BIO KEY INTERNATIONAL INC
Form POS AM
August 02, 2006

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As filed with the Securities and Exchange Commission on August 2, 2006

Registration No. 333-115037

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

POST-EFFECTIVE AMENDMENT NO. 4
TO
FORM SB-2

REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

BIO-key International, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**3577**	**41-1741861**
(State of incorporation)	*(Primary Standard Industrial Classification Code Number)*	*(I.R.S. Employer Identification No.)*

3349 Highway 138, Building D, Suite B, Wall, NJ 07719, (732) 359-1100

(Address and telephone number of registrant's principal executive offices)

Michael W. DePasquale
Chief Executive Officer
BIO-key International, Inc., 3349 Highway 138, Building D, Suite B, Wall, NJ 07719, (732) 359-1100

(Name, address and telephone number of agent for service)

Copy to:

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Approximate date of commencement of proposed sale to public: From time to time after this registration statement becomes effective.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, as amended, or the Securities Act, check the following box. ý

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. / /

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. o

Calculation of Registration Fee

Title of each class of securities to be registered	Number of units to be registered(1)	Proposed maximum aggregate offering price per unit(2)	Proposed maximum aggregate offering price(2)	Amount of registration fee(3)
Common Stock, $.01 par value per share	2,422,108 shares(4)	$1.95	$4,723,111	$598
Common Stock, $.01 par value per share	8,888,928 shares(5)	$1.95	$17,333,410	$2,196
Common Stock, $.01 par value per share, issuable upon exercise of warrants	4,444,464 shares(6)	$1.95	$8,666,705	$1,098

(1) Pursuant to Rule 416 under the Securities Act, this registration statement also covers an indeterminate number of additional shares of the registrant's common stock as may be issuable upon any stock split, stock dividend or similar transaction.

(2) Estimated pursuant to Rule 457(c) under the Securities Act solely for the purpose of calculating the registration fee, based upon the average of the high and low sale prices of the registrant's common stock as reported on the OTC Bulletin Board on April 28, 2004, a date within five days of the original filing date of this registration statement.

(3) Registration fee has been previously paid.

(4) Shares of the registrant's common stock issued in connection with an agreement and plan of merger dated as of March 30, 2004.

(5) Shares of the registrant's common stock issued pursuant to a securities purchase agreement dated as of March 31, 2004.

(6) Shares of the registrant's common stock issuable upon the exercise of warrants issued pursuant to a securities purchase agreement dated as of March 31, 2004.

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the registration statement shall become effective on such date as the Commission acting pursuant to said Section 8(a), may determine.

POS-AM No. 333-115037

Subject to completion, dated August 2, 2006

PROSPECTUS

15,755,500 Shares

BIO-key International, Inc.

Common Stock

We are registering up to 15,755,500 shares of our common stock for offer or sale by the selling security holders named in this prospectus. Of the shares being registered, 11,311,036 shares have been issued to the selling security holders and 4,444,464 shares are issuable upon exercise of warrants issued to the selling security holders. Of the 11,311,036 shares that have been issued to the selling security holders, 2,416,108 shares are being held in escrow and may not be offered or sold by the selling security holders until such escrow is released. The selling security holders may offer or sell all or a portion of their shares publicly or through private transactions at prevailing market prices or at negotiated prices. We will not receive any proceeds from the shares being registered for offer and sale by the selling security holders.

Investing in our common stock involves a high degree of risk.
See "Risk Factors" beginning on page 5.

Our common stock is traded on the OTC Bulletin Board under the symbol "BKYI". The last reported sale price of our common stock on July 26, 2006 was $0.44 per share.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense.

August , 2006

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You should rely only on the information contained in this prospectus. We have not authorized anyone to provide you with information that is different. This prospectus may only be used where it is legal to sell these securities. The information in this prospectus may only be accurate on the date of this prospectus, regardless of the time of delivery of this prospectus or of any sale of our common stock. Applicable rules of the Securities and Exchange Commission may require us to update this prospectus in the future.

PROSPECTUS SUMMARY

Effective January 1, 2005, BIO-key International, Inc., a Minnesota corporation ("Old BIO-key") and the original registrant under this Registration Statement, reincorporated as BIO-key International, Inc., a Delaware corporation (the "Company," "BIO-key," "we" or "us"). The reincorporation was effected pursuant to an Agreement and Plan of Merger (the "Merger Agreement"), whereby Old BIO-key was merged with and into the Company, its wholly owned subsidiary, in order to reincorporate in the State of Delaware (the "Reincorporation"). As a result of the Reincorporation, the legal domicile of the registrant is now Delaware.

Pursuant to the Merger Agreement, at the effective time of the Reincorporation: (i) each outstanding share of Common Stock of Old BIO-key, $0.01 par value per share, was automatically converted into one share of Common Stock, $0.0001 par value per share, of the Company; (ii) each outstanding share of Series C 7% Convertible Preferred Stock of Old BIO-key, $0.01 par value per share, was automatically converted into one share of Series A 7% Convertible Preferred Stock, $0.0001 par value per share, of the Company, with such Series A 7% Convertible Preferred Stock containing substantially identical terms and conditions as the Series C 7% Convertible Preferred Stock of Old BIO-key; (iii) each option to purchase shares of Old BIO-key's Common Stock granted by Old BIO-key under any warrant, stock option plan or similar plan of Old BIO-key outstanding immediately before the Reincorporation was, by virtue of the Merger Agreement and without any action on the part of the holder thereof, converted into and become an option to purchase, upon the same terms and conditions, the same number of shares of the Company's Common Stock at an exercise price per share equal to the exercise price per share thereunder immediately before the Reincorporation; and (iv) each warrant, option or stock option plan of Old BIO-key was assumed by, and continues to be, a warrant, option or plan of the Company. Accordingly, as a result of the Reincorporation, the shareholders of Old BIO-key became shareholders of the Company, and Old BIO-key has been merged out of existence by operation of law. Each certificate representing shares of capital stock of Old BIO-key outstanding immediately before the Reincorporation will, from and after the Reincorporation, be deemed for all corporate purposes to represent the same number of shares of capital stock of the Company.

This Post-Effective Amendment is being filed pursuant to Rule 414(d) under the Securities Act of 1933, as amended (the "Securities Act"), in connection with the Reincorporation. In accordance with Rule 414(d) under the Securities Act, the Company, as successor issuer to Old BIO-key, hereby expressly adopts this Registration Statement as its own for all purposes under the Securities Act and the Securities Exchange Act of 1934. The Registration Statement shall hereafter be deemed to relate to that number of shares of the Company's Common Stock to which this Registration Statement originally related.

About BIO-key International, Inc.

BIO-key International, Inc., a Delaware corporation (the "Company," "BIO-key," "we," or "us"), was founded in 1993 to develop and market proprietary biometric technology and software solutions. Biometric technology is the science of analyzing specific human characteristics which are unique to each individual in order to identify a specific person from a broader population.

On March 30, 2004, BIO-key acquired Public Safety Group, Inc. (PSG), a privately held company that is a leader in wireless solutions for law enforcement and public safety markets. PSG's primary technology is PocketCop , a handheld solution that provides mobile officers, such as detectives who are not typically in their vehicles, a hand-held mobile information software solution.

On September 30, 2004, BIO-key completed a transaction with Aether Systems, Inc. to purchase its Mobil Government Division ("Mobile Government" or "AMG"), a leading provider of wireless data solutions for use by public safety organizations, primarily state, local police, fire and rescue and

emergency medical services organizations. The PacketCluster mobile information software is integrated with 50 separate State/NCIC databases, as well as other state, local and federal databases. Its open architecture and its published Application Programming Interface (API) make it easy to interface with a wide range of information sources. PacketCluster products deliver real-time information in seconds, freeing dispatchers to handle more pressing emergencies.

Effective January 1, 2005, BIO-key International, Inc., a Minnesota corporation ("Old BIO-key"), reincorporated in the State of Delware. The reincorporation was effected pursuant to an Agreement and Plan of Merger (the "Merger Agreement") whereby Old BIO-key was merged with and into the Company, its wholly owned subsidiary, in order to reincorporate in the State of Delaware (the "Reincorporation"). As a result of the Reincorporation, the legal domicile of the Company is now Delaware.

Pursuant to the Merger Agreement, at the effective time of the Reincorporation: (i) each outstanding share of Common Stock of Old BIO-key, $0.01 par value per share, was automatically converted into one share of Common Stock, $0.0001 par value per share, of the Company; (ii) each outstanding share of Series C 7% Convertible Preferred Stock of Old BIO-key, $0.01 par value per share, was automatically converted into one share of Series A 7% Convertible Preferred Stock, $0.0001 par value per share, of the Company, with such Series A 7% Convertible Preferred Stock containing substantially identical terms and conditions as the Series C 7% Convertible Preferred Stock of Old BIO-key; (iii) each option to purchase shares of Old BIO-key's Common Stock granted by Old BIO-key under any warrant, stock option plan or similar plan of Old BIO-key outstanding immediately before the Reincorporation was, by virtue of the Merger Agreement and without any action on the part of the holder thereof, converted into and become an option to purchase, upon the same terms and conditions, the same number of shares of the Company's Common Stock at an exercise price per share equal to the exercise price per share thereunder immediately before the Reincorporation; and (iv) each warrant, option or stock option plan of Old BIO-key was assumed by, and continues to be, a warrant, option or plan of the Company. Accordingly, as a result of the Reincorporation, the shareholders of Old BIO-key became shareholders of the Company, and Old BIO-key has been merged out of existence by operation of law. Each certificate representing shares of capital stock of Old BIO-key outstanding immediately before the Reincorporation, is deemed from and after the Reincorporation for all corporate purposes to represent the same number of shares of capital stock of the Company.

As a result of these recent mergers, and as discussed in Note M to the Consolidated Financial Statements included in this prospectus, we have organized the Company into three reporting segments: Law Enforcement, Fire Safety and Biometrics. During 2005, the Company continued to integrate the products, operations and technologies acquired from Public Safety Group, Inc. and Aether Systems, Inc.

We have evolved from a development stage company to a revenue generating company, but we have sustained substantial losses to date. We may need to obtain additional funding to (i) conduct the sales, marketing and technical support necessary to execute our plan to substantially grow operations, increase revenue and serve a significant customer base, and (ii) provide working capital. Due to, among other factors, our history of losses and limited revenue, our independent auditors have included an explanatory paragraph in their opinion for the year ended December 31, 2005 as to the substantial doubt about our ability to continue as a going concern. Our long-term viability and growth will depend upon the successful commercialization of our technologies and our ability to obtain adequate financing. To the extent that we require such additional financing, no assurance can be given that any form of additional financing will be available on terms acceptable to us, that adequate financing will be obtained to meet our needs, or that such financing would not be dilutive to existing stockholders. If available financing is insufficient or unavailable or we fail to continue to generate meaningful revenue, we may be required to further reduce operating expenses, delay the expansion of operations, or be unable to pursue merger or acquisition candidates.

Our principal executive offices are located at 3349 Highway 138, Building D, Suite B, Wall, NJ 07719 and our telephone number is (732) 359-1100.

About the Offering

This prospectus covers the public sale of up to 15,755,500 shares of our common stock to be sold by the selling security holders identified herein. Of this amount, 2,422,108 shares were issued to certain of the selling security holders in connection with our acquisition on March 30, 2004 of PSG, a privately-held company providing wireless solutions for law enforcement and public safety markets. This acquisition was accomplished through the exchange of 2,416,108 shares of our common stock, in addition to cash and our assumption of certain indebtedness of PSG, for all of the outstanding capital stock of PSG. We also issued 6,000 shares of our common stock in connection with this acquisition to Harward Investments, Inc. ("Harward") pursuant to an arrangement involving the discharge of certain prior debt obligations of PSG to Harward. Following the acquisition, PSG became a wholly-owned subsidiary of the Company.

The 2,416,108 shares of our common stock issued to the former PSG shareholders (the "Merger Shares") are subject to escrow provisions contained in the agreement and plan of merger and a related escrow agreement, which provide for periodic releases of such shares from escrow. One-twelfth ($^{1}/_{12}$) of the Merger Shares (the "Initial Shares") will be released from the escrow upon the effectiveness of this registration statement to Harward and the former shareholders of PSG. Specifically, Harward will receive an amount of Initial Shares that is equal to $110,000 divided by the closing price of our common stock as reported by the OTC Bulletin Board on such date, and the balance of the Initial Shares will be concurrently released to the former shareholders of PSG. An additional one-twelfth ($^{1}/_{12}$) of the Merger Shares will be released from the escrow to the former shareholders of PSG on each of June 30, 2004, September 30, 2004 and December 31, 2004. The remaining eight-twelfths ($^{8}/_{12}$) of the Merger Shares (the "Remaining Shares") will be released from the escrow to the former shareholders of PSG according to the following distribution schedule determined by the license, service and maintenance fee revenue achieved by the Company's Public Safety Division during fiscal year 2004: (i) in the event that such qualifying revenue is less than $2 million, one-twelfth ($^{1}/_{12}$) of the Remaining Shares will be released on each of March 31, 2005, June 30, 2005, September 30, 2005, December 31, 2005, March 31, 2006, June 30, 2006, September 30, 2006, December 31, 2006, March 31, 2007, June 30, 2007, September 30, 2007 and December 31, 2007; (ii) in the event that such qualifying revenue is equal to or greater than $2 million, one-eighth ($^{1}/_{8}$) of the Remaining Shares will be released on each of March 31, 2005, June 30, 2005, September 30, 2005, December 31, 2005, March 31, 2006, June 30, 2006, September 30, 2006 and December 31, 2006; and (iii) in the event that such qualifying revenue is equal to or greater than $6 million, one-sixth ($^{1}/_{6}$) of the Remaining Shares will be released on each of March 31, 2005, June 30, 2005, September 30, 2005, December 31, 2005, March 31, 2006 and June 30, 2006.

