



# CLEAR DIRECTION

FOR HEALTHCARE INFORMATION SOLUTIONS

2008 ANNUAL REPORT

# COMPANY PROFILE

CPSI is a leading provider of healthcare information solutions for community hospitals with over 650 client hospitals in 47 states and the District of Columbia. Founded in 1979, the Company is a single-source vendor providing comprehensive software and hardware products, complemented by complete installation services and extensive support. Its fully integrated, enterprise-wide system automates clinical and financial data management in each of the primary functional areas of a hospital. CPSI's staff of over 800 technical, healthcare and medical professionals provides system implementation and continuing support services as part of a comprehensive program designed to respond to clients' information needs in a constantly changing healthcare environment. For more information, visit [www.cpsinet.com](http://www.cpsinet.com).

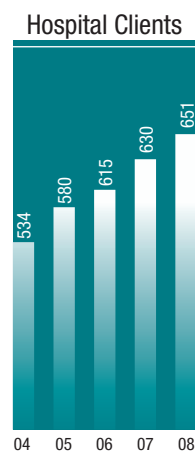
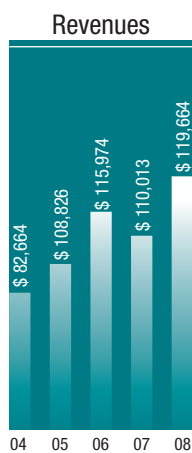
# ANNUAL MEETING

The annual meeting of stockholders will be held on May 7, 2009, at 9:00 a.m. Central Time at the Mobile Convention Center, One South Water Street, Mobile, Alabama.

# FINANCIAL HIGHLIGHTS

(in thousands, except per share data)

	Years Ended December 31,	
	2008	2007
Total sales revenues	\$ 119,664	\$ 110,013
Total cost of sales	66,443	63,257
Gross profit	53,221	46,756
Total operating expenses	29,510	27,708
Operating income	23,711	19,048
Interest income, net	940	1,203
Net income before taxes	24,651	20,251
Provision for income taxes	9,213	7,335
Net income	\$ 15,438	\$ 12,916
Basic earnings per share	\$ 1.43	\$ 1.21
Diluted earnings per share	\$ 1.43	\$ 1.20
Weighted average shares outstanding:		
Basic	10,772	10,698
Diluted	10,791	10,741



# LETTER TO SHAREHOLDERS

April of 2009 marks CPSI's 30<sup>th</sup> anniversary as a company. By any measurement, our 29<sup>th</sup> year, 2008, was a remarkable year for our company. Although pleased with our success, we recognize that the upcoming year will present even greater challenges and opportunities. We are confident of our ability to confront these challenges and take advantage of these opportunities. Taking full advantage of these opportunities will require an even higher level of performance, and we are confident in our ability to achieve continued success. We have been in business for three decades and have operated in a variety of different business environments. Our track record has proven that we can be trusted to continue fulfilling and exceeding the expectations of our customers and our shareholders, regardless of national economic cycles.

One measurement of our success was the Company's financial performance in 2008. Revenues increased to \$119.7 million, generating record net income of \$15.4 million. Earnings per share increased 19% to \$1.43. Our strong performance translated into continued dividends for our shareholders in the amount of \$1.44 per share. Our balance sheet is very strong, with solid cash flow and no debt. We are proud of our financial performance and pleased that our focus on financial results and fiscal discipline shows us to be good stewards of our shareholders' investment.

From an operational perspective, 2008 exceeded expectations. Demand for our products remained strong and largely unaffected by the economy. In fact, during the second half of 2008, we were operating at near peak capacity with regard to software installations. Although the sales cycle has lengthened somewhat, we continue to benefit from a strong backlog that is being driven primarily by the transition within the healthcare industry to Electronic Health Records (EHRs).

The American Recovery and Reinvestment Act of 2009 includes over \$19 billion in incentives through the Medicare and Medicaid reimbursement systems to encourage and assist providers in adopting and using EHRs. CPSI is fully committed to ensuring that its customers are in the best position possible to benefit from the financial incentives contained in this legislation. Our strategy is to continue to focus our efforts in the areas of support services and product development so that our clients, both current and prospective, can be confident of success through the use of the CPSI system.

I am grateful to our employees for their dedication and loyalty and to our customers for their business and the recognition of the value we provide. Finally, I want to thank our shareholders, whose investment and support are indispensable.

Sincerely,



J. Boyd Douglas

Chief Executive Officer and President

# DIRECTORS AND OFFICERS

## Board of Directors

### **David A. Dye**

Partner  
Bulow Biotech Prosthetics

### **J. Boyd Douglas, Jr.**

President and Chief Executive Officer  
Computer Programs and Systems, Inc.

### **Ernest F. Ladd, III**

Retired Executive Vice President  
and Chief Financial Officer  
Dravo Corporation

### **W. Austin Mulherin, III**

Attorney  
Frazer, Greene, Upchurch & Baker, LLC

### **M. Kenny Muscat**

Retired Executive Vice President  
and Chief Operating Officer  
Computer Programs and Systems, Inc.

### **William R. Seifert, II**

Executive Vice President  
Regions Bank

### **John C. Johnson**

Real Estate Appraiser  
Courtney & Morris Appraisals, Inc.

### **Charles P. Huffman**

Retired Executive Vice President and  
Chief Financial Officer  
EnergySouth, Inc.

## Officers

### **J. Boyd Douglas, Jr.**

President and Chief Executive Officer

### **Michael S. Jones**

Executive Vice President and  
Chief Operating Officer

### **Darrell G. West**

Vice President - Finance and  
Chief Financial Officer

# CORPORATE DATA

Independent Registered  
Public Accounting Firm

## Grant Thornton LLP

Marquis One  
Suite 300  
245 Peachtree Center Avenue, NE  
Atlanta, GA 30303

Transfer Agent

## American Stock Transfer & Trust Company

59 Maiden Lane  
Plaza Level  
New York, NY 10038  
(866) 668-6550

Legal Counsel

## Maynard, Cooper & Gale, P.C.

1901 Sixth Avenue North  
Suite 2400, AmSouth/Harbert Plaza  
Birmingham, AL 35203-2618

Corporate Headquarters

## Computer Programs and Systems, Inc.

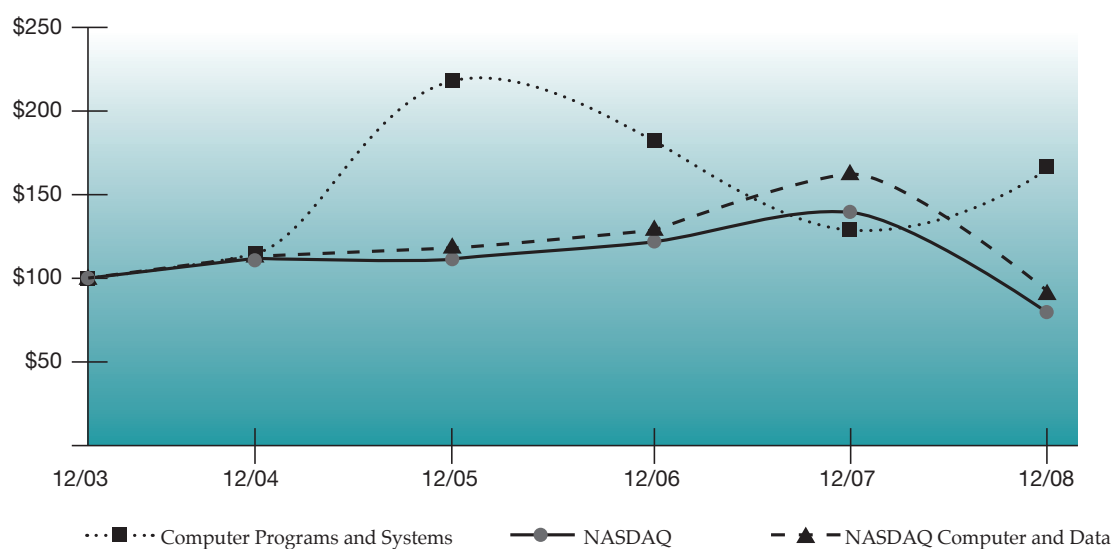
6600 Wall Street  
Mobile, AL 36695  
(251) 639-8100  
www.cpsinet.com

Common Stock

Computer Programs and Systems, Inc.'s common stock is traded on The NASDAQ Stock Market's Global Select Market under the symbol "CPSI."

## Stock Performance Graph

The following graph sets forth the cumulative total stockholder return (assuming reinvestment of dividends) to our stockholders during the period beginning December 31, 2003, and ending on December 31, 2008,



	12/31/03	12/31/04	12/31/05	12/31/06	12/31/07	12/31/08
Computer Programs and Systems, Inc.	\$ 100.00	\$ 117.89	\$ 216.56	\$ 184.22	\$ 129.78	\$ 162.57
NASDAQ Composite	100.00	110.08	112.88	126.51	138.13	80.47
NASDAQ Computer & Data Processing	100.00	115.62	118.29	133.40	158.91	90.83

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

**FORM 10-K**

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

**FOR THE FISCAL YEAR ENDED DECEMBER 31, 2008**

**OR**

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

**FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_.**

**Commission file number: 000-49796**

**COMPUTER PROGRAMS AND SYSTEMS, INC.**

**(Exact Name of Registrant as Specified in Its Charter)**

**Delaware**

**(State or Other Jurisdiction of  
Incorporation or Organization)**

**6600 Wall Street, Mobile, Alabama**

**(Address of Principal Executive Offices)**

**74-3032373**

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

**36695**

**(Zip Code)**

**(251) 639-8100**

**(Registrant's telephone number, including area code)**

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

Title of Each Class

Name of Each Exchange on Which Registered

**Common Stock, par value \$.001 per share**

**The NASDAQ Stock Market LLC**

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

**None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No

The aggregate market value of common stock held by non-affiliates of the registrant at June 30, 2008 was \$166,099,281. As of March 6, 2009 the registrant had outstanding 10,905,708 shares of its common stock.

**DOCUMENTS INCORPORATED BY REFERENCE IN THIS FORM 10-K:**

Portions of the definitive Proxy Statement for the Annual Meeting of Stockholders to be held on May 7, 2009 are incorporated by reference into Part III of this report.

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\* Portions of the definitive Proxy Statement for the Annual Meeting of Stockholders to be held on May 7, 2009 are incorporated by reference in Part III of this Form 10-K.



## SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS

This Annual Report on Form 10-K contains forward-looking statements within the meaning of the “safe harbor” provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements can be identified generally by the use of forward-looking terminology and words such as “expects,” “anticipates,” “estimates,” “believes,” “predicts,” “intends,” “plans,” “potential,” “may,” “continue,” “should,” “will” and words of comparable meaning. Without limiting the generality of the preceding statement, all statements in this Annual Report relating to estimated and projected earnings, margins, costs, expenditures, cash flows, growth rates and future financial results are forward-looking statements. We caution investors that any such forward-looking statements are only predictions and are not guarantees of future performance. Certain risks, uncertainties and other factors may cause actual results to differ materially from those projected in the forward-looking statements. Such factors may include:

- overall business and economic conditions affecting the healthcare industry;
- saturation of our target market and hospital consolidations;
- changes in customer purchasing priorities, capital expenditures and demand for information technology systems;
- competition with companies that have greater financial, technical and marketing resources than we have;
- failure to develop new technology and products in response to market demands;
- fluctuations in quarterly financial performance due to, among other factors, timing of customer installations;
- failure of our products to function properly resulting in claims for medical losses;
- government regulation of our products and customers, including changes in healthcare policy affecting Medicare reimbursement rates;
- changes in accounting principles generally accepted in the United States of America;
- general economic conditions, including changes in the financial markets that may affect the availability and cost of credit to us or our customers; and
- interruptions in our power supply and/or telecommunications capabilities.

For more information about the risks described above and other risks affecting us, see “Risk Factors” beginning on page 17 of this Annual Report. We also caution investors that the forward-looking information described herein represents our outlook only as of this date, and we undertake no obligation to update or revise any forward-looking statements to reflect events or developments after the date of this Annual Report.

## PART I

### ITEM 1. BUSINESS

#### Overview

We are a healthcare information technology company that designs, develops, markets, installs and supports computerized information technology systems to meet the unique demands of small and midsize hospitals. Our target market includes acute care community hospitals with 300 or fewer beds and small specialty hospitals. We are a single-source vendor providing comprehensive software and hardware products, complemented by data conversion, complete installation and extensive support. Our fully integrated, enterprise-wide system automates the management of clinical and financial data across the primary functional areas of a hospital. In addition, we provide services that enable our customers to outsource certain data-related business processes which we can perform more efficiently. We believe our products and services enhance hospital performance in the critical areas of clinical care, revenue cycle management, cost control and regulatory compliance. From our initial hospital installation in 1981, we have grown to serve over 650 hospital customers across 47 states and the District of Columbia. In 2008, we generated revenues of \$119.7 million from the sale of our products and services.

#### Industry Dynamics

The healthcare industry is the largest industry in the United States economy. According to the Centers for Medicare and Medicaid Services, or “CMS,” the U.S. is projected to have spent \$2.4 trillion on healthcare in 2008, or approximately 16.6% of the U.S. gross domestic product. CMS estimates that by fiscal 2017 total U.S. healthcare spending will reach \$4.3 trillion, or 19.5% of the estimated U.S. gross domestic product.

Hospital services represents one of the largest categories of total healthcare expenditures. According to CMS, in fiscal 2009, spending on hospital services will amount to approximately \$800 billion, or 31.3% of total healthcare expenditures. According to the American Hospital Association, there are approximately 4,900 community hospitals in the United States that are in our target market of hospitals with 300 or fewer acute care beds. In addition, there is a market of small specialty hospitals that focus on discrete medical areas such as surgery, rehabilitation and psychiatry.

Notwithstanding the size and importance of the healthcare industry within the United States economy, the industry is constantly challenged by changing economic dynamics, increased regulation and pressure to improve the quality of healthcare. These challenges are particularly significant for the hospitals in our target market due to their more limited financial and human resources. However, we believe healthcare providers can successfully address these issues with the help of advanced medical information systems. Specific examples of the challenges facing healthcare providers include the following.

*Changing Economic Dynamics.* Community hospitals typically generate a significant portion of their revenues from beneficiaries of the Medicare program. Consequently, even small changes in this federal program have a disproportionately larger impact on community hospitals as compared to larger facilities where greater portions of their revenues are typically generated from beneficiaries of private insurance programs. Medicare funding and reimbursements fluctuate year to year and, with the anticipated growth in healthcare costs, will continue to be scrutinized as the federal government attempts to control the costs and growth of the program. The Medicaid program, which is a federal/state program managed by the individual states and dependent in part on funding from the states, also continues to struggle due to the increasing cost of healthcare and limited state revenues. In addition to issues in state funding, the Deficit Reduction Act of 2005, which included cuts of \$6.4 billion and \$4.7 billion from Medicare and Medicaid, respectively, over the five-year period from 2006 to 2010, is cutting deeper into Medicaid reimbursements, and the gains made in Medicare reimbursements are being adversely affected. Furthermore, federal and state budget shortfalls could lead to potential reductions in funding for Medicare and Medicaid. Reductions in reimbursements from Medicare and Medicaid could lead to hospitals postponing expenditures on information technology.

Additionally, the current credit crisis has increased the costs to hospitals of borrowing money and made it more difficult to find the financing for necessary facility and technology improvements. According to a study conducted by the American Hospital Association in November 2008, due to the credit crisis and a significant increase in uncompensated care, more than 50% of the hospitals in the United States of America are reconsidering or postponing investments in facilities and equipment, including information technologies.

*The American Recovery and Reinvestment Act of 2009.* On February 17, 2009, President Barack Obama signed into law the American Recovery and Reinvestment Act of 2009 (the “ARRA”). This \$787 billion economic stimulus package includes a number of health care policy provisions, including approximately \$19 billion in funding over the next ten years for health information technology infrastructure and Medicare and Medicaid incentives to encourage doctors, hospitals and other providers to use health information technology to electronically exchange patients’ health information, including through the development of health information exchanges (“HIE”) and the adoption of electronic health records (“EHR”). Approximately \$2 billion of the total funding amount is in appropriated funds for discretionary grants, loans and technical assistance programs designed to aid providers with the adoption of EHR and the development of HIE. These funds will be disbursed by various agencies within the Department of Health and Human Services, either directly to providers – including private physician offices – or to other entities like states or non-profit organizations. The remaining allocated amounts will take the form of Medicare and Medicaid payment incentives. The ARRA identifies four priority areas for spending with respect to health information technology: (1) establishing HIE; (2) EHR adoption; (3) workforce training; and (4) new technology research and development. In order to qualify for EHR funding, providers are required to connect to an HIE, which means funding is dependent on state action to establish HIEs. The payment incentives do not become available until 2011. The ARRA includes payment incentives for critical access hospitals that are meaningful users of EHR. We are still evaluating the potential impact of the ARRA on our business and the businesses of the community hospitals that comprise our target market.

*Continued Push for Improved Patient Care.* With pressure mounting to reduce medical errors and improve patient safety, hospitals are actively seeking information technology solutions for clinical decision support. This migration toward clinical decision support solutions is further supported by CMS quality initiatives. For 2009, CMS reports that Medicare inpatient rates for operating expenses will increase by 3.6% for hospitals that report quality data. Hospitals that do not report quality data will only see a 1.6% increase. We believe hospitals utilizing fully integrated enterprise-wide medical information systems that allow professionals real-time access to information such as electronic charts, treatment protocols and pathways, pharmaceutical records and treatment schedules will continue to be favored by large employers and government payers.

*Emergence of Electronic Medical Records/Electronic Health Records.* In 2004, George W. Bush, former President of United States of America, launched an initiative to make electronic health records available to most Americans within 10 years. Since that time, significant progress has been made in the establishment by the federal government of a National Health Information Network. The stated goal of the national electronic health record is to bring together patient information from across the disparate healthcare vendor systems used in all of the individual hospitals, clinics and physician offices where a patient may receive healthcare services. Achievement of this ambitious goal will revolutionize the healthcare industry. Data sharing of this magnitude will increase the efficiency of healthcare delivery, support better clinical decision making, and reduce clinical errors in all participating facilities. However, the first requirement for participation in national or regional initiatives is the implementation of an electronic medical record in the individual healthcare facilities. To share patient information electronically, the information must first be captured and stored electronically. We believe hospitals utilizing fully integrated enterprise-wide medical information systems, and consequently the vendors that supply such systems, will be best positioned to participate in and benefit from national and regional initiatives. During 2007, we received certification from the Certification Commission for Healthcare Information Technology (CCHIT<sup>SM</sup>) for our inpatient electronic medical record (EMR) product. CCHIT is the certification authority endorsed by a number of professional healthcare organizations for electronic health records (EHRs).

While economic, regulatory and consumer pressures such as those described above have increased rapidly over the last several years, we believe healthcare organizations have historically underinvested in information technology and services compared to other industries. This underinvestment has caused healthcare providers to rely on non-integrated, complex and inefficient information systems. A hospital's failure to adequately invest in modern medical information systems could result in fewer patient referrals, cost inefficiencies, lower than expected reimbursement, increased malpractice risk and possible regulatory infractions.

In the face of decreasing revenue and increasing pressure to improve patient care, healthcare providers are in need of management tools that (1) increase efficiency in the delivery of healthcare services, (2) reduce medical errors, (3) effectively track the cost of delivering services so those costs can be properly managed and (4) increase the speed and rate of reimbursement. Despite challenging economic conditions, we believe the industry will increase its adoption of information technology as a management tool. We further believe these dynamics should allow for future revenue growth.

## **Our Solution**

We have tailored an information technology solution that effectively addresses the specific needs of small and midsize hospitals. Due to their smaller operating budgets, community hospitals have limited financial and human resources to operate manual or inefficient information systems. However, these hospitals are expected to achieve the same quality of care and regulatory compliance as larger hospitals, placing them in a particularly difficult operating environment.

We believe that the CPSI solution meets this challenge. We provide fully integrated, enterprise-wide, HIPAA compliant medical information systems and services that collect, process, retain and report data in the primary functional areas of a hospital, from patient care to clinical processing to administration and accounting. As a key element of our complete solution, we provide ongoing customer service through regular interaction with customers, customer user groups and extensive customer support. Further, we offer business management services that allow customers to avoid some of the fixed costs of a business office. We are capable of providing a single-source solution for small and midsize hospitals, making us a partner in their initiatives to improve operations and medical care.

