ION NETWORKS INC
Form 10QSB
September 12, 2003

U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-QSB

[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2003

OR

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ____________ to ____________

Commission File No.: 0-13117

ION NETWORKS, INC.
(Exact Name of Small Business Issuer in Its Charter)

Delaware	22-2413505
(State or Other Jurisdiction of Incorporation or Organization)	(IRS Employer Identification Number)

120 Corporate Boulevard, South Plainfield, NJ 07080
(Address of Principal Executive Offices)

(908) 546-3900
(Issuer's telephone number, including area code)

1551 South Washington Ave., Piscataway, NJ 08854
(Former address of Principal Executive Offices)

There were 24,875,500 shares of Common Stock outstanding as of September 12, 2003.

Transitional Small Business Disclosure Format:

Yes___ No X

ION NETWORKS, INC. AND SUBSIDIARIES

FORM 10-QSB

FOR THE QUARTER ENDED JUNE 30, 2003

PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Information

Consolidated Balance Sheets as of June 30, 2003 (Unaudited) and December 31, 2002

Consolidated Statements of Operations for the Three and Six Months ended June 30, 2003 and 2002 (

Consolidated Statement of Stockholders' Equity for the Six Months ended June 30, 2003 (Unaudited)
and for the Nine Months ended December 31, 2002

Consolidated Statements of Cash Flows for the Six Months ended June 30, 2003 (Unaudited) and 2002

Notes to Consolidated Financial Statements

Item 2. Management's Discussion and Analysis

Item 3. Controls and Procedures

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Item 2. Changes in Securities

Item 3. Defaults Upon Senior Securities

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

Item 5. Other Information

Item 6. Exhibits and Reports on Form 8-K

SIGNATURES

1

PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL INFORMATION

The consolidated financial statements included herein have been prepared by the registrant without audit pursuant to the rules and regulations of the Securities and Exchange Commission. Although the registrant believes that the disclosures are adequate to make the information presented not misleading, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been

condensed or omitted pursuant to such rules and regulations. It is suggested that these financial statements be read in conjunction with the audited financial statements and the notes thereto included in the registrant's Transition Report on Form 10-KSB for the nine months ended December 31, 2002.

ION NETWORKS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

Assets	June 30, 2003 (Unaudited)
Current assets	
Cash and cash equivalents	$ 93,54
Accounts receivable, less allowance for doubtful accounts of $90,774, and $90,521, respectively	572,58
Inventory, net	1,021,69
Prepaid expenses and other current assets	46,56
Total current assets	1,734,39
Restricted cash	
Property and equipment, net	164,99
Capitalized software, less accumulated amortization of $4,012,306 and $3,920,223, respectively	590,92
Other assets	9,16
Total assets	$ 2,499,48
Liabilities and Stockholders' Equity	
Current liabilities	
Current portion of capital leases	$ 91,05
Current portion of long-term debt	
Accounts payable	930,97
Accrued expenses	524,64
Accrued payroll and related liabilities	89,71
Deferred income	139,68
Sales tax payable	70,81
Other current liabilities	59,74
Total current liabilities	1,906,64
Long term portion of capital leases	27,00
Long term debt, net of current portion	

Commitments and contingencies (Note 10)	
Stockholders' Equity	
Preferred stock - par value $.001 per share; authorized 1,000,000 shares at June 30, 2003, and December 31, 2002; 200,000 shares designated Series A at June 30, 2003 and December 31, 2002; 166,835 shares issued and outstanding at June 30, 2003 and December 31, 2002	16
Common stock - par value $.001 per share; authorized 50,000,000 shares at June 30, 2003 and December 31, 2002; 24,875,500 shares issued and outstanding at June 30, 2003 and December 31, 2002	24,87
Additional paid-in capital	44,585,74
Notes receivable from officers	(482,342
Accumulated deficit	(43,549,225
Accumulated other comprehensive loss	(13,378
Total stockholders' equity	565,83
Total liabilities and stockholders' equity	$ 2,499,48

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

ION NETWORKS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended June 30, 2003	Three Months Ended June 30, 2002	Six Months Ended June 30, 200
Net sales	$ 874,200	$ 960,132	$ 1,639,3
Cost of sales	230,851	356,505	474,8
Gross Margin	643,349	603,627	1,164,4
Research and development expenses	124,356	235,309	261,7
Selling, general and administrative expenses	579,668	2,136,968	1,482,2
Restructuring, asset impairment and other charges	(315,841)	-	(192,33
Depreciation and amortization expenses	205,657	281,971	440,4
Total operating expense	593,840	2,654,248	1,992,0

Income(Loss) from operations	49,509	(2,050,621)	(827,57
Interest income	1,782	9,534	11,3
Interest expense	(2,659)	(5,246)	(10,02
Income(Loss) before income taxes	48,632	(2,046,333)	(826,27
Income tax expense	-	5,301	
Net Income(loss)	$ 48,632	$ (2,051,634)	$ (826,27
Per share data			
Net income(loss) per share			
Basic	$ 0.00	$ (0.09)	$ (0.0
Diluted	$ 0.00	$ (0.09)	$ (0.0
Weighted average number of common shares outstanding			
Basic	23,902,643	22,600,501	23,902,6
Diluted	25,570,993	22,600,501	23,902,6

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

ION NETWORKS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
FOR THE SIX MONTHS ENDED JUNE 30, 2003 (Unaudited)
AND NINE MONTHS ENDED DECEMBER 31, 2002

	Preferred		Common		Additional Paid-In Capital
	Shares	Stock	Shares	Stock	
Balance, March 31, 2002	-	-	25,138,000	$ 25,138	$44,381,454
Comprehensive loss					

Net loss					
Translation adjustments					
Total comprehensive loss					
Issuances of preferred stock	166,835	167			285,136
Cancellation of restricted shares			(262,500)	(262)	(80,850)
Notes receivable from officers					
Deferred compensation					
Non-cash stock-based compensation					95,000
Balance, December 31, 2002	166,835	$ 167	24,875,500	$ 24,876	$44,680,740
Comprehensive loss					
Net loss					
Translation adjustments					
Total comprehensive loss					
Notes Receivable from officers					
Non-cash stock-based compensation					(95,000)
Balance, June 30, 2003	166,835	$ 167	24,875,500	$ 24,876	$44,585,740

ION NETWORKS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
FOR THE SIX MONTHS ENDED JUNE 30, 2003 (Unaudited)
AND NINE MONTHS ENDED DECEMBER 31, 2002

	Notes Receivable from Officers	Deferred Compensation	Total Stockholders' Equity

Balance, March 31, 2002	$ (549,914)	$ (62,893)	$ 6,727,22
Comprehensive loss			
Net loss			(5,628,522
Translation adjustments			(41,135
Total comprehensive loss			(5,669,657
Issuances of preferred stock			285,30
Cancellation of restricted shares			(81,112
Notes receivable from officers	76,509		76,50
Deferred compensation		62,893	62,89
Non-cash stock-based compensation			95,00
Balance, December 31, 2002	$ (473,405)	-	$ 1,496,16
Comprehensive loss			
Net loss			(826,279
Translation adjustments			(109
Total comprehensive loss			(826,388
Notes Receivable from officers	(8,937)		(8,937
Non-cash stock-based compensation			(95,000
Balance, June 30, 2003	$ (482,342)	-	$ 565,83

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

ION NETWORKS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	For the Six Months Ended June 30, 2003	For the Months End 30, 200
Cash flows from operating activities		
Net loss	$ (826,279)	$(3,26
Adjustments to reconcile net loss to net cash used in operating activities:		
Restructuring, asset impairments and other charges, non-cash	(192,331)	
Depreciation and amortization	440,428	7
Other charges	-	
Non-cash stock-based compensation	(95,000)	
Issuances of restricted stock	-	5
Notes receivable from officers	(8,937)	(54
Deferred compensation	-	
Changes in operating assets and liabilities:		
Accounts receivable	(10,820)	6
Other receivables	-	(1
Inventory	237,571	(9
Prepaid expenses and other current assets	157,368	
Other assets	5,710	
Accounts payable and other accrued expenses	(260,602)	(32
Accrued payroll and related liabilities	(95,643)	(30
Deferred income	(15,337)	(4
Sales tax payable	(13,211)	(
Other current liabilities	(29,571)	(7
Net cash used in operating activities	(706,654)	(2,61
Cash flows from investing activities		
Acquisition of property and equipment	-	(
Capitalized software expenditures	(138,803)	(30
Related party notes receivable, net of repayments	-	
Restricted cash	125,700	2
Net cash used in investing activities	(13,103)	(4
Cash flows from financing activities		
Principal payments on debt and capital leases	(52,272)	(9
Proceeds from sales of common stock/exercise of stock options and warrants	-	3,4
Exercises of options and warrants	-	
Net cash (used in) provided by financing activities	(52,272)	3,4
Effect of exchange rates on cash	(109)	(2

Net (decrease) increase in cash and cash equivalents	(772,138)	7
Cash and cash equivalents - beginning of period	865,684	1,7
Cash and cash equivalents - end of period	$ 93,546	$ 2,4

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

ION NETWORKS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED
FINANCIAL STATEMENTS
June 30, 2003
(Unaudited)

NOTE 1 -CONSOLIDATED FINANCIAL STATEMENTS:

ION Networks, Inc ("ION" or the "Company") designs, develops, manufactures and sells infrastructure security and management products to corporations, service providers and government agencies. The Company's hardware and software products are designed to form a secure auditable portal to protect IT and network infrastructure from internal and external security threats. ION's infrastructure security solution operates in the IP, data center, telecommunications and transport, and telephony environments and is sold by a direct sales force and indirect channel partners mainly throughout North America and Europe.