8,888,928 shares of our common stock covered by this prospectus were issued on March 31, 2004 in a private placement transaction to certain institutional and accredited investors pursuant to a securities purchase agreement by and among the Company and such investors. The remaining 4,444,464 shares of our common stock covered by this prospectus are issuable upon the exercise of warrants issued to the investors pursuant to such securities purchase agreement. The aggregate purchase price paid by the investors for the securities issued in such private placement was approximately $12,000,000.

RISK FACTORS

An investment in our common stock involves a high degree of risk. You should carefully consider the following information about certain of the risks of investing in our common stock, together with other information contained in this prospectus, before you decide to purchase our common stock.

Business and Financial Risks

Based on our lack of significant revenue since inception and recurring losses from operations, our auditors have included an explanatory paragraph in their opinion as to the substantial doubt about our ability to continue as a going concern.

Due to, among other factors, our history of losses (excluding gains from valuation changes in embedded derivatives) and limited revenue, our independent auditors have included an explanatory paragraph in their opinion for the year ended December 31, 2005 as to the substantial doubt about our ability to continue as a going concern. Our financial statements have been prepared in accordance with accounting principals generally accepted in the United States, which contemplate that we will continue to operate as a going concern. Our financial statements do not contain any adjustments that might result if we are unable to continue as a going concern.

Since our formation, we have historically generated minimal revenue and have sustained substantial operating losses.

As of December 31, 2005, we had negative working capital of approximately $10,400,000 and an accumulated deficit of approximately $42,762,000. Since our inception, we have focused almost exclusively on developing our core technologies and, until the fourth quarter of 2004 have not generated any significant revenue. In order to increase revenue, we have developed a direct sales force and anticipate the need to retain additional sales, marketing and technical support personnel and may need to incur substantial expenses. We cannot assure you that we will be able to secure these necessary resources, that a significant market for our technologies will develop or that we will be able to achieve our targeted revenue.

We have identified material weaknesses in our internal control over financial reporting and have failed to maintain an effective system of disclosure controls and procedures. If we are unable to successfully address such material weaknesses or if we continue to maintain an ineffective system of disclosure controls and procedures, we may not be able to accurately report our financial results or prevent fraud. As a result, current and potential stockholders could lose confidence in our financial reporting; this would harm our business and the trading price of our common stock.

After a review of our March 31, 2005, June 30, 2005 and September 30, 2005 quarterly operating results, as well as our 2005 annual operating results, conducted pursuant to Rule 13a-15 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), our Co-Chief Executive Officers and our Chief Financial Officer have determined that, as of each such date, our disclosure controls and procedures were not effective to provide reasonable assurance that information that we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission rules and forms. Our management reached this conclusion after identifying our system to capture disclosure items, our internal process of review for account reconciliations, our documentation of internal controls and our internal process for preparing our annual report on Form 10-KSB for the fiscal year ended December 31, 2005 as being inadequate to provide such assistance.

In addition, our independent auditors, DS&B, Ltd., notified the Audit Committee of our Board of Directors on April 18, 2005 that they believed there were reportable conditions during 2004 and 2005 which constituted a material weakness in our internal controls. These weaknesses concerned

deficiencies in the design and implementation of our internal controls and the fact that, due to two recent acquisitions, we were not staffed properly in our accounting and reporting department and may not have had appropriate accounting and reporting software. For these reasons, we were not able to meet our schedule for preparing our audit and for filing our annual report on Form 10-KSB for the fiscal year ended December 31, 2004 in a timely manner.

Effective internal control over financial reporting and disclosure controls and procedures are necessary for us to provide reliable financial reports and effectively prevent fraud and to operate successfully as a public company. We have in the past discovered, as described above, and may in the future discover, areas of our disclosure and internal controls that need improvement. We are in the process of addressing these issues to ensure that our internal control over financial reporting and disclosure controls and procedures are improved so as to provide reasonable assurance that the information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange rules and forms. If, however, we cannot provide reliable financial reports or prevent fraud, our reputation and operating results would be harmed.

We cannot be certain that our efforts to improve the material weaknesses in our internal control over financial reporting and the ineffectiveness of our disclosure controls and procedures will be successful or that we will be able to maintain adequate controls over our financial processes and reporting in the future. We will need to commit substantial resources, including substantial time from our management team's accounting personnel and from external consultants, to implement and integrate into our organization improved disclosure controls and additional procedures generally and to improve systems to report financial information on a timely basis. Any failure or delay to develop or maintain effective controls, or difficulties encountered in their implementation or in other effective improvement of our internal and disclosure controls could materially harm our operating results or cause us to fail to meet our reporting obligations. If we are unable to adequately establish or improve our internal controls over financial reporting, our external auditors may not be able to issue an unqualified opinion on the effectiveness of our internal controls. Ineffective internal and disclosure controls could also cause investors to lose confidence in our reported financial information, which would likely have a significant negative effect on the trading price of our securities.

Our biometric technology has yet to gain widespread market acceptance and we do not know how large of a market will develop for our technology.

Biometric technology has received only limited market acceptance, particularly in the private sector. Our technology represents a novel security solution and we have not yet generated significant sales. Although recent security concerns relating to identification of individuals has increased interest in biometrics generally, it remains an undeveloped, evolving market. Biometric based solutions compete with more traditional security methods including keys, cards, personal identification numbers and security personnel. Acceptance of biometrics as an alternative to such traditional methods depends upon a number of factors including:

- the reliability of biometric solutions;
- public perception regarding privacy concerns;
- costs involved in adopting and integrating biometric solutions.

For these reasons, we are uncertain whether our biometric technology will gain widespread acceptance in any commercial markets or that demand will be sufficient to create a market large enough to produce significant revenue or earnings. Our future success depends, in part, upon business customers adopting biometrics generally, and our solution specifically.

Biometric technology is a new approach to Internet security which must be accepted in order for our WEB-key® solution to generate significant revenue.

Our WEB-key® authentication initiative represents a new approach to Internet security which has been adopted on a limited basis by companies which distribute goods, content or software applications over the Internet. The implementation of our WEB-key® solution requires the distribution and use of a finger scanning device and integration of database and server side software. Although we believe our solutions provides a higher level of security for information transmitted over the Internet than existing traditional methods, unless business and consumer markets embrace the use of a scanning device and believe the benefits of increased accuracy outweigh implementation costs, our solution will not gain market acceptance.

Our software products may contain defects which will make it more difficult for us to establish and maintain customers.

Although we have completed the development of our core biometric technology, it has only been used by a limited number of business customers. Despite extensive testing during development, our software may contain undetected design faults and software errors, or "bugs" that are discovered only after it has been installed and used by a greater number of customers. Any such default or error in new or existing software or applications could cause delays in delivering our technology or require design modifications. These could adversely affect our competitive position and cause us to lose potential customers or opportunities. Since our technologies are intended to be utilized to secure physical and electronic access, the effect of any such bugs or delays will likely have a detrimental impact on us. In addition, given that biometric technology generally, and our biometric technology specifically, has yet to gain widespread acceptance in the market, any delays would likely have a more detrimental impact on our business than if we were a more established company.

While we have commenced a significant sales and marketing effort, we have only begun to develop a significant distribution channel and may not have the resources or ability to sustain these efforts or generate any meaningful sales.

In order to generate revenue from our biometric products, we are dependent upon independent original equipment manufacturers, system integrators and application developers, which we do not control. As a result, it may be more difficult to generate sales.

We market our technology through licensing arrangements with:

- Original equipment manufacturers, system integrators and application developers which develop and market products and applications which can then be sold to end users;

- Companies which distribute goods, services or software applications over the Internet.

As a technology licensing company, our success will depend upon the ability of these manufacturers and developers to effectively integrate our technology into products and services which they market and sell. We have no control over these licensees and cannot assure you that they have the financial, marketing or technical resources to successfully develop and distribute products or applications acceptable to end users or generate any meaningful revenue for us. These third parties may also offer the products of our competitors to end users.

We derive nearly all of our revenue from government contracts, which are often non-standard, involve competitive bidding, may be subject to cancellation with or without penalty and may produce volatility in earnings and revenue.

Most of our business involves providing products and services under contracts with U.S. federal, state and local government agencies. Obtaining contracts from government agencies is challenging, and government contracts often include provisions that are not standard in private commercial transactions. For example, government contracts may:

- include provisions that allow the government agency to terminate the contract without penalty under some circumstances;
- be subject to purchasing decisions of agencies that are subject to political influence;
- contain onerous procurement procedures; and
- be subject to cancellation if government funding becomes unavailable.

Securing government contracts can be a protracted process involving competitive bidding. In many cases, unsuccessful bidders may challenge contract awards, which can lead to increased costs, delays and possible loss of the contract for the winning bidder.

We face intense competition and may not have the financial and human resources necessary to keep up with rapid technological changes, which may result in our technology becoming obsolete.

The Internet, facility access control and information security markets are subject to rapid technological change and intense competition. We compete with both established biometric companies and a significant number of startup enterprises as well as providers of more traditional methods of access control. Most of our competitors have substantially greater financial and marketing resources than we do and may independently develop superior technologies, which may result in our technology becoming less competitive or obsolete. We may not be able to keep pace with this change. If we are unable to develop new applications or enhance our existing technology in a timely manner in response to technological changes, we will be unable to compete in our chosen markets. In addition, if one or more other biometric technologies such as voice, face, iris, hand geometry or blood vessel recognition are widely adopted, it would significantly reduce the potential market for our fingerprint identification technology.

We depend on key employees and members of our management team, including our Chairman of the Board and Co-Chief Executive Officer, in order to achieve our goals. We cannot assure you that we will be able to retain or attract such persons.

A loss of our current Chairman of the Board of Directors or Co-Chief Executive Officer could severely and negatively impact our operations. We have an employment contract with Michael W. DePasquale, our Co-Chief Executive Officer, through March 28, 2008. Although the contract does not prevent him from resigning, it does contain confidentiality and non-compete clauses which are intended to prevent him from working for a competitor within one year after leaving our Company. Our success depends on our ability to attract, train and retain employees with expertise in developing, marketing and selling software solutions. In order to successfully market our technology, we will need to retain additional engineering, technical support and marketing personnel. The market for such persons remains highly competitive and our limited financial resources will make it more difficult for us to recruit and retain qualified persons.

We cannot assure you that the limited intellectual property protection for our core technology provides a meaningful competitive advantage or barrier to entry against our competitors.

Our success and ability to compete is dependent in part upon proprietary rights to our technology. We rely primarily on a combination of patent, copyright and trademark laws, trade secrets and technical measures to protect our propriety rights. We have filed a patent application relating to both the optic technology and biometrics solution components of our technology wherein several claims have been allowed. In May 2005, the U.S. Patent Office issued us a patent for our Vector Segment fingerprint technology (VST), BIO-key's core biometric analysis and identification technology. We cannot assure you that any additional patents will be issued, or that, if issued, we will have the resources to protect any patent from infringement. Although we believe our technology does not currently infringe upon patents held by others, we cannot assure you that such infringements do not exist or will not exist in the future, particularly as the number of products and competitors in the biometric industry segment grows.

We may need to obtain additional financing to execute our business plan, which may not be available. If we are unable to raise additional capital or generate significant revenue, we may not be able to continue operations.

Since our inception, we have not generated any significant revenue (other than revenue from acquired businesses) and have experienced substantial losses, including approximately $10,221,000 during 2005, excluding the impact related to embedded derivatives and warrant fair value adjustments. In March 2004, we completed a private placement equity offering that resulted in approximately $12,000,000 in gross proceeds to the Company and a private placement convertible debt offering in September 2004 that resulted in approximately $10,000,000 in gross proceeds to the Company (a portion of which was used to finance the acquisition of Aether Mobile Government). In June 2005, we raised approximately $5,000,000 in gross proceeds through a private placement convertible debt offering and in January 2006 we received approximately $1,000,000 in another a private placement convertible debt offering. To the extent that we will require additional capital to support our operations, expand our marketing and sales efforts and to execute our business plan to substantially increase revenue, we may need to obtain additional financing through the issuance of debt or equity securities. Our long-term viability and growth will depend upon the successful commercialization of our technologies and our ability to obtain adequate financing. We have not and cannot assure you that we will ever be able to secure any such financing on terms acceptable to us. If we cannot obtain such financing or generate such revenues, we may not be able to execute our business plan or continue operations.

We may not be able to successfully complete the integration of PSG and AMG into our operations.

The integration of PSG and AMG into our operations involves a number of risks, including:

- difficulty integrating operations and personnel;
- diversion of management attention;
- potential disruption of ongoing business;
- inability to retain key personnel;
- inability to successfully incorporate the acquired products and services into our product and service offerings and to develop new products and services; and
- impairment of relationships with employees, customers or vendors.

Failure to overcome these risks or any other problems encountered in connection with the acquisitions of PSG and AMG could slow our growth or lower the quality of our services, which could

reduce customer demand. The result could be a material adverse effect on our financial position and results of operations.

We may not achieve profitability with respect to the law enforcement and public safety components of our business if we are unable to maintain, improve and develop the wireless data services we offer.

We believe that our future business prospects depend in part on our ability to maintain and improve our current services and to develop new ones on a timely basis. Our services will have to achieve market acceptance, maintain technological competitiveness and meet an expanding range of customer requirements. As a result of the complexities inherent in our service offerings, major new wireless data services and service enhancements require long development and testing periods. We may experience difficulties that could delay or prevent the successful development, introduction or marketing of new services and service enhancements. Additionally, our new services and service enhancements may not achieve market acceptance. If we cannot effectively develop and improve services we may not be able to recover our fixed costs or otherwise become profitable.

Our law enforcement and public safety division depends upon wireless networks owned and controlled by others.