Our customers continuously communicate with us through our support teams and through organized user groups, allowing us to continue to provide a state-of-the-art solution that meets their specific needs. By remaining sensitive and responsive to the ever-changing demands of our customers and regularly updating our products, we believe we provide an information technology solution that meets the needs of community hospitals. Our business has continued to grow because we have successfully addressed the needs of community hospitals for fully integrated enterprise-wide information systems that allow them to improve operating effectiveness, reduce costs and improve the quality of patient care.

## **Strategy**

Our objective is to continue to grow as a leading provider of healthcare information technology systems and services to small and midsize hospitals by following the same strategy that we have successfully pursued for over twenty-five years, the key elements of which are described below.

*Deliver a Single-Source Solution.* When a customer purchases the CPSI system, we provide everything necessary for the customer to implement and use our system. We deliver the application software, computer hardware, peripherals, forms and supplies used in the comprehensive information network. Our installation teams work extensively with each customer to convert existing data to the new system, to install all of the necessary equipment and to train hospital personnel to use our system. After installation, our support teams answer and address customer questions and issues related to any aspect of the system. We also offer customers additional services such as business office management, electronic billing and ISP services. We believe our single-source approach to delivering a complete information system makes our system easier and more convenient for customers to understand and manage, which results in greater customer satisfaction and retention.

*Provide Enterprise-Wide, Fully Integrated Software Applications.* We have developed all of our software products internally as part of our fully integrated system architecture. Our experience has taught us that using a fully integrated system in the primary functional areas of a hospital ensures compatibility among applications and avoids pitfalls associated with interfacing disparate systems. Our system utilizes one central database where information is stored and used by all of our software applications. With our single database model, our systems provide secure, real-time access to all information across multiple applications for all those needing such access, including physicians, nurses, laboratory technicians, pharmacists, clinicians and other users. The enterprise-wide, fully integrated nature of our system also allows customers to monitor user access to information for purposes of compliance with new federal and state privacy regulations.

*Maintain Commitment to Customer Oriented Operating Philosophy.* A key factor in our success has been our focus on customer service and support. We make available to our customers experienced support teams that can assist with any question or problem. We currently have a greater than one to one support staff to customer ratio. Our support teams are extensively trained, and our employees are generally promoted from within so that they have a thorough knowledge of our system and a commitment to our culture. Because all of our customers use the same version of our system, our support teams can be more effective by maintaining a complete understanding of a single system. As part of our commitment to system support, we actively solicit customer feedback regarding ways in which we can improve the effectiveness and efficiency of our systems. To further this goal, we have organized our customers into a national user group to promote the exchange of information regarding our system and to identify product enhancements based on our customers' operational experiences. We believe our user group concept is a key component of our success by positively impacting customer satisfaction and retention and by enhancing product development and system functionality. We will continue to focus on our national user group as a key component to our goal of maintaining and growing our customer base and market share.

*Expand Presence in Target Market.* We will continue to target small to midsize domestic hospitals of 300 or fewer acute care beds. We believe this market of 4,900 community hospitals nationwide has been traditionally overlooked and underserved by other healthcare technology companies. In addition, a number of our customers are small specialty hospitals that focus on discrete medical areas such as surgery, rehabilitation and psychiatry. We intend to continue gaining customers from this market segment. Our system can help these smaller hospitals reduce costs and increase their operating efficiencies. We believe our personalized marketing approach and emphasis on customer relationships are attractive to the management of these hospitals. We also believe our system is well-suited to hospitals of this size because they typically demonstrate a greater commitment than larger hospitals to the concept of an enterprise-wide, fully integrated system. In addition, we will continue to sell additional services and software products to our existing customers who have not purchased our complete package of services and software applications.

*Emphasize Recurring Revenue Opportunities.* In addition to revenues from new system installations, we have developed and will continue to develop sources of recurring revenues. Our current principal source of recurring revenues is our support and maintenance fees paid by existing customers. As our customer base grows, our recurring revenues from support and maintenance fees should also grow. We believe growth in recurring revenues will also continue to come from our business management services, which we market to our existing customers as well as new customers. These services include electronic billing, patient statement processing, accounts receivable management, payroll processing, ISP services and web site hosting. We also provide our software products on an ASP basis. When we provide ASP services, we maintain a customer's computer server in our facility and provide our system to the customer through remote access. Instead of the one-time system purchase price, these customers pay a monthly fee for the term of the ASP customer agreement, generating recurring revenues.

## **Our Products and Services**

### *Software Systems*

We offer a full array of software applications designed to streamline the flow of information to the primary functional areas of community hospitals in one fully integrated system. We intend to continue to enhance our existing software applications and develop new applications as required by evolving industry standards and the

changing needs of our customers. Pursuant to our customer support agreements, we provide our customers with software enhancements and upgrades periodically on a when-and-if-available basis. See “Support and Maintenance Services.” These enhancements enable each customer, regardless of its original installation date, to have the benefit of the most advanced CPSI products available. Our software applications:

- provide automated processes that improve clinical workflow and support clinical decision-making;
- allow healthcare providers to efficiently input and easily access the most current patient medical data in order to improve the quality of care and patient safety;
- integrate clinical, financial and patient information to promote efficient use of time and resources, while eliminating dependence on paper medical records;
- provide tools that permit healthcare organizations to analyze past performance, model new plans for the future and measure and monitor the effectiveness of those plans;
- provide for rapid and cost-effective implementation, whether through the installation of an in-house system or through our ASP services; and
- increase the flow of information by replacing centralized and limited control over information with broad-based, secure access by clinical and administrative personnel to data relevant to their functional areas.

Our software applications are grouped for support purposes according to the following functional categories:

- Patient Management
- Financial Accounting
- Clinical
- Patient Care
- Enterprise Applications

Due to the integrated nature of the CPSI system, our software applications are not marketed as distinct products, and our sales force attempts to sell all applications to each customer as a single product. New customers must purchase from us and install the core applications of patient management and financial accounting and all hardware necessary to run these applications. In addition to the core applications, customers may also acquire one or more of our clinical, patient care and enterprise applications. Approximately one-third of our customers have purchased a combination of applications that meet their enterprise-wide information technology needs.

The general functional categories, as well as the software applications in each of these categories, are described below.

Patient Management. Our patient management software enables a hospital to identify a patient at any point in the healthcare delivery system and to collect and maintain patient information throughout the entire process of patient care on an enterprise-wide basis. The single database structure of our software permits authorized hospital personnel to simultaneously access appropriate portions of a patient’s record from any point on the system. The patient management software performs the following functions:

- |                           |   |
|---------------------------|---|
| <i>Registration</i>       | <ul style="list-style-type: none"><li>• records patient admissions, discharges and transfers</li><li>• manages patient status, room assignments and recurring charges</li><li>• keeps information available to all hospital personnel in formats designed for their particular requirements</li></ul> |
| <i>Patient Accounting</i> | <ul style="list-style-type: none"><li>• records patient charges and maintains accounts receivable information including aging, service charges and cash receipts</li><li>• generates and processes insurance claims</li></ul>   |

*Health Information Management*

- supports the operational needs of the modern medical records department including transcription, case indexing/abstracting and statistical reporting
- tracks deficiencies in a patient's chart and provides chart location information

*Patient Index*

- maintains a master index of hospital patients and provides immediate online access to patient financial and medical data associated with a patient stay

*Electronic Claims Processing*

- provides a computer-to-computer link with intermediaries for Medicare and other payers for the submission of claims

*Medical Practice Management*

- supports patient account management and insurance processing for single and multiple practices/clinics
- supports both hospital-based and remote practices/clinics

We also offer the following optional products that may be purchased as part of our core patient management suite:

*Enterprise Wide Scheduling*

- maintains all patient scheduling information

*Contract Management*

- tracks patients enrolled in managed care plans and conforms billing functions to such plans

*Quality Improvement*

- automates hospital-wide total quality management and reporting requirements for utilization activity, risk management, infection surveillance and all accreditation review functions

Financial Accounting. Our financial accounting software provides a variety of business office applications designed to efficiently track and coordinate information needed for managerial decision-making. Our financial accounting software:

*Executive Information System*

- summarizes daily financial transactions regarding patient revenues, receipts, census statistics and billing information for ready access by hospital administrators

*General Ledger*

- provides timely, accurate, financial information generated from daily hospital operations
- formats financial statements to the specifications of each user and is able to generate up to 999 different user-defined reports

*Accounts Payable*

- processes vendor invoices and payments and their related general ledger entries

*Payroll/Personnel*

- calculates all employee wages and benefits for an unlimited number of salaried and hourly employees
- allocates employee time to user-defined cost centers

- Time and Attendance*
  - uses touch screen time clocks to eliminate manual time entry
  - reduces effort of gathering employee time data and increases access of managers to such data
  - makes time records more accurate by identifying employees through bar-coding and optional biometric fingerprint technology
- Electronic Direct Deposits*
  - provides for computerized bank deposits to meet payroll and accounts payable needs
- Human Resources*
  - provides for computerized employee files through document/image scanning and data entry
  - allows for complete tracking of benefits and other employee data through a variety of user-defined reports
  - tracks job applicant information to assist in the employee recruiting and hiring process
- Budgeting*
  - allows for complete on-line budget preparation through computerized access to historical data
- Fixed Assets*
  - allows access to information regarding hospital assets including locations and depreciation scheduling
- Materials Management*
  - tracks the flow of materials throughout the hospital
  - automates the process of inventory control, materials purchasing, stock requisitions and patient charging

Clinical. Our clinical software automates record keeping and reporting for many clinical functions including laboratory, radiology, physical therapy, respiratory care, and pharmacy. These products eliminate tedious paperwork, calculations and written documentation while allowing for easy retrieval of patient data and statistics. Our clinical software:

- Laboratory Information Systems*
  - provides an interface to laboratory analytical instruments in order to transfer results to nurse stations, mobile point-of-care systems and remote physician offices
  - allows users to receive orders from any designated location, process orders and report results and maintain technical, statistical and account information
- Laboratory Instrument Interfaces*
  - provides an automated solution for reviewing test results and completing patient orders
  - reduces the amount of required manual data entry thereby reducing the likelihood of human error
  - reduces time to process laboratory specimens
- Radiology Information Systems*
  - includes flash card printing, patient scheduling, transcription, patient indexing by X-Ray film number, film tracking and location
  - receives patient data, patient locations and other interdepartmental communications support



*ImageLink®*

- provides a complete picture archiving and communications system (PACS) with comprehensive functionality designed to fit seamlessly with our other applications
- allows the realization of an electronic medical record complete with diagnostic images
- provides physicians real time access to diagnostic images via the internet through ChartLink®.

*Physical Therapy and Respiratory Care*

- communicates to nursing the appropriate procedures and patient preparation instructions from orders entered into the CPSI system
- keeps a journal of the orders received and processed
- handles a variety of processing tasks after a patient order is reviewed
- allows a department to customize its results to be sent back to nursing

*Pharmacy*

- allows the hospital pharmacist to enter and fill physician orders
- performs all of the functions related to patient charging, general ledger upgrading, re-supply scheduling and inventory reduction/statistics maintenance
- improves patient care by monitoring drug/drug and food/drug interactions, allergy contraindications, dosage ranges and duplicate therapy
- produces drug education information for each patient in an easy-to-read format

Patient Care. Our patient care applications allow hospitals to create computerized “patient files” in place of the traditional paper file systems. This software enables physicians, nurses and other hospital staff to improve the quality of patient care through increased access to patient information, assistance with projected care requirements and feedback regarding patient needs. Our software also addresses current safety initiatives in the healthcare industry such as the transition from written prescriptions and physician orders to computerized physician order entry. Our patient care software:

*Order Entry /Results Reporting*

- provides efficient order and result communication
- automates the entry of patient charges
- reduces “lost” charges and mistakes due to legibility
- increases efficiency of nursing stations
- provides interactive, real time status reports for orders

*Point-of-Care System*

- allows nurses to enter patient data into the network at the patient’s bedside thereby eliminating the duplicate entry of information
- utilizes touch-screen and wireless technology
- makes patient information instantly available throughout the entire hospital system

- Patient Acuity*

  - categorizes patients according to an assessment of the acuity of the illness, severity of the symptoms, and projected nursing dependency
  - allows nurses to project the total character and amount of care that should be provided to each patient
- ChartLink®*

  - provides physicians with secure and interactive portal to patient information through a hospital's website
  - optional computerized physician order entry, including the ability to enter medication, ancillary test and treatment orders
- Medication Verification*

  - verifies the accuracy of patient medication orders at a patient's bedside by comparing scans of patient and medication bar codes against the medication orders and history for that patient
  - screens medication orders for possible patient allergies and/or drug interactions
- Resident Assessment Instruments*

  - allows nursing staff to complete time consuming resident reporting requirements in an expeditious and efficient manner
  - generates nursing care plans based on deficiencies in the resident reports
- Medical Practice EMR*

  - provides medical practices and clinics with a complete CCHIT<sup>SM</sup> certified electronic medical record
  - supports patient account management and insurance processing for single and multiple practices/clinics
  - automates medical practice workflow with an interactive white board, template driven documentation, image capture/document scanning, and an integrated Superbill
  - integrated with CPSI's ChartLink® EMR portal, the module provides immediate and secure access to the patient's complete ambulatory and inpatient history
  - supports both hospital-based and remote practices/clinics
  - supports patient account management and insurance processing for home health agencies
  - provides complete, regulatory compliant home care tracking
  - provides for remote in home documentation of care
- Outreach Client Access*

  - provides the hospital's outreach clients, such as physicians, their office administrators, nursing homes, home health agencies, and local businesses, with remote access to online, real time, secure patient data as needed and appropriate for each outreach client
  - available information includes insurance and billing information, diagnosis and procedure coding, discharge summaries, pharmacy profiles and other clinical and administrative information
- Electronic Forms*

  - electronic form templates replace paper based records and care forms
  - completed forms become a permanent part of the patient's electronic medical record

Enterprise Applications. We provide software applications that support the products described above and are useful to all areas of the hospital. These applications include: ad hoc reporting, automatic batch and real-time system backups, an integrated fax system, archival data repository, document scanning and Microsoft Office integration and an Application Portal. The Application Portal allows clients to access our applications remotely via Microsoft Internet Explorer and the Internet without requiring the loading of any additional client software on the accessing PC. User information and data accessed is secured with HIPAA compliant 128 bit cipher strength Secure Socket Layer (SSL) encryption. Remote access using the Application Portal results in no discernable difference to the user in software functionality.

### ***Support and Maintenance Services***

After a customer installs a CPSI system, we provide software application support, hardware maintenance, continuing education and related services pursuant to a support agreement. The following describes services provided to customers using CPSI systems.

Total System Support. We believe the quality of continuing customer support is one of the most critical considerations in the selection of an information system provider. We provide hardware, technical and software support for all aspects of our system which gives us the flexibility to take the necessary course of action to resolve any issue. Unlike our competitors who use third-party services for hardware and software support, we provide a single, convenient and efficient resource for all of our customers' system support needs. In order to minimize the impact of a system problem, we train our customer service personnel to be technically proficient, courteous and prompt. Because a properly functioning information system is crucial to a hospital's operations, our support teams are available 24 hours a day to assist customers with any problem that may arise. Customers can also use the Internet to directly access our support system. This allows customers to communicate electronically with our support teams at any time. With approximately 611 employees who provide customer service and support, we currently have close to a one-to-one support staff to customer ratio.

User Group. All of our customers have the opportunity to be members of our user group from which we solicit feedback regarding our products. We host a national user group meeting annually. We have also organized several active regional user groups which meet on a semi-annual basis. These groups meet to discuss and recommend product modifications and improvements which they then evaluate and prioritize. Upon confirming that the desired improvements are technically feasible, we agree to allocate a significant amount of programming time each year to undertake the requested modification or improvement. The majority of our product enhancements originate from suggestions from our customers through the user group structure.

Software Releases. We are committed to providing our customers with software and technology solutions that will continue to meet their information system needs. To accomplish this purpose, we continually work to enhance and improve our application programs. As part of this effort, for each customer covered under our general support agreement, we provide software updates as they become available at no additional cost. We design these enhancements to be seamlessly integrated into each customer's existing CPSI system. The benefit of these enhancements is that each customer, regardless of its original installation date, uses the most advanced CPSI software available. Through this process, we can keep our customers up-to-date with the latest operational innovations in the healthcare industry as well as changing governmental regulatory requirements. Another benefit of this "one system" concept is that our customer service teams can be more effective in responding to customer needs because they maintain a complete understanding of and familiarity with the one system that all customers use.

Purchasing a new information technology system requires the expenditure of a substantial amount of capital and other resources, and many customers are concerned that these systems will become obsolete as technology changes. Our periodic product updates eliminate our customers' concerns about system obsolescence. We believe providing this benefit is a strong incentive for potential customers to select our products over the products of our competitors.

Hardware Replacement. As part of our general support agreements, we are also committed to promptly replacing malfunctioning system hardware in order to minimize the effect of operational interruptions. By providing all hardware used in our system, we believe we are better able to meet and address all of the information technology needs of our customers.

Application Service Provider. In some circumstances, we offer ASP services to customers via remote access telecommunications. As an application service provider, we store and maintain computer servers dedicated to specific customers which contain all of such customers' critical patient and administrative data. These customers access this information remotely through direct telecommunications connections with these servers.

Internet Service Provider. As part of our total information solution, we can provide Internet connection services to our customers. We also can provide web-site design and hosting services.

Forms and Supplies. We offer our customers the forms that they need for their patient and financial records, as well as their general office supplies. Furnishing these forms and supplies helps us to achieve our objective of being a one-source solution for a hospital's complete healthcare information system requirements.

### ***Business Management Services***

Electronic Billing. We provide electronic billing for customers at prices competitive with other electronic billing vendors. Once a customer processes patient insurance claims in our system, we then perform the electronic billing function with no other participation by hospital staff. With this service, customers need not prepare billing files or maintain interfaces with third-party software, thereby saving the customer both time and money.

Statement Processing. Our customers may choose to have us prepare and distribute all patient billing statements. We use our knowledge of a customer's collection system to produce statements without requiring any actions on the part of the hospital data processing personnel. Because we can connect directly with a customer's system, the customer is not required to build and transfer files to us. All system enhancements are incorporated into the statement process without having to modify any third-party vendor interface. Like the electronic billing, this service saves the customer both time and money.

Accounts Receivable Management. We offer customers the option of using us to perform their patient billing functions and accounts receivable management. Using this service allows customers to reduce costs by employing fewer full time administrative employees.

Payroll Processing. We offer customers the option of using us to perform their payroll functions, including payroll processing, tax and deduction management, and quarterly and yearly reporting.

Contract Management. We offer customers the option of using us to perform audits of payments from third party insurers with which a customer executes managed care contracts to ensure payments are made in accordance to the agreed upon metrics.

Insurance Services. We offer customers the option of using us to provide insurance services to include Insurance Follow-up, Claim Eligibility Checking, Claim Status Checking, Pharmacy Online Adjudication, and Medical Necessity Database Updates. Using these services allows customers to improve their revenue cycle management by reducing the incidents of invalid claims and monitoring the progress of valid claims.

### **System Implementation and Training**

Conversion Services. When a customer purchases our system, we convert its existing data to the CPSI system. Our knowledge of hospital data processing, in conjunction with extensive in-house technical expertise,

allows us to accomplish this task in a cost effective manner. When we install a new system, the data conversion has already occurred so that the system is immediately operational. Our goal is for each customer to be immediately productive in order not to waste time and money on the costly and inefficient task of maintaining the same data on parallel systems. Our services also relieve the hospital staff of the time-consuming burden of data conversion.

*Training.* In order to integrate the new system and to ensure its success, we spend approximately three weeks providing individualized training on-site at each customer's facility at the time of installation. We directly train all hospital users, including staff members and healthcare providers, during all hospital shifts in the use of hardware and software applications. In contrast, some of our competitors train only a hospital's training staff at an off-site location. We employ nurses and medical technicians in addition to our technical training staff in order to help us communicate more effectively with our customers during the training process.

