amount that has been estimated and accrued in the current consolidated financial statements could have a material adverse effect on our business, financial condition or results of operations. See *Note 9 Commitments and Contingencies* in the accompanying Notes to Consolidated Financial Statements.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of security holders during the fourth quarter of 2002.

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PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

During 2002, our common stock traded on the NASDAQ National Market under the symbol ITWO. On May 9, 2003, our common stock was delisted from The NASDAQ Stock Market. As support for its decision to delist our stock, a NASDAQ Listing Qualifications Panel cited our failure to timely file this annual report on Form 10-K. We have appealed the Listing Qualifications Panel s decision. Since our delisting, our common stock has been quoted in the over-the-counter Pink Sheets under the OTC symbol ITWO. Upon the filing of this annual report on Form 10-K and our quarterly report on Form 10-Q for the quarter ended March 31, 2003, we believe that our stock will be eligible to trade on the OTC Bulletin Board while we await the outcome of our appeal of the Listing Qualifications Panel s decision. See *Note 10 Stockholders Equity (Deficit) and Loss Per Common Share* in the accompanying Notes to Consolidated Financial Statements.

The following table lists the high and low per share intra-day sales prices for our common stock as reported by the NASDAQ National Market or as quoted in the over-the-counter Pink Sheets, as applicable, for the periods indicated.

	High	Low
2003		
Second quarter	$ 1.19	$ 0.53
First quarter	1.50	0.69
2002		
Fourth quarter	$ 1.93	$ 0.41
Third quarter	1.70	0.49
Second quarter	5.48	1.30
First quarter	9.58	5.00
2001		
Fourth quarter	$ 8.59	$ 3.10
Third quarter	20.05	2.98
Second quarter	28.20	12.88
First quarter	61.00	12.56

As of July 2, 2003, there were 432,853,021 shares of our common stock outstanding held by 1,406 holders of record.

Dividends

We have never declared or paid cash dividends on our capital stock. We currently intend to retain any earnings for use in our business and do not anticipate paying any cash dividends in the foreseeable future. Future dividends, if any, will be determined by our board of directors.

Stock Option Plans

In October 2001, we announced a voluntary cash compensation for stock options program whereby employees were given the opportunity to elect, by November 15, 2001, to receive a reduction in base salary for a twelve-month period starting on November 16, 2001 in exchange for stock options. The options were granted on November 16, 2001 and on December 21, 2001. The options were to vest in 24 equal monthly increments from the grant date. No compensation charge related to this program was required. In July 2002, the Compensation Committee of the Board of Directors approved the acceleration of the vesting of options granted under this

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program. Effective July 23, 2002, all unvested options issued under this program were immediately vested. No compensation charge was recorded in connection with the acceleration of vesting because the market value of our stock on the modification date was less than the exercise price of the modified options.

During the fourth quarter of 2002, we issued an aggregate of 59,000 shares of our common stock to employees pursuant to exercises of stock options that were granted prior to April 26, 1996 with exercise prices ranging from $0.0675 to $1.09 per share. These issuances were deemed exempt from registration under Section 5 of the Securities Act of 1933 in reliance upon Rule 701 thereunder, and appropriate legends were affixed to the share certificates issued in each such transaction.

In December 2002, we announced a voluntary stock option exchange program for the benefit of our employees. Under the program, our employees were initially offered the opportunity, if they so elected by January 29, 2003, to cancel certain outstanding stock options previously granted to them for new stock options to be granted no earlier than July 30, 2003. The exchange program was terminated in January 2003 following our decision to re-audit our consolidated financial statements for the years ended December 31, 2001 and 2000.

Information regarding stock-based compensation awards outstanding and available for future grants as of December 31, 2002, segregated between stock-based compensation plans approved by stockholders and stock-based compensation plans not approved by stockholders, is presented in the table below. Included in the table are stock options granted to former employees of acquired companies that were assumed by us. We do not intend to grant additional stock options under any of the assumed plans of acquired companies. While our stockholders approved certain of our acquisitions of the companies from which these plans were assumed, our stockholders have not approved any of the assumed plans (in thousands, except per share amounts):

Plan Category	Number of Shares to be Issued Upon Exercise of Outstanding Awards	Weighted-Average Exercise Price of Outstanding Awards	Number of Shares Available for Future Grants
Plans approved by stockholders:			
1995 Plan	95,922	$ 7.68	74,445
Plans not approved by stockholders:			
2001 Plan	12,646	5.84	7,310
Assumed plans of acquired companies	3,838	12.80	26,610
Total	112,406	$ 7.64	108,365

Stock Rights Plan

On January 17, 2002, our Board of Directors approved adoption of a stockholder rights plan and declared a dividend of one preferred share purchase right for each outstanding share of common stock. Stockholders of record on January 28, 2002 received, for each share of common stock then owned, one right to purchase a unit of one one-thousandth of a share of Series A junior participating preferred stock at a price of $75.00 per unit. The rights, which expire on January 17, 2012, will only become exercisable upon distribution. Distribution of the rights will not occur until ten days after the earlier of (i) the public announcement that a person or group has acquired beneficial ownership of 15.0% or more of our outstanding common stock or (ii) the commencement of, or announcement of an intention to make, a tender offer or exchange offer that would result in a person or group acquiring the beneficial ownership of 15.0% or more of our outstanding common stock.