If we do not have continued access to sufficient capacity on reliable networks, we may be unable to deliver services and our sales could decrease. Our ability to grow and achieve profitability partly depends on our ability to buy sufficient capacity on the networks of wireless carriers such as Verizon Wireless, Bell South Corporation, Metrocall, Motient and AT&T Wireless and on the reliability and security of their systems. All of our services are delivered using airtime purchased from third parties. We depend on these companies to provide uninterrupted and bug free service and would not be able to satisfy our customers' needs if they failed to provide the required capacity or needed level of service. In addition, our expenses would increase and our profitability could be materially adversely affected if wireless carriers were to increase the prices of their services. Our existing agreements with the wireless carriers generally have one-year terms. Some of these wireless carriers are, or could become, our competitors and if they compete with us they may refuse to provide us with their services.

New laws and regulations that impact our law enforcement and public safety division could increase our costs or reduce our opportunities to earn revenue.

We are not currently subject to direct regulation by the Federal Communications Commission or any other governmental agency, other than regulations applicable to businesses in general. However, in the future, we may become subject to regulation by the FCC or another regulatory agency. In addition, the wireless carriers who supply us airtime and certain of our hardware suppliers are subject to regulation by the FCC and regulations that affect them could increase our costs or reduce our ability to continue selling and supporting our services.

If we fail to adequately manage our resources, it could have a severe negative impact on our financial results or stock price.

We could be subject to fluctuations in technology spending by existing and potential customers. Accordingly, we will have to actively manage expenses in a rapidly changing economic environment. This could require reducing costs during economic downturns and selectively growing in periods of economic expansion. If we do not properly manage our resources in response to these conditions, our results of operations could be negatively impacted.

We granted a blanket security interest in all of our assets to the holders of our secured debt. If we are unable to make our required monthly payments on such debt, or any other event of default occurs, it could have a material adverse effect on our business and operations, and the debt holders may foreclose on our assets.

As part of our secured convertible debt financing transactions, we granted to Laurus Master Fund, Ltd. and another holder of such secured debt a blanket security interest in all of our assets, including assets of our subsidiary. See the "Management's Discussion and Analysis or Plan of Operation" section of this report. In the event we default in payment on such debt, or any other event of default occurs under the relevant financing documents, and the default is not cured, 120% of the outstanding principal amount of the secured notes, plus accrued interest and fees will accelerate and be due and payable in full. See the "Long Term Obligations" footnote to this prospectus for a list of such potential events of default.

The cash required to pay such accelerated amounts on the secured notes following an event of default would most likely come out of our working capital. As we rely on our working capital for our day to day operations, such a default could have a material adverse effect on our business, operating results, or financial condition to such extent that we are forced to restructure, file for bankruptcy, sell assets or cease operations. In addition, upon an event of default, the holder of the secured debt could foreclose on our assets or exercise any other remedies available to them. If our assets were foreclosed upon, we were forced to file for bankruptcy or cease operations; stockholders may not receive any proceeds from disposition of our assets and may lose their entire investment in our stock.

Our obligations under our debt securities may adversely affect our ability to enter into potential significant transactions with other parties.

As a result of our debt financing transactions with Laurus Master Fund, Ltd., the Shaar Fund, Ltd. and other institutional and accredited investors, we incurred significant repayment obligations, and we agreed to certain restrictive covenants. In particular, for so long as 25% of the aggregate principal amount of the convertible term notes remains outstanding, we will need the consent of the holders of such notes before we can take certain actions, including the following:

- pay any dividends;
- merge, effect a material reorganization, liquidate or dissolve;
- materially change the scope of our business; or
- create, incur or assume any debt (other than certain trade debt, equipment financings and debt for the purchase of assets in the ordinary course of business).

Accordingly, unless we obtain the noteholders' consent, we may not be able to enter into certain transactions. In addition, in connection with any potential significant transaction (such as a merger, sale of substantially all our assets, joint venture, or similar transaction), it is likely that we would have to pay off such debt obligations and have the applicable security interests released. Although we have the right at any time to prepay our debt obligations, we can only do so upon payment of either 110% or 120% of the then principal balance, plus all other amounts owing under the notes. See the "Long Term Obligations" footnote of this prospectus. Based on an aggregate principal balance of $11.3 million at December 31, 2005, a complete prepayment would require a cash payment of approximately $12.7 million. These provisions could have the practical effect of increasing the costs of any potential significant transaction, and restrict our ability to enter into any such transaction.

Our obligations to the holders of our outstanding preferred stock may further affect our ability to enter into potential significant transactions with other parties.

We will need to obtain the consent of the holders of a majority of the then outstanding shares of our convertible preferred stock before we can take certain actions, including the following:

- a sale or other disposition of any material assets;
- an acquisition of a material amount of assets;
- engaging in a merger, reorganization or consolidation; or
- incur or guaranty any indebtedness in excess of $50,000.

Accordingly, unless we obtain such consent, we may not be able to enter into certain transactions.

Risks Related To Our Common Stock

We have issued a substantial number of securities that are convertible into shares of our common stock which will result in substantial dilution to the ownership interests of our existing shareholders.

As of March 15, 2006, approximately 45,764,000 shares of our common stock were reserved for issuance upon exercise or conversion of the following securities:

- 15,273,000 shares upon conversion of outstanding convertible term notes;
- 20,729,000 shares upon exercise of outstanding stock options and warrants;
- 1,878,000 shares upon exercise of options available for future grant under our existing option plans; and
- 7,884,000 shares or more upon conversion of our outstanding shares of convertible preferred stock and cumulative dividends in arrears.

The exercise or conversion of these securities will result in a significant increase in the number of outstanding shares and substantially dilute the ownership interests of our existing shareholders.

A substantial number of our convertible securities are convertible into shares of common stock at a conversion price of $.70 per share. Most of these shares are eligible for public resale. The trading price of our common stock and our ability to raise additional financing may be adversely affected by the influx into the market of such a substantial number of shares.

Our outstanding Series A Convertible Preferred Stock and cumulative dividends in arrears are convertible into 7,287,987 shares of common stock as of December 31, 2005 at a per share conversion price of $.70. Although many of the shares issuable upon conversion of our Series A Convertible Preferred Stock are eligible for public resale under Securities Exchange Commission Rule 144, we have agreed to file a registration statement to cover the public resale of all of these shares. This significant increase in the number of shares available for public sale may have a negative impact on the trading price of our shares and substantially dilute the ownership interests of our existing shareholders. In the event that our stock trades below $.70 per share, in order to raise additional financing we would likely be required to issue additional shares of common stock or securities convertible into common stock at a purchase or conversion price, as applicable, of less than $.70 per share. Any issuance of shares at a purchase price of less than $.70 per share would reduce the conversion price of our Series A Convertible Preferred Shares to such lower price. This would require us to issue additional shares upon conversion of our Series A Shares and further dilute the ownership interests of our existing shareholders. To the extent these factors are viewed negatively by the market, it may provide an incentive for persons to execute short sales of our common stock that could adversely affect the trading price of our common stock.

In January 2006, the Company issued Convertible Term Notes in the aggregate principal amount of $1,000,000 to certain investors. The Convertible Notes are convertible into 1,000,000 shares of Series B Convertible Preferred Stock of the Company, which shares are convertible into shares of the Common Stock of the Company at an initial fixed conversion of $.70 per share for an aggregate amount of 1,428,571 shares. Although many of the shares issuable upon conversion of our Series B Convertible Preferred Stock are eligible for public resale under Securities Exchange Commission Rule 144, we have agreed to file a registration statement to cover the public resale of all of these shares. This significant increase in the number of shares available for public sale may have a negative impact on the trading price of our shares and substantially dilute the ownership interests of our existing shareholders. In the event that our stock trades below $.70 per share, in order to raise additional financing we would likely be required to issue additional shares of common stock or securities convertible into common stock at a purchase or conversion price, as applicable, of less than $.70 per share. Any issuance of shares at a purchase price of less than $.70 per share would reduce the conversion price of our Series B Convertible Preferred Shares to such lower price. This would require us to issue additional shares upon conversion of our Series B Shares and further dilute the ownership interests of our existing shareholders. To the extent these factors are viewed negatively by the market, it may provide an incentive for persons to execute short sales of our common stock that could adversely affect the trading price of our common stock.

Applicable SEC Rules governing the trading of "penny stocks" limits the trading and liquidity of our common stock, which may affect the trading price of our common stock.

Our common stock currently trades on the OTC Bulletin Board. Since our common stock continues to trade below $5.00 per share, our common stock is considered a "penny stock" and is subject to SEC rules and regulations, which impose limitations upon the manner in which our shares can be publicly traded. These regulations require the delivery, prior to any transaction involving a penny stock, of a disclosure schedule explaining the penny stock market and the associated risks. Under these regulations, certain brokers who recommend such securities to persons other than established customers or certain accredited investors must make a special written suitability determination regarding such a purchaser and receive such purchaser's written agreement to a transaction prior to sale. These regulations have the effect of limiting the trading activity of our common stock and reducing the liquidity of an investment in our common stock.

We do not intend to pay dividends in the foreseeable future.

We have never declared or paid a dividend on our common stock. In addition, the terms of our outstanding Convertible Preferred Shares preclude us from declaring or paying a dividend on our common stock unless a dividend is also declared or paid, as applicable, on our Convertible Preferred Shares. We intend to retain earnings, if any, for use in the operation and expansion of our business and, therefore, do not anticipate paying any dividends on our common stock in the foreseeable future.

The trading price of our common stock may be volatile.

The trading price of our shares has from time to time fluctuated widely and in the future may be subject to similar fluctuations. The trading price may be affected by a number of factors including the risk factors set forth in this prospectus as well as our operating results, financial condition, announcements of innovations or new products by us or our competitors, general conditions in the biometrics and access control industries, and other events or factors. Although we believe that approximately 15 registered broker dealers currently make a market in our common stock, we can not assure you that any of these firms will continue to serve as market makers or have the financial capability to stabilize or support our common stock. A reduction in the number of market makers or the financial capability of any of these market makers could also result in a decrease in the trading

volume of and price of our shares. In recent years broad stock market indices, in general, and the securities of technology companies, in particular, have experienced substantial price fluctuations. Such broad market fluctuations may adversely affect the future-trading price of our common stock.

Selling security holders intend to sell their shares of common stock in the market, which sales may cause our stock price to decline.

The selling stockholders named in this prospectus intend to sell in the public market 15,755,500 shares of our common stock being registered in that offering. That means that up to 15,755,500 shares may be sold pursuant to this registration statement. Such sales may cause our stock price to decline. Our officers and directors and those shareholders who are significant shareholders as defined by the Securities and Exchange Commission will continue to be subject to the provisions of various insider trading and Rule 144 regulations.

FORWARD-LOOKING STATEMENTS

All statements other than statements of historical facts contained in this prospectus, including statements regarding our future financial position, business strategy and plans and objectives of management for future operations, are forward-looking statements. The words "anticipate," "believe," "estimate," "will," "may," "future," "plan," "intend" and "expect" and similar expressions generally identify forward-looking statements. Although we believe that our plans, intentions and expectations reflected in the forward-looking statements are reasonable, we cannot be sure that they will be achieved. Actual results may differ materially due to a number of factors. Many of these factors are set forth in the "RISK FACTORS" section of this prospectus. Actual results may differ materially from the forward-looking statements contained in this prospectus. These factors are not intended to represent a complete list of the general or specific factors that may affect us. It should be recognized that other factors, including general economic factors and business strategies, may be significant, presently or in the future. Except as required by law, we undertake no obligation to update any forward-looking statement, whether as a result of new information, future events or otherwise.

USE OF PROCEEDS

The shares are being registered hereunder for resale by the selling security holders. We will not receive any proceeds from the sale of the shares by the selling security holders. We will receive the proceeds from the exercise price of certain warrants held by certain of the selling security holders to the extent such warrants are exercised. We expect to use the proceeds of any such sales for general working capital purposes.

MARKET FOR OUR COMMON STOCK AND RELATED STOCKHOLDER MATTERS

Our common stock currently trades on the OTC Bulletin Board under the symbol "BKYI." The following table sets forth the range of high and low bid prices per share of our common stock for each of the calendar quarters identified below as reported by the OTC Bulletin Board. These quotations represent inter-dealer prices, without retail mark-up, markdown or commission, and may not represent actual transactions.

2006:	**High**	**Low**
Quarter ended March 31, 2006	$ 0.94	$ 0.58
2005:	**High**	**Low**
Quarter ended December 31, 2005	$ 0.81	$ 0.50
Quarter ended September 30, 2005	1.21	0.74
Quarter ended June 30, 2005	1.39	0.99
Quarter ended March 31, 2005	1.63	1.13
2004:	**High**	**Low**
Quarter ended December 31, 2004	$ 1.61	$ 0.74
Quarter ended September 30, 2004	1.43	0.60
Quarter ended June 30, 2004	3.00	1.26
Quarter ended March 31, 2004	1.85	1.03
2003:	**High**	**Low**
Quarter ended December 31, 2003	$ 1.40	$ 0.53
Quarter ended September 30, 2003	.59	0.38
Quarter ended June 30, 2003	.64	0.30
Quarter ended March 31, 2003	.73	0.35

The last price of our common stock as reported on the OTC Bulletin Board on July 26, 2006 was $0.44 per share.

Holders

As of March 15, 2006, the number of stockholders of record of our common stock was 192. Based on broker inquiry conducted in connection with the distribution of proxy solicitation materials in connection with the Company's special meeting of shareholders in February 2006, we believe that there are approximately 4,816 beneficial owners of our common stock.

Dividends

We have not paid any cash dividends to date, and have no intention of paying any cash dividends on our common stock in the foreseeable future. The terms of our outstanding Series A preferred shares preclude us from declaring or paying a dividend on our common stock unless a dividend is also declared or paid, as applicable, on our Series A preferred shares. The declaration and payment of dividends is also subject to the discretion of our Board of Directors and certain limitations imposed under the Delaware General Corporation Law. The timing, amount and form of dividends, if any, will depend on, among other things, our results of operations, financial condition, cash requirements and other factors deemed relevant by our Board of Directors.

MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

This Management's Discussion and Analysis of Financial Condition and Results of Operations and other parts of this prospectus contain forward-looking statements that involve risks and uncertainties. All forward-looking statements included in this prospectus are based on information available to us on the date hereof, and we assume no obligation to update any such forward-looking statements. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of a number of factors, including those set forth in the section captioned "RISK FACTORS" and elsewhere in this prospectus. The following should be read in conjunction with our audited financial statements included elsewhere herein.

The following Management's Discussion and Analysis or Plan of Operation ("MD&A") is intended to help you understand BIO-key International (the "Company," "we," "us" or "our"). MD&A is provided as a supplement to and should be read in conjunction with our financial statements and the accompanying notes. The results included in this MD&A have been restated. Our MD&A includes the following sections:

OVERVIEW provides a description of our business, the major items that affected our business, and how we analyze our business. It then provides an analysis of our overall 2005 performance and a description of the significant events impacting 2005 and thereafter.

RESULTS OF OPERATIONS provides an analysis of the consolidated and segment results of operations for 2005 compared to 2004 and 2004 compared to 2003. It also includes an analysis of the consolidated and segment results of operations for the quarter ended March 31, 2006 compared to the quarter ended March 31, 2005.

LIQUIDITY AND CAPITAL RESOURCES provides an overview of our cash flows, financing, contractual obligations and embedded derivatives activities.

RESTATEMENT provides a description and reconciliation of the restatement. For additional information, see Item 8, Financial Statements and Supplementary Data, Note B, Restatement of Previously Issued Financial Statements.

CRITICAL ACCOUNTING POLICIES provides a discussion of our accounting policies that require critical judgment, assumptions and estimates.

OTHER MATTERS provides a discussion of our significant non-operational items which impact our financial statements, such as the SEC comment letter.

RECENT ACCOUNTING STANDARDS by reference to Note 1 to the Consolidated Financial Statements provides a description of accounting standards which we have not yet been required to implement and may be applicable to our operations, as well as those significant accounting standards which were adopted during 2005.

OVERVIEW

Our Business

We develop and market proprietary fingerprint identification biometric technology and software solutions. We also deliver advanced identification solutions and information services to law enforcement departments, public safety agencies and other government and private sector customers. Our mobile wireless technology provides first responders with critical, reliable, real-time data and images from local, state and national databases.

We pioneered the development of automated, finger identification technology that can be used without the aid of non-automated methods of identification such as a personal identification, password, token, smart card, ID card, credit card, passport, driver's license or other form of possession or

knowledge based identification. This advanced BIO-key identification technology improves both the accuracy and speed of finger-based biometrics and is the only finger identification algorithm that has been certified by the International Computer Security Association (ICSA).

Since our inception in 1993, we have spent substantial time and effort in completing the development of what we believe is the most discriminating and effective finger biometric technology available. During the past two years, our focus has shifted to marketing and selling this technology and completing strategic acquisitions that can help us leverage our capability to deliver identification solutions. We have built a direct sale force of professionals with substantial experience in selling technology solutions to government and corporate customers. We expect to continue to add additional qualified personnel beyond 2005.

On March 30, 2004, we acquired all of the outstanding capital stock of Public Safety Group, Inc., a privately-held provider of wireless solutions for law enforcement and public safety markets based in Winter Park, Florida, in exchange for an aggregate of 2,422,108 shares of our common stock, $500,000 in cash, and our assumption of $600,000 in aggregate net liabilities of PSG. The acquisition was completed pursuant to the terms of an agreement and plan of merger by and among the Company, BIO-key Acquisition Corp., a wholly-owned subsidiary of the Company, PSG and all of the shareholders of PSG. As a result of this transaction, PSG became a wholly-owned subsidiary of the Company.

On September 30, 2004, we completed our acquisition of the Mobile Government Division from Aether Systems Inc. Pursuant to the Asset Purchase Agreement dated as of August 16, 2004 by and among the Company, Aether, Cerulean Technology, Inc. and SunPro, Inc., the Company paid Aether a purchase price of $10,000,000 in cash, subject to post-closing adjustments to reflect changes in Aether Mobile Government's working capital and cash flows since June 30, 2004. Post-closing working capital adjustments resulted in an additional payment by the Company of $341,878 in December 2004. In connection with this acquisition, the Company issued a subordinated secured promissory note to Aether in the face amount of $6,884,588 (the "Aether Note"). The Aether Note evidences a contingent reimbursement obligation of the Company to Aether and a surety fee payable by the Company to Aether, in each case with respect to a letter of credit maintained by Aether for the Company's benefit in connection with the acquisition. The Company's obligations under the Aether Note are secured by a security interest granted to Aether in all or substantially all of the Company's assets, subordinate to the security interest described in the "Long-Term Obligations" footnote to this annual report.

Aether Mobile Government provides wireless data solutions for use by public safety organizations, primarily state and local police, fire and rescue and emergency medical services organizations that enable such organizations to access law enforcement databases to validate identities and obtain suspect information. Its public safety solutions are integrated into fifty (50) different state databases, as well as local and federal databases, and its products deliver real-time information in seconds, without the need for human dispatchers or other resources.

RESULTS OF OPERATIONS

YEARS ENDED DECEMBER 31, 2005 AS COMPARED TO DECEMBER 31, 2004 AND DECEMBER 31, 2004 AS COMPARED TO DECEMBER 31, 2003

INTRODUCTION

During 2005, the Company continued to integrate the products, operations and technology of the Mobile Government business, acquired from Aether Systems in September 2004, in an effort to leverage new business opportunities. Our financial objective is to increase revenue, manage expenses and attain profitability. While total expenses have increased in dollars, they have declined as a

percentage of revenue in 2005 and 2004. In the fourth quarter of 2005, the Company restructured its operations into three business segments: Biometrics, Law Enforcement and Fire Safety. Each segment will be headed by a General Manager and organized to quickly respond to market needs as well as to drive down costs to achieve profitability. Management believes that this initiative will lead to increased opportunities in 2006 as the General Managers develop their organizations. A detailed analysis of each segment can be found below.

RESULTS OF OPERATIONS

Consolidated Results of Operations

Three Year % trend

	Years ended December 31,		
	2005	**2004**	**2003**
	(Restated)	**(Restated)**	**(Restated)**
Revenues			
Services	76%	59%	5%
License fees and other	24%	41%	95%
	100%	100%	100%
Costs and other expenses			
Services	20%	21%	1%
Cost of license fees and other	7%	16%	41%
Selling, general and administrative	83%	124%	975%
Research, development and engineering	48%	52%	481%
	158%	213%	1498%
Operating loss	-58%	-113%	-1398%
Other income (deductions)			
Total other income (deductions)	-32%	-77%	-486%
NET INCOME (LOSS)	-26%	-190%	-1884%

As discussed in Note M to the Consolidated Financial Statements, we have three reporting segments: Law Enforcement, Fire Safety and Biometrics. The Law Enforcement and Fire Safety segments were purchased during 2004. As noted earlier, in the fourth quarter of 2005 the Company restructured its operations into three business segments, prior to this segmentation of the business management evaluated the business as one consolidated operation. For presentation and comparability purposes the allocation of costs between segments for prior periods have been estimated.

The Company evaluates performance and allocates resources based on revenues and operating income (loss). Operating income (loss) for each segment includes selling, general and administrative expenses directly attributable to the segment in addition to those allocated as a percentage based on the segments revenues. The segmentation of operating income as noted above and detailed below reflects how management now evaluates its business. Assets for the company are commingled and are

related to all operating segments. Management does not evaluate or identify the operating assets of the segments separately.

	2005	2004	2003	2005-2004		2004-2003	
				$ Chg	% Chg	$ Chg	% Chg
		Restated	Restated				
Revenues							
Law Enforcement							
Service	$ 7,886,000	$ 2,562,136	$	$ 5,323,863	208%	$ 2,562,136	n/a
License & other	2,638,938	1,920,642		718,297	37%	1,920,642	n/a
	10,524,938	4,482,778		6,042,160	135%	4,482,778	n/a
Fire Safety							
Service	2,814,616	693,967		2,120,649	306%	693,967	n/a
License & other	406,470	187,229		219,241	117%	187,229	n/a
	3,221,086	881,196		2,339,890	266%	881,196	n/a
Biometrics							
Service	161,033	95,303	10,694	65,730	69%	84,609	791%
License & other	319,038	261,674	204,787	57,364	22%	56,887	28%
	480,071	356,977	215,481	123,094	34%	141,496	66%
Total Revenue	$ 14,226,095	$ 5,720,951	$ 215,481	$ 8,505,144	149%	$ 5,505,470	2555%
Cost of goods sold							
Law Enforcement							
Service	$ 2,260,845	$ 902,794	$	$ 1,358,051	150%	$ 902,794	n/a
License & other	679,170	686,806		(7,636)	-1%	686,806	n/a
	2,940,015	1,589,600		1,350,415	85%	1,589,600	n/a
Fire Safety							
Service	602,317	253,913		348,404	137%	253,913	n/a
License & other	165,074	96,081		68,993	72%	96,081	n/a
	767,391	349,994		417,397	119%	349,994	n/a
Biometrics							
Service	42,980	17,617	1,694	25,363	144%	15,923	940%
License & other	93,247	107,009	87,387	(13,762)	13%	19,622	22%
	136,227	124,626	89,081	11,601	9%	35,545	40%
Total COGS	$ 3,843,633	$ 2,064,220	$ 89,081	$ 1,779,413	86%	$ 1,975,139	2217%

Revenues

Law Enforcement

The increase in these revenue components from 2004 is primarily attributable to the fact that the business was acquired in the third quarter of 2004. Therefore 2004 represents only one quarter of revenue, whereas 2005 reflects four quarters of revenue. The increase was partially offset with a reduction of revenues related to long-term project work, which during 2005 has diminished as a result of the Company focusing the

business to more of a licensing model.

Fire Safety

The increase in these revenue components from 2004 is primarily attributable to the fact that the business was acquired in the third quarter of 2004. Therefore 2004 represents only one quarter of revenue, whereas 2005 reflects four quarters of revenue. This was compounded by a general increase in overall revenue that can be attributed to a strengthened market presence through concerted efforts toward penetrating new markets by actively pursuing and marketing our Fire Safety products. Additionally revenue growth can be also attributable to functionality that was added across the entire

Fire Safety product suite as well as the release of new FireRMS mobile product which was released in the middle of 2005.

Biometrics

During 2004 and 2005 Biometric segment continues to show strong revenue growth year over year. This is reflective of continued market acceptance of the product and strategic channel relationships that have been developed. Additionally, the product has been a proven solution in the educational industry as well has shown continued commercial integration and acceptance of the product.

Costs of goods sold

Law Enforcement

License and other costs are attributable primarily to revenues derived from product sales for which we are required to pay a royalty. The slight decrease in cost is primarily driven by the sales mix and is solely dependent specifically on what products were sold.

Service costs increased primarily because of personnel related costs that have increased over the prior year primarily from the inclusion of a full year of costs as compared to only one quarter in 2004. This was offset by reductions related to a reduced concentration of project related revenues which are heavily burdened with labor costs, both employees and contracted labor. As significant project revenues declined after the first two quarters of 2005, this reduction offset the increase that would have occurred related to maintaining a full twelve months of expense.

Fire Safety

License and other costs are attributable primarily to revenues derived from product sales for which we are required to pay a royalty. The slight increase in cost is primarily driven by the sales volume in addition to product mix. These costs are solely dependent specifically on what products were sold.

Services costs have increased over the prior year primarily from the inclusion of a full year of costs as compared to only one quarter as well as contractors and related costs that have been incurred related to project and service related revenues. There was a significant growth in service revenues for which additional outside contractors were used in providing some of those services.

Biometrics

License and other costs are primarily related to the hardware costs related to sales of biometric fingerprint readers. The change in cost of goods sold is directly attributable to the product mix between types of readers sold and the volume of readers sold. During 2004 and 2003 the volume attributable to readers remained fairly constant whereas in 2005 volume decreased resulting in a reduction of related product cost.

Service cost has increased during 2005 related primarily to a higher percentage of revenue requiring software customization and integration costs as compared to 2004 and 2003.

Selling, general and administrative

	2005	2004	2003	2005-2004		2004-2003	
				$ Chg	% Chg	$ Chg	% Chg
		Restated	Restated				
Law Enforcement	$ 7,471,524	$ 3,047,247	$	$ 4,424,277	145%	$ 3,047,247	n/a
Fire Safety	2,802,220	783,948		2,018,272	257%	783,948	n/a
Biometrics	1,550,865	3,283,093	2,099,922	(1,732,228)	-53%	1,183,171	56%
Total	$ 11,824,609	$ 7,114,288	$ 2,099,922	$ 4,710,321	66%	$ 5,014,366	238%

SG&A costs increased during the year as a result of 2005 representing a full 12 months worth of expenses as compared to 2004 which included only 3 months of expenses of the Law and Fire segments. As noted above, these costs are allocated based on the Segment's percentage of revenue. Changes in SG&A costs between business segments are the result of the change in their respective percentage of BIO-key's total revenue.

During 2004 the increase in SG&A was primarily attributable to the acquisition of Mobile Government. The additional costs incurred were the result of legal and audit costs surrounding both the acquisition of Mobile Government as well as Public Safety Group. Additionally, the increase was due to an increased workforce in sales and administration functions as well as the associated overhead which results from fully loaded labor charges associated with supporting larger operations. This increase was offset slightly by the elimination of non essential functions done in order to align the business with its revised model of focusing sales through channel partners and creating a model focused on licensing as oppose to integration projects.