## **Technology**

*Operating Systems and Server Platform.* We utilize Intel-based servers running industry standard "open systems," including Unix, Linux and Microsoft Windows 2000 Server operating systems.

*ClientWare® Networking.* Our ClientWare® application integrates the UNIX and Linux systems with Microsoft operating systems. This integration brings together the strengths of both operating environments. The processing power of UNIX and Linux combined with the communication capabilities of Microsoft Windows creates an information system that allows the use of familiar "point and click" processing. This architecture also facilitates integration of other Microsoft software and provides expanded opportunities for the inclusion of new technologies without sacrificing system reliability or performance.

*Wireless Technology.* Traditional workstations were designed around access to electrical and network outlets. We now use wireless networking technology to connect computers to the CPSI system. This allows customers to use mobile computers and to place stationary computers in locations for optimum convenience and ease of use. We incorporate wireless laptop and hand held computers into our system. Convenient to carry and use, these mobile computers allow effective data collection and real-time access to patient information from practically anywhere in the hospital. Information efficiently collected will then be more quickly accessible by other caregivers throughout the hospital.

*Point-of-Care Stations.* We use "point-of-care stations" which allow nurses to enter information into the system at a patient's bedside. These stations consist of compact computers on individual data entry stations that are lightweight, durable and easy to maneuver. We incorporate our wireless networking capabilities into these stations in order to provide extended range and mobility.

*Touch Sensitive Displays.* Data entry is made easier through the use of touch sensitive displays. With this technology, work areas are free of the traditional keyboard and mouse associated with most personal computers. Touch screens are also more efficient for users who are not proficient in computer skills.

*Biometric Recognition.* As unique as each individual, a fingerprint cannot be duplicated, making it one of the most secure methods of verifying a person's identity. Because of the sensitivity of healthcare information and proposed federal security requirements, we have incorporated licensed fingerprint identification technology as an option for our systems. When a user signs on to the system, he or she must scan his or her fingerprint as well as enter a traditional password. The system rapidly responds with the confirmation or rejection of the user's identity.

## **Product Development and Enhancement**

We are continually working to improve and enhance the CPSI system and to develop new products and services for our system. The primary source of ideas for improvements to our products and services comes from

our customers through our national user group. We believe our interaction with customers and their communication with each other is the most efficient way to learn about and respond to changes in the healthcare operating environment. This approach to research and development allows us to quickly adapt to technology advances and improve our products and services to better serve the needs of our customers. Our management and customer support and service teams play a significant role in product development by continually monitoring the needs and desires of our customers and our market. In addition to our customer support and service teams, during 2008, the Product Development Services division was created. This division is responsible for the development, quality assurance/testing, documentation, and distribution of all application software. By consolidating all our development efforts under a single division, we can ensure standardization in our software development processes and effective utilization of our resources. We currently have 133 employees in our Product Development Services division, including 4 research and development employees whose dedicated function is to develop new uses for and applications of technology available in the marketplace.

## **Customers, Sales and Marketing**

*Target Market.* The target market for our information system consists of small and midsize hospitals of 300 or fewer acute care beds. In the United States, there are approximately 4,900 hospitals in this size range. In addition, we market our products to small specialty hospitals in the United States that focus on discrete medical areas such as surgery, rehabilitation and psychiatry. As of February 28, 2009, we had installed our system in over 650 facilities in 47 states and the District of Columbia. Approximately 94% of our existing customers are hospitals with 100 or fewer acute care beds, while approximately 99% of our existing customers are hospitals with 200 or fewer acute care beds. Our goal is to increase sales to hospitals with 100 to 300 acute care beds while maintaining our competitive position in the under 100 bed market segment.

*Sales Staff.* Most of our new customers are referrals from our existing customers, thereby reducing the need for a large sales force. Currently, we have 30 employees dedicated to direct sales, 15 of whom concentrate on new prospects, and 15 of whom are responsible for the sale of additional products and services to existing customers. We hire our sales representatives from our existing employees. Our current sales representatives have an average of over 14 years of experience with CPSI, including experience in installation, training and customer support. Our sales representatives have defined geographic territories in the United States in which to target new customers. A significant portion of the compensation for all sales personnel is commission based.

*Marketing Strategy.* Our primary marketing strategy is to generate referrals from our existing customers and directly solicit potential users through presentations at industry seminars and trade shows. We also advertise in various healthcare industry trade publications. For hospitals that we have targeted as potential customers, most of our direct sales efforts involve site visits and meetings with hospital management. The typical sales cycle of a healthcare information system usually takes six to eighteen months from the time of initial contact to the signing of a contract. Therefore, we believe it is important for our sales staff to dedicate a substantial amount of time and energy to building relationships with potential new customers. We do not conduct extensive marketing activities and promotions because hospitals are easily identified, finite in number and generally send a request for proposal to vendors when they contemplate the purchase of a hospital information system.

## **Competition**

The market for our products and services is competitive, and we expect additional competition from established and emerging companies in the future. Our market is characterized by rapidly changing technology, evolving user needs and the frequent introduction of new products. We believe the principal competitive factors that hospitals consider when choosing between us and our competitors are:

- product features, functionality and performance;
- level of customer service and satisfaction;
- ease of integration and speed of implementation;

- product price;
- knowledge of the healthcare industry;
- sales and marketing efforts; and
- company reputation.

Our principal competitors are Medical Information Technology, Inc., or “Meditech,” Healthland and Healthcare Management Systems, Inc., or “HMS.” Meditech, Healthland and HMS compete with us directly in our target market of small and midsize hospitals. These companies offer products and systems that are comparable to our system and address the needs of hospitals in the markets we serve.

Our secondary competitors include McKesson Corporation, Quadramed Corp., Cerner Corporation and Siemens Corporation. These companies are significantly larger than we are, and they typically sell their products and services to larger hospitals outside of our target market. However, they will sometimes compete directly with us.

We also face competition from providers of practice management systems, general decision support and database systems and other segment-specific applications, as well as from healthcare technology consultants. Any of these companies as well as other technology or healthcare companies could decide at any time to specifically target hospitals within our target market.

A number of existing and potential competitors are more established than we are and have greater name recognition and financial, technical and marketing resources than we have. Products of our competitors may have better performance, lower prices and broader market acceptance than our products. We expect that competition will continue to increase.

### **Internal Management Control System**

We have developed and maintain an automated enterprise management system which permits us to manage not only all of our internal management, accounting and personnel functions, but also all information relating to each customer’s information system. Our system maintains detailed records of all information regarding each customer’s system, including all system specifications, service history and customer communications, among other things. This internal control system helps us to more effectively respond to customer support needs through complete and current system information and through situation-based problem solving.

### **Intellectual Property**

We regard some aspects of our internal operations, software and documentation as proprietary, and rely primarily on a combination of contract and trade secret laws to protect our proprietary information. We believe, because of the rapid pace of technological change in the computer software industry, trade secret and copyright protection is less significant than factors such as the knowledge, ability and experience of our employees, frequent software product enhancements and the timeliness and quality of support services. We cannot guarantee that these protections will be adequate or that our competitors will not independently develop technologies that are substantially equivalent or superior to our technology.

We do not believe our software products or other CPSI proprietary rights infringe on the property rights of third parties. However, we cannot guarantee that third-parties will not assert infringement claims against us with respect to current or future software products or that any such assertion may not require us to enter into royalty arrangements or result in costly litigation.

### **Employees**

As of February 28, 2009, we had 886 employees, all but 9 of whom are located at our offices in Mobile and Lanett, Alabama. Our employees can be grouped according to the following general categories: 568 in

software services and support, 102 in information technology services and support, 133 in product development services, 43 in sales and marketing and 40 in administration. Our general practice is to recruit recent college graduates for entry-level positions and then promote these individuals within the organization to fill vacancies in higher positions. We also hire nurses and other medically-trained professionals in connection with our support services.

Since 1991, we have maintained a non-qualified profit sharing plan under which all full-time employees with three years of uninterrupted service are eligible to participate, other than executive officers and commissioned salespeople. The plan is designed to provide each eligible employee with periodic cash bonuses based on our profitability. Each eligible employee receives a pro rata share of the amount of cash distributed under the profit sharing plan based on the amount of their base salary compared to the sum of the salaries of all participating employees. Our profit sharing plan is not a qualified plan for tax purposes or a guaranteed benefit. Contributions to the plan are made periodically at the discretion of the Board of Directors. During 2008, we distributed approximately \$2.0 million under this profit sharing plan. We plan to continue to make distributions under the profit sharing plan based on our profitability.

We are fortunate to have a high rate of employee retention, with our senior management having an average tenure in excess of 16 years. Our performance depends in significant part on our ability to attract, train and retain highly qualified personnel. None of our employees are represented by a labor union, and we believe our relations with our employees are good.

### **Executive Officers**

The executive officers of CPSI serve at the pleasure of the Board of Directors. Set forth below is a list of the current executive officers of CPSI and a brief explanation of their principal employment during the last five (5) years.

**J. Boyd Douglas – President and Chief Executive Officer.** J. Boyd Douglas, age 42, has served as our President and Chief Executive Officer since May 2006. He was elected as a director in March 2002. Mr. Douglas began his career with us in August 1988 as a Financial Software Support Representative. From May 1990 until November 1994, Mr. Douglas served as Manager of Electronic Billing, and from December 1994 until June 1999, he held the position of Director of Programming Services. From July 1999 until May 2006, Mr. Douglas served as our Executive Vice President and Chief Operating Officer.

**Darrell G. West – Vice President—Finance, Chief Financial Officer, Secretary and Treasurer.** Darrell G. West, age 42, has served as our Vice President—Finance, Chief Financial Officer, Secretary and Treasurer since November 2007. From January 2002 until November 2007, Mr. West served as our controller with primary responsibility for all of our accounting functions.

**Michael S. Jones – Executive Vice President and Chief Operating Officer.** Michael S. Jones, age 35, has served as our Executive Vice President and Chief Operating Officer since May 2006. Mr. Jones began his career with us in 1994 as a Senior Research and Development Analyst in our Technical R&D Department and served as Director of Networking and Internet Services from August 2000 to May 2006.

**Victor S. Schneider – Senior Vice President—Corporate and Business Development.** Victor S. Schneider, age 50, has served as our Senior Vice President—Corporate and Business Development since December 2005. Mr. Schneider is responsible for revenue generation efforts, customer relations, strategic growth initiatives and positioning, and market execution. Mr. Schneider began his career with us in June 1983 as Sales Manager. He served in that capacity until January 1997 when he was promoted to Sales Director. He served as our Vice President—Sales and Marketing from July 1999 until December 2005.

**Robert D. Hinckle – Vice President—Software Services.** Robert D. Hinckle, age 39, has served as our Vice President—Software Services since October 2004. Mr. Hinckle is responsible for overseeing all aspects of



the installation and support of our software products. Since beginning his career with us in 1995 as a Financial Software Support Representative, Mr. Hinckle has worked in various positions in our Software Services Division, including Team Manager, Assistant Director and Director of that division.

**Thomas W. Peterson – Senior Vice President—Clinical Informatics.** Mr. Peterson, age 57, has served as our Senior Vice President—Clinical Informatics since January 2009. He served as Senior Vice President—Clinical Services since October 2005 and as our Vice President—Clinical Software Services from July 1999 through October 2005. Mr. Peterson is responsible for overseeing the design and development of new clinical software applications and continued improvement of existing clinical modules. Since beginning his career with us in 1988 as a Clinical Software Support Representative, Mr. Peterson has worked in various positions in our Clinical Software Services Division including Manager and Director of that division.

**Patrick A. Immel – Vice President—Information Technology Services.** Patrick A. Immel, age 38, has served as our Vice President—Information Technology Services since January 2000. Mr. Immel is responsible for overseeing technical hardware and support and hardware research and development. Mr. Immel began his career with us in July 1993 as a Financial Software Support Representative. Since that time, Mr. Immel has served as a programmer, Manager of Technical Support and most recently as Director of Information Technology Services.

**Troy D. Rosser – Vice President—Sales.** Troy D. Rosser, age 44, has served as our Vice President—Sales since October 2005. Mr. Rosser is responsible for overseeing all of our sales and marketing efforts. Mr. Rosser began his career with us in March 1989 as a Financial Software Support Representative. In 1992, Mr. Rosser was transferred to the Sales and Marketing division where he has worked in various positions, including Sales Manager and, since October 2000, as Director of Sales.

**Michael K. Muscat, Jr. – Senior Vice President—Product Development Services.** Michael K. Muscat, Jr., age 35, has served as our Senior Vice President—Product Development Services since March 2008. Mr. Muscat is responsible for overseeing all aspects of the development quality assurance/testing, documentation, and distribution of all application software. Mr. Muscat began his career with us in July 1996 as a Software Support Representative. Mr. Muscat then served as a Programmer and Manager of Outsourcing Services. From June 2002 to May 2006, Mr. Muscat served as the Director of Business Management Services and from May of 2006 until March of 2008 as the Vice President of Business Management Services. Mr. Muscat is the son of M. Kenny Muscat, who serves as one of our directors.

**Robert D. Smith – Vice President—Product Development Services.** Robert D. Smith, age 38, has served as our Vice President—Product Development Services since March 2008. Mr. Smith is responsible for overseeing all aspects of system programming and enhancements within our Product Development division. Since Mr. Smith began his career with us in September 1993, he has served in the capacity of Technical Support Representative, Programmer, and Programming Manager. From January 2001 to May 2006, Mr. Smith served as the Director of Programming Services and from May 2006 to March of 2008 as Vice President of Programming Services.

**Christopher L. Fowler – Vice President—Business Management Services.** Christopher L. Fowler, age 33, has served as our Vice President—Business Management Services since March 2008. Mr. Fowler is responsible for overseeing all aspects of the business management services we provide to our clients. Mr. Fowler began his career with us in May 2000 as a Software Support Representative and later as a manager of Financial Software Services. From August 2004 until March 2008, Mr. Fowler served as Assistant Director and Director of Business Management Services.

## **Company Website**

The Company maintains a website at <http://www.cpsinet.com>. The Company makes available on its website, free of charge, its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K,

and all amendments to those reports, as soon as it is reasonably practicable after such material is electronically filed with the Securities and Exchange Commission. The Company is not including the information contained on or available through its website as a part of, or incorporating such information into, this Annual Report on Form 10-K.

## **ITEM 1A. RISK FACTORS**

***Economic, market and other factors may cause a decline in spending for information technology and services by our current and prospective customers which may result in less demand for our products, lower prices and, consequently, lower revenues and a lower revenue growth rate.***

The purchase of our information system involves a significant financial commitment by our customers. At the same time, the healthcare industry faces significant financial pressures that could adversely affect overall spending on healthcare information technology and services. For example, the current economic recession and credit crisis, combined with potential reductions in federal and state funding for Medicare and Medicaid, could cause hospitals to reduce, eliminate or postpone information technology related spending. To the extent spending for healthcare information technology and services declines or increases slower than we anticipate, demand for our products and services, as well as the prices we charge, could be adversely affected. Accordingly, we cannot assure you that we will be able to increase or maintain our revenues or our growth rate.

***There are a limited number of hospitals in our target market. Continued consolidation in the healthcare industry could result in the loss of existing customers, a reduction in our potential customer base and downward pressure on our products' prices.***

There are a finite number of small and midsize hospitals with 300 or fewer acute care beds. Saturation of this market with our products or our competitors' products could eventually limit our revenues and growth. Furthermore, many healthcare providers have consolidated to create larger healthcare delivery enterprises with greater market power. If this consolidation continues, we could lose existing customers and could experience a decrease in the number of potential purchasers of our products and services. The loss of existing and potential customers due to industry consolidation could cause our revenue growth rate to decline. In addition, larger, consolidated enterprises could have greater bargaining power, which may lead to downward pressure on the prices for our products and services.

***We may experience fluctuations in quarterly financial performance that cause us to fail to meet revenues or earnings expectations. Failure to meet these expectations could adversely impact our stock price.***

There is no assurance that consistent quarterly growth in our business will continue. Our quarterly revenues may fluctuate and may be difficult to forecast for a variety of reasons. For example, prospective customers often take significant time evaluating our system and related services before making a purchase decision. Moreover, a prospective customer who has placed an order for our system could decide to cancel that order or postpone installation of the ordered system. If a prospective customer delays or cancels a scheduled system installation during any quarter, we may not be able to schedule a substitute system installation during that quarter. The amount of revenues that would have been generated from that installation will be postponed or lost. The possibility of delays or cancellations of scheduled system installations could cause our quarterly revenues to fluctuate.

The following factors may also affect demand for our products and services and cause our quarterly revenues to fluctuate:

- changes in customer budgets and purchasing priorities;
- market acceptance of new products, product enhancements and services from us and our competitors;
- product and price competition; and
- delay of revenue recognition to future quarters due to an increase in the sale of our remote access ASP services.

Variations in our quarterly revenues may adversely affect our operating results. In each fiscal quarter, our expense levels, operating costs and hiring plans are based on projections of future revenues and are relatively fixed. If our actual revenues fall below expectations, our earnings will also likely fail to meet expectations. If we fail to meet the revenue or earnings expectations of securities analysts and investors, then the price of our common stock will likely decrease.

***Continued volatility and disruption to the global capital and credit markets may adversely affect our ability to access credit in the future, the cost of any credit obtained in the future, and the financial soundness of our customers.***

While the Company does not currently have any debt, recent volatility and disruption in the global capital and credit markets, including the bankruptcy or restructuring of certain financial institutions, reduced lending activity by other financial institutions and decreased liquidity, may adversely affect the availability, terms and cost of credit should we seek it in the future. Although we believe that our operating cash flow and financial assets will give us the ability to meet our financing needs for the foreseeable future, there can be no assurance that the continued or increased volatility and disruption in the global capital and credit markets will not impair our liquidity or increase the costs of any future borrowing.

Our business could also be negatively impacted to the extent that our hospital customers experience disruptions resulting from tighter capital and credit markets or the current economic recession. As a result, hospitals may modify, delay or cancel plans to purchase our software systems or services. Additionally, if hospitals' operating and financial performance deteriorates, or if they are unable to make scheduled payments or obtain credit, they may not be able to pay, or may delay payment of, accounts receivable owed to us. Any inability of customers to pay us for our products and services may adversely affect our earnings and cash flow.

***Competition with companies that have greater financial, technical and marketing resources than we have could result in loss of customers and/or a lowering of prices for our products, causing a decrease in our revenues and/or market share.***

Our principal competitors are Meditech, Healthland and HMS. Meditech, Healthland and HMS compete with us directly in our target market of small and midsize hospitals. These companies offer products and services that are comparable to our system and are designed to address the needs of community hospitals.

Our secondary competitors include McKesson Corporation, Quadramed Corp., Cerner Corporation, and Siemens Corporation. These companies are significantly larger than we are, and they typically sell their products and services to larger hospitals outside of our target market. However, they sometimes compete directly with us. We also face competition from providers of practice management systems, general decision support and database systems and other segment-specific applications, as well as from healthcare technology consultants. Any of these companies as well as other technology or healthcare companies could decide at any time to specifically target hospitals within our target market.

A number of existing and potential competitors are more established than we are and have greater name recognition and financial, technical and marketing resources. Products of our competitors may have better performance, lower prices and broader market acceptance than our products. We expect increased competition that could cause us to lose customers, lower our prices to remain competitive and experience lower revenues, revenue growth and profit margins.

***Our failure to develop new products or enhance current products in response to market demands could adversely impact our competitive position and require substantial capital resources to correct.***

The needs of hospitals in our target market are subject to rapid change due to government regulation, trends in clinical care practices and technological advancements. As a result of these changes, our products may quickly become obsolete or less competitive. New product introductions and enhancements by our competitors that more effectively or timely respond to changing industry needs may weaken our competitive position.

We continually redesign and enhance our products to incorporate new technologies and adapt our products to ever-changing hardware and software platforms. Often we face difficult choices regarding which new technologies to adopt. If we fail to anticipate or respond adequately to technological advancements, or experience significant delays in product development or introduction, our competitive position could be negatively affected. Moreover, our failure to offer products acceptable to our target market could require us to make significant capital investments and incur higher operating costs to redesign our products, which could negatively affect our financial condition and operating results.

