

VITAL IMAGES INC  
Form 10-K/A  
August 09, 2005

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K/A**

(Amendment No. 3)

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

For the fiscal year ended December 31, 2004

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**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 0-22229

**VITAL IMAGES, INC.**

(Exact name of Registrant as specified in its charter)

**Minnesota**

(State or other jurisdiction of  
incorporation or organization)  
**5850 Opus Parkway, Suite 300**  
**Minnetonka, MN 55343-4414**  
(Address of principal  
executive offices)

**42-1321776**

(I.R.S. Employer Identification No.)

**55343-4414**

(Zip Code)

**(952) 487-9500**

(Registrant's telephone number, including area code)

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

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

**Common Stock, \$.01 par value**

**Preferred Stock 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 o

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 the Form 10-K. o

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

The aggregate market value of the common stock held by non-affiliates of the registrant computed by reference to the price at which the common stock was last sold as of June 30, 2004, the last business day of the registrant's most recently completed second fiscal quarter, was \$144,724,926. The common stock is the registrant's only class of voting stock.

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The number of shares outstanding of the issuer's classes of common stock as of February 28, 2005: Common stock, \$.01 Par Value 12,051,530.

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**Explanatory Note**

This Amendment No. 3 on Form 10-K/A (the Amendment ) to the Annual Report on Form 10-K for the fiscal year ended December 31, 2004, which was originally filed with the Securities and Exchange Commission on March 16, 2005 and amended by Amendment No. 1 filed on May 2, 2005 and Amendment No. 2 filed on May 4, 2005 (the Original Filing ), is being filed to amend the Original Filing as follows:

To clarify disclosure about our changes in internal control over financial reporting during the quarter ended December 31, 2004, as required by Item 9A of the Annual Report on Form 10-K and Item 308(c) of Regulation S-K; and

A currently dated consent letter is included from the Company's Independent Registered Public Accounting Firm dated August 5, 2005 to cover their report related to internal control over financial reporting; and

Currently dated certifications from our Chief Executive Officer and Chief Financial Officer as required by Rules 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934 are included as exhibits.

Except for the amendments described above, this Amendment does not modify or update other disclosures in, or exhibits to, the Original Filing.

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Vital Images, Inc.

Form 10-K/A

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## Item 9A. Controls and Procedures

### Disclosure controls and procedures

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports that the Company files or submits under Securities Exchange Acts are recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required financial disclosure.

As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of Company management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 ( Exchange Act ). Based upon, and as of the date of this evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that our disclosure controls and procedures were not effective, because of the material weaknesses discussed below. In light of the material weaknesses described below, the Company performed additional analysis and other post-closing procedures to ensure that the consolidated financial statements were prepared in accordance with generally accepted accounting principles. Accordingly, management believes that the financial statements previously filed with the Original Filing fairly present in all material respects our financial condition, results of operations and cash flows for the periods presented.

### Management's report on internal control over financial reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with established policies or procedures may deteriorate.

Management has completed its evaluation of the Company's internal control over financial reporting as of December 31, 2004. In making its assessment of internal control over financial reporting, management used the criteria described in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. Management's assessment identified the following material weaknesses in the Company's internal control over financial reporting as of December 31, 2004:

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(i) As of December 31, 2004, the Company did not maintain effective control over the accuracy and completeness of maintenance and services revenues and deferred revenues. Specifically, effective controls were not in place to recognize maintenance and services revenue in the appropriate period. This control deficiency resulted in the restatement of the Company's consolidated financial statements for the year ended December 31, 2003, for the first and second quarters of 2004 and for the first, second and third quarters of 2003. Additionally, this control deficiency could result in a misstatement of maintenance and services revenue and deferred revenue that would result in a material misstatement to annual or interim financial statements that would not be prevented or detected. Accordingly, management determined that this control deficiency constitutes a material weakness.

(ii) As of December 31, 2004, the Company did not maintain effective control over property and equipment. Specifically, effective controls were not in place to verify the existence of certain property and equipment. This control deficiency did not result in an adjustment to the Company's consolidated financial statements; however, it could result in a misstatement of property and equipment that would result in a material misstatement to annual or interim financial statements that would not be prevented or detected. Accordingly, management determined that this control deficiency constitutes a material weakness.

(iii) As of December 31, 2004, the Company did not maintain effective control over the period-end financial reporting

process. Specifically, review and approval controls over quarterly financial results and related disclosures did not operate as designed for a sufficient period of time to demonstrate that they operate effectively. This control deficiency did not result in an adjustment to the Company's consolidated financial statements; however, it could result in a misstatement of accounts and disclosures that would result in a material misstatement to annual or interim financial statements that would not be prevented or detected. Accordingly, management determined that this control deficiency constitutes a material weakness.

Because of the material weaknesses discussed above, management has concluded that the Company did not maintain effective internal control over financial reporting as of December 31, 2004 based on the criteria in *Internal Control - Integrated Framework*.

Management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2004 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report included herein.

#### **Remediation of material weaknesses**

During the first quarter of 2005, the Company has implemented, or is in the process of implementing, the following remediation steps to address the material weaknesses described above:

The process of recognizing revenue related to maintenance and services has been redesigned to ensure more timely receipt of information from operational areas to ensure revenue is recognized in the appropriate period.