Research, development and engineering

	2005	2004	2003	2005-2004		2004-2003	
				$ Chg	% Chg	$ Chg	% Chg
Law Enforcement	$ 3,931,265	$ 1,309,026	$	$ 2,622,239	200%	$ 1,309,026	n/a
Fire Safety	1,207,263	337,310		869,953	258%	337,310	n/a
Biometrics	1,707,507	1,333,568	1,037,330	373,939	28%	296,238	29%
Total	$ 6,846,035	$ 2,979,904	$ 1,037,330	$ 3,866,131	130%	$ 1,942,574	187%

Law Enforcement

R&D costs have increased over 2004 primarily related to the acquisition of Mobile Government in Q3 of 2004. During 2005 the Company spent significant R&D resources in sustaining engineering related to the large customer base as well as developing new version releases that incorporated these changes. While remaining focused on achieving these operational objectives the Company also undertook cost reduction initiatives which resulted in an approximately 25-30% reduction of the fourth quarter 2004 run rate for R&D costs in the Law Enforcement segment.

Fire Safety

R&D costs have increased over 2004 primarily related to the acquisition of Mobile Government in Q3 of 2004. Additionally, subsequent to the acquisition, the company had several engineering initiatives in the Fire segment. As noted above a number of product enhancements were made to functionality across the entire software suite in addition to focused development of the new FireRMS mobile solution delivered to the market mid 2005. While remaining focused on achieving these product

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objectives, in conjunction with the Company wide cost reduction initiatives, Fire Safety was able to realize an approximate reduction of 10% the fourth quarter 2004 run rate for R&D costs.

Biometrics

R&D costs have increased sequentially from 2003 to 2005. This is representative of the increased spending to enhance the interoperability and functionality of the software. The company continues to spend in R&D to enhance the products usability in different markets as well as to develop the product for integration with products from BIO-key's other segments. During 2005, BIO-key released IdentityMatch, a product which integrates BIO-key's advanced biometric offerings with BIO-key's mobile data and fire records management solutions. BIO-key continues to develop further integration of its Biometric software solutions in other products with in Company as well as partnering with other solutions in the marketplace. Additionally, in May of 2005 the Company was awarded a patent for its award-winning leadership Vector Segment fingerprint technology or "Image Identification System."

Other income and expense

				2005-2004		2004-2003	
	2005	2004	2003	$ Chg	% Chg	$ Chg	% Chg
	Restated	Restated	Restated				
Interest expense	$ (4,521,344)	$ (1,415,535)	$ (1,909,788)	$ (3,105,809)	219%	$ 494,253	26%
Ineterest income	35,958	66,824		(30,866)	-46%	66,824	n/a
Gain on sale of marketable securities	(20,000)	33,125		(53,125)	-160%	33,125	n/a
Derivative and warrant fair value adjustments	9,154,951	(3,008,419)	857,545	12,163,370	-404%	(3,865,964)	-451%
Other income (expense)	(34,767)	(88,425)	4,145	53,658	-61%	(92,570)	-2,233%
	$ 4,614,798	$ (4,412,430)	$ (1,048,098)	$ 9,027,228	-205%	$ (3,364,332)	321%

For the year ended December 31, 2005, consolidated interest expense increased $3,105,809 or 219% as compared to 2004, which was attributable to the increase in long term debt from issuance of the 2004 and 2005 Senior and Subordinated notes. For the year ended December 31, 2004, consolidated interest expense increased $494,253 or 26% from 2003.

For the year ended December 31, 2005, consolidated interest income decreased $30,866 or 46% as compared to 2004, which was attributable to the average amount of cash held on hand in interest bearing accounts. For the year ended December 31, 2004, consolidated interest income increased $66,824 as compared to 2003, which was attributable to deposits held in interest bearing accounts in 2004. No deposits were held in interest bearing accounts in 2003.

For the year ended December 31, 2005, derivative and warrant fair value adjustments increased $12,163,370 or 404% as compared to 2004, which was attributable to changes in the fair market value of embedded derivatives and detachable warrants issued with convertible debt. The fair value of the derivatives will fluctuate based on; our stock price at particular points in time, the debt conversion price, the volatility of our stock price over a period of time, changes in the value of the risk free interest rate, and the time to maturity of the outstanding debt at different points in time. The major factor contributing to this change was due to the decline in the market price of our stock from $1.60 as of December 31, 2004 to $.69 as of December 31, 2005. For the year ended December 31, 2004, derivative and warrant fair value adjustments decreased $3,865,964 or 451% as compared to 2003, which was also attributable to changes in the fair value of embedded derivatives and detachable warrants issued with convertible debt. The major factor contributing to the large fluctuation in the fair

value was due to the net increase in the market price of our stock from $1.03 as of September 29, 2004 to $1.60 as of December 31, 2004.

THREE MONTHS ENDED MARCH 31, 2006 AS COMPARED TO THREE MONTHS ENDED MARCH 31, 2005

INTRODUCTION

In the fourth quarter of 2005, the Company restructured its operations into three business segments: Biometrics, Law Enforcement and Fire Safety. Each segment will be headed by a General Manager and organized to quickly respond to market needs as well as to drive down costs to achieve profitability. Management believes that this initiative will lead to increased opportunities throughout 2006 as the General Managers continue to develop their business units. During the first quarter of 2006 the Company continued to stay focused on its objectives of increasing revenue and managing expenses.

Consolidated Results of Operations Percent Trend

	Three Months Ended March 31,	
	2006	2005
	(Restated)	(Restated)
Revenues		
Services	71%	78%
License fees and other	29%	22%
	100%	100%
Costs and other expenses		
Services	21%	21%
Cost of license fees and other	3%	8%
Selling, general and administrative	82%	72%
Research, development and engineering	53%	53%
	159%	154%
Operating loss	-59%	-54%
Other income (deductions)		
Total other income (deductions)	-62%	70%
NET LOSS	-121%	16%

We have three reporting segments: Law Enforcement, Fire Safety and Biometrics. The Law Enforcement and Fire Safety segments were purchased during 2004. In the fourth quarter of 2005 the Company restructured its operations into three business segments, prior to this segmentation of the business, management evaluated the business as one consolidated operation. For presentation and comparability purposes the allocation of costs between segments for prior periods has been estimated.

The Company evaluates performance based on revenues and operating income (loss). Operating income (loss) for each segment includes selling, general and administrative expenses directly attributable to the segment in addition to those allocated as a percentage based on a number of factors including revenue and bookings. The segmentation of operating income as noted above and detailed below reflects how management now evaluates its business. Assets for the company are commingled

and are related to all operating segments. Management does not evaluate or identify the operating assets of the segments separately.

	Three months ended March 31,			
	2006	2005	$ Change	% Change
Revenues				
Law Enforcement				
Service	$ 1,598,559	2,352,776	$ (754,217)	-32%
License & other	426,066	717,734	(291,668)	-41%
	2,024,625	3,070,510	(1,045,885)	-34%
Fire Safety				
Service	631,732	662,228	(30,496)	-5%
License & other	73,400	105,867	(32,467)	-31%
	705,132	768,095	(62,963)	-8%
Biometrics				
Service	16,618	44,850	(28,232)	-63%
License & other	402,816	56,135	346,681	618%
	419,434	100,985	318,449	315%
Total Revenue	$ 3,149,191	$ 3,939,590	$ (790,399)	-20%
Cost of goods sold				
Law Enforcement				
Service	$ 424,929	$ 675,473	$ (250,542)	-37%
License & other	33,087	251,251	(218,163)	-87%
	458,016	926,724	(468,705)	-51%
Fire Safety				
Service	217,415	146,829	70,586	48%
License & other	37,560	55,570	(18,010)	-32%
	254,975	202,399	52,575	26%
Biometrics				
Service	31,159	13,264	17,895	135%
License & other	10,837	21,035	(10,198)	-48%
	41,996	34,299	7,697	22%
Total COGS	$ 754,987	$ 1,163,422	$ (408,434)	-35%

Revenues

Law Enforcement

The decrease in revenue for this segment from 2005 was primarily attributable to a reduction in revenue from longer-term project work of approximately $762,000 as the Company moves to more of a licensing based model.

Fire Safety

The revenue for this segment decreased over the same quarter in the prior year. Although revenue decreased, the company expects future growth in the segment as the market for fire safety products continues to remain strong, and the decrease is mainly attributable to timing of orders being received.

Biometrics

During the first quarter of 2006 the Biometric segment continued to show strong revenue growth. The growth in the current quarter was primarily attributable a large license order from a new customer. The Biometric business continues to gain traction and acceptance in the market place and is pursuing new customers to grow its installed customer base.

Costs of goods sold

Law Enforcement

License and other costs are attributable primarily to revenues derived from product sales for which we are required to pay a royalty. The decrease in cost is primarily driven by the sales mix and is solely dependent specifically on what products were sold.

Due to the change in focus from long-term project revenue to licensing agreements, cost of good sold also decreased as labor costs, both employees' costs are reduced and consultants are eliminated as projects are completed.

Fire Safety

License and other costs are attributable primarily to revenues derived from product sales for which we are required to pay a royalty. The slight decrease in cost is primarily driven by the sales volume in addition to product mix. These costs are solely dependent specifically on what products were sold.

Service costs have increased over the same quarter in the prior year, which is not in line with the slight decrease in revenue for this business segment. This is primarily due to additional resources being allocated to this segment in anticipation of expected growth.

Biometrics

License and other costs are primarily related to the hardware costs related to sales of biometric fingerprint readers. The change in cost of goods sold is directly attributable to the product mix between types of readers sold and the volume of readers sold.

Selling, general and administrative

	Three months ended March 31,			
	2006	**2005**	**$ Change**	**% Change**
Law Enforcement	$ 1,354,772	$ 1,798,673	$ (443,901)	-25%
Fire Safety	700,390	674,599	25,791	4%
Biometrics	521,659	373,351	148,308	40%
Total	$ 2,576,820	$ 2,846,623	$ (269,802)	-9%

SG&A costs are allocated based on a number of factors including revenue and bookings. Changes in SG&A costs between business segments are the result of the change in their respective percentage of BIO-key's total revenue.

The overall decline in total SG&A costs is primarily attributable to the continued focus by management on cost reduction initiatives taken on during 2005 after the acquisitions of Public Safety Group and Aether Mobile Government were completed. Management believes the appropriate resources are in place to support its strategic goals but also continues to analyze the expense structure and continues to explore ways to further reduce costs. These reductions have been offset by additional costs related to reporting and compliance that the Company has experienced due to the restatements of

our previously filed financial statements. The Company expects that these additional costs will continue into the second quarter as our discussions with the SEC continue.

Research, development and engineering

	Three months ended March 31,			
	2006	2005	$ Change	% Change
Law Enforcement	$ 942,150	$ 1,191,587	$ (249,437)	-21%
Fire Safety	334,173	365,928	$ (31,755)	-9%
Biometrics	378,315	517,555	$ (139,239)	-27%
Total	$ 1,654,638	$ 2,075,070	$ (420,431)	-20%

Law Enforcement and Fire Safety

R & D costs have decreased in the first quarter of 2006 as compared to 2005 primarily related to the staff and cost structure reductions undertaken to move the company toward the break-even point while still supporting sales growth.

Biometrics

R & D costs have decreased in the first quarter of 2006 as compared to 2005, however BIO-key continues to develop further integration of its Biometric software solutions in other products with in Company as well as partnering with other solutions in the marketplace.

Other income and expense

	Three months ended March 31,			
	2006	2005	$ Change	% Change
	(Restated)	(Restated)		
Interest income	$	$ 26,062	(26,062)	-100%
Interest expense	(2,066,524)	(834,916)	(1,231,608)	-148%
Loss on sale of marketable securities		(20,000)	20,000	-100%
Loss on extinguishment of debt	(2,322,018)		(2,322,018)	n/a
Derivative and warrant fair value adjustments	2,444,693	3,576,881	(1,132,188)	-32%
Other income (expense)	(15,176)		(15,176)	n/a
Total	$ (1,959,026)	$ 2,748,027	(4,707,053)	-171%

For the quarter ended March 31, 2006, consolidated interest expense increased $1,231,608 or 148% as compared to the same quarter in 2005. The increase was attributable to increases in long term debt, related discount and other debt related instruments. Interest expense includes actual cash paid for interest as well non-cash charges for amortization of debt discounts, and interest expense on the deferred rent obligations. The increase in interest expense was primarily related to the default interest provisions and the liquidating damages provision during 2006 which approximated $234,000 and $315,000, respectively.

For the quarter ended March 31, 2006, consolidated interest income decreased $26,062 or 100% as compared to the same quarter in 2005, which was attributable to the average amount of cash held on hand in interest bearing accounts.

For the quarters ended March 31, 2006 and 2005, derivative and warrant fair value adjustments decreased which was attributable to changes in the fair market value of embedded derivatives and detachable warrants issued with convertible debt. The changes represent non-cash income and expenses charges to the statement of operations. The fair value of the derivatives will fluctuate based on; our stock price on the valuation date, the debt conversion price, the volatility of our stock price over a period of time, changes in the value of the risk free interest rate, and the time to maturity of the outstanding debt at different points in time. Another factor that contributed to the change was the additional derivatives recorded as a result of the May, June and July 2005 and January 2006 debt traunches.

LIQUIDITY AND CAPITAL RESOURCES

OPERATING ACTIVITIES OVERVIEW

YEARS ENDED DECEMBER 31, 2005 AS COMPARED TO DECEMBER 31, 2004 AND DECEMBER 31, 2004 AS COMPARED TO DECEMBER 31, 2003

The net cash used in operating activities during 2005 was $4,513,497, as compared to $5,644,759 and $2,857,145 in 2004 and 2003, respectively. Some of the major drivers of this change are discussed in more detail below.

The Company's income statement includes four non-cash items which made the most significant contributions to the net cash used in operating activities in 2004 and 2005.

The Company issued notes in 2004 and 2005 which contained embedded derivatives. In 2004, the company recorded a loss of approximately $3,008,419 related to the increase in value of the derivatives. The increase in value was caused by the increase in the value of the underlying BIO-key stock. In 2005, the company recorded a gain of approximately $9,154,951 related to the decrease in value of the derivatives. The decrease in value is the result of the decline in value of the underlying BIO-key stock.