***Potential regulation of our products as medical devices by the U.S. Food and Drug Administration could increase our costs, delay the introduction of new products and slow our revenue growth.***

The U.S. Food and Drug Administration, or the “FDA,” could become more active in regulating the use of computer software for clinical purposes. The FDA has increasingly regulated computer products and computer-assisted products as medical devices under the federal Food, Drug and Cosmetic Act, an example of which is our ImageLink® product. If the FDA regulates any more of our products as medical devices, we would likely be required to, among other things:

- seek FDA clearance by demonstrating that our product is substantially equivalent to a device already legally marketed, or obtain FDA approval by establishing the safety and effectiveness of our product;
- comply with rigorous regulations governing pre-clinical and clinical testing, manufacture, distribution, labeling and promotion of medical devices; and
- comply with the Food, Drug and Cosmetic Act’s general controls, including establishment registration, device listing, compliance with good manufacturing practices and reporting of specified device malfunctions and other adverse device events.

We anticipate that some of our products currently in development could be subjected to FDA regulation similar to our ImageLink® product. If any of our products fail to comply with FDA requirements, we could face FDA refusal to grant pre-market clearance or approval of products; withdrawal of existing clearances and approvals; fines, injunctions or civil penalties; recalls or product corrections; production suspensions; and criminal prosecution. FDA regulation of our products could increase our operating costs, delay or prevent the marketing of new or existing products and adversely affect our revenue growth.

***Governmental regulations relating to patient confidentiality and other matters could increase our costs.***

State and federal laws regulate the confidentiality of patient records and the circumstances under which those records may be released. These regulations may require the users of such information to implement security measures. Regulations governing electronic health data transmissions are also evolving rapidly, and they are often unclear and difficult to apply.

In our support agreements with our customers, we agree to update our software applications to comply with applicable federal and state laws. While we believe we have developed products that will comply with the Health Insurance Portability and Accountability Act of 1996 (“HIPAA”) and other regulatory requirements, new laws, regulations and interpretations could force us to further redesign our products. Any such product redesign could consume significant capital, research and development and other resources, which could significantly increase our operating costs.

***Our products assist clinical decision-making and related care by capturing, maintaining and reporting relevant patient data. If our products fail to provide accurate and timely information, our customers could assert claims against us that could result in substantial cost to us, harm our reputation in the industry and cause demand for our products to decline.***

We provide products that assist clinical decision-making and related care by capturing, maintaining and reporting relevant patient data. Our products could fail or produce inaccurate results due to a variety of reasons,

including mechanical error, product flaws, faulty installation and/or human error during the initial data conversion. If our products fail to provide accurate and timely information, customers and/or patients could sue us to hold us responsible for losses they incur from these errors. These lawsuits, regardless of merit or outcome, could result in substantial cost to us, divert management's attention from operations and decrease market acceptance of our products. We attempt to limit by contract our liability for damages arising from negligence, errors or mistakes. Despite this precaution, such contract provisions may not be enforceable or may not otherwise protect us from liability for damages. We maintain general liability insurance coverage, including coverage for errors or omissions. However, this coverage may not be sufficient to cover one or more large claims against us or otherwise continue to be available on terms acceptable to us. In addition, the insurer could disclaim coverage as to any future claim.

***Breaches of security in our system could result in customer claims against us and harm to our reputation causing us to incur expenses and/or lose customers.***

We have included security features in our systems that are intended to protect the privacy and integrity of patient data. Despite the existence of these security features, our system may experience break-ins and similar disruptive problems that could jeopardize the security of information stored in and transmitted through the computer networks of our customers. Because of the sensitivity of medical information, customers could sue us for breaches of security involving our system. Also, actual or perceived security breaches in our system could harm the market perception of our products which could cause us to lose existing and prospective customers.

***New products that we introduce or enhancements to our existing products may contain undetected errors or problems that could affect customer satisfaction and cause a decrease in revenues.***

Highly complex software products such as ours sometimes contain undetected errors or failures when first introduced or when updates and new versions are released. Tests of our products may not detect bugs or errors because it is difficult to simulate our customers' wide variety of computing environments. Despite extensive testing, from time to time we have discovered defects or errors in our products. Defects or errors discovered in our products could cause delays in product introductions and shipments, result in increased costs and diversion of development resources, require design modifications, decrease market acceptance or customer satisfaction with our products, cause a loss of revenue, result in legal actions by our customers and cause increased insurance costs.

***Our facilities are located in an area vulnerable to hurricanes and tropical storms, and the occurrence of a severe hurricane, similar storm or other natural disaster could cause damage to our facilities and equipment, which could require us to cease or limit our operations.***

Most of our facilities and employees are situated on one campus in Mobile, Alabama, which is located on the coast of the Gulf of Mexico. Our facilities are vulnerable to significant damage or destruction from hurricanes and tropical storms. We are also vulnerable to damage from other types of disasters, including tornadoes, fires, floods and similar events. If any disaster were to occur, our ability to conduct business at our facilities could be seriously impaired or completely destroyed. This would have adverse consequences for our customers who depend on us for system support or business management services. Also, the servers of customers who use our remote access services could be damaged or destroyed in any such disaster. This would have potentially devastating consequences to those customers. Although we have an emergency recovery plan, there can be no assurance that this plan will effectively prevent the interruption of our business due to a natural disaster. Furthermore, the insurance we maintain may not be adequate to cover our losses resulting from any natural disaster or other business interruption.

***Interruptions in our power supply and/or telecommunications capabilities could disrupt our operations, cause us to lose revenues and/or increase our expenses.***

We currently have backup generators to be used as alternative sources of power in the event of a loss of power to our facilities. If these generators were to fail during any power outage, we would be temporarily unable

to continue operations at our facilities. This would have adverse consequences for our customers who depend on us for system support and business management services. Any such interruption in operations at our facilities could damage our reputation, harm our ability to retain existing customers and obtain new customers, and could result in lost revenue and increased insurance and other operating costs.

We also have customers for whom we store and maintain computer servers containing critical patient and administrative data. Those customers access this data remotely through telecommunications lines. If our power generators fail during any power outage or if our telecommunications lines are severed or impaired for any reason, those customers would be unable to access their mission critical data causing an interruption in their operations. In such event our remote access customers and/or their patients could seek to hold us responsible for any losses. We would also potentially lose those customers, and our reputation could be harmed.

***If we are unable to attract and retain qualified customer service and support personnel our business and operating results will suffer.***

Our customer service and support is a key component of our business. Most of our hospital customers have small information technology staffs, and they depend on us to service and support their systems. Future difficulty in attracting, training and retaining capable customer service and support personnel could cause a decrease in the overall quality of our customer service and support. That decrease would have a negative effect on customer satisfaction which could cause us to lose existing customers and could have an adverse effect on our new customer sales. The loss of customers due to inadequate customer service and support would negatively impact our ability to continue to grow our business.

***We do not have employment or non-competition agreements with our key personnel, and their departure could harm our future success.***

Our future success depends to a significant extent on the leadership and performance of our chief executive officer, chief operating officer and other executive officers. We do not have employment or non-competition agreements with any of our executive officers. Therefore, they may terminate their employment with us at any time and may compete against us. The loss of the services of any of our executive officers could have a material adverse effect on our business, financial condition and results of operations.

***We have limited protection of our intellectual property and, if we fail to adequately protect our intellectual property, we may not be able to compete effectively.***

We consider some aspects of our internal operations, products and documentation to be proprietary. To some extent we have relied on a combination of confidentiality provisions in our customer agreements, copyright, trademark and trade secret laws and other measures to protect our intellectual property. To date, however, we have not filed any patent applications to protect our proprietary software products. In addition, existing copyright laws afford only limited protection. Although we attempt to control access to our intellectual property, unauthorized persons may attempt to copy or otherwise use our intellectual property. Monitoring unauthorized use of our intellectual property is difficult, and the steps we have taken may not prevent unauthorized use. If our competitors gain access to our intellectual property, our competitive position in the industry could be damaged. An inability to compete effectively could cause us to lose existing and potential customers and experience lower revenues, revenue growth and profit margins.

***In the event our products infringe on the intellectual property rights of third-parties, our business may suffer if we are sued for infringement or if we cannot obtain licenses to these rights on commercially acceptable terms.***

Others may sue us alleging infringement of their intellectual property rights. Many participants in the technology industry have an increasing number of patents and patent applications and have frequently demonstrated a readiness to take legal action based on allegations of patent and other intellectual property

infringement. Further, as the number and functionality of our products increase, we believe we may become increasingly subject to the risk of infringement claims. If infringement claims are brought against us, these assertions could distract management. We may have to spend a significant amount of money and time to defend or settle those claims. If we were found to infringe on the intellectual property rights of others, we could be forced to pay significant license fees or damages for infringement. If we were unable to obtain licenses to these rights on commercially acceptable terms, we would be required to discontinue the sale of our products that contain the infringing technology. Our customers would also be required to discontinue the use of those products. We are unable to insure against this risk on an economically feasible basis. Even if we were to prevail in an infringement lawsuit, the accompanying publicity could adversely impact the demand for our system. Under some circumstances, we agree to indemnify our customers for some types of infringement claims that may arise from the use of our products.

#### **ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

#### **ITEM 2. PROPERTIES**

Our corporate headquarters and executive offices are located on approximately 27.8 acres in Mobile, Alabama. We occupy approximately 135,500 square feet of space in thirteen buildings. Our main building consists of approximately 66,000 square feet of space. We also have eleven additional buildings each consisting of approximately 6,000 square feet. Each of these smaller buildings is designed to accommodate a team of employees assigned to install and support a particular software application. We also occupy a building consisting of approximately 3,500 square feet of space which houses our research and development employees dedicated to developing new uses for and applications of available technology.

We lease approximately 16.5 acres and all of our buildings in Mobile, Alabama from C.P. Investments, Inc., an Alabama corporation, the stockholders of which are John Morrissey, John Heyer, Bob O'Donnell, Elissa Stillings, Kevin P. Wilkins, Tabitha M. Wilkins Olzinski, Ellen M. Harvey, Michael K. Muscat, Jr. and Susan M. Slaton. All of these individuals are either stockholders of CPSI, or, in the case of Ms. Stillings, the spouse of a stockholder. Additionally, Mr. Morrissey was one of our directors until May 8, 2008, Mr. Muscat is one of our executive officers, and Ms. Harvey, Mr. Muscat, and Ms. Slaton are the children of one of our directors. Our leases with C.P. Investments, Inc. expire at various times between April 2012 and December 2015. We also own 11.3 acres of undeveloped real property adjacent to our primary premises in order to accommodate future growth.

On January 1, 2007, we entered into a lease with Riverside Corporation to house a call center to support the growth of our business office management services. This building consists of approximately 10,000 square feet and is located in Lanett, Alabama.

On January 20, 2009, we entered into a lease agreement with Strauss Properties, LLC to house a call center to further support the growth of our business management services. This lease consists of approximately 10,800 square feet of space and is located in Monroe, Louisiana.

We believe our existing facilities will be sufficient to meet our needs until the end of 2009. At that time we believe we may need to construct additional facilities on the undeveloped portion of our campus in order to accommodate our expansion needs.

#### **ITEM 3. LEGAL PROCEEDINGS**

From time to time, we are involved in routine litigation that arises in the ordinary course of business. We are not currently involved in any litigation that we believe could reasonably be expected to have a material adverse effect on our business, financial condition or results of operations.

#### **ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY-HOLDERS**

None.

## PART II

### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

#### Market for CPSI Common Stock

At March 6, 2009, CPSI had 92 stockholders of record (which does not include the number of beneficial owners whose shares are held in "street" names by nominees who are record holders) and 10,905,708 shares of common stock outstanding.

CPSI common stock is listed on the NASDAQ Global Select Market under the symbol "CPSI." The following table sets forth, for the calendar quarters indicated, the high and low sales prices per share for CPSI's common stock on the NASDAQ Global Select Market, and the cash dividends declared per share in each such quarter:

	<u>High</u>	<u>Low</u>	<u>Dividends Declared Per Share</u>
<b>2008</b>			
First Quarter . . . . .	\$24.00	\$19.64	\$0.36
Second Quarter . . . . .	22.00	17.13	0.36
Third Quarter . . . . .	30.00	17.07	0.36
Fourth Quarter . . . . .	31.00	21.64	0.36
<b>2007</b>			
First Quarter . . . . .	\$34.07	\$25.80	\$0.36
Second Quarter . . . . .	33.65	26.36	0.36
Third Quarter . . . . .	33.56	24.85	0.36
Fourth Quarter . . . . .	30.05	19.90	0.36

The last reported sales price of CPSI's common stock as reported on the NASDAQ Global Select Market on March 6, 2009 was \$24.85.

#### Dividends

During 2007 and 2008 we paid a quarterly dividend in the amount of \$0.36 per share. On January 29, 2009 we announced a dividend for the first quarter of 2009 in the amount of \$0.36 per share. We believe that paying dividends is an effective way of providing an investment return to our stockholders and a beneficial use of our cash. However, the declaration of dividends by CPSI is subject to the discretion of our board of directors. Our board of directors will take into account such matters as general business conditions, our financial results and such other factors as our board of directors may deem relevant in determining future dividends.



## ITEM 6. SELECTED FINANCIAL DATA

	Year Ended December 31,				
	2008	2007	2006	2005	2004
	(in thousands except for share and per share data)				
<b>INCOME DATA:</b>					
Total sales revenue	\$ 119,664	\$ 110,013	\$ 115,974	\$ 108,826	\$ 82,664
Total costs of sales	66,443	63,257	64,269	60,707	49,576
Gross profit	53,221	46,756	51,705	48,119	33,088
Total operating expenses	29,510	27,708	27,039	24,827	21,886
Operating income	23,711	19,048	24,666	23,292	11,202
Total other income	940	1,203	1,132	658	501
Income before taxes	24,651	20,251	25,798	23,950	11,703
Income taxes	9,213	7,335	9,983	9,381	4,639
Net income	\$ 15,438	\$ 12,916	\$ 15,815	\$ 14,569	\$ 7,064
Net income per share - basic	\$ 1.43	\$ 1.21	\$ 1.49	\$ 1.38	\$ 0.67
Net income per share - diluted	\$ 1.43	\$ 1.20	\$ 1.48	\$ 1.37	\$ 0.67
Weighted average shares outstanding:					
Basic	10,772,160	10,698,143	10,638,028	10,559,589	10,489,849
Diluted	10,790,769	10,740,947	10,717,865	10,646,376	10,535,555

	As of December 31,				
	2008	2007	2006	2005	2004
	(in thousands)				
<b>BALANCE SHEET DATA:</b>					
Cash and cash equivalents	\$ 11,744	\$ 11,806	\$ 8,760	\$ 11,670	\$ 13,785
Working capital	33,223	31,118	30,563	29,308	22,480
Total assets	52,867	50,408	47,905	46,984	36,078
Total current liabilities	11,852	11,459	8,690	9,897	7,526
Total stockholders' equity	40,559	38,378	38,706	36,388	27,834

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion of our financial condition and results of operations in conjunction with "Selected Financial Data" and our financial statements and the related notes included elsewhere in this Annual Report. This discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of many factors, including but not limited to those set forth under "Risk Factors" and elsewhere in this Annual Report.

### Background

CPSI was founded in 1979 and specializes in delivering comprehensive healthcare information systems and related services to community hospitals. Our systems and services are designed to support the primary functional areas of a hospital and to enhance access to needed financial and clinical information. Our comprehensive system enables healthcare providers to improve clinical, financial and administrative outcomes. Our products and services provide solutions in key areas, including patient management, financial management, patient care and clinical, enterprise and office automation. In addition to servicing small to medium-sized hospitals, we provide information technology services to other related entities in the healthcare industry, such as nursing homes, home health agencies and physician clinics.

We sell a fully integrated, enterprise-wide financial and clinical hospital information system comprised of all necessary software, hardware, peripherals, forms and office supplies, together with comprehensive customer service and support. We also offer business management services, including electronic billing submissions, patient statement processing and accounts receivable management, as part of our overall information system solution. We believe that as our customer base grows, the demand for our business management services will also continue to grow, supporting further increases in recurring revenues.

Our system currently is installed and operating in over 650 hospitals in 47 states and the District of Columbia. Our customers consist of community hospitals with 300 or fewer acute care beds, with hospitals having 100 or fewer acute care beds comprising approximately 94% of our customers.

## **Overview**

We have achieved a compounded annual growth rate in revenues and net income of approximately 8.0% and 14.4%, respectively, over the past five years. We installed our financial and patient accounting system in 27 new hospitals in 2008 compared with 26 in 2007.

Our gross revenues increased 8.8% from 2007, while our net income increased 19.5%, principally as a result of increased information technology spending by community hospitals during the latter half of 2008. Cash flow from operations decreased 17.9% from 2007 due to an increase in accounts and financing receivables during the year. We did experience an increase in customers seeking financing arrangements for system installation during 2008 due to deteriorating economic conditions and availability of third-party credit. We will grant financing arrangements to customers on a case-by-case basis depending upon various aspects of the proposed contract and customer attributes. While our operating cash flows did decline during 2008, we maintained a strong cash position sufficient to meet our operating requirements and continue our dividends at historic levels. We believe that a strong cash position enables us to compete better in the marketplace and maintain the quality of our customer service and product offerings.

## **Revenues**

The Company recognizes its multiple element arrangements, including software and software-related services, using the residual method under SOP 97-2, *Software Revenue Recognition*, as amended by SOP 98-4, SOP 98-9 and clarified by Staff Accounting Bulletin (“SAB”) 101, *Revenue Recognition in Financial Statements*, as amended by SAB 104, *Revenue Recognition*. Revenue from general support agreements for post-contract support services (support and maintenance) is recognized by the Company ratably over the term of the agreement.

*System Sales.* Revenues from system sales are derived from the sale of information systems (including software, conversion and installation services, hardware, peripherals, forms and office supplies) to new customers and from the sale of new or additional products to existing customers. We do not record revenue upon the execution of a sales contract. Upon the execution of a contract to purchase a system from us, each customer pays a non-refundable 10% deposit that is recorded as deferred revenue. The customer pays 40% of the purchase price for the software and the related installation, training and conversion when we install the system and commence on-site training at the customer’s facility, which is likewise recorded as deferred revenue. When the system begins operating in a live environment, the remaining 50% of the system purchase price for each module that has been installed is payable. Revenue from the sale of the software perpetual license and the system installation and training is recognized on a module by module basis after the installation and training have been completed and the system is functioning as designed for each individual module. Revenue from the sale of hardware is recognized upon shipment of the hardware to the customer.

*Support and Maintenance.* We also derive revenues from the provision of system support services, including software application support, hardware maintenance, continuing education and related services. Support services

are provided pursuant to a support agreement under which we provide comprehensive system support and related services in exchange for a monthly fee based on the services provided. The initial term of these contracts ranges from one to seven years, with a typical duration of five years. Upon expiration of the initial term, these contracts renew automatically on a year-to-year basis thereafter until terminated. Revenues from support services are recognized in the month when these services are performed.

We provide our products to some customers as an application service provider, or “ASP.” We provide ASP services on a remote access basis by storing and maintaining servers at our headquarters which contain customers’ patient and administrative data. These customers then access this data remotely in exchange for a monthly fee. In addition, as part of our total information solution, we serve as an Internet service provider, or “ISP,” for some of our customers for a monthly fee. We also provide web-site design and hosting services if needed. Revenues from our ASP and ISP services are recognized in the month when these services are performed.

*Business Management Services.* During 2007, we changed the name of our Outsourcing Services to Business Management Services to overcome a perceived negative view of the title “Outsourcing”. There have not been any changes to the actual services we offer customers, only a change in the name under which these services are provided. All references to Outsourcing Services in previous Company filings are included under Business Management Services in filings made since October 1, 2007. Our business management services include electronic billing, statement processing, payroll processing and business office management (primarily accounts receivable management). Most of these business management services are sold pursuant to one year customer agreements, with automatic one year renewals until terminated. Revenues from business management services are recognized when these services are performed.

## **Costs of Sales**

*System Sales.* The principal costs associated with the design, development, sale and installation of our systems are employee salaries, benefits, travel expenses and certain other overhead expenses. These costs are expensed as incurred. For the sale of equipment, we incur costs to acquire these products from the respective distributors or manufacturers. The costs related to the acquisition of equipment are capitalized into inventory and expensed upon the sale of the equipment utilizing the average cost method.