The consolidated balance sheet as of June 30, 2003, the consolidated statements of operations for the three month and six month periods ended June 30, 2003 and 2002, the consolidated statements of cash flows for the six month periods ended June 30, 2003 and 2002 and the consolidated statement of stockholders' equity for the six month period ended June 30, 2003, have been prepared by the Company without audit. In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary for the fair presentation of the Company's financial position, results of operations and cash flows at June 30, 2003 and 2002 have been made.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been or omitted. It is suggested that these consolidated financial statements be read in conjunction with the audited consolidated financial statements and notes thereto included in the transition report on Form 10-KSB for the nine months ended December 31, 2002.

Our consolidated financial statements have been prepared on the basis that we will continue as a going concern. At June 30, 2003, we had an accumulated deficit of $43,549,225 and negative working capital of $172,250. We also

realized a net loss of $826,279 for the six months ended June 30, 2003. We believe that our working capital as of June 30, 2003 is not sufficient to fund the Company's operations beyond December 2003; and management has implemented cost saving measures and improved margins on sales, which it expects will extend the companies ability to meet its cash requirements through December 31, 2003. We have been aggressively seeking to raise additional capital through selling our equity since August 2002 and have been unable to secure such financing other than the $300,303 raised from the sale of our preferred stock in September 2002. Our efforts to raise approximately $1.5 million of additional capital through selling securities and/or debt have not been successful. Because of the weak financial condition of the Company, we expect that it will be necessary to issue securities having a valuation and terms that are far more favorable to investors than securities ION has previously issued. In order to induce investors to provide capital to ION at this time, it may be necessary to pledge all of the assets of the Company as collateral for such securities, provide liquidation preferences at a multiple of the purchase price of the securities, provide favorable conversion premiums to investors and other similar terms which could have a negative effect on the value of our common stock and rights of our equity shareholders upon liquidation or other circumstances. There is no assurance we can raise the needed $1.5 million or any additional capital on any terms reasonably acceptable to the Company. Nonetheless, the management will continue to have discussions with the creditors to defer payments and/or extend payment terms in order to improve the ability for its cash flows to fund its ongoing operations. The board of directors has also been considering strategic alternatives for the Company, which have not materialized as of this date. If the Company is unable to secure additional financing, enter into a strategic transaction or generate revenues sufficient to sustain its operations, the Company may need to consider other alternatives including ceasing its operations as early as January 2004.

Subsequent to June 30, 2003, Kam Saifi, President and Chief Executive Officer, and Cameron Saifi, Executive Vice President and Chief Operating Officer, have agreed to separate from the Company. We are continuing to negotiate the specific terms of their separation and the termination of their employment agreements. In view of the Company's financial condition, we have no plans to hire a Chief Operating Officer at this time, and Mr. Cameron Saifi's duties will be assumed by the Director of Financial Reporting, the Vice President of Sales and the Chief Technology Officer. Until the appointment of Norman E. Corn as our new Chief Executive Officer on August 16, 2003, Mr. Stephen M. Deixler served as the interim Chief Executive Officer in addition to his current responsibilities as Chairman of the Board of Directors and interim Chief Financial Officer. Also subsequent to June 30, 2003, Christopher Corrado resigned from the Board of Directors citing other professional commitments.

NOTE 2. - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of ION Networks, Inc. and its subsidiaries (collectively, the "Company") and have been prepared on the accrual basis of accounting. All inter-company balances and transactions have been eliminated in consolidation.

8

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and

liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the year. Actual results could differ from those estimates.

The significant estimates include the allowance for doubtful accounts, allowance for inventory obsolescence, capitalized software including estimates of future gross revenues, and the related amortization periods, deferred tax asset valuation allowance and estimated lives of property and equipment.

Cash and Cash Equivalents

The Company considers all highly liquid investments with an original maturity of three months or less at the time of purchase to be cash equivalents.

Allowance for Doubtful Accounts Receivable

The Company sells its products on credit to its customers and is subject to credit risk. Accounts receivable are reduced by an allowance to estimate the amount that will actually be collected from our customers. Many of our customers have been adversely affected by economic downturn in the telecommunications industry. If the financial condition of our customers were to materially deteriorate, resulting in an impairment of their ability to make payments, additional allowances could be required.

Inventory

Inventories are stated at the lower of cost (average cost) or market. Reserves for slow moving and obsolete inventories are provided based on historical experience and current product demand. If our estimate of future demand is not correct or if our customers place significant order cancellations, inventory reserves could increase from our estimate. We may also receive orders for inventory that has been fully or partially reserved. To the extent that the sale of reserved inventory has a material impact on our financial results, we will appropriately disclose such effects. Our inventory carrying costs are not material; thus we may not physically dispose of reserved inventory immediately.

Property and Equipment

Property and equipment are stated at cost. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets, which are generally two to five years. Expenditures for maintenance and repairs, which do not extend the economic useful life of the related assets, are charged to operations as incurred. Gains or losses on disposal of property and equipment are reflected in the statements of operations in the period of disposal.

Capitalized Software

The Company capitalizes computer software development costs in accordance with the provisions of Statement of Financial Accounting Standards No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed" ("SFAS No. 86"). SFAS No. 86 requires that the Company capitalize computer software development costs upon the establishment of the technological feasibility of a product, to the extent that such costs are expected to be recovered through future sales of the product. Management is required to use professional judgment in determining whether development costs meet the criteria for immediate expense or capitalization. These costs are amortized by the greater of the amount computed using (i) the ratio that current gross revenues from the sales of software bear to the total of current and anticipated future gross revenues from the sales of that software, or (ii) the straight-line method over the estimated useful life of the product. As a result, the carrying amount of the capitalized software costs may be reduced materially in the near term.

We record impairment losses on capitalized software and other long-lived assets used in operations when events and circumstances indicate that the assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amount of those items. Our cash flow estimates are based on historical results adjusted to reflect our best estimate of future market and operating conditions. The net carrying value of assets not recoverable is reduced to fair value. While we believe that our estimates of future cash flows are reasonable, different assumptions regarding such cash flows could materially affect our estimates.

Research and Development Costs

The Company charges all costs incurred to establish the technological feasibility of a product or enhancement to research and development expense in the period incurred.

Revenue Recognition Policy

The Company recognizes revenue from product sales to end users, value-added resellers (VARs) and original equipment manufacturers (OEMs) upon shipment if no significant vendor obligations exist and collectibility is probable. We do not

offer our customers the right to return products, however the Company records warranty costs at the time revenue is recognized. Management estimates the anticipated warranty costs but actual results could differ from those estimates. Maintenance contracts are sold separately and maintenance revenue is recognized on a straight-line basis over the period the service is provided, generally one year.

Fair Value of Financial Instruments

The carrying value of items included in working capital and debt approximates fair value because of the relatively short maturity of these instruments.