Shares of Series A preferred stock purchasable upon exercise of the rights are not redeemable. Each share of Series A preferred stock will be entitled to a dividend of 1,000 times the dividend declared per share of common stock. In the event of liquidation, each share of Series A preferred stock will be entitled to a payment of the greater of (i) 1,000 times the payment made per share of common stock or (ii) $1,000. Each share of Series A

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preferred stock will have 1,000 votes, voting together with the common stock. Finally, in the event of any merger, consolidation or other transaction in which shares of common stock are exchanged, each share of Series A preferred stock will be entitled to receive 1,000 times the amount received per share of common stock. Because of the nature of the dividend, liquidation and voting rights, the value of each unit of Series A preferred stock purchasable upon exercise of each right should approximate the value of one share of common stock.

If, after the rights become exercisable, we are acquired in a merger or other business combination transaction, or 50% or more of our consolidated assets or earning power are sold, proper provision will be made so that each holder of a right will thereafter have the right to receive upon exercise that number of shares of common stock of the acquiring company having market value of two times the exercise price of the right.

If any person or group becomes the beneficial owner of 15.0% or more of the outstanding shares of common stock, proper provision will be made so that each holder of a right, other than rights beneficially owned by the acquiring person (which will thereafter be void), will have the right to receive upon exercise that number of shares of common stock or units of Series A preferred stock (or cash, other securities or property) having a market value of two times the exercise price of the right.

The rights have significant anti-takeover effects by causing substantial dilution to a person or group that attempts to acquire us on terms not approved by our Board of Directors. The rights should not interfere with any merger or other business combination approved by the Board of Directors since the rights may be redeemed by us at the redemption price of $0.01 per unit prior to the occurrence of a distribution date. Additional details of this stock rights plan are presented in *Note 10 Stockholders Equity (Deficit) and Loss Per Common Share* in the accompanying Notes to Consolidated Financial Statements.

Convertible Debt

As of December 31, 2002, we had $410.9 million of outstanding debt, the majority of which is convertible into shares of our common stock. Details of this debt are presented in Note 8 *Borrowings* in the accompanying Notes to Consolidated Financial Statements included elsewhere in this report. As of December 31, 2002, none of the notes had been converted to common stock. See Note 17 *Subsequent Events* in the accompanying Notes to Consolidated Financial Statements for information regarding our prepayment of the $60.9 million note issued in connection with our acquisition of Trade Service Corporation.

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ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

The following summary of consolidated financial data is derived from our consolidated financial statements as of December 31, 2002 and 2001 and for the three years ended December 31, 2002, included elsewhere in this report. The balance sheet data as of December 31, 2000 has been derived from our financial statements not included herein. The selected consolidated financial data as of December 31, 1999 and 1998 is derived from our unaudited restated consolidated financial statements not included elsewhere in this report. The following consolidated financial data as of December 31, 2002 and 2001 and for the three years ended December 31, 2002 should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and our Consolidated Financial Statements and related notes included elsewhere in this report. As discussed in *Note 3 Business Combinations* in the accompanying Notes to Consolidated Financial Statements, our acquisitions in 2001 and 2000 were accounted for using the purchase method. Accordingly, the operating results of the acquired companies are included with our results of operations since their respective dates of acquisition. Amounts shown are in thousands, except per share data.