*Support and Maintenance.* The principal costs associated with our system support and maintenance services are employee salaries, benefits and certain other overhead expenses. These costs are expensed as incurred.

We have the same employee groups providing both system installations and support and maintenance services. Salary related expenses are allocated between cost of system sales and cost of support and maintenance services based upon an estimate of the percentage of time employees spend performing each function.

*Business Management Services.* The principal cost related to our statement processing services is postage. The principal costs related to our electronic billing services are employee related expenses, such as salaries and benefits, and long distance telecommunication fees. Supplies and forms represent an additional cost associated with our business management services. These costs are expensed as incurred.

## Results of Operations

The following table sets forth certain items included in our results of operations for each of the three years in the period ended December 31, 2008, expressed as a percentage of our total revenues for these periods (dollar amounts in thousands):

	Year Ended December 31,					
	2008		2007		2006	
	Amount	% Sales	Amount	% Sales	Amount	% Sales
<b>INCOME DATA:</b>						
<b>Sales revenues:</b>						
System sales . . . . .	\$ 41,581	34.7%	\$ 37,981	34.5%	\$ 51,603	44.5%
Support and maintenance . . . . .	53,324	44.6%	50,478	45.9%	46,724	40.3%
Business management services . . . . .	24,759	20.7%	21,554	19.6%	17,647	15.2%
Total sales revenues . . . . .	119,664	100.0%	110,013	100.0%	115,974	100.0%
<b>Costs of sales:</b>						
System sales . . . . .	32,499	27.3%	30,083	27.4%	34,109	29.4%
Support and maintenance . . . . .	19,349	16.2%	19,856	18.0%	19,977	17.2%
Business management services . . . . .	14,595	12.2%	13,318	12.1%	10,183	8.8%
Total costs of sales . . . . .	66,443	55.5%	63,257	57.5%	64,269	55.4%
Gross profit . . . . .	53,221	44.5%	46,756	42.5%	51,705	44.6%
<b>Operating expenses:</b>						
Sales and marketing . . . . .	8,872	7.5%	9,400	8.6%	8,868	7.6%
General and administrative . . . . .	20,638	17.2%	18,308	16.6%	18,171	15.7%
Total operating expenses . . . . .	29,510	24.7%	27,708	25.2%	27,039	23.3%
Operating income . . . . .	23,711	19.8%	19,048	17.3%	24,666	21.3%
<b>Other income:</b>						
Interest income . . . . .	940	0.8%	1,203	1.1%	1,132	1.0%
Income before taxes . . . . .	24,651	20.6%	20,251	18.4%	25,798	22.3%
Income taxes . . . . .	9,213	7.7%	7,335	6.7%	9,983	8.6%
Net income . . . . .	\$ 15,438	12.9%	\$ 12,916	11.7%	\$ 15,815	13.7%

### 2008 Compared to 2007

*Revenues.* Total revenues increased by 8.8%, or \$9.7 million, to \$119.7 million for 2008, from \$110.0 million for 2007.

System sales revenues increased by 9.5%, or \$3.6 million, to \$41.6 million in 2008, from \$38.0 million in 2007. We completed financial and patient software system installations at 27 new hospital clients in 2008, compared to installations at 26 new hospital clients in 2007. System sales to existing customers in 2008 was 21% of total revenues as compared to 24% for 2007.

Support and maintenance revenues increased by 5.7%, or \$2.8 million, to \$53.3 million in 2008, from \$50.5 million in 2007. The increase in revenues from support and maintenance was attributable to an increase in recurring revenues as a result of a larger customer base and additional support and maintenance services to existing customers. We had 656 customers at December 31, 2008, compared to 630 at December 31, 2007. ASP services revenues increased by 9.5%, or \$0.2 million, due to a net increase of 5 ASP clients in 2008. ISP services revenues remained flat.

Business management service revenues increased by 14.9%, or \$3.2 million, to \$24.8 million in 2008, from \$21.6 million in 2007. Business management service revenues increased as a result of continued growth in customer demand for electronic billing and business office services such as private pay collections, insurance follow-up services and contract management services. Electronic billing revenues increased 14.0% and business office services increased 21.1%. We were providing our full suite of business management services to 20 customers at December 31, 2008, compared to 19 customers at December 31, 2007.

*Costs of Sales.* Total costs of sales increased by 5.0%, or \$3.2 million, to \$66.4 million in 2008, from \$63.3 million in 2007. As a percentage of revenues, cost of sales decreased to 55.5% for 2008, from 57.5% for 2007.

Cost of system sales increased by 8.0%, or \$2.4 million, to \$32.5 million for 2008, from \$30.1 million for 2007. The increase in cost of system sales was due to an increase in the average size and in the number of new system sales. The gross margin on system sales increased to 21.8% in 2008 from 20.8% in 2007. This increase was primarily due to relatively fixed employee headcount and payroll expenses with increased system sales. As a percentage of system sales, payroll and related expenses decreased to 38.5% in 2008 from 41.6% in 2007, travel expense increased to 15.2% from 14.6% and cost of software increased to 4.3% from 3.5%. Cost of equipment increased to 19.1% in 2008 from 17.1% in 2007 due to increased costs of system configurations of computers and related peripheral equipment during the year. The Company seeks to control cost of system sales primarily through the management of staffing levels.

Cost of support and maintenance decreased slightly to \$19.3 million in 2008 from \$19.8 million in 2007. The decrease in the cost of support and maintenance was due to a decrease in payroll costs of \$0.5 million. The gross margin on support and maintenance revenues increased to 63.7% for 2008, from 60.7% for 2007. The increase in the gross margin was primarily due to the addition of new customers with a proportionately smaller support personnel staff. Because the same personnel that conduct system installations also provide support and maintenance services the Company is better able to control payroll costs between the two functions through staffing controls.

Our costs associated with business management services increased 9.6%, or \$1.3 million, to \$14.6 million in 2008, from \$13.3 million in 2007. The increase in the cost of business management services was primarily due to increased payroll related expense of \$0.7 million due to additional employees hired to support our growing business management services. Contract labor also increased \$0.4 million as we moved to utilizing more staffing services to control turnover and benefit costs. Postage costs increased \$0.2 million as a result of an increase in transaction volumes as well as a postage rate increase in May of 2008. The gross margin on business management services increased to 41.1% for 2008, from 38.2% for 2007 due to the realization of economies of scale of our existing business management staff across a larger customer base.

*Sales and Marketing Expenses.* Sales and marketing expenses decreased 5.6%, or \$0.5 million, to \$8.9 million in 2008, from \$9.4 million in 2007. The decrease in sales and marketing expenses was attributable to decreased sales commission expense of \$0.4 million and travel related expenses of \$0.1 million. We had an attrition of 2 salespersons during the year, the territories of which were absorbed by existing sales staff.

*General and Administrative Expenses.* General and administrative expenses increased by 12.7%, or \$2.3 million, to \$20.6 million for 2008, from \$18.3 million for 2007. The increase in general and administrative expenses was due to an increase in bad debt expense of \$1.2 million as the result of the write-off of specific accounts during the year. Our collections remained good during the year despite economic conditions, however certain accounts that had been in legal collection efforts were determined to be unsalvageable during the year. Group health insurance expense increased \$0.6 million during the year as the result of negative claims experience. Legal and accounting expense increased \$0.5 million during the year as the result of non-recurring tax credit consulting expenses and contract settlements. These cost increases were offset partially by decreases in payroll and related costs and retirement plan costs due to some minor attrition of administrative employees and retirement plan participants.

As a result of the foregoing factors, income before taxes increased by 21.7%, or \$4.4 million, to \$24.7 million for 2008, from \$20.3 million for 2007.

## **2007 Compared to 2006**

*Revenues.* Total revenues decreased by 5.1%, or \$6.0 million, to \$110.0 million for 2007, from \$116.0 million for 2006.

System sales revenues decreased by 26.4%, or \$13.6 million, to \$38.0 million in 2007, from \$51.6 million in 2006. We completed software system installations at 26 new hospital clients in 2007, compared to installations at 42 new hospital clients in 2006. The decrease in installations at new hospital clients in 2007 was due primarily to increased competition. System sales to existing customers in 2007 was 24% of total revenues as compared to 25% for 2006.

Support and maintenance revenues increased by 8.0%, or \$3.8 million, to \$50.5 million in 2007, from \$46.7 million in 2006. The increase in revenues from support and maintenance was attributable to an increase in recurring revenues as a result of a larger customer base and additional system sales to existing customers. We had 630 customers at December 31, 2007, compared to 615 at December 31, 2006. ASP services revenues increased by 17.6%, or \$0.3 million, due to a net increase of 5 ASP clients in 2007. ISP services revenues remained unchanged.

Business management service revenues increased by 22.1%, or \$3.9 million, to \$21.6 million in 2007, from \$17.6 million in 2006. Business management service revenues increased as a result of continued growth in customer demand for electronic billing, business office and statement processing services. Statement processing revenues increased 8.8% and electronic billing revenues increased 14.3%. Revenue from business office services increased 31.4%. We were providing full business management services to 19 customers at December 31, 2007, compared to 18 customers at December 31, 2006.

*Costs of Sales.* Total costs of sales decreased by 1.6%, or \$1.0 million, to \$63.3 million in 2007, from \$64.3 million in 2006. As a percentage of revenues, cost of sales increased to 57.5% for 2007, from 55.4% for 2006.

Cost of system sales decreased by 11.8%, or \$4.0 million, to \$30.1 million for 2007, from \$34.1 million for 2006. The decrease in the cost of system sales is primarily due to decreased new system sales. The gross margin on system sales decreased to 20.8% in 2007 from 33.9% in 2006. This decrease is primarily due to relatively fixed employee headcount and payroll expenses with decreased system sales. As a percentage of system sales, payroll and related expenses increased to 41.6% in 2007 from 30% in 2006, travel expense increased to 14.6% from 13.4% and cost of software increased to 3.5% from 2.4%. Cost of equipment decreased to 17.1% in 2007 from 19.0% in 2006 due to softening costs of computers and related peripheral equipment during the year. In a more competitive market for community hospital information technology systems, we seek to contain costs through hiring freezes, wage controls and more efficient use of existing personnel across installation and support functions.

Cost of support and maintenance decreased slightly to \$19.9 million in 2007 from \$20.0 million in 2006. The decrease in the cost of support and maintenance was caused primarily by a slight decrease in payroll, telephony and supply costs of \$0.1 million. The gross margin on support and maintenance revenues increased to 60.7% for 2007, from 57.2% for 2006. The increase in the gross margin was primarily due to the addition of new customers with a proportionately smaller increase in support personnel and more efficient use of system installation personnel in support functions.

Our costs associated with business management services increased 30.8%, or \$3.1 million, to \$13.3 million in 2007, from \$10.2 million in 2006. The increase in the cost of business management services was primarily due

to increased payroll related expense of \$2.3 million due to additional employees hired to support our growing business office management services. Postage costs increased \$0.6 million as a result of an increase in transaction volumes of our statement processing services as well as a postage rate increase in May of 2007. The gross margin on business management services decreased to 38.2% for 2007, from 42.3% for 2006.

*Sales and Marketing Expenses.* Sales and marketing expenses increased 6.0%, or \$0.5 million, to \$9.4 million in 2007, from \$8.9 million in 2006. The increase in sales and marketing expenses was attributable to increased payroll related expenses of \$0.2 million and travel related expenses of \$0.3 million.

*General and Administrative Expenses.* General and administrative expenses increased by 0.8%, or \$0.1 million, to \$18.3 million for 2007, from \$18.2 million for 2006. The increase in general and administrative expenses was due to increases in taxes and licenses of \$0.2 million, bad debt expense of \$0.2 million, employee group and commercial insurance of \$0.1 million, retirement plan contributions of \$0.1 million and occupancy costs of \$0.1 million. These increases were offset by decreases in payroll related expense of \$0.4 million and customer user group meeting expense of \$0.3 million.

As a result of the foregoing factors, income before taxes decreased by 21.5%, or \$5.5 million, to \$20.3 million for 2007, from \$25.8 million for 2006.

## **Liquidity and Capital Resources**

As of December 31, 2008, we had \$11.7 million in cash and cash equivalents. Management believes that cash on hand plus cash generated from our normal operating activities should be adequate to fund our business for the foreseeable future. Our principal source of liquidity has been cash provided by operating activities. Cash provided by operating activities has been used primarily to fund the growth in our business and return cash to our shareholders in the form of dividends. Because of our strong cash position, our board of directors decided to begin paying a quarterly dividend in 2003. We declared and paid dividends in the aggregate amount of \$15.5 million each year for 2008, 2007 and 2006. We believe that paying dividends is an effective way of providing an investment return to our stockholders and a beneficial use of our cash.

Net cash provided by operating activities totaled \$15.7 million, \$19.1 million and \$14.5 million for 2008, 2007 and 2006, respectively. The decrease in net cash provided by operating activities in 2008 predominantly resulted from an increase in accounts receivable and financing receivables. Our cash collections remained strong in 2008, but we did experience an increase in requests by customers for payment terms and financing arrangements in 2008 as a result of the deteriorating financial markets and decreasing availability of credit from third parties.

Net cash used in investing activities totaled \$1.6 million, \$1.8 million and \$2.4 million for 2008, 2007 and 2006, respectively. In 2008, we purchased \$1.1 million of property and equipment. We also purchased investments in the amount of \$0.5 million which are classified as available for sale. In 2007, we purchased investments in the amount of \$0.5 million which are classified as available for sale. We also purchased \$1.2 million of property and equipment. In 2006, we used cash of \$0.4 million for the purchase of investments and \$2.1 million for the purchase of property and equipment.

Net cash used in financing activities totaled \$14.2 million, \$14.3 million and \$14.9 million for 2008, 2007 and 2006, respectively. During 2008, we declared and paid dividends in the aggregate amount of \$15.6 million. We also received proceeds of \$1.2 million and a tax benefit of \$0.2 million from the exercise of employee stock options. During 2007, we declared and paid dividends in the aggregate amount of \$15.5 million. We also received proceeds of \$1.0 million and a tax benefit of \$0.2 million from the exercise of employee stock options. During 2006, we declared and paid dividends in the aggregate amount of \$15.5 million and received proceeds of \$0.3 million and a tax benefit of \$0.2 million from the exercise of employee stock options.

Our days sales outstanding for the years 2008, 2007 and 2006 were 48, 48 and 43 days, respectively.

We currently do not have a bank line of credit or other credit facility in place. Because we have no debt, we are not subject to contractual restrictions or other influences on our operations, such as payment demands and restrictions on the use of operating funds that are typically associated with debt. If we borrow money in the future, we will likely be subject to operating and financial covenants that could limit our ability to operate as profitably as we have in the past. Defaults under applicable loan agreements could result in the demand by lenders for immediate payment of substantial funds and substantial restrictions on expenditures, among other things. Due to the current economic recession and disruption in the capital and credit markets, additional capital, if needed, may not be available on terms favorable to us, or at all.

### Related Party Transactions

We lease our corporate headquarters campus from C.P. Investments, Inc., an Alabama corporation, the stockholders of which are John Morrissey, John Heyer, Bob O'Donnell, Elissa Stillings, Kevin P. Wilkins, Tabitha M. Wilkins Olzinski, Ellen M. Harvey, Michael K. Muscat, Jr. and Susan M. Slaton. All of these individuals are either stockholders of CPSI, or, in the case of Ms. Stillings, the spouse of a stockholder. Additionally, Mr. Morrissey was a director until May 8, 2008, Mr. Muscat is one of our executive officers, and Ms. Harvey, Mr. Muscat and Ms. Slaton are the children of one of our directors. In 2008, we made total lease payments in the amount of \$1,697,479 to C.P. Investments, Inc. Under these lease agreements, we expect to make annual lease payments in 2009 in the amount of \$1,697,479, subject to adjustment as set forth in the agreements. The annual rent payable under these leases has been determined by an independent, third-party appraisal firm. The parties may agree, from time to time, to make adjustments in the annual rent payable under these leases based on subsequent third-party appraisals.

### Contractual Obligations

Our real estate leases, most of which are with related parties as described above, are our only material contractual obligations requiring payments in the future. Our payments under these leases subsequent to December 31, 2008, will be as follows:

Contractual Obligations	Payment due by period				
	Total	Less than 1 year	1-3 Years	3-5 Years	More than 5 years
Operating Lease Obligations . . . . .	\$6,745,368	1,762,999	3,525,998	1,082,329	374,042

The table above excludes any amounts related to the payment of the \$207,000 income tax uncertainties as the Company cannot make a reasonably reliable estimate of the periods of cash settlements with the respective taxing authorities.

### Off-Balance Sheet Arrangements

Our only off-balance sheet arrangement, as defined by Item 303(a)(4) of SEC Regulation S-K, consists of our guarantee of certain lease obligations of Solis Healthcare, LP ("Solis Healthcare") to Winthrop Resources Corporation ("Winthrop") under a lease agreement. Winthrop purchased a software system from us and leased it to Solis Healthcare in the first quarter of 2008. We provided this guarantee in order to facilitate Solis Healthcare in leasing the new system.

The lease has an initial term of five years and continues from year to year thereafter until terminated. We are contingently liable as guarantor under the lease such that, if at any time prior to the termination of the lease, Solis Healthcare (i) enters into bankruptcy or (ii) defaults for more than 60 days in its payments or performance under the lease, we will be obligated to perform under the guaranty by making the required lease payments, including late fees and penalties. The guaranty runs for the entire term of the lease; however, the maximum potential



amount of future payments that we would be required to make to Winthrop under the guaranty is \$2,145,000, plus any fees and costs that Winthrop incurs in collecting amounts due under the lease (including attorney's fees and costs). We recorded \$2,154,389, the amount billed to date for the new system installation, as revenue during the first quarter of 2008. Due to the contingent nature of the guaranty, the maximum amount of the guaranty is not recorded on our balance sheet; however, when necessary, we record reserves to cover potential losses. A liability in the amount of \$244,138, the estimated fair value of the guaranty, is recorded on our balance sheet as an other accrued liability at December 31, 2008. See Note 11 to the financial statements for additional information.

### **Critical Accounting Policies**

*General.* Our discussion and analysis of our financial condition and results of operations are based on our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. We are required to make some estimates and judgments that affect the preparation of these financial statements. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, but actual results may differ from these estimates under different assumptions or conditions.

*Revenue Recognition.* We recognize revenue in accordance with SEC Staff Accounting Bulletin (SAB) No. 101, *Revenue Recognition in Financial Statements*, as amended by SAB No. 104, *Revenue Recognition*, and the American Institute of Certified Public Accountants Statement of Position (SOP) 97-2, *Software Revenue Recognition*. SAB No. 104 and SOP 97-2 require that four basic criteria must be met before revenues can be recognized: (1) persuasive evidence that an arrangement exists; (2) delivery has occurred or services have been rendered; (3) the fee is fixed and determinable; and (4) collectibility is reasonably assured. Determination of criteria (3) and (4) are based on our judgment regarding the fixed nature of the fee charged for services rendered and products delivered and the collectibility of those fees. Should changes in conditions cause us to determine these criteria are not met for certain future transactions, revenues recognized for any reporting period could be adversely affected.

*Allowance for Doubtful Accounts.* Trade accounts receivable are stated at the amount the Company expects to collect and do not bear interest. The collectibility of trade receivable balances is regularly evaluated based on a combination of factors such as customer credit-worthiness, past transaction history with the customer, current economic industry trends and changes in customer payment patterns. If it is determined that a customer will be unable to fully meet its financial obligation, such as in the case of a bankruptcy filing or other material events impacting its business, a specific reserve for bad debt is recorded to reduce the related receivable to the amount expected to be recovered.

*Stock-Based Compensation.* The Company previously accounted for stock-based compensation using the intrinsic value method prescribed in APB No. 25. The Company grants stock options with exercise prices equal to the respective grant date's fair market value and, as such, recognized no compensation cost for such stock options under APB No. 25. Effective January 1, 2006, we adopted the provisions of SFAS No. 123R for our stock based awards. See Note 6 of the Financial Statements for further discussion of the impact on the Company's earnings.