Net Income (Loss) Per Share of Common Stock

Basic net loss per share excludes dilution for potentially dilutive securities and is computed by dividing net income(loss) attributable to common shareholders by the weighted average number of common shares outstanding during the period. Diluted net loss per share reflects the potential dilution that could occur if securities or other instruments to issue common stock were exercised or converted into common stock. Potentially dilutive securities are excluded from the computation of diluted net loss per share when their inclusion would be antidilutive. A reconciliation between basic and diluted weighted average shares outstanding is as follows:

	Three Months Ended June 30, 2003 (Unaudited)	Three Months Ended June 30, 2002 (Unaudited)	Six Months End June 30, 2003 (Unaudited)
Basic Weighted Average No. of Shares Outstanding	23,902,643	22,600,501	23,902,6
Incremental Shares for Common Stock Equivalents	1,668,350	553,313	1,668,3

Total*	25,570,993	23,153,814	25,570,9

* Since there was a loss attributable to common shareholders in the three months ended June 30, 2002 and the six months ended June 30, 2003 and 2002 periods, the basic weighted average shares outstanding were used in calculating diluted loss per share, as inclusion of the incremental shares shown in this calculation would be antidilutive. Potential common shares of 553,313 for the three month period ending June 30, 2002 and 1,668,350 and 626,535 for the six months ending June 30, 2003 and 2002 were excluded from the computation of diluted earnings per share.

Stock Compensation

We account for stock-based employee compensation arrangements in accordance with provisions of Accounting Principals Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees", and comply with the disclosure requirements of Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation" as amended by SFAS No. 148 "Accounting for Stock-Based Compensation - Transition and Disclosure, an amendment of FASB Statement No. 123," issued in December 2002. Under APB Opinion No. 25, compensation expense is based on the difference, if any, generally on the date of grant, between the fair value of our stock and the exercise price of the option. We account for equity instruments issued to non-employee vendors in accordance with the provisions of SFAS No. 123 and Emerging Issues Task Force ("EITF") Issue No. 96-18, "Accounting for Equity Instruments That are Issued to Other Than Employees from Acquiring, or in Conjunction with Selling, Goods and Services". All transactions in which goods or services are the consideration received for the issuance of equity instruments are accounted for based on the fair value of the consideration received or the fair value of the equity instrument issued, whichever is more reliably measurable. The measurement date of the fair value of the equity instrument issued is the date on which the counter party's performance is complete.

If the Company had elected to recognize compensation costs based on the fair value at the date of grant for awards for the three and six months ended June 30, 2003 and 2002, consistent with the provisions of SFAS No. 123, the Company's net income (loss) and basic and diluted net income (loss) per share would have increased to the pro forma amounts indicated below:

		Three months ended June 30, 2003 (Unaudited)	Three months ended June 30, 2002 (Unaudited)	J
Net Income (loss)	As reported	$ 48,632	$ (2,051,634)	$
	Add back (Deduct): Stock based employee compensation determined under fair value methods for all awards granted since 1994 (inception)	156,320	(459,350)	
Pro forma net income (loss)		$ 204,952	$ (2,510,984)	$

Basic and diluted net income (loss) per share of common stock			
As reported	$ 0.00	$ (0.09)	$
Pro forma	$ 0.01	$ (0.11)	$

10

Foreign Currency Translation

The financial statements of the foreign subsidiaries were prepared in local currency and translated into U.S. dollars based on the current exchange rate at the end of the period for the balance sheet and a weighted-average rate for the period on the statement of operations. Translation adjustments are reflected as foreign currency translation adjustments in stockholders' equity and, accordingly, have no effect on net loss. Transaction adjustments for the foreign subsidiaries are included in income and are not material.

Income Taxes

Deferred income tax assets and liabilities are computed annually based on enacted tax laws and rates for temporary differences between the financial accounting and income tax bases of assets and liabilities. A valuation allowance is established, when necessary, to reduce deferred income tax assets to the amount that is more likely than not to be realized.

Warranty Costs

The Company estimates its warranty costs based on historical warranty claim experience. Future costs for warranties applicable to sales recognized in the current period are charged to cost of sales. The warranty accrual is reviewed quarterly to reflect the remaining obligation. Adjustments are made when actual warranty claim experience differs from estimates. The warranty accrual included in other current liabilities as of June 30, 2003 and December 30, 2002 approximated $55,000 and $48,400, respectively.

NOTE 3 - RESTRICTED CASH:

The Company maintains a restricted cash balance in accordance with its Lease Agreement for its former Piscataway, NJ facility. On March 17, 2003 the Lease Agreement for the Piscataway, NJ facility was amended to apply $105,908 of the remaining restricted cash balance of $125,700 towards the payment of the outstanding rent obligations. The balance of $19,792 was added to the working capital reducing the letter of credit to zero. This amendment to the Lease Agreement required the Company to deposit $60,000 into a new letter of credit by December 2003. The Company has leased new premises subsequent to the balance sheet date and accordingly this lease was terminated and therefore the Company no longer has to deposit $60,000 into a new letter of credit by December 2003.(Note 10)

NOTE 4 - INVENTORY:

Inventory, net of allowance for obsolescence of $326,981 and $720,772, at June 30, 2003 and December 31, 2002, respectively, consists of the following:

	June 30, 2003	December 31, 2002

Raw materials	85,093	195,283
Work-in-progress	70,929	84,230
Finished goods	865,675	979,755
	$ 1,021,697	$ 1,259,268

NOTE 5 - COMPREHENSIVE INCOME:

The Company adopted Statement of Financial Accounting Standards ("SFAS") No. 130, "Reporting Comprehensive Income". The following table reflects the reconciliation between net loss per the financial statements and comprehensive loss.

	Six Months Ended June 30, 2003 (Unaudited)	Six Months Ended June 30, 2002 (Unaudited)
Net loss	$ (826,279)	$ (3,269,180)
Effect of foreign currency translation	(109)	(19,277)
Comprehensive loss	$ (826,388)	$ (3,288,457)

NOTE 6 - INCOME TAXES:

The Company has recorded a full valuation allowance against the federal and state net operating loss carry-forwards and a full valuation allowance against the foreign net operating loss carry-forwards and the research and development credit because management currently believes that it is more likely than not that substantially all of the net operating loss carry-forwards and credits will expire unutilized.

11

NOTE 7 - NEW ACCOUNTING PRONOUNCEMENTS:

In July 2001, the FASB also issued SFAS No.143, "Accounting for Asset Retirement Obligations," which requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred and the associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. SFAS No. 143 is effective for years beginning after June 15, 2002. The Company adopted this statement on January 1, 2003 and determined that there is no impact on its consolidated financial statements.

In April 2002, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which requires all long-lived assets classified as held for sale to be valued at the lower of their carrying amount of fair value less cost to sell and which broadens the presentation of discontinued operations to include more disposal transactions. The Company adopted this

standard on April 1, 2002. There was no effect upon adoption on the Company's consolidated financial statements.

In July 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities," which requires that a liability for costs associated with an exit or disposal activity be recognized when the liability is incurred. This differs from prior guidance, which required the liability to be recognized when a commitment plan was put into place. SFAS No. 146 also establishes that fair value is the objective for initial measurement of the liability. This statement is effective for exit or disposal activities that are initiated after December 31, 2002. There was no effect upon the adoption of this standard to the Company's consolidated financial position, results of operations, or cash flow.

In November 2002, the FASB issued Interpretation No. 45 (FIN 45), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others," which addresses the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees. FIN 45 also requires the recognition of a liability by a guarantor at the inception of certain guarantees that are entered into or modified after December 31, 2002. The impact of FIN 45 on the Company's consolidated financial statements will depend upon whether the company enters into or modifies any guarantee arrangements. The Company did not enter into any guarantees in 2003. The Company has no guarantees.

In January 2003, the FASB issued Interpretation No. 46 (FIN 46), "Consolidation of Variable Interest Entities," which addresses consolidation by business enterprises of variable interest entities that either: (1) do not have sufficient equity investment at risk to permit the entity to finance its activities without additional subordinated financial support, or (2) the equity investors lack an essential characteristic of a controlling financial interest. FIN 46 requires disclosure of Variable Interest Entities (VIEs) in financial statements issued after January 31, 2003, if it is reasonably possible that as of the transition date: (1) the company will be the primary beneficiary of an existing VIE that will require consolidation or, (2) the company will hold a significant variable interest in, or have significant involvement with, an existing VIE. The Company does not have any entities that require disclosure or new consolidation as a result of adopting the provisions of FIN 46.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity" ("SFAS No. 150"). SFAS No. 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. SFAS No. 150 requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). The requirements of this statement apply to issuers' classification and measurement of freestanding financial instruments, including those that comprise more than one option or forward contract. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The Company is in the process of assessing the impact of adopting SFAS No. 150 on its consolidated results of operations, consolidated financial position or consolidated cash flows.

NOTE 8 - RELATED PARTY TRANSACTIONS:

During April 2000, the Company issued a loan (the "Loan") to the former Chief Executive Officer (the "Former CEO") of the Company in the amount of $750,000. The Loan accrues interest at a rate of LIBOR plus 1%. This Loan had an original maturity date of the earlier of April 2005 or thirty days after the Company, for

any reason, no longer employs the Former CEO.

