

Edgar Filing: AROTECH CORP - Form 10-K/A

AROTECH CORP
Form 10-K/A
May 02, 2005

OMB APPROVAL

OMB Number: 3235-0063
Expires: November 30, 2006
Estimated average burden
hours per response...1,647.00

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K/A

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF
1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2004.

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT
OF 1934 FOR THE TRANSITION PERIOD FROM _____ TO _____.

Commission File Number: 0-23336

AROTECH CORPORATION

(Exact name of registrant as specified in its charter)

Delaware

95-4

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer

354 Industry Drive, Auburn, Alabama

3

(Address of principal executive offices)

(Zip

(334) 502-9001

(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
None	Not applicable

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

Common Stock, \$0.01 par value

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

Edgar Filing: AROTECH CORP - Form 10-K/A

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 (ss. 229.405 of this chapter) 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 an accelerated filer (as defined in Rule 12b-2 of the Act). Yes No

The aggregate market value of the registrant's voting stock held by non-affiliates of the registrant as of June 30, 2004 was approximately \$128,605,410 (based on the last sale price of such stock on such date as reported by The Nasdaq National Market and assuming, for the purpose of this calculation only, that all of the registrant's directors and executive officers are affiliates).

(Applicable only to corporate registrants) Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date: 80,103,668 as of 3/31/05

Documents incorporated by reference: None

=====

Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.

EXPLANATORY NOTE

Arotech Corporation is filing this Amendment No. 1 to its Annual Report on Form 10-K for the year ended December 31, 2004, as filed with the Securities and Exchange Commission on March 31, 2005. This amendment reports the following changes resulting from Arotech's and Arotech's Independent Registered Public Accounting Firm's completed analysis of internal control over financial reporting as required under Section 404 of the Sarbanes-Oxley Act of 2002:

- >> Replaces Item 9A, "Controls and Procedures";
- >> Adds the report on internal control over financial reporting from Kost, Forer, Gabbay & Kassierer, a member of Ernst & Young Global, Independent Registered Public Accounting Firm;
- >> Provides an additional Consent of Kost, Forer, Gabbay & Kassierer, a member of Ernst & Young Global, Independent Registered Public Accounting Firm; and
- >> Replaces the Section 302 certifications from the Chairman, President and Chief Executive Officer and the Vice President - Finance and Chief Financial Officer.

This amendment does not reflect the restatement of any previously reported financial statements, results of operations or any other related financial disclosures.

PART II

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As of December 31, 2004, our management, including the principal executive officer and principal financial officer, evaluated our disclosure controls and procedures related to the recording, processing, summarization, and reporting of information in our periodic reports that we file with the SEC. These disclosure controls and procedures are intended to ensure that material information relating to us, including our subsidiaries, is made known to our management, including these officers, by other of our employees, and that this information is recorded, processed, summarized, evaluated, and reported, as applicable, within the time periods specified in the SEC's rules and forms. Due to the inherent limitations of control systems, not all misstatements may be detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Any system of controls and procedures, no matter how well designed and operated, can at best provide only reasonable assurance that the objective of the system are met and management necessarily is required to apply its judgment in evaluating the cost benefit relationship of possible controls and procedures. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. Our controls and procedures are intended to provide only reasonable, not absolute, assurance that the above objectives have been met.

Based on their evaluation as of December 31, 2004, except as otherwise described herein and below, our principal executive officer and principal financial officer were able to conclude that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) were effective to ensure that the information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms.

In light of the material weakness described below, our management performed additional analyses and other post-closing procedures to ensure our consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States (U.S. GAAP). Accordingly, management believes that the consolidated financial statements included in this report fairly present in all material respects our financial position, results of operations and cash flows for the periods presented.

Management's Report on Internal Control Over Financial Reporting

Our management, including our principal executive and financial officers, is responsible for establishing and maintaining adequate internal control over our financial reporting. Our management has evaluated the effectiveness of our internal controls, pursuant to the requirements of Sarbanes-Oxley Section 404, as of the end of the period covered by this Annual Report on Form 10-K for December 31, 2004. In making our assessment of internal control over financial reporting, management used the criteria set forth by the Committee of Sponsoring Organizations ("COSO") of the Treadway Commission in Internal Control - Integrated Framework. In accordance with the rules of the SEC, we did not assess

Edgar Filing: AROTECH CORP - Form 10-K/A

the internal control over financial reporting of Armour of America, Incorporated, which we acquired in August 2004, financial statements of which reflect total assets of 4% of our consolidated assets as of December 31, 2004, and total revenues of 5% of our consolidated revenues for the year then ended. In our Annual Report on Form 10-K for the year ending December 31, 2005, we will be required to provide an assessment of our compliance that takes into account an assessment of Armour of America, Incorporated and all of our other currently existing subsidiaries as of December 31, 2005.