### **Backlog**

Backlog consists of revenues we reasonably expect to recognize over the next twelve months under existing contracts. The revenues to be recognized may relate to a combination of one-time fees for system sales, and recurring fees for support, business management, ASP and ISP services. As of December 31, 2008, we had a twelve-month backlog of approximately \$20.7 million in connection with non-recurring system purchases and approximately \$80.0 million in connection with recurring payments under support, business management, ASP and ISP contracts.

## Quantitative and Qualitative Disclosures about Market and Interest Rate Risk

Our exposure to market risk relates primarily to the potential change in the value of our investment portfolio as a result of fluctuations in interest rates. The primary purpose of our investment activities is to preserve principal while maximizing the income we receive from our investments without significantly increasing risk of loss. As of December 31, 2008, our investment portfolio consisted of a variety of financial instruments, including, but not limited to, money market securities, commercial paper and high quality government and corporate obligations. It is our intent to ensure the safety and preservation of our invested principal funds by limiting default risk, market risk, and reinvestment risk. We do not hold financial instruments for trading or other speculative purposes. The securities in our investment portfolio are classified as available-for-sale and, consequently, are recorded on our balance sheet as a current asset at fair market value with their unrealized gain or loss reflected as a component of accumulated other comprehensive income (loss) in stockholders' equity.

Investments in both fixed rate and floating rate interest earning instruments carry a degree of interest rate risk. Fixed rate securities may have their fair market value adversely impacted due to a rise in interest rates, while floating rate securities may produce less income than expected if interest rates fall. Due in part to these factors, our future investment income may fall short of expectation due to changes in interest rates or we may suffer losses in principal if forced to sell securities which have declined in market value due to changes in interest rates.

We believe that the market risk arising from our holdings of these financial instruments is minimal. Due to the conservative allocation of our investment portfolio, we do not believe that an immediate 10% increase in interest rates would have a material effect on the market value of our portfolio. Since we have the ability to liquidate this portfolio, we do not expect our operating results or cash flows to be materially effected to any significant degree by a sudden change in market interest rates on our investment portfolio. We do not utilize derivative financial instruments to manage our interest rate risks.

The table that follows presents fair values of principal amounts and weighted average interest rates for our investment portfolio as of December 31, 2008 and 2007.

	Aggregate Fair Value		Weighted Average Interest Rate	
	2008	2007	2008	2007
<b>Cash and Cash Equivalents:</b>				
Cash	\$ 2,047,289	\$ 6,124,302	0.00%	0.00%
Money market funds	6,969,523	58,836	1.19%	4.32%
Certificates of deposit	2,727,654	5,622,879	2.90%	4.69%
Total cash and cash equivalents	<u>\$11,744,466</u>	<u>\$11,806,017</u>		
<b>Short-Term Investments: (1)</b>				
Accrued Income	\$ 180,223	\$ 152,569	0.00%	0.00%
Money market funds	269,953	224,791	1.59%	4.57%
Commercial paper	200,000	—	0.00%	—
Obligations of the U.S. Treasury, U.S Government corporations and agencies	3,959,406	2,772,407	4.59%	3.91%
Corporate debt securities	2,963,240	1,298,537	4.78%	4.41%
Total short-term investments	<u>\$ 7,572,822</u>	<u>\$ 4,448,304</u>		
<b>Long-Term Investments: (2)</b>				
Obligations of the U.S. Treasury, U.S Government corporations and agencies	\$ 880,331	\$ 2,854,310	3.66%	4.81%
Mortgage backed securities	189,724	297,661	5.00%	5.00%
Municipal obligations	—	800,000	—	3.55%
Corporate debt securities	3,202,769	2,952,182	5.05%	4.74%
Total long-term investments	<u>\$ 4,272,824</u>	<u>\$ 6,904,153</u>		

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- (1) Reflects instruments with a contractual maturity of less than one year.
  - (2) Reflects instruments with a contractual maturity of one year or more.

**Recent Accounting Pronouncements**

Reference is made to Note 2 to the financial statements for a discussion of accounting pronouncements that have been recently issued which we have not yet adopted.

**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The information required by this item is contained in Item 7 herein under the heading “Quantitative and Qualitative Disclosures about Market and Interest Rate Risk.”

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

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All other schedules to the financial statements required by Article 9 of Regulation S-X are not applicable and therefore have been omitted.

## MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934. CPSI's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. CPSI's internal control over financial reporting includes those policies and procedures that:

- (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of CPSI;
- (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of CPSI are being made only in accordance with authorizations of management and directors of CPSI; and
- (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of CPSI's assets that could have a material effect on the financial statements.

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

Management assessed the effectiveness of CPSI's internal control over financial reporting as of December 31, 2008. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework.

Based on our assessment and those criteria, management believes that CPSI maintained effective internal control over financial reporting as of December 31, 2008.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM  
ON FINANCIAL STATEMENTS**

Board of Directors and Shareholders  
Computer Programs and Systems, Inc.

We have audited the accompanying balance sheets of **Computer Programs and Systems, Inc.** (a Delaware corporation) as of December 31, 2008 and 2007, and the related statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2008. Our audits of the basic financial statements included the financial statement schedule listed in the index appearing under Item 8 Schedule II. These financial statements and financial statement schedule are the responsibility of the Computer Programs and Systems, Inc.'s management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Computer Programs and Systems, Inc. as of December 31, 2008 and 2007, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2008 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Computer Program and Systems, Inc.'s internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated February 27, 2009 expressed an unqualified opinion.

/s/ GRANT THORNTON LLP

Atlanta, Georgia  
February 27, 2009

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM  
ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

Board of Directors and Shareholders  
Computer Programs and Systems, Inc.

We have audited **Computer Programs and Systems, Inc.’s** (a Delaware Corporation) internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Computer Programs and Systems, Inc.’s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Report of Management. Our responsibility is to express an opinion on Computer Programs and Systems, Inc.’s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

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

In our opinion, Computer Programs and Systems, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control—Integrated Framework* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the balance sheets of Computer Programs and Systems, Inc. as of December 31, 2008 and 2007, and the related statements of income, stockholders’ equity, and cash flows for each of the three years in the period ended December 31, 2008, and our report dated February 27, 2009 expressed an unqualified opinion on those financial statements.

/s/ GRANT THORNTON LLP

Atlanta, Georgia  
February 27, 2009

## COMPUTER PROGRAMS AND SYSTEMS, INC.

### Balance Sheets

	<u>December 31, 2008</u>	<u>December 31, 2007</u>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents .....	\$11,744,466	\$11,806,017
Investments .....	11,845,646	11,352,457
Accounts receivable, net of allowance for doubtful accounts of \$628,000 and \$949,000, respectively .....	15,600,865	14,333,934
Financing receivables, current portion .....	2,357,014	1,734,954
Inventories .....	1,374,302	1,450,164
Deferred tax assets .....	1,331,708	1,393,602
Prepaid income taxes .....	319,152	—
Prepaid expenses .....	501,265	505,565
Total current assets .....	<u>45,074,418</u>	<u>42,576,693</u>
Property and equipment		
Land .....	936,026	936,026
Maintenance equipment .....	3,442,925	3,821,013
Computer equipment .....	5,818,875	5,663,741
Office furniture and equipment .....	1,749,348	1,576,728
Automobiles .....	132,926	132,926
	<u>12,080,100</u>	<u>12,130,434</u>
Less accumulated depreciation .....	(7,267,069)	(6,621,407)
Net property and equipment .....	4,813,031	5,509,027
Financing receivables .....	2,979,639	2,322,471
Total assets .....	<u>\$52,867,088</u>	<u>\$50,408,191</u>
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable .....	\$ 1,829,505	\$ 1,716,882
Deferred revenue .....	3,728,356	3,580,709
Accrued vacation .....	2,297,116	2,112,256
Income taxes payable .....	—	541,987
Other accrued liabilities .....	3,996,547	3,506,845
Total current liabilities .....	<u>11,851,524</u>	<u>11,458,679</u>
Deferred tax liabilities .....	456,394	571,142
Stockholders' equity:		
Common stock, \$0.001 par value; 30,000,000 shares authorized; 10,893,711 and 10,807,444 shares issued and outstanding .....	10,894	10,807
Additional paid-in capital .....	27,006,573	24,658,818
Accumulated other comprehensive income .....	56,715	44,825
Retained earnings .....	13,484,988	13,663,920
Total stockholders' equity .....	<u>40,559,170</u>	<u>38,378,370</u>
Total liabilities and stockholders' equity .....	<u>\$52,867,088</u>	<u>\$50,408,191</u>

See accompanying notes.



**COMPUTER PROGRAMS AND SYSTEMS, INC.**

**Statements of Income**

	Year ended December 31,		
	2008	2007	2006
<b>Sales revenues:</b>			
System sales .....	\$ 41,581,002	\$ 37,981,258	\$ 51,602,788
Support and maintenance .....	53,324,398	50,477,558	46,724,345
Business management services .....	24,758,690	21,553,979	17,646,684
Total sales revenues .....	119,664,090	110,012,795	115,973,817
<b>Costs of sales:</b>			
System sales .....	32,498,956	30,082,999	34,108,712
Support and maintenance .....	19,349,244	19,856,210	19,976,670
Business management services .....	14,594,711	13,317,539	10,183,221
Total costs of sales .....	66,442,911	63,256,748	64,268,603
Gross profit .....	53,221,179	46,756,047	51,705,214
<b>Operating expenses:</b>			
Sales and marketing .....	8,872,137	9,400,341	8,867,860
General and administrative .....	20,638,012	18,308,107	18,171,784
Total operating expenses .....	29,510,149	27,708,448	27,039,644
Operating income .....	23,711,030	19,047,599	24,665,570
<b>Other income:</b>			
Interest income .....	940,191	1,203,332	1,131,906
Income before taxes .....	24,651,221	20,250,931	25,797,476
Income taxes .....	9,213,226	7,335,323	9,982,931
Net income .....	\$ 15,437,995	\$ 12,915,608	\$ 15,814,545
Net income per share - basic .....	\$ 1.43	\$ 1.21	\$ 1.49
Net income per share - diluted .....	\$ 1.43	\$ 1.20	\$ 1.48
Weighted average shares outstanding			
Basic .....	10,772,160	10,698,143	10,638,028
Diluted .....	10,790,769	10,740,947	10,717,865

See accompanying notes.

**COMPUTER PROGRAMS AND SYSTEMS, INC.**

**Statements of Stockholders' Equity**

	<u>Common Shares</u>	<u>Common Stock</u>	<u>Additional Paid-in Capital</u>	<u>Deferred Compensation</u>	<u>Accumulated Other Comprehensive Income(Loss)</u>	<u>Retained Earnings</u>	<u>Total Stockholders' Equity</u>
Balance at December 31, 2005 .....	10,624,901	\$10,625	\$20,576,268	\$(72,305)	\$(67,979)	\$ 15,941,540	\$ 36,388,149
Net income .....	—	—	—	—	—	15,814,545	15,814,545
Issuance of common stock .....	154,779	155	337,636	—	—	—	337,791
Forfeiture of restricted stock .....	(23,299)	(24)	24	—	—	—	—
Unrealized gain on investments held for sale, net of tax .....	—	—	—	—	60,646	—	60,646
Stock-based compensation .....	—	—	1,376,177	—	—	—	1,376,177
Dividends .....	—	—	—	—	—	(15,480,985)	(15,480,985)
Income tax benefit from stock option exercises ...	—	—	210,167	—	—	—	210,167
Adoption of SFAS No. 123R .....	—	—	(72,305)	72,305	—	—	—
Balance at December 31, 2006 .....	<u>10,756,381</u>	<u>\$10,756</u>	<u>\$22,427,967</u>	<u>\$ —</u>	<u>\$ (7,333)</u>	<u>\$ 16,275,100</u>	<u>\$ 38,706,490</u>
Net income .....	—	—	—	—	—	12,915,608	12,915,608
Issuance of common stock .....	60,383	60	996,499	—	—	—	996,559
Forfeiture of restricted stock .....	(9,320)	(9)	9	—	—	—	—
Unrealized gain on investments held for sale, net of tax .....	—	—	—	—	52,158	—	52,158
Stock-based compensation .....	—	—	1,024,975	—	—	—	1,024,975
Dividends .....	—	—	—	—	—	(15,526,788)	(15,526,788)
Income tax benefit from stock option exercises ...	—	—	209,368	—	—	—	209,368
Balance at December 31, 2007 .....	<u>10,807,444</u>	<u>\$10,807</u>	<u>\$24,658,818</u>	<u>\$ —</u>	<u>\$ 44,825</u>	<u>\$ 13,663,920</u>	<u>\$ 38,378,370</u>
Net income .....	—	—	—	—	—	15,437,995	15,437,995
Issuance of common stock .....	86,267	87	1,152,207	—	—	—	1,152,294
Unrealized gain on investments held for sale, net of tax .....	—	—	—	—	11,890	—	11,890
Stock-based compensation .....	—	—	914,147	—	—	—	914,147
Dividends .....	—	—	—	—	—	(15,616,927)	(15,616,927)
Income tax benefit from restricted stock dividends .....	—	—	43,278	—	—	—	43,278
Income tax benefit from stock option exercises ...	—	—	238,123	—	—	—	238,123
Balance at December 31, 2008 .....	<u>10,893,711</u>	<u>\$10,894</u>	<u>\$27,006,573</u>	<u>\$ —</u>	<u>\$ 56,715</u>	<u>\$ 13,484,988</u>	<u>\$ 40,559,170</u>

See accompanying notes.

**COMPUTER PROGRAMS AND SYSTEMS, INC.**

**Statements of Cash Flows**

	Year ended December 31,		
	2008	2007	2006
<b>Operating Activities</b>			
Net income	\$ 15,437,995	\$ 12,915,608	\$ 15,814,545
Adjustments to net income:			
Provision for bad debt	1,338,135	90,017	(52,004)
Deferred taxes	(61,894)	41,988	(434,332)
Stock based compensation	914,147	1,024,975	1,376,176
Income tax benefit from stock option exercises	(238,123)	(209,368)	(210,167)
Income tax benefit from restricted stock dividends	(43,278)	—	—
Depreciation	1,811,097	1,968,501	1,976,319
Changes in operating assets and liabilities:			
Accounts receivable	(2,605,066)	(328,160)	(1,629,990)
Financing receivables	(1,279,227)	516,769	(1,800,496)
Inventories	75,861	217,955	320,065
Prepaid expenses	4,300	(186,032)	(54,405)
Accounts payable	112,624	512,603	(846,916)
Deferred revenue	147,648	1,306,117	(1,011,086)
Other liabilities	674,561	408,228	650,277
Income taxes payable	(579,739)	858,781	371,062
Net cash provided by operating activities	15,709,041	19,137,982	14,469,048
<b>Investing Activities</b>			
Purchases of property and equipment	(1,115,102)	(1,222,328)	(2,058,482)
Purchases of investments	(472,258)	(548,898)	(387,108)
Net cash used in investing activities	(1,587,360)	(1,771,226)	(2,445,590)
<b>Financing Activities</b>			
Proceeds from exercise of stock options, net	1,152,294	996,559	337,792
Dividends paid	(15,616,927)	(15,526,788)	(15,480,985)
Income tax benefit from stock option exercises	238,123	209,368	210,167
Income tax benefit from restricted stock dividends	43,278	—	—
Net cash used in financing activities	(14,183,232)	(14,320,861)	(14,933,026)
Increase (decrease) in cash and cash equivalents	(61,551)	3,045,895	(2,909,568)
Cash and cash equivalents at beginning of year	11,806,017	8,760,122	11,669,690
Cash and cash equivalents at end of year	\$ 11,744,466	\$ 11,806,017	\$ 8,760,122
<b>Supplemental disclosure of cash flow information</b>			
Cash paid for interest	\$ —	\$ —	\$ —
Cash paid for income taxes	\$ 9,647,407	\$ 6,434,464	\$ 10,046,201

See accompanying notes.

**COMPUTER PROGRAMS AND SYSTEMS, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2008**

**1. NATURE OF OPERATIONS**

Computer Programs and Systems, Inc. (CPSI or the Company) is a healthcare information technology solutions provider which was formed and commenced operations in 1979. The Company provides, on an integrated basis, enterprise-wide clinical management, access management, patient financial management, health information management, strategic decision support, resource planning management and enterprise application integration solutions to healthcare organizations throughout the United States. Additionally, CPSI provides other information technology solutions, including business management services, remote hosting, networking technologies and other related services. The Company operates in a single segment reporting to the chief executive officer, based on the criteria of Statement of Accounting Standards No. 131, *Disclosures about Segments of an Enterprise and Related Information*.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

***Cash and Cash Equivalents***

Cash and cash equivalents can include time deposits, commercial paper, municipal bond funds and bankers acceptances with original maturities of three months or less or that are highly-liquid and readily convertible to a known amount of cash. These investments are stated at cost, which approximates market, due to their short duration or liquid nature.

***Investments***

The Company accounts for investments in accordance with Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Accordingly, investments are classified as available-for-sale securities and are reported at fair value, with unrealized gains and losses excluded from earnings and reported in a separate component of stockholders' equity. The Company's management determines the appropriate classifications of investments in fixed maturity securities at the time of acquisition and re-evaluates the classifications at each balance sheet date. The Company's investments in fixed maturity securities are classified as available-for-sale.

Investments are comprised of the following at December 31, 2008:

	<u>Amortized Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>
Short term investments (cash and accrued income) . . . . .	\$ 650,092	\$ 83	\$ —	\$ 650,175
Obligations of U.S. Treasury, U.S. government corporations and agencies . . .	4,753,603	86,135	—	4,839,738
Mortgaged backed securities . . . . .	197,026	—	7,302	189,724
Corporate bonds . . . . .	6,151,949	44,569	30,509	6,166,009
	<u>\$11,752,670</u>	<u>\$130,787</u>	<u>\$37,811</u>	<u>\$11,845,646</u>

Shown below are the amortized cost and estimated fair value of securities with fixed maturities at December 31, 2008, by contract maturity date. Actual maturities may differ from contractual maturities because issuers of certain securities retain early call or prepayment rights.

	<u>Amortized Cost</u>	<u>Fair Value</u>
Due in 2009 .....	\$ 7,501,178	\$ 7,572,822
Due in 2010 .....	2,636,638	2,651,725
Due in 2011 .....	1,417,828	1,431,375
Due thereafter .....	197,026	189,724
	<u>\$11,752,670</u>	<u>\$11,845,646</u>

Investments are comprised of the following at December 31, 2007:

	<u>Amortized Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>
Short term investments .....	\$ 377,360	\$ —	\$ —	\$ 377,360
Obligations of U.S. Treasury, U.S. government corporations and agencies ...	5,571,662	55,860	804	5,626,718
Mortgaged backed securities .....	298,097	—	436	297,661
Municipal Obligations .....	800,000	—	—	800,000
Corporate bonds .....	4,219,731	36,840	5,853	4,250,718
	<u>\$11,266,850</u>	<u>\$92,700</u>	<u>\$7,093</u>	<u>\$11,352,457</u>

#### ***Accounts Receivable and Allowance for Doubtful Accounts***

Trade accounts receivable are stated at the amount the Company expects to collect and do not bear interest. The collectibility of trade receivable balances is regularly evaluated based on a combination of factors such as customer credit-worthiness, past transaction history with the customer, current economic industry trends and changes in customer payment patterns. If it is determined that a customer will be unable to fully meet its financial obligation, such as in the case of a bankruptcy filing or other material events impacting its business, a specific reserve for bad debt is recorded to reduce the related receivable to the amount expected to be recovered.

#### ***Inventories***

Inventories are stated at cost using the average cost method. The Company's inventories are composed of computer equipment, forms and supplies.

#### ***Property and Equipment***

Property and equipment is recorded at cost, less accumulated depreciation. Additions and improvements to property and equipment that materially increase productive capacity or extend the life of an asset are capitalized. Maintenance, repairs and minor renewals are expensed as incurred. Upon retirement or other disposition of such assets, the related costs and accumulated depreciation are removed from the respective accounts and any resulting gain or loss is included in the results of operations.

Depreciation expense is computed using the straight-line method over the asset's useful life, generally 5 years. The Company reviews for the possible impairment of long-lived assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Depreciation expense is reported on the income statement as a component of support and maintenance costs and operating expenses.