The Former CEO resigned his position at the Company effective September 29, 2000. On October 5, 2000, the Company entered into an agreement with the Former CEO pursuant to which the $750,000 promissory note for the Loan was amended to extend the due date to April 30, 2001, and to provide that interest on the note shall accrue through September 29, 2000. Pursuant to the terms of the Separation and Forbearance Agreement between the Company and the Former CEO, the Former CEO also agreed to reimburse the Company for certain expenses totaling $200,000, to be paid over a period of six months ending March 31, 2001. During the year ended March 31, 2001, $50,000 of the amounts owed to the Company by the Former CEO was repaid and $22,000 has been recorded as a non-cash offset as a result of earned but unpaid vacation owed to the Former CEO. During the year ended March 31, 2002, $813,593 was repaid. At June 30, 2003, the total amount owed to the Company by the Former CEO was approximately $164,089 (including accrued interest) has been fully reserved. The Company will continue to attempt to collect the note receivable.

NOTE 9 - STOCKHOLDERS' EQUITY:

On September 13, 2002 the Company received equity financing in the amount of $300,303 ($285,303, net of issuance cost) for the issuance of 166,835 unregistered shares of the Company's Preferred Stock at $1.80 per share. The Company has designated 200,000 of the 1,000,000 authorized shares of preferred stock as Series A Preferred Stock ("Preferred Stock"). Each share of Preferred Stock is convertible into 10 shares of the Company's common stock at the conversion price of $0.18 per share of common stock, which was the closing bid price of the Company's common stock on September 13, 2002. The Preferred Stock is non-voting, has a standard liquidation preference equal to its purchase price, and does not pay dividends. Proceeds of the equity financing will be used for working capital and general corporate purposes. All of the shares of Preferred Stock were purchased by directors and management of the Company. The purpose of the Preferred Stock Financing was to enable the Company to comply with the Nasdaq SmallCap Market's initial listing requirement of a minimum of $5,000,000 of stockholders' equity so that the Company was eligible for an additional 180-day grace period to attempt to regain compliance with the $1.00 minimum bid price requirement of the Nasdaq SmallCap Market (based on stockholders equity of $5,004,215 at June 30, 2002, adjusted on a pro forma basis for the equity financing). The preferred stock is recorded in Stockholders' equity, net of issuance costs.

Effective October 2001, the Company approved and granted 2,900,000 shares of restricted stock to Messrs. Kam Saifi, Cameron Saifi, and David Arbeitel at fair value. The Restricted Shares are subject to a repurchase right which will permit the Company to repurchase any shares which have not yet vested at the effective date of termination of the officers' employment, as defined in their employment agreements, for an amount equal to the purchase price per share paid by the officers. The Company received a series of partial recourse interest bearing (5.46% on an annual basis) promissory notes for the value of the Restricted Shares to be repaid by the officers.

The notes are to be repaid by the officers at the earlier of ten years or the date upon which the employees dispose of their shares or under certain circumstances, when the borrower's employment with the Company terminates for any reason. The issuance of the restricted shares and the notes receivable due from the officers is recorded in the Company's financial statements. Only the vested portion of the shares has been included in the weighted average number of common shares outstanding at June 30, 2003 and 2002. As of June 30, 2003 Mr. Kam

Saifi owes approximately $283,035 (including approximately $25,035 in interest) for 2,000,000 Restricted Shares and; Mr. Cameron Saifi owes approximately $204,976 (including approximately $19,576 in interest) for 600,000 Restricted Shares.

On September 29, 2002, Mr. David Arbeitel separated employment from the Company. As a result, the note relating to Mr. Arbeitel's 37,500 vested Restricted Shares became due and payable and as of September 30, 2002, Mr. Arbeitel owed approximately $12,190 (including approximately $602 of interest) with respect to such vested shares. On November 11, 2002, Mr. Arbeitel paid the Company $12,264 (including accrued interest of $676) in satisfaction of the note for the 37,500 vested shares. The Company and Mr. Arbeitel agreed to rescind the stock purchase transaction with respect to 262,500 of the unvested Restricted Shares thereby canceling the unpaid portion of the notes in an amount of $ 85,322 (including accrued interest of $4,210) relating to such unvested shares. Messrs. Kam Saifi and Cameron Saifi have separated from the Company subsequent to June 30, 2003. The Company has entered into negotiations regarding the specific terms of Messrs. Kam Saifi and Cameron Saifi's separation and the termination of their employment agreements.

The variable accounting method used to account for the partial recourse restricted stock granted to management resulted in a cashless credit of $95,000 for the six month period ended June 30, 2003.

NOTE 10 - COMMITMENTS AND CONTINGENCIES:

Operating Leases

The Company entered into a lease on February 18, 1999 for approximately 26,247 square feet for its former principal executive offices at 1551 South Washington Avenue, Piscataway, New Jersey. On March 17, 2003, the Company signed an amendment with the landlord reducing the space from 26,247 to 12,722 square feet and the rent from $50,154 to $20,143 per month effective March 1, 2003. The Company is also obligated to make additional payments to the landlord relating to certain taxes and operating expenses. Under the term of the amendment the landlord retained the right to cancel the lease. During the quarter ended June 30, 2003, the landlord notified the Company it has exercised their right effective August 15, 2003.

The Company entered into a lease on July 21, 2003 for approximately 7,000 square feet for its principal executive offices at 120 Corporate Blvd., South Plainfield, New Jersey 07080. The Company moved it's offices to this location on August 6, 2003. The terms of the lease require payment of $162,180 in monthly installments of $4,505 from October 1, 2003 to July 31, 2006. The Company is also obligated to make additional payments to the landlord relating to certain taxes and operating expenses.

Capital Leases

The Company leases certain equipment under agreements which are classified as capital leases. Each of the capital lease agreements expire within five years and have purchase options at the end of the lease term.

13

Consulting Contracts

On October 5, 2000, the Company entered into a consulting agreement with VCGI whereby VCGI is to provide the services of Ronald C. Sacks as Chief Executive Officer of the Company, and the services of three additional consultants

functioning in various capacities for the Company. The fees for the consultants' services were $500,000 over a one-year period. The final payment was issued on July 2003. In addition, the individual consultants from VCGI, including Ronald C. Sacks, were issued options to purchase 240,000 shares of common stock.

Contingent Liabilities

In the normal course of business the Company and its subsidiaries may be involved in legal proceedings, claims and assessments arising in the ordinary course of business. Such matters are subject to many uncertainties, and outcomes are not predictable with assurance. In the opinion of management, the outcome of such current legal proceedings, claims and assessments will not have a material effect on the Company's financial position, results of operations or cash flows.

NOTE 11 - RESTRUCTURING, ASSET IMPAIRMENTS AND OTHER CHARGES:

As a result of the Company being notified by the landlord to cancel its lease effective August 15, 2003, the remaining value of leasehold improvements amounting to $28,955 were written-off. In addition, the Company was required to sell property and equipment in order to move into its smaller newly leased facility. Accordingly, an impairment of $163,662 was recorded which reflected the difference between the cash proceeds of the sale and the remaining value. The asset sale occurred in August 2003.

During the quarter ended June 30, 2003, the Company completed its liquidation of its UK subsidiary. As a result of the liquidation, the Company reversed its prior restructuring accrual of $508,458 related to the remaining long-term lease, and other operating accruals of $294,704. These accruals were reflected in the consolidated statement of operations in the line items that reflected the original charge.

The components of the restructuring, asset impairments and other charges are as follows:

	Asset Write-down	Lease Termination Costs
First Quarter 2003 charges	$ -	$ 123,510
Second Quarter 2003 charges	$ 192,617	$ (508,458)
Total	$ 192,617	$ (384,948)

The movement of the reserve, which related to lease termination costs, during 2003 were as follows:

Balance at December 31, 2002	$ 508
First quarter 2003 provision	123

First quarter 2003 payments	
Second quarter 2003 adjustment	(508,
Second quarter 2003 payments	
Total	$ 123

The Company is in negotiations with the landlord for the reserved amount of $123,510 and intends to have resolution by the end of the fourth quarter 2003.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS

OVERVIEW

ION Networks, Inc. (the "Company"), designs, develops, manufactures and sells infrastructure security and management products to corporations, service providers and government agencies. The Company's hardware and software products are designed to form a secure auditable portal to protect IT and network infrastructure from internal and external security threats. ION's products operate in the IP, data center, telecommunications and transport, and telephony environments and are sold by a direct sales force and indirect channel partners mainly throughout North America and Europe.