	As of or for the Year Ended December 31,				
	2002	**2001**	**2000**	**1999**	**1998**
		(As Restated)/(1)	**(As Restated)/(1)**	**(As Restated)/(2)**	**(As Restated)/(2)**
Statement of Operations Data:					
Revenues:					
Software licenses	$ 88,629	$ 196,383	$ 216,222	$ 228,807	$ 235,219
Contract	527,755	304,531	116,877	4,140	
Services	147,274	222,485	219,915	149,099	92,863
Maintenance	144,718	151,943	119,526	70,037	43,115
Total revenues	908,376	875,342	672,540	452,083	371,197
Costs and expenses:					
Cost of revenues:					
Software licenses	2,976	27,257	18,947	12,493	10,089
Contract	157,820	76,374	42,482	133,810	
Amortization of acquired technology	15,156	43,861	24,857		
Services and maintenance	131,884	247,305	218,464	2,802	79,198
Sales and marketing	198,825	404,832	379,663	194,324	128,777
Research and development	173,064	288,880	218,544	132,293	93,413
General and administrative	65,446	108,512	90,111	53,149	38,360
Amortization of intangibles	11,223	3,084,991	1,713,533	3,285	
Write-off of in-process research and development		12,700	94,574	5,100	7,618
Impairment of intangibles and goodwill	37,660	4,363,803			
Restructuring charges and adjustments	111,928	113,294			
Total costs and expenses	905,982	8,771,809	2,801,175	537,256	357,455
Operating income (loss)	2,394	(7,896,467)	(2,128,635)	(85,173)	13,742
Non-operating expense, net:					
Interest income	13,926	35,948	43,533	9,679	7091
Interest expense	(23,839)	(21,997)	(18,467)	(1,792)	
Realized gains (losses) on investments, net	1,895	(68,640)	(1,578)		1,816
Foreign currency hedge and transaction losses, net	(2,203)	(2,817)	(3,194)	99	269
Litigation settlements			(47,912)		
Other expense, net	(1,809)	(2,322)	(2,484)	(344)	(420)
Non-operating income (expense), net	(12,030)	(59,828)	(30,102)	7,642	8,756
Income (loss) before income taxes	(9,636)	(7,956,295)	(2,158,737)	(77,531)	22,498

Provision (benefit) for income taxes	889,296	(237,433)	(131,218)	(26,867)	12,111
Net income (loss)	$ (898,932)	$ (7,718,862)	$ (2,027,519)	$ (50,664)	$ 10,387
Earnings (loss) per common share:					
Basic	$ (2.10)	$ (18.61)	$ (5.59)	$ (0.15)	$ 0.04
Diluted	$ (2.10)	$ (18.61)	$ (5.59)	$ (0.15)	$ 0.03
Weighted-average common shares outstanding:					
Basic	428,746	414,860	362,723	335,678	287,176
Diluted	428,746	414,860	362,723	335,678	314,120
Balance Sheet Data:					
Cash, cash equivalents, restricted cash, short-term and long-term investments	$ 457,245	$ 753,747	$ 884,696	$ 579,391	$ 155,998
Working capital	$ (68,192)	$ 145,144	$ 436,983	$ 505,849	$ 182,950
Total assets	$ 633,223	$ 2,026,370	$ 9,285,367	$ 901,553	$ 350,759
Total long-term debt	$ 350,000	$ 410,930	$ 350,000	$ 350,000	$ 0
Total stockholders equity (deficit)	$ (302,025)	$ 581,843	$ 8,125,265	$ 266,779	$ 235,717

(1) The 2001 and 2000 consolidated financial statements have been restated for certain revenue and expense items. (See *Note 2 Restatement* in the accompanying Notes to Consolidated Financial Statements).

(2) The 1999 consolidated financial statements have been restated for certain revenue and expense items as discussed above in Business Recent Events. The 1998 consolidated financial statements have been restated for an income tax adjustment relating to a 1999 business combination accounted for as a pooling of interests.

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The following tables set forth unaudited consolidated quarterly statements of operations data for the years ended December 31, 2002, 2001 and 2000. Amounts shown are in thousands, except per share data (see *Note 2 Restatement* in the accompanying Notes to Consolidated Financial Statements).

	March 31, 2002		June 30, 2002		September 30, 2002		December 31, 2002
	As Reported	As Restated	As Reported	As Restated	As Reported	As Restated	
Revenues:							
Software licenses	$ 58,615	$ 26,464	$ 26,105	$ 18,907	$ 30,376	$ 21,451	$ 21,807
Contract		94,914		71,846		286,694	74,301
Services	60,853	42,875	47,330	34,147	43,348	33,059	37,193
Maintenance	48,946	38,277	46,163	37,590	40,895	33,263	35,588
Total revenues	168,414	202,530	119,598	162,490	114,619	374,467	168,889
Costs and expenses:							
Cost of revenues:							
Software licenses	16,257	4,330	1,327	(2,625)	3,093	(516)	1,787
Contract		35,599		32,321		65,271	24,629
Amortization of acquired technology	7,722	6,631	6,501	5,411	4,061	2,970	144
Services and maintenance	59,978	38,345	59,224	29,644	54,499	31,011	32,884
Sales and marketing	62,897	62,873	62,664	63,341	40,129	40,769	31,842
Research and development	56,005	54,917	50,542	49,152	47,752	45,680	23,315
General and administrative	20,343	18,054	19,755	20,455	16,431	16,256	10,681
Amortization of intangibles	3,232	3,616	3,232	3,616	3,186	3,569	422
Impairment of Intangibles					46,233	37,660	
Restructuring charges and adjustments	(257)	130	(2,114)	(61)	89,390	88,774	23,085
Total costs and expenses	226,177	224,495	201,131&n				