## ***Deferred Revenue***

Deferred revenue represents amounts received from customers under licensing agreements and implementation fees for which the revenue earnings process has not been completed.

## ***Revenue Recognition***

The Company recognizes revenue in accordance with accounting principles generally accepted in the United States of America, principally:

- Statement of Position (“SOP”) No. 97-2, *Software Revenue Recognition*, issued by the American Institute of Certified Public Accountants (“AICPA”).
- AICPA SOP No. 98-9, *Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions*.
- Staff Accounting Bulletin (“SAB”) No. 101, *Revenue Recognition in Financial Statements*, issued by the United States Securities and Exchange Commission, as amended by SAB No. 104.
- The Emerging Issues Task Force (“EITF”) Issue 00-3, *Application of AICPA Statement of Position 97-2 to Arrangements That Include the Right to Use Software Stored on Another Entities’ Hardware*.
- EITF Issue 03-5, *Applicability of AICPA Statement of Position 97-2 to Non-Software Deliverables in an Arrangement Containing More-Than-Incidental Software*.

The Company’s revenue is generated from three sources:

- the sale of information systems, which includes software, conversion and installation services, hardware, peripherals, forms and supplies.
- the provision of system support services, which includes software application support, hardware maintenance, continuing education, application service provider (“ASP”) products, and internet service provider (“ISP”) products.
- the provision of business management services, which includes electronic billing, statement processing, payroll processing and accounts receivable management.

The Company enters into contractual obligations to sell hardware, perpetual software licenses, installation and training services, and maintenance services. Revenue from hardware sales is recognized upon shipment, when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collection is probable. Revenue from the perpetual software licenses and installation and training services are recognized using the residual method. The residual method allocates an amount of the arrangement to the elements for which fair value can be determined and any remaining arrangement consideration (the “residual revenue”) is then allocated to the delivered elements. The fair value of maintenance services is determined based on vendor specific objective evidence (“VSOE”) of fair value and is deferred and recognized as revenue ratably over the maintenance term. VSOE of fair value of maintenance services is determined by reference to the price the Company’s customers are required to pay for the services when sold separately via renewals. The residual revenue is allocated to the perpetual license and installation and training services and is recognized over the term that the installation and training services are performed for the entire arrangement. The method of recognizing revenue for the perpetual license for the associated modules included in the arrangement and related installation and training services over the term the services are performed is on a module by module basis as the respective installation and training for each specific module is completed as this is representative of the pattern of provision of these services. The installation and training services are normally completed in three to four weeks.

Revenue derived from maintenance contracts primarily includes revenue from software application support, hardware maintenance, continuing education and related services. Maintenance contracts are typically sold for a separate fee with initial contract periods ranging from one to seven years, with renewal for additional periods thereafter. Maintenance revenue is recognized ratably over the term of the maintenance agreement.

The Company accounts for ASP contracts in accordance with the EITF 00-3, *Application of AICPA Statement of Position 97-2 to Arrangements That Include the Right to Use Software Stored on Another Entity's Hardware*. EITF 00-3 states that the software element of ASP services is covered by SOP 97-2 only "if the customer has the contractual right to take possession of the software at any time during the hosting period without significant penalty and it is feasible for the customer to either run the software on its own hardware or contract with another party related to the vendor to host the software." Each ASP contract includes a system purchase and buyout clause, and this clause specifies the total amount of the system buyout. In addition, a clause is included which states that should the system be bought out by the customer, the customer would be required to enter into a general support agreement (for post-contract support services) for the remainder of the original ASP term. Accordingly, the Company has concluded that ASP customers do not have the right to take possession of the system without significant penalty (i.e. the purchase price of the system), and thus ASP revenue of CPSI does not fall within the scope of SOP 97-2. In accordance with SAB No. 104, revenue is recognized when the services are performed.

Revenue for ISP and business management services are recognized in the period in which the services are performed.

The Company collects various taxes from customers and remits these amounts to applicable taxing authorities. The Company's accounting policy is to exclude these taxes from revenues and cost of sales.

### ***Stock Based Compensation***

Effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123 (Revised 2004), *Share Based Payment* (SFAS No. 123R). SFAS No. 123R establishes accounting for stock-based awards exchanged for employee services. Accordingly, stock-based compensation cost is measured at grant date based on the fair value of the award, and is recognized as an expense on a straight-line basis over the employee's requisite service period.

### ***Research and Development Costs***

Research and development costs are expensed as incurred. Research and development costs totaled approximately \$1,833,000, \$1,881,000 and \$1,385,000 for the years ended December 31, 2008, 2007 and 2006, respectively. Research and development expense is included in cost of support and maintenance in the accompanying statements of income.

### ***Advertising***

Advertising costs are expensed as incurred. Advertising expense was approximately \$70,000, \$15,000 and \$5,000, for the years ended December 31, 2008, 2007 and 2006, respectively, and are recorded in sales and marketing expenses in the accompanying statements of income.

### ***Shipping and Handling Costs***

Shipping and handling costs are expensed as incurred and included in general and administrative expenses. Shipping and handling costs totaled approximately \$1,208,000, \$1,074,000 and \$974,000 for the years ended December 31, 2008, 2007 and 2006, respectively.

### ***Use of Estimates***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires that management make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosures of contingent assets and liabilities at the date of the financial statements and the reported revenues and expenses during the reporting periods. Actual results could differ from those estimates.

### ***Accounting Standards Adopted in 2008***

The Company adopted the provisions of Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (“SFAS 159”), on January 1, 2008. SFAS 159 permits entities to choose, at specified election dates, to measure eligible items at fair value (the “fair value option”). Under this pronouncement, a business entity must report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting period. The Company did not elect the fair value option for any items on its balance sheets and has not determined whether or not it will elect this option for any financial instruments that may be acquired in the future.

The Company adopted the provisions of the FASB Emerging Issues Task Force (“EITF”) Issue No. 07-3, *Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities* (“EITF No. 07-3”), on January 1, 2008. EITF No. 07-3 requires that nonrefundable advance payments for goods or services that will be used or rendered for future research and development activities be deferred and capitalized and recognized as an expense as the goods are delivered or the related services are performed. The adoption of EITF No. 07-3 did not have an impact on the Company’s financial position, results of operations or cash flows.

The Company adopted the provisions of the FASB EITF Issue No. 06-11, *Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards* (“EITF No. 06-11”), on January 1, 2008. EITF No. 06-11 requires that the income tax benefits from dividends on equity-classified employee share-based payment awards be reflected as an increase in paid-in-capital. The effects of the adoption are disclosed in the Statement of Stockholders’ Equity and Statements of Cash Flows in the financial statements for the year ended December 31, 2008.

The adoption of Statement of Financial Accounting Standards No. 157, *Financial Measurements* (“SFAS 157”), is discussed in Note 13 to these financial statements.

### ***Recently Issued Accounting Pronouncements Not Yet Adopted***

In June 2008, the FASB issued FSP Emerging Issues Task Force 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* (“FSP EITF 03-6-1”). This FSP would require unvested share-based payment awards containing non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) to be included in the computation of basic EPS according to the two-class (basic and diluted) method. The effective date of FSP EITF 03-6-1 is for fiscal years beginning after December 15, 2008 and requires all prior-period EPS data presented to be adjusted retrospectively (including interim financial statements, summaries of earnings, and selected financial data) to conform with the provisions of this FSP. FSP EITF 03-6-1 does not permit early application. This FSP changes the calculation of basic and diluted EPS and may lower previously reported basic and diluted EPS as weighted-average shares outstanding used in the EPS calculation will increase. The Company is currently evaluating the impact of this statement on its financial statements.

In September 2008, the FASB issued Staff Position (FSP) No. 133-1 and FIN 45-4, *Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161* (“FSP No. 133-1 and FIN 45-4”). This FSP amends FASB Interpretation No. 45, *Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others* (“FIN 45”), to require an additional disclosure about the current status of the payment/performance risk of a guarantee. The provisions of the FSP that amend FIN 45 are effective for reporting periods (annual or interim) beginning after November 15, 2008. The Company is currently evaluating the additional disclosure requirements of FSP No. 133-1 and FIN 45-4 to its financial statements.



### 3. DETAILS OF BALANCE SHEET AMOUNTS

Other accrued liabilities are comprised of the following at December 31, 2008 and 2007:

	<u>2008</u>	<u>2007</u>
Salaries and benefits .....	\$2,686,862	\$2,560,116
Commissions .....	374,990	392,033
Self-Insurance reserves .....	395,900	388,400
Other .....	538,795	166,296
	<u>\$3,996,547</u>	<u>\$3,506,845</u>

### 4. NET INCOME PER SHARE

The Company presents both basic and diluted earnings per share (EPS) amounts. Basic EPS is calculated by dividing net income by the weighted average number of common shares outstanding during the period presented. Diluted EPS amounts are based upon the weighted average number of common and common equivalent shares outstanding during the period presented. The difference between basic and diluted EPS is solely attributable to stock options. The Company uses the treasury stock method to calculate the impact of outstanding stock options. For the years ended December 31, 2008, 2007, and 2006 these dilutive shares were 18,609, 42,804, and 79,837, respectively.

The effect of 76,086, and 79,487 unvested shares of restricted stock was excluded from the calculation of EPS as inclusion of these securities would be anti-dilutive for the years ended December 31, 2008 and 2007, respectively.

### 5. INCOME TAXES

Effective January 1, 2007, we adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* ("FIN 48"). The Company previously had accounted for tax contingencies in accordance with SFAS No. 5, *Accounting for Contingencies*. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with the FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 requires a company to determine whether it is more likely than not that a tax position will be sustained upon examination based on the technical merits of the position. If the more-likely-than-not threshold is met, a company must measure the tax position to determine the amount to recognize in the financial statements.

At the adoption date of January 1, 2007, the Company applied FIN 48 to all tax positions for which the statute of limitations remained open and had no unrecognized tax benefits which would affect the effective tax rate if recognized. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

	<u>2008</u>	<u>2007</u>
Beginning Balance .....	\$ —	\$ —
Additions based on tax positions related to the current year .....	—	—
Additions for tax positions of prior years .....	207,000	—
Reductions for tax positions of prior years .....	—	—
Ending balance .....	<u>\$207,000</u>	<u>\$ —</u>

The total amount of unrecognized tax benefits, if recognized, that would affect the effective tax rate is \$207,000.

The Company classifies interest and penalties arising from the underpayment of income taxes in the statements of income under general and administrative expenses. As of December 31, 2008, the Company had no accrued interest or penalties related to uncertain tax positions. The tax years 2004 – 2007 remain open to federal examination and to other taxing jurisdictions to which the Company is subject.

It is reasonably possible that the amount of unrecognized tax benefits, inclusive of related interest, will change in the next twelve months. At December 31, 2008, the estimated increase in the amount of unrecognized tax benefits relating to various credits for the next twelve months is expected to be approximately \$400,000 due to the filing of current year returns and the amendment of prior year returns.

Deferred income taxes arise from the temporary differences in the recognition of income and expenses for tax purposes. A valuation allowance is established when the Company believes that it is more likely than not that some portion of its deferred tax assets will not be realized. Deferred tax assets and liabilities are comprised of the following at December 31, 2008 and 2007:

	<u>2008</u>	<u>2007</u>
Deferred tax assets:		
Accounts receivable .....	\$ 245,008	\$ 369,998
Accrued vacation .....	895,875	823,780
Stock compensation .....	382,291	519,571
Accrued liabilities .....	322,248	227,031
Total deferred tax assets .....	<u>\$1,845,422</u>	<u>\$1,940,380</u>
Deferred tax liabilities:		
Other comprehensive income .....	\$ 36,247	\$ 27,207
Depreciation .....	933,861	1,090,713
Total deferred tax liabilities .....	<u>\$ 970,108</u>	<u>\$1,117,920</u>

Significant components of the income tax provision for the year ended December 31, 2008, 2007 and 2006 are as follows:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Current provision:			
Federal .....	\$7,512,603	\$5,834,031	\$8,555,098
State .....	1,762,517	1,459,304	1,862,165
Deferred provision:			
Federal .....	(50,132)	37,524	(389,785)
State .....	(11,762)	4,464	(44,547)
Total income tax provision .....	<u>\$9,213,226</u>	<u>\$7,335,323</u>	<u>\$9,982,931</u>

The difference between income taxes at the U.S. federal statutory income tax rate of 35% and those reported in the statement of income for the years ended December 31, 2008, 2007 and 2006 are as follows:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Income taxes at U. S. Federal statutory rate .....	\$8,627,927	\$7,087,826	\$9,029,117
State income tax, net of federal tax effect .....	1,148,528	934,122	1,160,461
Impact of tax credits .....	(454,219)	(428,461)	(197,249)
Other .....	(109,010)	(258,164)	(9,398)
	<u>\$9,213,226</u>	<u>\$7,335,323</u>	<u>\$9,982,931</u>

## 6. STOCK BASED COMPENSATION

Effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123 (Revised 2004), *Share Based Payment* ("SFAS No. 123R"). SFAS No. 123R establishes accounting for stock-based awards exchanged for employee services. Accordingly, stock-based compensation

cost is measured at grant date based on the fair value of the award, and is recognized as an expense over the employee's requisite service period. The Company previously applied Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations and provided pro forma disclosures of SFAS No. 123, *Accounting for Stock Based Compensation*. The Company elected to adopt the modified prospective application method as provided by SFAS No. 123R, and, accordingly, prior periods are not restated for the effects of the adoption of SFAS No. 123R. The Company recorded compensation costs as the requisite service rendered for the unvested portion of previously issued awards that remain outstanding at the initial date of adoption and any awards issued, modified, repurchased, or cancelled after the effective date of SFAS 123R.

The following table shows total stock-based compensation expense for the years ended December 31, 2008, 2007 and 2006, included in the Statements of Income:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Costs of sales .....	\$299,988	\$ 419,523	\$ 587,560
Operating expenses .....	<u>614,159</u>	<u>605,452</u>	<u>788,617</u>
Pre-tax stock-based compensation expense .....	914,147	1,024,975	1,376,177
Less: income tax effect .....	<u>356,517</u>	<u>404,865</u>	<u>538,086</u>
Net stock-based compensation expense .....	<u>557,630</u>	<u>620,110</u>	<u>838,091</u>
Basic and diluted per share impact .....	<u>\$ 0.05</u>	<u>\$ 0.06</u>	<u>\$ 0.08</u>

SFAS No. 123R requires cash flows resulting from excess tax benefits to be classified as a part of cash flows from financing activities. Excess tax benefits are realized tax benefits from tax deductions for exercised options in excess of the deferred tax asset attributable to stock compensation costs for such options. As a result of adopting SFAS No. 123R, \$238,123, \$209,368 and \$210,167 of excess tax benefits for the years ended December 31, 2008, 2007 and 2006, respectively, have been classified as a financing cash inflow.

### **2002 Stock Option Plan**

Under the 2002 Stock Option Plan, the Company has authorized the issuance of equity-based awards for up to 865,333 shares of common stock to provide additional incentive to employees and officers. Pursuant to the plan, the Company can grant either incentive or non-qualified stock options. Options to purchase common stock under the 2002 Stock Option Plan have been granted to Company employees with an exercise price equal to the fair market value of the underlying shares on the date of grant.

Stock options granted under the 2002 Stock Option Plan to executive officers of the Company become vested as to all of the shares covered by such grant on the fifth anniversary of the grant date and expire on the seventh anniversary of the grant date. Stock options granted under the 2002 Stock Option Plan to employees other than executive officers become vested as to 50% of the shares covered by the option grant on the third anniversary of the grant date and as to 100% of such shares on the fifth anniversary of the grant date. In addition, options become vested upon termination of employment resulting from death, disability or retirement. Such options expire on the seventh anniversary of the grant date.

Under the methodology of SFAS No. 123, the fair value of the Company's stock options was estimated at the date of grant using the Black-Scholes option pricing model. The multiple option approach was used, with assumptions for expected option life of 5 years and 44% expected volatility for the market price of the Company's stock in 2002. An estimated dividend yield of 3% was used. The risk-free rate of return was determined to be 2.79% in 2002. No options were granted in 2008, 2007 or 2006.

A summary of stock option activity under the plan is as follows:

	2008		2007		2006	
	Shares	Exercise Price	Shares	Exercise Price	Shares	Exercise Price
Outstanding at beginning of year	152,444	\$ 16.50	222,597	\$ 16.50	251,519	\$ 16.50
Granted	—	—	—	—	—	—
Exercised	(69,836)	16.50	(60,383)	16.50	(20,471)	16.50
Forfeited	—	16.50	(9,770)	16.50	(8,451)	16.50
Outstanding at end of year	<u>82,608</u>	<u>\$ 16.50</u>	<u>152,444</u>	<u>\$ 16.50</u>	<u>222,597</u>	<u>\$ 16.50</u>
Exercisable at end of year	<u>82,608</u>	<u>\$ 16.50</u>	<u>152,444</u>	<u>\$ 16.50</u>	<u>35,516</u>	<u>\$ 16.50</u>
Shares available for future grants under the plan as end of year		<u>495,134</u>		<u>495,134</u>		<u>485,364</u>
Weighted-average grant date fair value		<u>\$ —</u>		<u>\$ —</u>		<u>\$ —</u>
Weighted-average remaining contractual life		<u>0.5</u>		<u>1.5</u>		<u>2.5</u>
Aggregate intrinsic value outstanding options		<u>\$850,862</u>				
Aggregate intrinsic value exercisable options		<u>\$850,862</u>				

The aggregate intrinsic value in the above table represents the total pre-tax intrinsic value (the difference between the Company's closing stock price on the last trading date of the fourth quarter of 2008 and the exercise price, multiplied by the number of options). The amount of aggregate intrinsic value will change based on the fair market value of the Company's stock.

The aggregate intrinsic value of options exercised during the years ended December 31, 2008, 2007 and 2006 was \$728,695, \$823,493 and \$533,285, respectively.

As of December 31, 2008, there was no unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the existing stock option plan.

### **2005 Restricted Stock Plan**

On January 27, 2006, the Compensation Committee of the Board of Directors approved the grant of 116,498 shares of restricted stock, effective January 30, 2006, to certain executive officers of the Company. The grant date fair value was \$42.91 per share. The restricted stock vests in five equal annual installments commencing on the first anniversary of the date of grant.

On May 17, 2006, the Company's CEO, David A. Dye, resigned his position as CEO. Upon resignation, 23,299 shares of restricted stock which had been granted to him under the 2005 Restricted Stock Plan were forfeited. The forfeiture of these shares resulted in the reversal of previously recognized stock compensation expense of \$51,076.

On May 17, 2006, the Compensation Committee of the Board of Directors approved the grant of 17,810 shares of restricted stock, effective May 17, 2006, to Michael Jones, the newly named Chief Operating Officer of the Company. The grant date fair value was \$42.11 per share. The restricted stock vests in five equal annual installments commencing January 30, 2007, and each January 30 thereafter.

On October 31, 2007, the Company's CFO, M. Stephen Walker resigned his position as CFO. Upon resignation, 9,320 shares of restricted stock which had been granted to him under the 2005 Restricted Stock Plan were forfeited. The forfeiture of these shares resulted in the reversal of previously recognized stock compensation expense of \$91,663.

On January 23, 2008, the Compensation Committee of the Board of Directors approved the grant of 16,471 shares of restricted stock to Darrell G. West, the Company's Vice President—Finance and Chief Financial Officer. The grant date fair value was \$21.25 per share. The restricted stock vests in five equal annual installments commencing January 30, 2009, and each January 30 thereafter.

	<u>Shares</u>	<u>Weighted-Average Grant-Date Fair Value</u>
Nonvested stock outstanding at January 1, 2006 . . . . .	—	\$ —
Granted . . . . .	134,308	42.81
Vested . . . . .	—	—
Forfeited . . . . .	<u>23,299</u>	<u>42.91</u>
Nonvested stock outstanding at December 31, 2006 . . . . .	<u>111,009</u>	<u>42.77</u>
Granted . . . . .	—	—
Vested . . . . .	22,202	42.81
Forfeited . . . . .	<u>9,320</u>	<u>42.91</u>
Nonvested stock outstanding at December 31, 2007 . . . . .	<u>79,487</u>	<u>42.77</u>
Granted . . . . .	16,471	21.25
Vested . . . . .	19,872	42.76
Forfeited . . . . .	—	—
Nonvested stock outstanding at December 31, 2008 . . . . .	<u><u>76,086</u></u>	<u><u>38.10</u></u>

As of December 31, 2008, there was \$2,052,207 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the 2005 Restricted Stock Plan. This cost is expected to be recognized over a weighted-average period of 2.3 years.