The Company is a Delaware corporation founded in 1999 through the combination of two companies - MicroFrame ("MicroFrame"), a New Jersey Corporation (the predecessor entity to the Company, originally founded in 1982), and SolCom Systems Limited ("SolCom"), a Scottish corporation located in Livingston, Scotland (originally founded in 1994). From the time of the merger in 1999 through the quarter ended December 31, 2001, the Company's principal objective was to address the need for security and network management and monitoring solutions, primarily for the PBX-based telecommunications market, resulting in a significant portion of our revenues being generated from sales to various telecommunications companies. During the quarter ended December 31, 2001, a new management team joined the Company and evaluated ION's revenue and expenditures, existing product suite, present customer base and evolving addressable market. As a result of this evaluation, the Company refocused its product line from that of network management monitoring to that of infrastructure security, which was the original focus of MicroFrame prior to the merger with Solcom. We also added significant network features to the product to broaden the scope of the potential customer base, emphasizing infrastructure security. We identified additional enterprise markets that extend beyond the telecommunications industry and believe that successfully penetrating these additional markets could positively impact revenue, although there can be no assurance that these efforts will be successful. Despite these efforts, during the last two years, the telecommunications industry has endured a significant economic downturn. Telecommunications service providers have generally reduced planned capital spending, have reduced staff, and, in some cases, sought bankruptcy proceedings and/or ceased operations. Consequently, the spending cutback of the organizations has affected the Company through reduced product orders. The decline in product orders negatively impacted our revenues, resulting in significant operating losses and negative cash flows.

As a result, it is imperative for us to be successful in increasing our revenue, reducing costs, and/or securing additional funding in the second half of 2003 in order to continue operating as a going concern. If we are not successful in raising additional equity capital, to generate sufficient cash flows to meet our obligations as they come due, our financial condition and results of operations will be materially and adversely affected and we will not be able to continue to operate as a going concern beyond December 2003. If we are successful in raising additional capital but fail to increase our revenue or reduce our expenses and defer payments and/or extend payment terms in order to allow the cash flows to meet ongoing operations, our financial condition and results of operations may be materially and adversely affected and we may not be able to continue to operate as a going concern.

RESULTS OF OPERATIONS

For the three months ended June 30, 2003 compared to the same period in 2002

Net sales for the three months ended June 30, 2003, was $874,200 compared to net sales of $960,132 for the same period in 2002, a decrease of $85,932 or 8.9%. The decrease in sales is attributable mainly to the reduction in the number of units sold in the three-month period ended June 30, 2003. The continuing impact of the overall downturn in the information technology and the telecommunications industry compounded by the weak financial condition of the Company has caused the Company's decrease in sales for this period.

Cost of sales for the three months ended June 30, 2003 was $230,851 compared to $356,505 for the same period in 2002. Cost of sales as a percentage of net sales for the six months ended June 30, 2003 decreased to 26.4% from 37.1% for the same period in 2002, and therefore gross margin increased to 73.6% from 62.9% as compared to the prior year. The decrease in cost of sales or the increase in gross margin is mainly due to lowering the costs associated with manufacturing of the appliances and lack of larger sales orders that typically require higher volume discounts.

Research and development expense, net of capitalized software development, for the three months ended June 30, 2003 was $124,356 compared to $235,309 for the same period in 2002 or a decrease of $110,953 as compared to the comparable period of the prior year. The decrease is primarily attributable to the reduction in salaries.

Selling, general and administrative expenses ("SG&A") for the three months ended June 30, 2003 were $579,668 compared to $2,136,968 for the same period in 2002, a decrease of $1,557,300. The reduction is due to management's implementation of cost saving strategies primarily in the areas of salary reductions, selling expenses and overhead. During the quarter ended June 30, 2003, the Company completed its liquidation of its UK subsidiary. As a result of liquidation of a foreign subsidiary and its release from creditor obligations under a plan of insolvency the Company released liabilities which totaled approximately $803,162 of which $294,704 was credited to SG&A. These accruals were reflected in the consolidated statement of operations in the line items that reflected the original charge.

15

Restructuring credit for the three months ended June 30, 2003 was $315,841 compared to zero in the same period in 2002. The credit arose as a result of liquidation of a foreign subsidiary and its release from creditor obligations under a plan of insolvency. The total liabilities release was approximately $803,162 of which $508,458 was credited to restructuring for a lease accrual. In addition, due to leaving the facility at 1551 south Washington Ave. the Company

incurred an asset impairment charge for leasehold improvements and furniture of $192,617.

Depreciation and amortization expenses - amortization of capitalized software, goodwill and other acquisition related intangibles, and depreciation of property and equipment was $205,657 for the three months ended June 30, 2003 compared to $281,971 in the same period in 2002. The decrease was primarily the result of fully depreciated and amortized expenses..

Net income for the three months ended June 30, 2003 was $48,632 (Net loss of $754,530 less credit from liquidation of foreign subsidiary above in the amount of $803,162) compared to a loss of $2,051,634 for the same period in 2002. This is primarily due to the reduction of operating expenses and improved gross margin.

For the six months ended June 30, 2003 compared to the same period in 2002

Net sales for the six months ended June 30, 2003, was $1,639,319 compared to net sales of $3,036,329 for the same period in 2002, a decrease of $1,397,010 or 46%. The decrease in sales is attributable mainly to the reduction in the number of units sold in the six-month period ended June 30, 2003. The Company sold mostly the ION Secure 3000 series security appliances (formerly called the Sentinel 2000) in both periods so there was no impact on revenue from a change in product mix. The continuing impact of the overall downturn in the information technology and the telecommunications industry compounded by the weak financial condition of the Company has caused the Company's decrease in sales for this period.

Cost of sales for the six months ended June 30, 2003 was $474,839 compared to $1,317,590 for the same period in 2002. Cost of sales as a percentage of net sales for the six months ended June 30, 2003 decreased to 29.0% from 43.4% for the same period in 2002, and therefore gross margin increased to 71.0% from 56.6% as compared to the prior year. The decrease in cost of sales or the increase in gross margin is mainly due to lowering the costs associated with manufacturing of the appliances and lack of larger sales orders that typically require higher volume discounts.

Research and development expense, net of capitalized software development, for the six months ended June 30, 2003 was $261,755 compared to $406,425 for the same period in 2002 or a decrease of $144,670 as compared to the comparable period of the prior year. The decrease is primarily attributable to the reduction in salaries.

Selling, general and administrative expenses ("SG&A") for the six months ended June 30, 2003 were $1,482,205 compared to $3,852,003 for the same period in 2002, a decrease of $2,369,798. The reduction is due to management's implementation of cost saving strategies primarily in the areas of salary reductions, selling expenses and overhead. During the quarter ended June 30, 2003, the Company completed its liquidation of its UK subsidiary. As a result of the liquidation, the Company reversed its prior restructuring accrual of $508,458 related to the remaining long-term lease, and other operating accruals of $294,704. These accruals were reflected in the consolidated statement of operations in the line items that reflected the original charge.

Restructuring credit for the six months ended June 30, 2003 was $192,331 compared to zero in the same period in 2002. The credit arose as a result of liquidation of a foreign subsidiary and its release from creditor obligations under a plan of insolvency. The total debt release was approximately $803,162 of which $508,458 was credited to restructuring. During the quarter ended March 31, 2003, the Company abandoned the space at California location. As a result, the Company incurred a one-time charge of $123,510 in the six months ended June 30, 2003. In addition, due to leaving the facility at 1551 South Washington Ave.,

the Company incurred an asset impairment charge for leasehold improvements and furniture of $192,617.

Depreciation and amortization expenses - amortization of capitalized software, goodwill and other acquisition related intangibles, and depreciation of property and equipment - was $440,428 for the six months ended June 30, 2003 compared to $720,391 in the same period in 2002. The decrease was primarily the result of the three-year amortization period for the acquisitions of LeeMAH and Solcom Systems, Ltd coming to an end on March 31, 2002.

Net loss for the six months ended June 30, 2003 was $826,279 ($1,629,441 less credit from liquidation of foreign subsidiary above in the amount of $803,162) compared to a loss of $3,269,180 for the same period in 2002. This is primarily due to the reduction of operating expenses and improved gross margin.