A debt discount was recorded when the notes were initially recorded to reflect the FMV of derivatives and warrants related to the debt. The discount is amortized ratably into earnings over the life of the related debt. In 2004 and 2005, the company recorded non-cash interest expense related to the amortization of the debt discount of approximately $757,318 and $2,097,973, respectively.

The Company recorded a $55,150 and $664,043 charge in 2004 and 2005, respectively, for the non-cash expense of issuing options and warrants to non employees for services.

Finally, the Company recorded $550,421 and $1,509,880 in 2004 and 2005, respectively, for the non-cash expense related to the amortization of intangibles assets.

For the year ended December 31, 2005, the Company reported positive cash flows related to a decrease in costs and earnings in excess of billings on uncompleted contracts of $2,468,770. Costs and earnings in excess of billings on uncompleted contracts represent services which have been performed on long term contracts but have not been invoiced at year end due to milestones contained within the contracts. In 2005, the Company was able to bill the customer due to the fact that the milestones have been reached.

The Company experienced positive cash flows of $1,029,404 in 2005 due to increased accrued liabilities related to interest on the 2005 debt as well as contract related costs not being invoiced by vendors. In 2004, the Company experienced positive cash flows of $955,050 related to interest on the 2004 debt as well as liabilities assumed through acquisitions.

The Company also experienced a positive cash flow from an increase of $1,191,958 in deferred revenue from 2004 to 2005 due to customers who had purchased and paid for maintenance agreements which the company had to earn typically over a one year period.

The overall major drivers in operating cash flow are the current operating costs which are greater than the current revenues. The company has experienced improvements related to the ratio of operating expenses to revenues and expects this trend to continue to improve until such time as the Company is able to generate sustained profitability.

THREE MONTHS ENDED MARCH 31, 2006 AS COMPARED TO THREE MONTHS ENDED MARCH 31, 2005

Net cash used in operations during the three months ended March 31, 2006 was approximately $660,000 compared to approximately $419,000 during the three months ended March 31, 2005. The primary use of cash for both years was to fund the net loss. Net cash used in investing activities for the three months ended March 31, 2006 was approximately $24,000 compared to net cash provided by investing activities of approximately $957,000 for the corresponding period in 2005. The 2006 amount consisted of capital expenditures of approximately $14,000 and expenditures for patents of $10,000. The 2005 amount consisted of approximately $980,000 from sale of marketable securities and $50,000 in proceeds from the sale of a trademark. These amounts were partially offset by fixed asset purchases of approximately $73,000. Net cash provided by financing activities during the three months ended March 31, 2006 was approximately $855,000 compared to net cash used in financing activities of approximately $123,000 in the corresponding period in 2005. The 2006 amount included debt proceeds of $988,000 offset by $80,000 of debt repayments and $53,000 for costs to issue the new debt. The 2005 amount included debt repayments of approximately $738,000, which were partially offset by approximately $528,000 in proceeds from warrant and option exercises.

Working capital deficit at March 31, 2006 was approximately $9,739,594 as compared to a deficit of approximately $8,951,539 at December 31, 2005.

FINANCING ACTIVITIES OVERVIEW

Financing Activities

2005 Senior and Subordinated Term Notes

On June 8, 2005, we entered into a Securities Purchase Agreement (the "Senior Purchase Agreement") with an institutional investor. Under the Senior Purchase Agreement, the Company issued a Secured Convertible Term Note (the "Senior Convertible Note") in the aggregate principal amount of $2,000,000, convertible into Common Stock of the Company in certain circumstances at $0.85 per share, and issued a warrant (the "Senior Warrant") to purchase an aggregate of 444,444 shares of the Common Stock at a per share exercise price of $1.00. The aggregate consideration received by the Company, net of all fees and expenses, for the Senior Convertible Note and the Senior Warrant was approximately $1,841,000. The proceeds from this transaction are to be used for working capital purposes. The Company's obligations under the Senior Purchase Agreement and the Senior Convertible Notes are secured by a security interest in all or substantially all of the Company's assets.

Under the terms of the Senior Convertible Note, we are required to make monthly payments of accrued interest only beginning on July 1, 2005. In addition, the Senior Convertible Note provides for monthly payments of principal in equal $^{1}/_{32}$ increments thereof, plus accrued interest, commencing October 1, 2005.

We entered into a Securities Purchase Agreement, effective as of May 31, 2005, (the "Subordinated Purchase Agreement") with existing shareholders of the Company and other accredited investors (collectively, the "Subordinated Investors"). Under the Subordinated Purchase Agreement, the

Company issued Convertible Term Notes (the "Subordinated Convertible Notes") in the aggregate principal amount of $2,794,723, respectively convertible into Common Stock of the Company in certain circumstances at $0.70 per share, and issued warrants (the "Subordinated Warrants") to purchase an aggregate of 828,066 shares of the Common Stock at a per share exercise price of $1.00. The aggregate consideration received by the Company, net of all fees and expenses, for such Subordinated Convertible Notes and Subordinated Warrants was approximately $2,411,000. The proceeds from this transaction are to be used for working capital purposes. The Subordinated Convertible Notes were issued at a purchase price equal to $900 for each $1,000 of principal amount of the Note.

Certain Subordinated Investors purchased additional Subordinated Convertible Notes in the aggregate principal amount of $450,000 and received additional Subordinated Warrants to purchase an aggregate of 133,333 shares of Common Stock at a per share exercise price of $1.00. The aggregate consideration received by the Company net of all fees and expenses for such Subordinated Convertible Notes and Subordinated Warrants was $404,500, which was paid by the Subordinated Investors on July 8, 2005.

Under the terms of the Subordinated Convertible Notes, we are required to make quarterly payments of accrued interest only beginning on September 1, 2005. In addition, the Subordinated Convertible Notes provide for quarterly payments of principal in equal increments thereof, plus accrued interest, commencing September 1, 2006 through May 31, 2008, which payments may be made in shares of common stock at the option of each note holder.

2005 Amendment and Waivers

The Company entered into an Amendment and Waiver with Laurus, dated as of August 31, 2005, pursuant to which the Company was permitted to defer the payment of the monthly principal amounts due and payable for the months of September, October, November and December 2005 under both (a) the Secured Convertible Term Note in the original principal amount of $5,000,000 issued by the Company to Laurus on September 29, 2004 (the "September 2004 Note"), and (b) the Secured Convertible Term Note in the original principal amount of $2,000,000 issued by the Company to Laurus on June 8, 2005 (the "June 2005 Note"), such aggregate deferred principal amounts being equal to $625,000 and $187,500, respectively. The deferred principal amount under the September 2004 Note is now due on September 29, 2007, the maturity date of that note, and will be paid at the same time the final payments due with respect to that note upon maturity. The deferred principal amount under the June 2005 Note is now due on June 7, 2008, the maturity date of that note, and will be paid at the same time the final payments due with respect to that note upon maturity. The Company will remain obligated to pay all monthly interest amounts under these notes as they are currently due.

The Company also entered into Amendment and Waivers, dated as of August 31, 2005, pursuant to which certain Subordinated Investors allowed the Company to defer the payment of the monthly principal amounts due and payable for the months of September, October, November and December 2005 under the Convertible Term Notes in the aggregate original principal amount of $2,800,000 issued by the Company to the Subordinated Investors on September 29, 2004 (the "Subordinated Notes"), such aggregate deferred principal amount being equal to $350,004. The deferred principal amount under each Subordinated Note is now due on September 29, 2007, the maturity date of each such note, and will be paid at the same time the final payments due with respect to each such note upon maturity. The Company will remain obligated to pay all monthly interest amounts under these notes as they are currently due.

2006 Amendment and Waivers

The Company entered into an Amendment No. 1 to its Subordinated Secured Promissory Note, dated as of January 23, 2006, with Aether Systems, Inc. Pursuant to the Aether Note Amendment, the

Subordinated Secured Promissory Note issued by the Company to Aether on September 30, 2004 in the aggregate maximum principal amount of $6,884,588 was amended to increase such aggregate maximum principal amount to $7,884,588.

The Company entered into a Securities Purchase Agreement, effective as of January 23, 2006, with The Shaar Fund, Ltd., Longview Fund, L.P. and Longview Special Finance. Under the Securities Purchase Agreement, the Company issued to the Purchasers Convertible Term Notes in the aggregate principal amount of $1,000,000. The Convertible Notes converted into shares of the Series B Preferred Stock of the Company, which shares are convertible into shares of the Common Stock of the Company at an initial fixed conversion price of $0.70 per share.

Effective as of January 23, 2006, BIO-key International, Inc. entered into an Amendment and Waiver with Laurus Master Fund Ltd. in connection with the Secured Convertible Notes currently held by Laurus. Under the Secured Notes Amendment and Waiver, the Secured Notes issued by the Company to Laurus on September 29, 2004 in the aggregate principal amount of $5,000,000 and on June 8, 2008 in the aggregate principal amount of $2,000,000 were amended as follows: (i) the maturity date of the September 2004 Note was extended to January 1, 2008; (ii) the maturity date of the June 2005 Note was extended to December 1, 2008, and (iii) the fixed conversion price under each of the Secured Notes was reset from $1.35 to $0.85 per share. In addition, the exercise price of all warrants to purchase Common Stock of the Company held by Laurus was reset to $1.00 per share.

Effective as of January 23, 2006, the Company also entered into an Amendment and Waiver with certain holders of its Subordinated Convertible Promissory Notes. Under the Subordinated Notes Amendment and Waiver, the Subordinated Notes issued by the Company on September 29, 2004 in the aggregate principal amount of $5,288,221 and on May 31, 2005 in the aggregate principal amount of $3,244,723 were amended as follows: (i) the maturity dates were extended from September 29,2007 and May 31, 2008, respectively, to January 1, 2009; (ii) the interest rate was fixed at fifteen percent (15%); (iii) all principal amounts are due at the maturity date and shall be paid in shares of Common Stock priced at $0.70 per share if the average closing price of the Common Stock for the thirty (30) trading days immediately preceding the maturity date is greater than $1.10; (iv) interest shall be paid, at the Company's election, in cash or shares of Common Stock, with the Common Stock priced at the average closing price of the Common Stock for the ten (10) trading days immediately preceding the repayment date; and (v) the currently applicable fixed conversion price was amended to $0.70 per share. In addition, the exercise price of all warrants to purchase Common Stock held by the Subordinated Note Holders that currently have an exercise price greater than $1.00 per share was reset to $1.00 per share. In connection with this financing, we also reduced the conversion price of the Series A convertible Preferred shares held by the Shaar Fund Ltd. to $0.70 per share.

Liquidity outlook

At March 31, 2006 our total of cash and cash equivalents was $1,594,641, as compared to $1,422,827 at December 31, 2005. As discussed above, the Company has financed itself through access to the capital markets by issuing debt securities, convertible preferred stock and common stock.

As of May 17, 2006, we had cash resources of approximately $1,200,000 and $11,127,000 of convertible debt remaining as described in the "Long-Term Obligations" footnote of this report. We currently require approximately $1,700,000 per month to conduct our operations. During the first quarter of 2006, we generated approximately $3,149,000 of revenue and expect to increase quarterly revenue in 2006.

The Company has undertaken strategic steps to position itself to realize positive cash flows from operations in the future by increasing revenues and better managing expenses. These steps include the acquisition of two enterprises in 2004. Although the acquisitions inherently produced a greater demand for cash than we would have liked, we are confident that many of the initial costs are isolated in nature

and will not be recurring year after year. The Company has also taken strategic steps to downsize the workforce in areas that we felt were either nonessential or not in line with where we wanted the Company to develop in the near future. The Company has also recently experienced additional costs associated with various compliance related activities.

We may need to obtain additional funding to (i) conduct the sales, marketing and technical support necessary to execute our plan to substantially grow operations, increase revenue and serve a significant customer base; and (ii) provide working capital. Due to, among other factors, our history of losses and limited revenue, our independent auditors have included an explanatory paragraph in their opinion for the year ended December 31, 2005 as to the substantial doubt about our ability to continue as a going concern. Our long-term viability and growth will depend upon the successful commercialization of our technologies and our ability to obtain adequate financing. To the extent that we require such additional financing, no assurance can be given that any form of additional financing will be available on terms acceptable to us, that adequate financing will be obtained to meet our needs, or that such financing would not be dilutive to existing stockholders. If available financing is insufficient or unavailable or we fail to continue to generate meaningful revenue, we may be required to further reduce operating expenses, delay the expansion of operations, or be unable to pursue merger or acquisition candidates.

CONTRACTUAL OBLIGATIONS

We have various contractual obligations impacting our liquidity. The following represents some of our contractual obligations as of December 31, 2005:

	Total	2006	2007	2008	2009
Non-cancelable operating leases	$ 3,427,000	$ 1,260,000	$ 1,278,000	$ 866,000	$ 23,000
Senior secured convertible term notes	5,599,999	1,524,211	3,048,421	1,027,367	
Subordinated unsecured convertible term notes	5,677,028	18,750	14,063		5,644,215
Total	$ 14,704,027	$ 2,802,961	$ 4,340,484	$ 1,893,367	$ 5,667,215

The Company does not own any real estate but conducts operations from four leased premises. These non-cancelable operating leases expire a various dates through 2009. In addition to base rent, the Company pays for property taxes, maintenance, insurance and other occupancy expenses according to the terms of the individual leases.

RESTATEMENT

In the process of reviewing our registration statement for the securities issued in our June 2005 financing, the staff of the Securities and Exchange Commission ("SEC") raised questions with regard to our convertible term notes suggesting that we consider EITF 00-19 "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock" to evaluate whether there were any embedded derivative instruments and if so, whether they should be accounted for as an equity or liability classification. The SEC staff suggested that we review the methodology used in the valuations of the embedded derivative instruments and also review whether warrants issued with our 2004 financing should be accounted for as an equity or liability classification. The SEC staff also commented that the Company should review the convertible notes issued in fiscal 2003 and 2004. The SEC staff also asked us to review adjustments to revenue made in the fourth quarter of 2004. The SEC staff raised the question of whether the transactions had a material impact on previously filed Exchange Act reports and would be better characterized as restatements. Further, the Company recalculated the convertible preferred stock dividends and accretion including the accrued but unpaid dividends in accordance with FAS 128 *Earnings per Share.*

There were several items that were identified as requiring restatement, these items were:

Revenue Recognition
The Company reviewed contracts and purchase agreements related to certain non-governmental customers and identified specific contracts for which the initial accounting inflated annual and quarterly revenues and earnings in violation of generally accepted accounting principles ("GAAP"). These practices were primarily the result of recognizing revenue on transactions with customers that were not creditworthy and recognizing revenue when the earnings process had not been completed. The revenue and related cost has been adjusted on the income statement as well as the related balance sheet accounts.