New procedures have been established to address the tagging and tracking of fixed assets to ensure that property and equipment can be adequately accounted for.

Controls related to the quarterly financial reporting process are being closely monitored to ensure they are operating as designed. This material weakness was related to the third quarter of 2004. Although the controls related to the review and approval of fourth quarter results did operate as designed, the controls have not operated for a sufficient period of time to demonstrate that they operate effectively.

In addition, the Company has added a number of additional personnel to its finance and accounting staff to ensure that all of the material weaknesses described above are appropriately remediated in a timely manner. The additional personnel include a new Senior Director of Finance, a new Controller, a new Manager of Financial Reporting and Senior Staff Accountant, all of whom have strong public accounting and public company experience. The Company believes that these remediation steps will correct the material weaknesses described above.

#### **Changes in internal control over financial reporting**

The changes in our internal control over financial reporting during our fourth fiscal quarter ended December 31, 2004 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting are described above under the heading Remediation of material weaknesses.





**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Stockholders of Vital Images, Inc.:

We have audited management's assessment, included in Management's Report on Internal Control Over Financial Reporting appearing under Item 9A, that Vital Images, Inc. did not maintain effective internal control over financial reporting as of December 31, 2004, because the Company did not maintain effective controls over (i) the accuracy and completeness of maintenance and services revenues and deferred revenues, (ii) the existence of property and equipment and, (iii) the review and approval of quarterly financial results and related disclosures, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ( COSO ). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The following material weaknesses have been identified and included in management's assessment as of December 31, 2004:

(i) As of December 31, 2004, the Company did not maintain effective control over the accuracy and completeness of maintenance and services revenues and deferred revenues. Specifically, effective controls were not in place to recognize maintenance and services revenue in the appropriate period. This control deficiency resulted in the restatement of the Company's consolidated financial statements for the year ended December 31, 2003, for the first and second quarters of 2004 and for the first, second and third quarters of 2003. Additionally, this control deficiency could result in a misstatement of maintenance and services revenue and deferred revenue that would result in a material misstatement to annual or interim financial statements that would not be prevented or detected. Accordingly, management determined that this control

deficiency constitutes a material weakness.

(ii) As of December 31, 2004, the Company did not maintain effective control over property and equipment. Specifically, effective controls were not in place to verify the existence of certain property and equipment. This control deficiency did not result in an adjustment to the Company's consolidated financial statements; however, it could result in a misstatement of property and equipment that would result in a material misstatement to annual or interim financial statements that would not be prevented or detected. Accordingly, management determined that this control deficiency constitutes a material weakness.

(iii) As of December 31, 2004, the Company did not maintain effective control over the period-end financial reporting process. Specifically, review and approval controls over quarterly financial results and related disclosure did not operate as designed for a sufficient period of time to demonstrate that they operate effectively. This control deficiency did not result in an adjustment to the Company's consolidated financial statements; however, it could result in a misstatement of accounts and

disclosures that would result in a material misstatement to annual or interim financial statements that would not be prevented or detected. Accordingly, management determined that this control deficiency constitutes a material weakness.

These material weaknesses were considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2004 consolidated financial statements, and this report does not affect our report dated March 2, 2005 on those consolidated financial statements.

In our opinion, management's assessment that Vital Images, Inc. did not maintain effective internal control over financial reporting as of December 31, 2004, is fairly stated, in all material respects, based on criteria established in *Internal Control - Integrated Framework* issued by the COSO. Also, in our opinion, because of the effect of the material weaknesses described above on the achievement of the objectives of the control criteria, Vital Images, Inc. has not maintained effective internal control over financial reporting as of December 31, 2004, based on criteria established in *Internal Control - Integrated Framework* issued by the COSO.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of Vital Images, Inc. at December 31, 2004 and 2003 and for each of the three years in the period ended December 31, 2004 and in our report dated March 2, 2005 we expressed an unqualified opinion thereon.

/s/ PricewaterhouseCoopers LLP

Minneapolis, Minnesota

April 29, 2005

**Item 15. Exhibits and Financial Statement Schedules.**

(a)(3) Listing of Exhibits

The Exhibits required to be a part of this Report are listed in the Index to Exhibits.

(b) Exhibits

See Item 15(a)(3) above.

**Signatures**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in Minneapolis, Minnesota, on the ninth day of August, 2005.

Vital Images, Inc.

By: /s/Michael H. Carrel  
Michael H. Carrel  
Chief Operating Officer and Chief Financial Officer (Principal  
Financial Officer and Principal Accounting Officer)

**Vital Images, Inc.**  
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**Index to Exhibits**

| <b>Item No.</b> | <b>Description</b>  |
|-----------------|---|
| 23.1            | Consent of PricewaterhouseCoopers LLP (filed herewith electronically.)  |
| 31.1            | Certification of Chief Executive Officer Pursuant to Rules 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934 and Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith electronically.) |
| 31.2            | Certification of Chief Financial Officer Pursuant to Rules 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934 and Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith electronically.) |