FINANCIAL CONDITION AND CAPITAL RESOURCES

Our consolidated financial statements have been prepared on the basis that we will continue as a going concern. At June 30, 2003, we had an accumulated deficit of $43,549,225 and a working capital deficit of $172,250 as compared to $184,689 at December 31, 2002. This decline in working capital was due to continued operating losses generated throughout the six months ended June 30, 2003. We also realized net losses of $826,279 and $3,269,180 for the six months ended June 30, 2003 and 2002 respectively. We believe that our working capital

as of June 30, 2003 is not sufficient to fund the Company's operations beyond December 2003; and management has implemented cost saving measures and improved margins on sales, which it expects will extend the companies ability to meet its cash requirements through December 31, 2003. We have been aggressively seeking to raise additional capital through selling our equity since August 2002 and have been unable to secure such financing other than the $300,303 raised from the sale of our preferred stock in September 2002. Additionally, our efforts to raise approximately $1.5 million of additional capital through selling securities and/or debt have not been successful. Because of the weak financial condition of the Company, we expect that it will be necessary to issue securities having a valuation and terms that are far more favorable to investors than securities ION has previously issued. In order to induce investors to provide capital to ION at this time, it may be necessary to pledge all of the assets of the Company as collateral for such securities, provide liquidation preferences at a multiple of the purchase price of the securities, provide favorable conversion premiums to investors and other similar terms which could have a negative effect on the value of our common stock and rights of our equity shareholders upon liquidation or other circumstances. There is no assurance we can raise the needed $1.5 million or any additional capital on any terms reasonably acceptable to the Company. Nonetheless, the management will continue to have discussions with the creditors to defer payments and/or extend payment terms in order to improve the ability for its cash flows to fund its ongoing operations. The board of directors has also been considering strategic alternatives for the Company which have not materialized as of this date. If the Company is unable to secure additional financing, enter into a strategic transaction or generate revenues sufficient to sustain its operations, the Company may need to consider other alternatives including ceasing its operations as early as January 2004.

Net cash used in operating activities during the six months ended June 30, 2003 was $706,654 compared to net cash used during the same period in 2002 of $2,610,076. The decrease in net cash used during the six months ended June 30, 2003 compared to the same period in 2002, was primarily due to the reduction in operating expenses and improved gross margins.

Net cash used in investing activities during the six months ended June 30, 2003 was $13,103 compared to net cash used in during the same period in 2002 of $44,311. This decrease was primarily due to a reduction in Capitalized Software expenditures and restricted cash.

Net cash used from financing activities during the six months ended June 30, 2003 was $52,272 compared to net cash generated during the same period in 2002 of $3,403,401(which included $3,475,592 for the proceeds from sales of common stock).

Operating Lease commitments

The Company entered into a lease on July 21, 2003 for approximately 7,000 square feet for its principal executive offices at 120 Corporate Blvd., South Plainfield, New Jersey 07080. The Company moved it's offices to this location on August 6, 2003. The terms of the lease require payment of $162,180 in monthly installments of $4,505 from October 1, 2003 to July 31, 2006. The Company is also obligated to make additional payments to the landlord relating to certain taxes and operating expenses.

Capital Leases

The Company leases certain equipment under agreements which are classified as capital leases. Each of the capital lease agreements expire within five years and have purchase options at the end of the lease term. Future capital lease payments as of June 30, 2003 are approximately $118,056

SIGNIFICANT ACCOUNTING POLICIES

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amount of assets and liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities at the date of our financial statements. Actual results may differ from these estimates under different assumptions or conditions.

Significant accounting policies are defined as those that are reflective of significant judgments and uncertainties, and potentially result in materially different results under different assumptions and conditions. We believe that our critical accounting policies are limited to those described below.

Revenue Recognition - The Company recognizes revenue from product sales to end users, value-added resellers (VARs) and original equipment manufacturers (OEMs) upon shipment if no significant vendor obligations exist and collectibility is probable. We do not offer our customers the right to return products, however the Company records warranty costs at the time revenue is recognized. Management estimates the anticipated warranty costs but actual results could differ from those estimates. Maintenance contracts are sold separately and maintenance revenue is recognized on a straight-line basis over the period the service is provided, generally one year.

Allowance for Doubtful Accounts Receivable - Accounts receivable are reduced by an allowance to estimate the amount that will actually be collected from our customers. Many of our customers have been adversely affected by economic downturn in the telecommunications industry. If the financial condition of our customers were to materially deteriorate, resulting in an impairment of their ability to make payments, additional allowances could be required.

Inventory Obsolescence Reserves - Inventories are stated at the lower of cost

(average cost) or market. Reserves for slow moving and obsolete inventories are

provided based on historical experience and current product demand. If our estimate of future demand is not correct or if our customers place significant order cancellations, inventory reserves could increase from our estimate. We may also receive orders for inventory that has been fully or partially reserved. To the extent that the sale of reserved inventory has a material impact on our financial results, we will appropriately disclose such effects. Our inventory carrying costs are not material; thus we may not physically dispose of reserved inventory immediately.

Impairment of Software Development and Purchased Software Costs - The Company capitalizes computer software development costs in accordance with the provisions of Statement of Financial Accounting Standards No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed" ("SFAS 86"). SFAS 86 requires that the Company capitalize computer software development costs upon the establishment of the technological feasibility of a product, to the extent that such costs are expected to be recovered through future sales of the product. Management is required to use professional judgment in determining whether development costs meet the criteria for immediate expense or capitalization. These costs are amortized by the greater of the amount computed using (i) the ratio that current gross revenues from the sales of software bear to the total of current and anticipated future gross revenues from the sales of that software, or (ii) the straight-line method over the estimated useful life of the product. As a result, the carrying amount of the capitalized software costs may be reduced materially in the near term.

We record impairment losses on capitalized software and other long-lived assets used in operations when events and circumstances indicate that the assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amount of those items. Our cash flow estimates are based on historical results adjusted to reflect our best estimate of future market and operating conditions. The net carrying value of assets not recoverable is reduced to fair value. While we believe that our estimates of future cash flows are reasonable, different assumptions regarding such cash flows could materially affect our estimates.

NEW ACCOUNTING PRONOUNCEMENTS

In July 2001, the FASB also issued SFAS No.143, "Accounting for Asset Retirement Obligations," which requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred and the associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. SFAS No. 143 is effective for years beginning after June 15, 2002. The Company adopted this statement on January 1, 2003 and determined that there is no impact on its consolidated financial statements.

In April 2002, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which requires all long-lived assets classified as held for sale to be valued at the lower of their carrying amount of fair value less cost to sell and which broadens the presentation of discontinued operations to include more disposal transactions. The Company adopted this standard on April 1, 2002. There was no effect upon adoption on the Company's consolidated financial statements.

In July 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities," which requires that a liability for costs associated with an exit or disposal activity be recognized when the liability is incurred. This differs from prior guidance, which required the liability to be

recognized when a commitment plan was put into place. SFAS No. 146 also establishes that fair value is the objective for initial measurement of the liability. This statement is effective for exit or disposal activities that are initiated after December 31, 2002. There was no effect upon the adoption of this standard to the Company's consolidated financial position, results of operations, or cash flow.

In November 2002, the FASB issued Interpretation No. 45 (FIN 45), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others," which addresses the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees. FIN 45 also requires the recognition of a liability by a guarantor at the inception of certain guarantees that are entered into or modified after December 31, 2002. The impact of FIN 45 on the company's consolidated financial statements will depend upon whether the company enters into or modifies any guarantee arrangements. The Company did not enter into any guarantees in 2003.

In January 2003, the FASB issued Interpretation No. 46 (FIN 46), "Consolidation of Variable Interest Entities," which addresses consolidation by business enterprises of variable interest entities that either: (1) do not have sufficient equity investment at risk to permit the entity to finance its activities without additional subordinated financial support, or (2) the equity investors lack an essential characteristic of a controlling financial interest. FIN 46 requires disclosure of Variable Interest Entities (VIEs) in financial statements issued after January 31, 2003, if it is reasonably possible that as of the transition date: (1) the company will be the primary beneficiary of an existing VIE that will require consolidation or, (2) the company will hold a significant variable interest in, or have significant involvement with, an existing VIE. The Company does not have any entities that require disclosure or new consolidation as a result of adopting the provisions of FIN 46.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity" ("SFAS No. 150"). SFAS No. 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. SFAS No. 150 requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). The requirements of this statement apply to issuers' classification and measurement of freestanding financial instruments, including those that comprise more than one option or forward contract. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The Company is in the process of assessing the impact of adopting SFAS No. 150 on its consolidated results of operations, consolidated financial position or consolidated cash flows.

ITEM 3. CONTROLS AND PROCEDURES.

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our Chief Executive Officer and our Interim Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on this evaluation, our Chief Executive Officer and our Interim Chief Financial

Officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information required to be included in this report.