Accounting for Convertible Financing Arrangements
The Company reviewed the initial accounting for the 7% Convertible Notes issued in 2003, the Senior and Subordinated Convertible Term Notes issued in 2004 and the Senior and Subordinated Convertible Term Notes issued in 2005. During the review the company identified that EITF 00-19 should be applied to evaluate whether any embedded derivative instruments qualify as equity instruments or as liabilities. As such certain embedded derivatives were identified that met the conditions set forth under paragraph 12 of SFAS No. 133. These embedded derivative instruments have been evaluated using EITF 00-19 paragraphs 12 to 32 and determined that these instruments would not be classified as components of stockholders equity. The instruments have been deemed liabilities, and as such will be subject to SFAS 133 and should be recorded at fair value. Features that have been evaluated and determined to require such treatment include:

The principal conversion option

The monthly payments conversion option

The interest rate adjustment provisions.

Additionally, it was identified that certain other components of the related financings were also incorrectly accounted for. This includes the warrants issued with the above financing and the costs incurred by Company in obtaining the above financings. The correction of prior errors affected the subsequent accounting for debt conversions to equity as well as the amortization of related discounts and deferred finance charges associated with the above financings.

Accounting for Warrants Related to the Companies 2004 Debt Financing

Based on certain registration rights provisions it was determined that the warrants issued with the 2004 Debt Financing would require continued classification as a liability and revalued every quarter. The Company previously classified the warrants as equity upon the registration rights agreement becoming effective during the fourth quarter of 2004.

Valuations of Embedded Derivatives

The initial valuation methodology overstated the value of the conversion option derivatives. The company's review of the valuations of the embedded derivatives determined that the valuation of the principal conversion option and the monthly payments conversion option shared certain components that resulted in a double counting of the embedded derivative valuation. As such the company has adjusted its valuations of these embedded derivatives.

Additional Derivative (Default Provision)

The company also reviewed the default provisions set forth in the debt instruments and determined that an additional embedded derivative existed that required bifurcation from the host contract and would need to be revalued on a quarterly basis.

The Company reviewed the earnout calculations performed in the prior year for the PSG acquisition and identified an error in the calculation. As a result the Company has restated the prior year's impact relating to this error. At December 31, 2004 the Company had accrued $43,635 for the earnout provision. The corrected calculation resulted in no accrual being required, and as such the related accrual and goodwill balances have been reduced by $43,635.

Management believes the scope and process of its internal review of previously reported financial information was sufficient to identify issues of a material nature that could affect our Consolidated Financial Statements and all dates and periods presented herein have been restated to fairly present the results of our operations.

The errors in our previously reported financial information, and the failure to prevent them or detect them in our financial reporting process, were largely attributable to weak internal controls, an inadequate staff of competent accounting personnel with an appropriate level of knowledge of GAAP and to errors in the valuations of the previously identified embedded derivatives.

As a result of our review and communications with the SEC, we determined that a restatement of previously reported financial information was required. Our previously reported financial information should no longer be relied upon. Accordingly, we have restated our previously reported financial information for the years ended December 31, 2003 and 2004 and our previously reported unaudited financial statements for the first, second and third quarters of 2003, 2004 and 2005 (the "restatement"). The restatement covers a number of separate matters, each of which is described above.

For the quarterly impact of the restatement and the restated financial results for the first, second and third quarters of 2003, 2004 and 2005 see Note X, Results by Quarter in the Notes to the Financial Statements on Page F-7.

In the process of reviewing our Form 10-QSB for the three months ended March 31, 2006 filed on May 22, 2006, the Securities and Exchange Commission ("SEC") raised questions with regard to our mandatorily redeemable preferred stock. Specifically, the SEC suggested that we review the classification as permanent equity, a liability or mezzanine equity, and that the preferred stock contained derivatives that needed to be reported separately. After further review of EITF 96-19 and related guidance, the Company determined that additional items need to be expensed as part of the debt extinguishment loss. Additionally, the Company has made several other changes. For the impact of the restatement and the restated results for the quarter ended March 31, 2006, see the Financial Statements at page F-100.

The following tables summarize the impact of all of these adjustments on previously reported revenue and assets, liabilities, and stockholders' equity (deficit) for the years ended December 31, 2005, 2004 and 2003.

	Impact of Adjustments on Revenue For the Years Ended December 31,		
	2005	2004	2003
As previously reported	$ 14,226,095	$ 5,558,231	$ 524,101
Revenue recognition		162,720	(308,620)
As restated	$ 14,226,095	$ 5,720,951	$ 215,481

	Impact of Adjustments on Consolidated Balance Sheet Accounts As of December 31, 2005		
	Total Assets	Liabilities	Stockholders' Equity (Deficit)
As previously reported	$ 26,357,934	$ 17,050,206	$ 9,307,728
Revenue recognition and related SG&A expense			
Debt financing		3,143,724	(3,143,724)
Total Adjustments		3,143,724	(3,143,724)
As restated	$ 26,357,934	$ 20,193,930	$ 6,164,004

	Impact of Adjustments on Consolidated Balance Sheet Accounts					
	As of December 31, 2004			As of December 31, 2003		
	Total Assets	Liabilities	Stockholders' Equity (Deficit)	Total Assets	Total Liabilities	Stockholders' Equity (Deficit)
As previously reported	$ 30,844,681	$ 20,223,283	$ 10,621,398	$ 1,864,742	$ 11,000,731	$ (9,135,989)
Revenue recognition and related SG&A expense	(122,090)	23,810	(145,900)	(308,620)	(18,200)	(290,420)
Debt financing	816,501	4,742,344	(3,925,843)		(57,543)	57,543
Total Adjustments	694,411	4,766,154	(4,071,743)	(308,620)	(75,743)	(232,877)
As restated	$ 31,539,092	$ 24,989,437	$ 6,549,655	$ 1,556,122	$ 10,924,988	$ (9,368,866)

The following tables present the effect of the restatement adjustments on the consolidated Statement of Operations for the years ended December 31, 2005, 2004 and 2003.

	Year Ended December 31, 2005		
	As Previously Reported	Effect of Restatement	As Restated
Revenues			
Services	$ 10,861,649	$	$ 10,861,649
License fees and other	3,364,446		3,364,446
	14,226,095		14,226,095
Costs and other expenses			
Services	2,906,142		2,906,142
Cost of license fees and other	937,491		937,491
Selling, general and administrative	11,824,609		11,824,609
Research, development and engineering	6,846,035		6,846,035
	22,514,277		22,514,277
Operating loss	(8,288,182)		(8,288,182)
Other income (deductions)			
Interest income	35,958		35,958
Interest expense	(6,548,130)	2,026,786	(4,521,344)
Derivative and warrant fair value adjustments	15,213,186	(6,058,235)	9,154,951
Loss on sale of marketable securities	(20,000)		(20,000)
Other expense	(34,767)		(34,767)
Total other income (deductions)	8,646,247	(4,031,449)	4,614,798
NET INCOME (LOSS)	$ 358,065	$ (4,031,449)	$ (3,673,384)
Basic Loss per Share:			
Numerator			
Net loss	$ 358,065	$ (4,031,449)	$ (3,673,384)
Convertible preferred stock dividends and accretion	(313,517)		(313,517)
Net Income (Loss) attributable to common shareholders	$ 44,548	$ (4,031,449)	$ (3,986,901)
Denominator			
Weighted average common shares outstanding	44,787,807	44,787,807	44,787,807
Basic Loss per Share	$ 0.00	$ (0.09)	$ (0.09)
Diluted Loss per Share:			
Numerator			
Net Income (loss) attributable to common shareholders	$ 44,548	$ (4,031,449)	$ (3,986,901)
Effect of Dilutive Securities: Convertible Debentures	(8,795,834)	6,758,889	(2,036,945)

	Year Ended December 31, 2005		
Net loss attributable to common shareholders and assumed conversions	$ (8,751,286)	$ 2,727,440	$ (6,023,846)
Denominator			
Weighted average shares outstanding	44,787,807		44,787,807
Effect of Dilutive Securities: Convertible Debentures	7,258,496		7,258,496
Diluted weighted average common shares and common equivalents outstanding	52,046,303	52,046,303	52,046,303
Diluted Loss per Share	$ (0.17)	$ 0.05	$ (0.12)

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	Year Ended December 31, 2004		
	As Previously Reported	Effect of Restatement	As Restated
Revenues			
Services	$ 3,351,406	$	$ 3,351,406
License fees and other	2,206,825	162,720	2,369,545
	5,558,231	162,720	5,720,951
Costs and other expenses			
Services	1,174,324		1,174,324
Cost of license fees and other	889,896		889,896
Selling, general and administrative	7,096,088	18,200	7,114,288
Research, development and engineering	2,979,904		2,979,904
	12,140,212	18,200	12,158,412
Operating loss	(6,581,981)	144,520	(6,437,461)
Other income (deductions)			
Interest income	66,824		66,824
Interest expense	(667,008)	(748,527)	(1,415,535)
Derivative and warrant fair value adjustments		(3,008,419)	(3,008,419)
Other expense	(55,300)		(55,300)
Total other income (deductions)	(655,484)	(3,756,946)	(4,412,430)
NET LOSS	$ (7,237,465)	$ (3,612,426)	$ (10,849,891)
Basic Loss per Share:			
Numerator			
Net loss	$ (7,237,465)	$ (3,612,426)	$ (10,849,891)
Convertible preferred stock dividends and accretion	(414,240)	28,885	(385,355)
Net Loss attributable to common shareholders	$ (7,651,705)	$ (3,583,541)	$ (11,235,246)
Denominator			
Weighted average common shares outstanding	34,806,201	34,806,201	34,806,201
Basic Loss per Share	$ (0.22)	$ (0.10)	$ (0.32)
Diluted Loss per Share:			
Numerator			
Net loss attributable to common shareholders	$ (7,651,705)	$ (3,583,541)	$ (11,235,246)
Effect of Dilutive Securities: Convertible Debentures			
Net loss attributable to common shareholders and assumed conversions	$ (7,651,705)	$ (3,583,541)	$ (11,235,246)

	Year Ended December 31, 2004		
Denominator			
Weighted average shares outstanding	34,806,201	34,806,201	34,806,201
Effect of Dilutive Securities: Convertible Debentures			
Diluted weighted average common shares and common equivalents outstanding	34,806,201	34,806,201	34,806,201
Diluted Loss per Share	$ (0.22)	$ (0.10)	$ (0.32)

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	Year Ended December 31, 2003		
	As Previously Reported	Effect of Restatement	As Restated
Revenues			
Services	$ 10,694	$	$ 10,694
License fees and other	513,407	(308,620)	204,787
	524,101	(308,620)	215,481
Costs and other expenses			
Cost of services	1,694		1,694
Cost of license fees and other	87,387		87,387
Selling, general and administrative	2,118,122	(18,200)	2,099,922
Research, development and engineering	1,037,330		1,037,330
	3,244,533	(18,200)	3,226,333
Operating loss	(2,720,432)	(290,420)	(3,010,852)
Other income (deductions)			
Interest expense	(1,109,786)	(800,002)	(1,909,788)
Derivative and warrant fair value adjustments		857,545	857,545
Other income	4,145		4,145
Total other income (deductions)	(1,105,641)	57,543	(1,048,098)
NET LOSS	$ (3,826,073)	$ (232,877)	$ (4,058,950)
Basic Loss per Share:			
Numerator			
Net loss	$ (3,826,073)	$ (232,877)	$ (4,058,950)
Convertible preferred stock dividends and accretion	(136,755)		(136,755)
Net loss attributable to common shareholders	$ (3,962,828)	$ (232,877)	$ (4,195,705)
Denominator			
Weighted average common shares outstanding	17,543,586	17,543,586	17,543,586
Basic Loss per Share	$ (0.23)	$ (0.01)	$ (0.24)
Diluted Loss per Share:			
Numerator			
Net loss attributable to common shareholders	$ (3,962,828)	$ (232,877)	$ (4,195,705)
Effect of Dilutive Securities: Convertible Debentures			
Net loss attributable to common shareholders and assumed conversions	$ (3,962,828)	$ (232,877)	$ (4,195,705)
Denominator			
Weighted average shares outstanding	17,543,586	17,543,586	17,543,586

	Year Ended December 31, 2003		
Effect of Dilutive Securities: Convertible Debentures			
Diluted weighted average common shares and common equivalents outstanding	17,543,586	17,543,586	17,543,586
Diluted Loss per Share	$ (0.23)	$ (0.01)	$ (0.24)

The following tables present the effect of the restatement adjustments on the Consolidated Balance Sheet as of December 31, 2005, 2004 and 2003.