## 7. CONCENTRATION OF CREDIT RISK

Financial instruments, which potentially subject the Company to concentration of credit risk, consist principally of temporary cash investments and trade receivables. The Company maintains its cash and cash equivalents in bank deposit accounts, which, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts and does not believe it is exposed to any significant credit risk on cash and cash equivalents.

The Company's customer base is concentrated in the healthcare industry. Customers are located throughout the United States. The Company requires no collateral or other security to support customer receivables. An allowance for doubtful accounts has been established for potential credit losses based on historical collection experience.

## 8. FINANCING RECEIVABLES

The Company leases its information and patient care systems to certain healthcare providers under sales-type leases expiring in various years through 2014. These receivables typically have terms from 2 to 5 years, bear interest at various rates, and are usually collateralized by a security interest in the underlying assets. Since the

Company has a history of successfully collecting amounts due under the original payment terms of these extended payment arrangements without making any concessions to its customers, the Company satisfies the requirement of SOP 97-2 for revenue recognition. The Company's history with these types of extended payment term arrangements supports management's assertion that revenues are fixed and determinable and probable of collection.

The components of these lease receivables were as follows on December 31:

	<u>2008</u>	<u>2007</u>
Total minimum lease payments receivable .....	\$ 5,064,227	\$3,695,800
Less unearned income .....	(627,503)	(379,276)
Lease receivables .....	4,436,724	3,316,524
Less current portion .....	(1,457,085)	(994,053)
Amounts due after one year .....	<u>\$ 2,979,639</u>	<u>\$2,322,471</u>

Future minimum lease payments to be received at December 31, 2008 are as follows:

2009 .....	\$1,718,388
2010 .....	1,355,585
2011 .....	909,716
2012 .....	687,795
2013 .....	392,307
Thereafter .....	<u>436</u>
Total minimum lease payments to be received .....	5,064,227
Less unearned income .....	(627,503)
Net leases receivable .....	<u>\$4,436,724</u>

The Company has also sold information and patient care systems to certain healthcare providers under extended payment terms. These receivables, included in current portion of financing receivables, typically have terms from 3 to 12 months. Total amounts receivable under these arrangements at December 31, 2008 and 2007 were \$899,929 and \$740,901, respectively.

## 9. BENEFIT PLANS

In January 1994, the Company adopted the Computer Programs & System, Inc. 401(k) Retirement Plan that covers all eligible employees of the Company who have completed one year of service. The plan allows eligible employees to contribute up to 15% of their pre-tax earnings up to the statutory limit prescribed by the Internal Revenue Service. The Company matches the first \$1,000 contribution per participant plus a discretionary amount determined by the Company. The Company contributed approximately \$1,151,000, \$1,223,000 and \$1,154,000 to the plan for the years ended December 31, 2008, 2007 and 2006, respectively.

The Company provides certain health and medical benefits to eligible employees, their spouses and dependents pursuant to a benefit plan funded by the Company. Each participating employee contributes to the Company's costs associated with such benefit plan. The Company's obligation to fund this benefit plan and pay for these benefits is limited through the Company's purchase of an insurance policy from a third-party insurer. The amount established as a reserve is intended to recognize the Company's estimated obligations with respect to its payment of claims and claims incurred but not yet reported under the benefit plan. Management believes that the recorded liability for medical self-insurance at December 31, 2008 and 2007 is adequate to cover the losses and claims incurred, but these reserves are based on estimates and the amount ultimately paid may be more or less than such estimates.

## 10. OPERATING LEASES

The Company leases certain real property, almost all of which is owned by entities that are owned by one or more stockholders of the Company. The lease agreements have terms of ten years and expire on or before December 2015. For the second five years of the leases, the rental may be adjusted with consent of the landlord and the Company. If mutual consent cannot be obtained, the rental for the second five years will remain the same as the first five years. For the years ended December 31, 2008, 2007 and 2006 total rent expense paid to related parties was approximately \$1,700,000, \$1,700,000 and \$1,694,000, respectively.

The future minimum lease payments payable under operating leases subsequent to December 31, 2008 are as follows:

2009 .....	\$1,762,999
2010 .....	1,762,999
2011 .....	1,762,999
2012 .....	819,935
2013 .....	262,394
Thereafter .....	374,042
	<u>\$6,745,368</u>

## 11. COMMITMENTS AND CONTINGENCIES

As of December 31, 2008, the Company is contingently liable as guarantor on a lease obligation between Solis Healthcare, LP (“Solis Healthcare”) and Winthrop Resources Corporation (“Winthrop”). Winthrop purchased a software system from the Company and leased it to Solis Healthcare in the first quarter of 2008. The Company provided this guarantee in order to facilitate Solis Healthcare in leasing the new system. The lease has an initial term of five years and continues from year-to-year thereafter until terminated. The Company is contingently liable as guarantor under the lease such that, if at any time prior to the termination of the lease, Solis Healthcare (i) enters into bankruptcy or (ii) defaults for more than 60 days in its payments or performance under the lease, the Company will be obligated to perform under the guaranty by making the required lease payments, including late fees and penalties. The guaranty runs for the entire term of the lease; however, the maximum potential amount of future payments that the Company would be required to make to Winthrop under the guaranty is \$2,145,000, plus any fees and costs that Winthrop incurs in collecting amounts due under the lease (including attorney’s fees and costs). The Company recorded \$2,154,389, the amount billed for the new system installation, as revenue during the first quarter of 2008. Due to the contingent nature of the guaranty, the maximum amount of the guaranty is not recorded on the balance sheet; however, when necessary reserves are recorded to cover potential losses. A liability in the amount of \$244,138, the estimated fair value of the guaranty, is recorded on the balance sheet as an other accrued liability at December 31, 2008.

From time to time, the Company is involved in routine litigation that arises in the ordinary course of business. Management does not expect this to have a material adverse effect on the Company’s financial statements.

## 12. COMPREHENSIVE INCOME

Statement of Financial Accounting Standards No. 130, *Reporting Comprehensive Income*, requires the disclosure of certain revenue, expenses, gains and losses that are excluded from net income in accordance with accounting principles generally accepted in the United States of America. Total comprehensive income for the years ended December 31, 2008, 2007 and 2006 is as follows:

	Year ended December 31,		
	2008	2007	2006
Net income as reported .....	\$15,437,995	\$12,915,608	\$15,814,545
Other comprehensive income:			
Unrealized gain on investments, net of taxes .....	11,890	52,158	60,646
Total comprehensive income .....	<u>\$15,449,885</u>	<u>\$12,967,766</u>	<u>\$15,875,191</u>

## 13. FAIR VALUE

The Company adopted the provisions of Financial Accounting Standards Board (“FASB”) Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (“SFAS 157”), on January 1, 2008. SFAS 157 establishes a framework for measuring fair value and expands financial statement disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements, but rather applies to all other accounting pronouncements that require or permit fair value measurements. In February 2008, the FASB issued a final Staff Position to allow a one-year deferral of adoption of SFAS 157 for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. The Company has elected this one-year deferral and thus will not apply the provisions of SFAS 157 to nonfinancial assets and nonfinancial liabilities that are recognized at fair value in the financial statements on a nonrecurring basis until its fiscal year beginning January 1, 2009. The Company is in the process of evaluating the impact of applying SFAS 157 to nonfinancial assets and nonfinancial liabilities measured on a nonrecurring basis. The FASB also amended SFAS 157 to exclude FASB Statement No. 13 and its related interpretive accounting pronouncements that address leasing transactions. SFAS 157 requires that assets and liabilities carried at fair value be classified and disclosed in one of the following three categories:

Level 1: Quoted market prices in active markets for identical assets or liabilities.

Level 2: Observable market based inputs or unobservable inputs that are corroborated by market data.

Level 3: Unobservable inputs that are not corroborated by market data.

The fair values of the Company’s available-for-sale securities are based on quoted prices in active markets for identical assets. We generally apply fair value techniques on a non-recurring basis associated with (1) valuing potential impairment loss related to financing receivables accounted for pursuant to SFAS No. 13, and (2) valuing potential impairment loss related to long-lived assets accounted for pursuant to SFAS No. 144.

The following table summarizes the carrying amounts and fair values of certain assets and liabilities at December 31, 2008:

	Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available-for-sale securities .....	\$11,845,646	\$11,845,646	\$—	\$—

There was no cumulative effect of adoption related to SFAS 157, and the adoption did not have an impact on the Company’s financial position, results of operations or cash flows.



Cash, cash equivalents, accounts receivable, accounts payable and accrued liabilities are reflected in the accompanying financial statements at cost, which approximates fair value because of the short-term maturity of these instruments. Investments are reflected in the accompanying financial statements at current market value. Based on the borrowing rates currently available to the Company for bank loans with similar terms and average maturities, at December 31, 2008 and 2007 the fair values of the financing receivables approximate book value.

#### 14. SUBSEQUENT EVENTS

On January 26, 2009, the Company announced a dividend for the first quarter of 2009 in the amount of \$0.36 per share.

#### 15. QUARTERLY FINANCIAL STATEMENTS (UNAUDITED)

The following table presents a summary of our results of operations for our eight most recent quarters ended December 31, 2008. The information for each of these quarters is unaudited and has been prepared on a basis consistent with the audited financial statements. This information includes all adjustments, consisting only of normal recurring adjustments, we consider necessary for fair presentation of this information when read in conjunction with the audited financial statements and related notes. Our operating results have varied on a quarterly basis and may fluctuate significantly in the future.

	<u>1st Quarter</u>	<u>2nd Quarter</u>	<u>3rd Quarter</u>	<u>4th Quarter</u>
	(In thousands except for share and per share data)			
Year Ended December 31, 2008				
Sales revenues .....	\$ 29,517	\$ 27,752	\$ 30,353	\$ 32,042
Gross profit .....	13,232	12,125	13,294	14,570
Operating income .....	5,498	4,709	6,133	7,371
Net income .....	3,506	2,991	4,093	4,847
Net income per share				
Basic .....	0.33	0.28	0.38	0.45
Diluted .....	0.33	0.28	0.38	0.45
Weighted average shares outstanding				
Basic .....	10,745,976	10,752,951	10,776,840	10,812,377
Diluted .....	10,767,700	10,766,996	10,796,217	10,831,654
Year Ended December 31, 2007				
Sales revenues .....	\$ 25,946	\$ 27,963	\$ 27,992	\$ 28,111
Gross profit .....	10,653	11,896	11,839	12,368
Operating income .....	3,685	4,824	4,732	5,806
Net income .....	2,560	3,302	3,228	3,827
Net income per share				
Basic .....	0.24	0.31	0.30	0.36
Diluted .....	0.24	0.31	0.30	0.36
Weighted average shares outstanding				
Basic .....	10,664,009	10,682,876	10,718,643	10,726,134
Diluted .....	10,718,458	10,732,503	10,757,137	10,755,108

**SCHEDULE II  
COMPUTER PROGRAMS AND SYSTEMS, INC.  
VALUATION AND QUALIFYING ACCOUNTS**

<u>Description</u>		<u>Balance at beginning of period</u>	<u>(1) Additions charged to cost and expenses</u>	<u>(2) Deductions</u>	<u>Balance at end of period</u>
Allowance for doubtful accounts deducted from accounts receivable in the balance sheet . . . . .	2006	704,000	(52,000)	(162,000)	814,000
	2007	814,000	90,000	(45,000)	949,000
	2008	949,000	1,338,000	1,659,000	628,000

- (1) Adjustments to allowance for change in estimates.  
(2) Uncollectible accounts written off, net of recoveries.

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

**ITEM 9A. CONTROLS AND PROCEDURES**

Our management, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)), as of the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in timely alerting them to material information relating to the Company that is required to be included in our periodic Securities and Exchange Commission filings.

There have not been any changes in the Company's internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15(d)-15(f)) during the fourth quarter of 2008 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Management's Annual Report on Internal Control Over Financial Reporting**

This report is included in Item 8 on page 36 and is incorporated herein by reference.

**Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting**

This report is included in Item 8 on page 38 and is incorporated herein by reference.

**ITEM 9B. OTHER INFORMATION**

None.

### PART III

#### ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

We have adopted a Code of Business Conduct and Ethics applicable to all of our directors, officers (including our Chief Executive Officer and senior financial officers) and employees. We have also adopted a separate code of ethics with additional guidelines and responsibilities applicable to our Chief Executive Officer and senior financial officers, known as the Code of Ethics for CEO and Senior Financial Officers. Copies of the Code of Business Conduct and Ethics and the Code of Ethics for CEO and Senior Financial Officers are available on CPSI's website at [www.cpsinet.com](http://www.cpsinet.com) in the "Investors" section under "Corporate Governance."

Other information required by this Item regarding Executive Officers is included in Part I of this Form 10-K under the caption "Executive Officers" in accordance with Instruction 3 of the Instructions to Paragraph (b) of Item 401 of Regulation S-K.

Other information required by this Item is incorporated by reference pursuant to General Instruction G(3) of Form 10-K from CPSI's definitive Proxy Statement for the 2009 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission pursuant to Regulation 14A.

#### ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item is incorporated by reference pursuant to General Instruction G(3) of Form 10-K from CPSI's definitive Proxy Statement for the 2009 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission pursuant to Regulation 14A.

#### ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Certain of the information required by this Item is incorporated by reference pursuant to General Instruction G(3) of Form 10-K from CPSI's definitive Proxy Statement for the 2009 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission pursuant to Regulation 14A.

#### Securities Authorized for Issuance Under Equity Compensation Plans

The following table summarizes the securities that have been authorized for issuance as of December 31, 2008 under our 2002 Stock Option Plan and 2005 Restricted Stock Plan. Both of these plans have been approved by CPSI's stockholders. The plans are described in Note 6 of the notes to the financial statements.

Plan Category	Equity Compensation Plan Information		
	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by stockholders .....	82,608	\$16.50	676,974 <sup>1</sup>
Equity compensation plans not approved by stockholders .....	-0-	N/A	-0-
Total .....	<u>82,608</u>		<u>676,974<sup>1</sup></u>

<sup>1</sup> Represents 495,134 shares of common stock underlying stock options that are issuable pursuant to our 2002 Stock Option Plan and 181,840 shares of common stock issuable pursuant to our 2005 Restricted Stock Plan.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

The information required by this Item is incorporated by reference pursuant to General Instruction G(3) of Form 10-K from CPSI's definitive Proxy Statement for the 2009 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission pursuant to Regulation 14A.

**ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The information required by this Item is incorporated by reference pursuant to General Instruction G(3) of Form 10-K from CPSI's definitive Proxy Statement for the 2009 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission pursuant to Regulation 14A.

## PART IV

### ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

**(a)(1) and (2) and (c) – Financial Statements and Financial Statement Schedules.**

Financial Statements: The Financial Statements and related Financial Statements Schedule of CPSI are included herein in Part II, Item 8.

**(a)(3) and (b) – Exhibits.**

The exhibits listed on the Exhibit Index at page 62 of this Form 10-K are filed herewith or are incorporated herein by reference.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on this the 9th day of March, 2009.

### COMPUTER PROGRAMS AND SYSTEMS, INC.

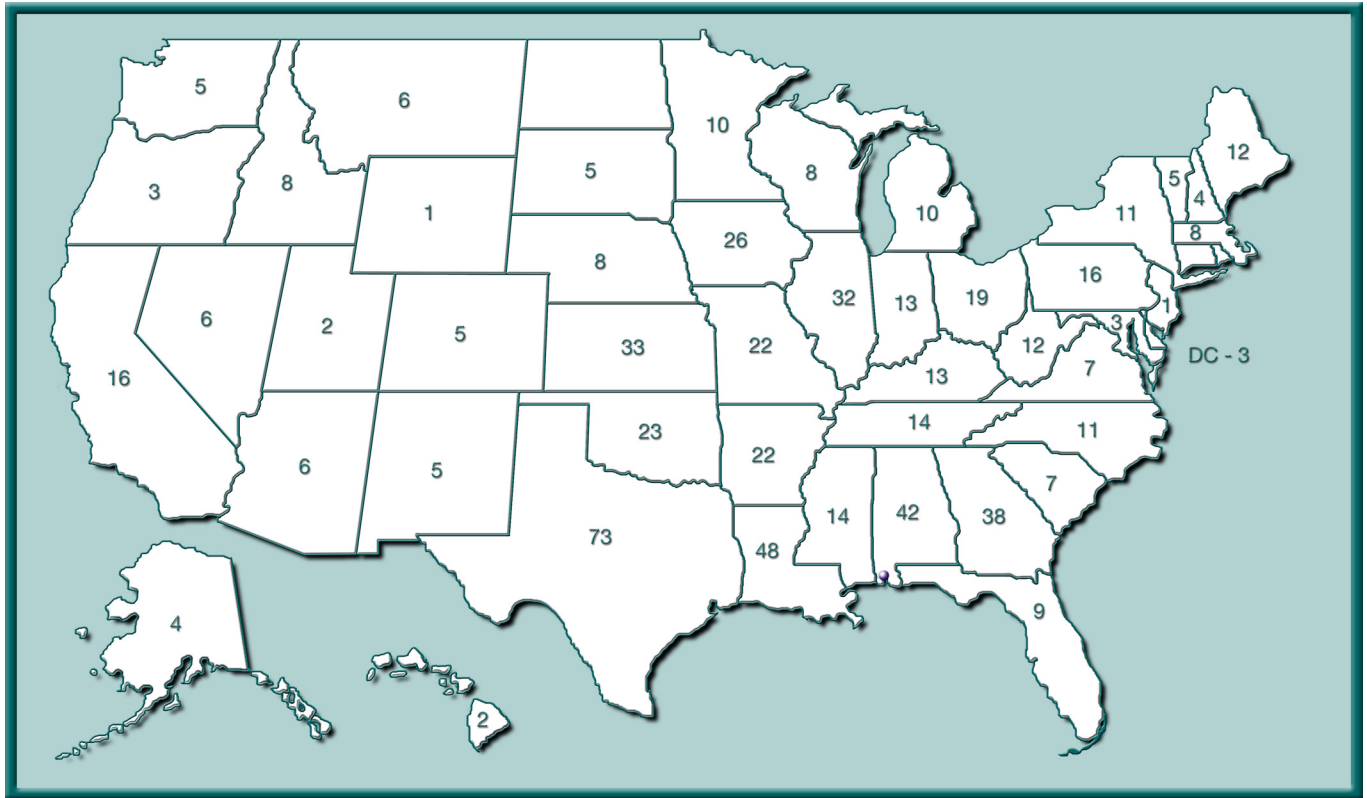
By: /s/ J. Boyd Douglas

J. Boyd Douglas  
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

<u>Name</u>	<u>Title</u>	<u>Date</u>
<u>/s/ David A. Dye</u> David A. Dye	Chairman of the Board and Director	March 9, 2009
<u>/s/ J. Boyd Douglas</u> J. Boyd Douglas	President, Chief Executive Officer and Director (principal executive officer)	March 9, 2009
<u>/s/ Darrell G. West</u> Darrell G. West	Vice President – Finance and Chief Financial Officer (principal financial officer)	March 9, 2009
<u>/s/ James B. Britain</u> James B. Britain	Controller (principal accounting officer)	March 9, 2009
<u>/s/ M. Kenny Muscat</u> M. Kenny Muscat	Director	March 9, 2009
<u>/s/ Ernest F. Ladd, III</u> Ernest F. Ladd, III	Director	March 9, 2009
<u>/s/ W. Austin Mulherin, III</u> W. Austin Mulherin, III	Director	March 6, 2009
<u>/s/ William R. Seifert, II</u> William R. Seifert, II	Director	March 9, 2009
<u>/s/ John C. Johnson</u> John C. Johnson	Director	March 9, 2009
<u>/s/ Charles P. Huffman</u> Charles P. Huffman	Director	March 9, 2009

# Customer Locations at December 31, 2008





6600 Wall Street  
Mobile, Alabama 36695