There has been no change in our internal control over financial reporting that occurred during our most recent fiscal quarter that has materially affected or is reasonably likely to materially affect our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

None.

ITEM 2. CHANGES IN SECURITIES.

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

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

None.

ITEM 5. OTHER INFORMATION.

Subsequent to June 30, 2003, Kam Saifi, President and Chief Executive Officer, and Cameron Saifi, Executive Vice President and Chief Operating Officer, have agreed to separate from the Company. We are continuing to negotiate the specific terms of their separation and the termination of their employment agreements. In view of the Company's financial condition, we have no plans to hire a Chief Operating Officer at this time, and Mr. Cameron Saifi's duties will be assumed by the Director of Financial Reporting, the Vice President of Sales and the Chief Technology Officer. Until the appointment of Norman E. Corn as our new Chief Executive Officer on August 16, 2003, Mr. Stephen M. Deixler served as the interim Chief Executive Officer in addition to his current responsibilities as Chairman of the Board of Directors and interim Chief Financial Officer. Also subsequent to June 30, 2003, Christopher Corrado resigned from the Board of Directors citing other professional commitments.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

(a) Exhibits:

Exhibit No.	Description
3.1	Certificate of Incorporation of the Company, as filed with the Secretary of State of the State of Delaware on August 5, 1998./(2)/
3.2	Certificate of Amendment of the Certificate of Incorporation, as filed with the Secretary of State of the State of Delaware on December 11, 1998./(2)/
3.3	Certificate of Amendment of the Certificate of Incorporation, as filed with the Secretary of state of the State of Delaware an October 12, 1999./(3)/
3.4	By-Laws of the Company./(2)/
3.5	Form of Specimen Common Stock Certificate of the Company./(4)/
4.1	1994 Stock Option Plan of the Company. /(1)/
4.2	1998 Stock Option Plan of the Company./(2)/
4.3	1998 U.K. Sub-Plan of the Company, as amended./(2)/
4.4	Amended and Restated Certificate of Designation of Rights Preferences, Privileges and Restrictions of Series A Preferred Stock of ION Networks, Inc. /(20)/
4.5	2000 Stock Option Plan of the Company./(17)/
4.6	2002 Stock Option Plan of the Company./(19)/
4.7	Form of Warrant Agreement dated July 17, 2001./(13)/
4.8	Form of Warrant Agreement dated January 4, 2002./(13)/
4.9	Form of Non-Qualified Stock Option Agreement dated March 19, 1999 by and between the Company's predecessor, Microframe, Inc. and its consultants./(13)/
4.10	Form of Non-Employee Director Stock Option Contract dated March 10, 1998 between the Company's predecessor, Microframe, Inc. and its non-employee directors./(13)/
4.11	Form of Non-Employee Director Stock Option Contract dated September 17, 1997 by and between the Company's predecessor, Microframe, Inc. and its non-employee directors./(13/)
4.12	Form of Non-Qualified Stock Option Agreement dated September 25, 1996 by and between the Company's predecessor, Microframe, Inc. and its employees./(13)/
4.13	Amended and Restated Non-Qualified Stock Option Agreement dated May 19, 1997 by and between the Company's Predecessor, Microframe, Inc. and its employees./(9)/

Exhibit No.	Description
10.1	Lease Agreement dated February 18, 1999 by and between the Company and Washington Plaza Associates, L.P., as landlord. /(4)/
10.2	Business Park Gross Lease dated May 17, 1999 by and between the Company and Bedford Property Investors, Inc./(4)/
10.3	Agreement dated as of December 19, 1994 by and between LeeMAH DataCom Security Corporation and Siemens Rolm Communications Inc./(4)/
10.4	Equipment Lease Agreements dated June 10, 1999 and May 5, 1999 by and between the Company and Siemens Credit Corporation./(4)/
10.5	Equipment Lease Agreement dated June 17, 1999 by and between the Company and Lucent Technologies./(4)/
10.6	(i) Non-negotiable Promissory Note in the principal amount of $750,000 issued by Stephen B. Gray to the Company./(5)/
	(ii) First Amendment to Promissory Note dated as of August 5, 2000 by and between the Company and Stephen B. Gray./(5)/
10.7	Line of Credit Agreement with United Nations Bank dated September 30, 1999./(5)/
10.8	(i) Separation and Forbearance Agreement made as of October 5, 2000 between the Company and Stephen B. Gray./(7)/
	(ii)Promissory Note in the amount of $163,000 dated October 5, 2000 made by Stephen B. Gray to the Company./(7)/
10.9	Materials and Services Contract dated January 16, 2001, between the Company and SBC Services, Inc./(8)/
10.10	Stock Purchase Agreement dated August 11, 2000 by and between the Company and the parties identified therein./(8)/
10.11	Purchase Agreement by and between the Company and the Selling Shareholders set forth therein dated February 7, 2002./(18)/
10.12	Employment Agreement dated October 4, 2001 between the Company and Kam Saifi./(11)/
10.13	Employment Agreement dated October 17, 2001 between the Company and Cameron Saifi./(12)/
10.14	Sublease Agreement dated April 17, 2002 between the Company

	and Multipoint Communications, LLC./(14)/
10.15	Agreement and General Release dated August 15, 2002 between the Company and Ron Forster./(16)/
10.16	Rescission Agreement dated September 29, 2002 between the Company and David Arbeitel./(16)/

Exhibit No.	Description
10.17	Separation Agreement and General Release dated October 31, 2002 between the Company and David Arbeitel./(16)/
10.18	Employment Agreement dated May 20, 2002 between the Company and Ted Kaminer./(15)/
10.19	Employment Agreement dated February 25, 2002, between the Company and William Whitney. /20)/
10.20	Employment Agreement Amendment 1 dated September 30, 2002 by and between the Company and Kam Saifi.*
10.21	Amendment dated January 8, 2003 to Employment Agreement by and between the Company and Kam Saifi.*
10.22	Employment Agreement Amendment 1 dated September 30, 2002 by and between the Company and Cameron Saifi.*
10.23	Amendment dated January 8, 2003 to Employment Agreement by and between the Company and Cameron Saifi.*
10.24	Amended and Restated Employment Agreement dated September 8, 2003 by and between the Company and Norman E. Corn.*
16.1	Letter dated June 28, 2001, from PricewaterhouseCoopers LLP to the Securities and Exchange Commission./(10)/
21.1	List of Subsidiaries./(14)/
31.1	Section 302 Certification of the Chief Executive Officer.*
31.2	Section 302 Certification of the Interim Chief Financial Officer.*
32.1	Section 906 Certification of the Chief Executive Officer.*
32.2	Section 906 Certification of the Interim Chief Financial Officer.*

(1) Incorporated by Reference to the Company's Registration Statement on Form S-8 filed on August 15, 1995.

(2) Incorporated by Reference to the Company's Registration Statement on Form S-8 filed on April 22, 1999.

(3) Incorporated by reference to the Company's Registration Statement on Form S-8 filed on March 17, 2000.

(4) Incorporated by reference to the Company's Annual Report on Form 10-KSB for the fiscal year ended March 31, 1999.

(5) Incorporated by reference to the Company's Annual Report on Form 10-KSB filed on June 28, 2000.

(6) Incorporated by Reference to the Company's Current Report on Form 8-K filed on March 12, 1999.

(7) Incorporated by reference to the Company's Quarterly report on Form 10-QSB filed on November 14, 2000

(8) Incorporated by reference to the Company's Annual report on Form 10-KSB filed on June 29, 2001.

(9) Incorporated by reference to the Company's Registration Statement on Form S-8 filed on November 17, 2000.

(10) Incorporated by reference to the Company's Annual report on Form 10-KSB filed on June 29, 2001.

(11) Incorporated by Reference to the Company's Current Report on Form 8-K filed on October 23, 2001.

(12) Incorporated by Reference to the Company's Current Report on Form 8-K filed on October 24, 2001.

(13) Incorporated by reference to the Company's Annual Report on Form 10-KSB for the fiscal year ended March 31, 2002, as filed on July 1, 2002.

(14) Incorporated by reference to the Company's Annual Report on Form 10-KSB/A, Amendment No.2, for the fiscal year ended March 31, 2002, as filed on August 2, 2002.

(15) Incorporated by reference to the Company's Quarterly Report on Form 10-QSB filed on August 14, 2002.

(16) Incorporated by reference to the Company's Quarterly Report on Form 10-QSB filed on November 14, 2002.

(17) Incorporated by Reference to the Company's Registration Statement on Form S-8 filed on January 11, 2002.