CONSOLIDATED BALANCE SHEET

	As of December 31, 2005		
	As Previously Reported	**Effect of Restatement**	**As Restated**
ASSETS			
Cash and cash equivalents	$ 1,422,827	$	$ 1,422,827
Receivables			
Billed less allowance for doubtful receivables as of $160,000	1,635,371		1,635,371
Unbilled	201,942		201,942
Costs and earnings in excess of billings on uncompleted contracts	4,321,392		4,321,392
Inventory	8,760		8,760
Prepaid expenses	137,000		137,000
Total current assets	7,727,292		7,727,292
Equipment and leasehold improvements, net	548,267		548,267
Deposits	1,828,560		1,828,560
Intangible assets less accumulated amortization	3,301,823		3,301,823
Deferred financing costs, net	1,562,338		1,562,338
Goodwill	11,389,654		11,389,654
Total non-current assets	18,630,642		18,630,642
TOTAL ASSETS	$ 26,357,934	$	$ 26,357,934
LIABILITIES			
Current maturities of long-term obligations	$ 4,924,224	$ 3,143,724	$ 8,067,948
Accounts payable	833,608		833,608
Billing in excess of costs and earnings on uncompleted contracts	32,385		32,385
Accrued liabilities	5,520,515		5,520,515
Deferred rent	443,603		443,603
Deferred revenue	3,264,283		3,264,283
Total current liabilities	15,018,618	3,143,724	18,162,342
Long-term obligations, net of discount and current maturities			
Deferred rent	867,850		867,850
Deferred revenue	1,163,738		1,163,738
Total non-current liabilities	2,031,588		2,031,588
TOTAL LIABILITIES	17,050,206	3,143,724	20,193,930
STOCKHOLDERS' EQUITY (DEFICIT)			
Preferred stock-authorized, 5,000,000 shares (liquidation preference of $100 per share) Series A 7% Convertible; issued and outstanding, 44,557 shares of $.0001 par value	4		4

	As of December 31, 2005		
Common stock-authorized, 85,000,000 shares, 46,306,589 issued and outstanding of $.0001 par value	4,632		4,632
Additional paid-in capital	51,529,332	(2,608,016)	48,921,316
Accumulated deficit	(42,226,240)	(535,708)	(42,761,948)
TOTAL STOCKHOLDERS' EQUITY (DEFICIT)	9,307,728	(3,143,724)	6,164,004
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)	$ 26,357,934	$	$ 26,357,934

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CONSOLIDATED BALANCE SHEET

	As of December 31, 2004		
	As Previously Reported	Effect of Restatement	As Restated
ASSETS			
Cash and cash equivalents	$ 956,230	$	$ 956,230
Marketable debt securities	1,000,000		1,000,000
Receivables			
Billed less allowance for doubtful receivables as of $422,393	1,698,144	(90,090)	1,608,054
Unbilled	310,523		310,523
Due from selling stockholders and other	60,793	(32,000)	28,793
Costs and earnings in excess of billings on uncompleted contracts	6,292,603		6,292,603
Inventory	29,599		29,599
Prepaid expenses	113,130		113,130
Total current assets	10,461,022	(122,090)	10,338,932
Equipment and leasehold improvements, net	644,101		644,101
Costs and earnings in excess of billings on uncompleted contracts	657,000		657,000
Deposits	2,838,031		2,838,031
Intangible assets less accumulated amortization	4,177,279	(77,982)	4,099,297
Deferred financing costs, net		938,118	938,118
Goodwill	12,067,248	(43,635)	12,023,613
Total non-current assets	20,383,659	816,501	21,200,160
TOTAL ASSETS	$ 30,844,681	$ 694,411	$ 31,539,092
LIABILITIES			
Current maturities of long-term obligations	$ 3,255,182	$ (192,460)	$ 3,062,722
Advances from stockholders	12,753		12,753
Accounts payable	1,325,282	23,810	1,349,092
Billing in excess of costs and earnings on uncompleted contracts	760,807		760,807
Accrued liabilities	4,639,619	(43,635)	4,595,984
Deferred rent	393,676		393,676
Deferred revenue	3,166,356		3,166,356
Total current liabilities	13,553,675	(212,285)	13,341,390
Long-term obligations, net of discount and current maturities	5,286,951	4,978,439	10,265,390
Deferred rent	1,311,454		1,311,454
Deferred revenue	71,203		71,203
Total non-current liabilities	6,669,608	4,978,439	11,648,047
TOTAL LIABILITIES	20,223,283	4,766,154	24,989,437
STOCKHOLDERS' EQUITY (DEFICIT)			
Preferred stock-authorized, 5,000,000 shares (liquidation preference of $100 per share) Series C 7% Convertible; issued and outstanding, 62,182 shares of $.01 par value	623		623

	As of December 31, 2004		
Common stock-authorized, 85,000,000 shares, 40,680,691 issued and outstanding of $.01 par value	406,808		406,808
Additional paid-in capital	45,325,172	(226,441)	45,098,731
Accumulated deficit	(35,111,205)	(3,845,302)	(38,956,507)
TOTAL STOCKHOLDERS' EQUITY (DEFICIT)	10,621,398	(4,071,743)	6,549,655
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)	$ 30,844,681	$ 694,411	$ 31,539,092

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CONSOLIDATED BALANCE SHEET

	As of December 31, 2003		
	As Previously Reported	Effect of Restatement	As Restated
ASSETS:			
Cash and cash equivalents	$ 1,012,790	$	$ 1,012,790
Receivables billed	409,803	(308,620)	101,183
Inventory	65,857		65,857
Prepaid expenses	165,929		165,929
Total current assets	1,654,379	(308,620)	1,345,759
Equipment and leasehold improvements, net	60,157		60,157
Intangible assets less accumulated amortization	68,306		68,306
Deferred financing costs, net	81,900		81,900
Total non-current assets	210,363		210,363
TOTAL ASSETS	$ 1,864,742	$ (308,620)	$ 1,556,122
LIABILITIES:			
Advances from stockholders	$ 34,030	$	$ 34,030
Accounts payable	351,742		351,742
Accrued liabilities	173,736	(18,200)	155,536
Deferred revenue	10,000		10,000
Total current liabilities	569,508	(18,200)	551,308
Long-term obligations, net of discount and current maturities	10,431,223	(57,543)	10,373,680
Total non-current liabilities	10,431,223	(57,543)	10,373,680
TOTAL LIABILITIES	11,000,731	(75,743)	10,924,988
STOCKHOLDERS' EQUITY (DEFICIT)			
Preferred stock-authorized, 5,000,000 shares (liquidation preference of $100 per share) Series B 9% Convertible; issued and outstanding, 4,180 shares of $.01 par value	42		42
Common stock-authorized, 85,000,000 shares, issued and outstanding 21,222,990 of $.01 par value	212,229		212,229
Additional paid-in capital	18,327,992		18,327,992
Accumulated deficit	(27,676,252)	(232,877)	(27,909,129)
TOTAL STOCKHOLDERS' EQUITY (DEFICIT)	(9,135,989)	(232,877)	(9,368,866)
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)	$ 1,864,742	$ (308,620)	$ 1,556,122

CRITICAL ACCOUNTING POLICIES

1. *Basis of Consolidation*

The accompanying consolidated financial statements include the accounts of BIO-key International, Inc. and its wholly owned subsidiary (collectively, the Company) and are stated in conformity with accounting principles generally accepted in the United States, pursuant to the rules and regulations of the Securities and Exchange Commission. Intercompany accounts and transactions have been eliminated in consolidation.

2. *Revenue Recognition*

Revenues from software licensing are recognized in accordance with Statement of Position (SOP) No. 97-2, Software Revenue Recognition, as amended by SOP No. 98-9. Accordingly, revenue from software licensing is recognized when all of the following criteria are met: persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collectability is probable.

The Company intends to enter into arrangements with end users for items which may include software license fees, usage fees and services or various combinations thereof. For each arrangement, revenues will be recognized when evidence of an agreement has been documented, the fees are fixed or determinable, collection of fees is probable, delivery of the product has occurred and no other significant obligations remain.

Multiple-Element Arrangements: For multiple-element arrangements, each element of the arrangement will be analyzed and the Company will allocate a portion of the total fee under the arrangement to the elements using vendor specific objective evidence of fair value of the element, regardless of any separate prices stated within the contract for each element. Vendor specific objective evidence is based on the price the customer is required to pay when the element is sold separately (i.e., software license fees charged when consulting or other services are not provided, hourly rates charged for consulting services when sold separately from a software license or usage fees). If vendor specific objective evidence of fair value does not exist for any undelivered elements, all revenue is deferred and recognized ratably over the service period if the undelivered element is services, or until sufficient objective evidence of fair value exists or all elements have been delivered.

License Revenues: Amounts allocated to license revenues are recognized at the time of delivery of the software and all other revenue recognition criteria discussed above have been met.

Revenue from licensing software, which requires significant customization and modification, is recognized using the percentage of completion method, based on the hours of effort incurred by the company in relation to the total estimated hours to complete. In instances where third party hardware, software or services form a significant portion of a customer's contract, the company recognizes revenue for the element of software customization by the percentage of completion method described above. Third party hardware, software, and services are recognized upon shipment or acceptance as appropriate. If the company makes different judgments or utilizes different estimates of the total amount of work expected to be required to customize or modify the software, the timing and revenue recognition, from period to period, and the margins on the project in the reporting period, may differ materially from amounts reported. Revenues earned but not yet billed are shown as an asset in Costs and Earnings in Excess of Billings in the balance sheet. Billings in excess of cost and earnings are reflected as a liability in the balance sheet. Anticipated contract losses are recognized as soon as they become known and are estimable.

Service Revenues: Revenues from services are comprised of maintenance and consulting and implementation services. Maintenance revenues include providing for unspecified when-and-if available product updates and customer telephone support services, and are recognized ratably over the term of

the service period. Consulting services are generally sold on a time-and-materials basis and include a range of services including installation of software and assisting in the design of interfaces to allow the software to operate in customized environments. Services are generally separable from other elements under the arrangement since performance of the services are not essential to the functionality of any other element of the transaction and are described in the contract such that the total price of the arrangement would be expected to vary as the result of the inclusion or exclusion of the services. Revenues from services are generally recognized as the services are performed.

Usage Fees: Usage fees are charged on certain applications based on the customer's volume of use. Usage revenue is recognized based on the actual level of activity used by the customer or, in the case of fixed-fee arrangements, ratably over the arranged time period.

The Company provides customers, free of charge or at a minimal cost, testing kits which potential licensing customers may use to test compatibility/acceptance of the Company's technology with the customer's intended applications.

3. *Accounting for Acquisitions*

We have completed our acquisitions of PSG and AMG. These acquisitions have been accounted for under the purchase method of accounting, which has resulted in recording significant goodwill and other intangible asset balances. The purchase prices have been allocated to assets acquired and liabilities assumed at their estimated fair values on the date of the acquisitions, as determined by management, and by appraisals with respect to identifiable intangible assets. Our accounting for these acquisitions involves significant judgments and estimates regarding fair values of acquired intangible assets, which are based on projections of future revenues and cash flows, assumptions regarding discount factors, royalty rates, tax rates, amortization methodologies and related useful lives. The developed technology (software), copyrighted software, marketing agreements, customer relationships and trademarks were valued using the income approach and are being amortized on a straight line basis over their estimated useful lives, which range from 5 to 7 years.

4. *Marketable Debt Securities*

The Company accounts for marketable securities pursuant to Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities" ("SFAS 115"). SFAS 115 requires classification of debt and equity securities in three categories: trading securities, available-for-sale securities and held-to-maturity securities. Debt and equity securities classified as trading securities are carried at fair value with unrealized gains or losses included in income. Debt and equity securities designated as available-for-sale, whose fair values are readily determinable, are carried at fair value with unrealized gains or losses included as a component of accumulated other comprehensive income, net of applicable taxes. Debt securities that are expected to be held-to-maturity are carried at amortized cost. On December 31, 2004, the Company's investments were all classified as available-for-sale. In January 2005 the Company sold these investments and did not purchase any additional Marketable Debt Securities as of December 31, 2005.

5. *Derivative and Warrant financial instruments*

In connection with the sale of debt or equity instruments, we may sell options or warrants to purchase our common stock. In certain circumstances, these options or warrants may be classified as derivative liabilities, rather than as equity. Additionally, the debt or equity instruments may contain embedded derivative instruments, such as conversion options, which in certain circumstances may be required to be bifurcated from the associated host instrument and accounted for separately as a derivative instrument asset or liability.

The identification of, and accounting for, derivative instruments is complex. Our derivative instrument liability is re-valued at the end of each reporting period, with changes in the fair value of the derivative liability recorded as charges or credits to income, in the period in which the changes occur. For options, warrants and bifurcated conversion options that are accounted for as derivative instrument liabilities, we determine the fair value of these instruments using the Black-Scholes option pricing model. That model requires assumptions related to the remaining term of the instruments and risk-free rates of return, our current common stock price and expected dividend yield, and the expected volatility of our common stock price over the life of the option. The identification of, and accounting for, derivative instruments and the assumptions used to value them can significantly affect our financial statements.

6. *Goodwill and Intangible Assets*

Goodwill represents the excess of costs of an acquired entity over the net of the amounts assigned to assets acquired and liabilities assumed. The Company has adopted Statement of Financial Accounting Standards ("SFAS") No. 142, Goodwill and Other Intangible Assets., which requires the Company to test goodwill for impairment annually or whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable, rather than amortize. Accordingly, the Company has not amortized goodwill. As provided by SFAS No. 142, the Company has elected to perform the annual assessment of the carrying value of all goodwill as of September 30th of each year using a number of criteria, including the value of the overall enterprise. As of December 31, 2005, the Company believes that no material impairment exists. Future impairment charges from previous or future acquisitions, if any, will be reflected as an operating expense in the statement of operations.

7. *Deferred Revenue*

Deferred revenue includes customer advances and amounts that have been billed per the contractual terms but have not been recognized as revenue. The majority of these amounts are related to maintenance contracts for which the revenue is recognized ratably over the applicable term, which generally is 12 months from the date the customer accepts the products.

8. *Research and Development Expenditures*

Research and development expenses include costs directly attributable to the conduct of research and development programs primarily related to the development of our software products and improving the efficiency and capabilities of our existing software. Such costs include salaries, payroll taxes, employee benefit costs, materials, supplies, depreciation on research equipment, services provided by outside contractors, and the allocable portions of facility costs, such as rent, utilities, insurance, repairs and maintenance, depreciation and general support services. All costs associated with research and development is expensed as incurred.

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