(18) Incorporated by Reference to the Company's Registration Statement on Form S-3 filed on March 4, 2002.

(19) Incorporated by Reference to the Company's Definitive Proxy Statement filed on September 16, 2002.

(20) Incorporated by reference to the Company's Transition Report on Form 10-KSB for the nine months ended December 31, 2002, as filed on April 15, 2003.

* Filed herewith

(b) Reports on Form 8-K:

On May 16, 2003, the Company filed a report on Form 8-K reporting the issuance of two press releases announcing the Company's financial results for the three months ended March 31, 2003 and a transcript of the conference call hosted on May 12, 2003 discussing such financial results.

SIGNATURES

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

Date: September 12, 2003

ION NETWORKS, INC.

/s/ Norman E. Corn

Norman E. Corn, Chief Executive Officer

Exhibit Index

Exhibit No.	Description
3.1	Certificate of Incorporation of the Company, as filed with the Secretary of State of the State of Delaware on August 5, 1998./(2)/
3.2	Certificate of Amendment of the Certificate of Incorporation, as filed with the Secretary of State of the State of Delaware on December 11, 1998./(2)/
3.3	Certificate of Amendment of the Certificate of

	Incorporation, as filed with the Secretary of state of the State of Delaware an October 12, 1999./(3)/
3.4	By-Laws of the Company./(2)/
3.5	Form of Specimen Common Stock Certificate of the Company./(4)/
4.1	1994 Stock Option Plan of the Company. /(1)/
4.2	1998 Stock Option Plan of the Company./(2)/
4.3	1998 U.K. Sub-Plan of the Company, as amended./(2)/
4.4	Amended and Restated Certificate of Designation of Rights Preferences, Privileges and Restrictions of Series A Preferred Stock of ION Networks, Inc. /(20)/
4.5	2000 Stock Option Plan of the Company./(17)/
4.6	2002 Stock Option Plan of the Company./(19)/
4.7	Form of Warrant Agreement dated July 17, 2001./(13)/
4.8	Form of Warrant Agreement dated January 4, 2002./(13)/
4.9	Form of Non-Qualified Stock Option Agreement dated March 19, 1999 by and between the Company's predecessor, Microframe, Inc. and its consultants./(13)/
4.10	Form of Non-Employee Director Stock Option Contract dated March 10, 1998 between the Company's predecessor, Microframe, Inc. and its non-employee directors./(13)/
4.11	Form of Non-Employee Director Stock Option Contract dated September 17, 1997 by and between the Company's predecessor, Microframe, Inc. and its non-employee directors./(13/)
4.12	Form of Non-Qualified Stock Option Agreement dated September 25, 1996 by and between the Company's predecessor, Microframe, Inc. and its employees./(13)/
4.13	Amended and Restated Non-Qualified Stock Option Agreement dated May 19, 1997 by and between the Company's Predecessor, Microframe, Inc. and its employees./(9)/

27

Exhibit No.	Description
10.1	Lease Agreement dated February 18, 1999 by and between the Company and Washington Plaza Associates, L.P., as landlord. /(4)/
10.2	Business Park Gross Lease dated May 17, 1999 by and between the Company and Bedford Property Investors, Inc./(4)/

10.3	Agreement dated as of December 19, 1994 by and between LeeMAH DataCom Security Corporation and Siemens Rolm Communications Inc./(4)/
10.4	Equipment Lease Agreements dated June 10, 1999 and May 5, 1999 by and between the Company and Siemens Credit Corporation./(4)/
10.5	Equipment Lease Agreement dated June 17, 1999 by and between the Company and Lucent Technologies./(4)/
10.6	(i) Non-negotiable Promissory Note in the principal amount of $750,000 issued by Stephen B. Gray to the Company./(5)/
	(ii) First Amendment to Promissory Note dated as of August 5, 2000 by and between the Company and Stephen B. Gray./(5)/
10.7	Line of Credit Agreement with United Nations Bank dated September 30, 1999./(5)/
10.8	(i) Separation and Forbearance Agreement made as of October 5, 2000 between the Company and Stephen B. Gray./(7)/
	(ii)Promissory Note in the amount of $163,000 dated October 5, 2000 made by Stephen B. Gray to the Company./(7)/
10.9	Materials and Services Contract dated January 16, 2001, between the Company and SBC Services, Inc./(8)/
10.10	Stock Purchase Agreement dated August 11, 2000 by and between the Company and the parties identified therein./(8)/
10.11	Purchase Agreement by and between the Company and the Selling Shareholders set forth therein dated February 7, 2002./(18)/
10.12	Employment Agreement dated October 4, 2001 between the Company and Kam Saifi./(11)/
10.13	Employment Agreement dated October 17, 2001 between the Company and Cameron Saifi./(12)/
10.14	Sublease Agreement dated April 17, 2002 between the Company and Multipoint Communications, LLC./(14)/
10.15	Agreement and General Release dated August 15, 2002 between the Company and Ron Forster./(16)/
10.16	Rescission Agreement dated September 29, 2002 between the Company and David Arbeitel./(16)/
10.17	Separation Agreement and General Release dated October 31, 2002 between the Company and David Arbeitel./(16)/

Exhibit No.	Description

-------	-----------
10.18	Employment Agreement dated May 20, 2002 between the Company and Ted Kaminer./(15)/
10.19	Employment Agreement dated February 25, 2002, between the Company and William Whitney. /20)/
10.20	Employment Agreement Amendment 1 dated September 30, 2002 by and between the Company and Kam Saifi.*
10.21	Amendment dated January 8, 2003 to Employment Agreement by and between the Company and Kam Saifi.*
10.22	Employment Agreement Amendment 1 dated September 30, 2002 by and between the Company and Cameron Saifi.*
10.23	Amendment dated January 8, 2003 to Employment Agreement by and between the Company and Cameron Saifi.*
10.24	Amended and Restated Employment Agreement dated September 8, 2003 by and between the Company and Norman E. Corn.*
16.1	Letter dated June 28, 2001, from PricewaterhouseCoopers LLP to the Securities and Exchange Commission./(10)/
21.1	List of Subsidiaries./(14)/
31.1	Section 302 Certification of the Chief Executive Officer.*
31.2	Section 302 Certification of the Interim Chief Financial Officer.*
32.1	Section 906 Certification of the Chief Executive Officer.*
32.2	Section 906 Certification of the Interim Chief Financial Officer.*

(1) Incorporated by Reference to the Company's Registration Statement on Form S-8 filed on August 15, 1995.

(2) Incorporated by Reference to the Company's Registration Statement on Form S-8 filed on April 22, 1999.

(3) Incorporated by reference to the Company's Registration Statement on Form S-8 filed on March 17, 2000.

(4) Incorporated by reference to the Company's Annual Report on Form 10-KSB for the fiscal year ended March 31, 1999.

(5) Incorporated by reference to the Company's Annual Report on Form 10-KSB filed on June 28, 2000.

(6) Incorporated by Reference to the Company's Current Report on Form 8-K filed on March 12, 1999.

(7) Incorporated by reference to the Company's Quarterly report on Form 10-QSB filed on November 14, 2000

(8) Incorporated by reference to the Company's Annual report on Form 10-KSB filed on June 29, 2001.

(9) Incorporated by reference to the Company's Registration Statement on Form S-8 filed on November 17, 2000.

(10) Incorporated by reference to the Company's Annual report on Form 10-KSB filed on June 29, 2001.

(11) Incorporated by Reference to the Company's Current Report on Form 8-K filed on October 23, 2001.

(12) Incorporated by Reference to the Company's Current Report on Form 8-K filed on October 24, 2001.

(13) Incorporated by reference to the Company's Annual Report on Form 10-KSB for the fiscal year ended March 31, 2002, as filed on July 1, 2002.

(14) Incorporated by reference to the Company's Annual Report on Form 10-KSB/A, Amendment No.2, for the fiscal year ended March 31, 2002, as filed on August 2, 2002.

(15) Incorporated by reference to the Company's Quarterly Report on Form 10-QSB filed on August 14, 2002.

(16) Incorporated by reference to the Company's Quarterly Report on Form 10-QSB filed on November 14, 2002.

(17) Incorporated by Reference to the Company's Registration Statement on Form S-8 filed on January 11, 2002.

(18) Incorporated by Reference to the Company's Registration Statement on Form S-3 filed on March 4, 2002.

(19) Incorporated by Reference to the Company's Definitive Proxy Statement filed on September 16, 2002.

(20) Incorporated by reference to the Company's Transition Report on Form 10-KSB for the nine months ended December 31, 2002, as filed on April 15, 2003.

* Filed herewith