For the reasons described below, we have concluded that there were material weaknesses in our internal controls at December 31, 2004. We note in this connection that our Independent Registered Public Accounting Firm audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), our consolidated financial statements and financial statement schedule as of and for the year ended December 31, 2004, and their report dated March 24, 2005 expressed an unqualified opinion with respect thereto.

On November 22, 2004, the Audit Committee of our Board of Directors, on the recommendation of our management and after discussion with our Independent Registered Public Accounting Firm, made an internal determination and concluded that our Annual Report on Form 10-K for the year ended December 31, 2003, including the financial statements that our Independent Registered Public Accounting Firm had previously audited that are contained therein, contained certain errors related to the re-pricing of warrants and grant of additional warrants to certain of our investors and others and the amortization of debt discount arising from the allocation of the debt discount between the convertible debentures and their detachable warrants. The net effect of these errors, which generally related to the timing and characterization of certain non-cash expenses, was (i) to increase our net loss attributable to common stockholders for 2003 by approximately \$579,000 and to decrease our net loss for the first half of 2004 by approximately \$608,000, and (ii) to decrease our net loss attributable to common stockholders for the nine and three months ended September 30, 2004 by approximately \$1,583,778 and \$976,129, respectively. The Audit Committee of our Board of Directors therefore concluded to restate certain previously issued financial statements contained in our Annual Report on Form 10-K for the year ended December 31, 2003. The decision to restate these financial statements was made by our Audit Committee, upon the recommendation of our management and with the concurrence of our Independent Registered Public Accounting Firm.

As a result of the restatement referred to in the preceding paragraph, we have identified material weaknesses for inadequate controls related to the financial statement close process, convertible debentures and share capital processes as it applies to non-routine and highly complex financial transactions. A material weakness is a control deficiency (within the meaning of the Public Company Accounting Oversight Board ("PCAOB") Auditing Standard No. 2), or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The material weaknesses arise from insufficient staff with technical accounting expertise to independently apply our accounting policies, as they relate to non-routine and highly complex transactions, in accordance with U.S. generally accepted accounting principles. Management has identified that due to the reasons described above, we did not consistently follow established internal control over financial reporting procedures related to the analysis, documentation and review of selection of the appropriate accounting treatment for non-routine and highly complex transactions. Because of these material weaknesses, we have concluded that we did not maintain effective internal control over financial reporting as of December 31, 2004, based on the criteria in Internal Control-Integrated Framework.

The foregoing management assessment of the effectiveness of our internal control over financial reporting as of December 31, 2004, has been audited by Kost, Forer, Gabbay and Kassierer, a member of Ernst & Young Global, the registered public accounting firm that audited the financial statements included in our annual report, as stated in their report which is included below.

Management's Response to the Material Weaknesses

In response to the material weaknesses described above, we have undertaken to take the following initiatives with respect to our internal controls and procedures that we believe are reasonably likely to improve and materially affect our internal control over financial reporting. We anticipate that remediation will be continuing throughout fiscal 2005, during which we expect to continue pursuing appropriate corrective actions, including the following:

- >> Preparing appropriate written documentation of our financial control procedures;
- >> Adding additional qualified staff to our finance department;
- >> Scheduling training for accounting staff to heighten awareness of generally accepted accounting principles applicable to complex transactions;
- >> Strengthening our internal review procedures in conjunction with our ongoing work to enhance our internal controls so as to enable us to identify and adjust items proactively;
- >> Engaging an outside accounting firm to support our Sarbanes-Oxley Section 404 compliance activities and to provide technical expertise in the selection and application of generally accepted accounting principles related to complex transactions to identify areas that require control or process improvements and to consult with us on the appropriate accounting treatment applicable to complex transactions; and
- >> Implementing the recommendations of our outside accounting consultants.

Our management and Audit Committee will monitor closely the implementation of our remediation plan. The effectiveness of the steps we intend to implement is subject to continued management review, as well as Audit Committee oversight, and we may make additional changes to our internal control over financial reporting.

We cannot assure you that we will not in the future identify further material weaknesses in our internal control over financial reporting. We currently are unable to determine when the above-mentioned material weaknesses will be fully remediated. However, because remediation will not be completed until we have added finance staff and strengthened pertinent controls, we presently anticipate that we will report in our Quarterly Report on Form 10-Q for the first quarter of fiscal 2005 that material weaknesses continue to exist.

Edgar Filing: AROTECH CORP - Form 10-K/A

Except as noted above, there have been no changes in our internal control over financial reporting that occurred during our last fiscal quarter to which this Annual Report on Form 10-K relates that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

-4-

[LOGO] ERNST & YOUNG

Phone: 972-3-6232525

Fax: 972-3-5622555

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders of

AROTECH CORPORATION

We have audited management's assessment, included in the accompanying "Report of Management on Internal Control Over Financial Reporting," that Arotech Corporation did not maintain effective internal control over financial reporting as of December 31, 2004, because of the effect of material weaknesses in internal controls related to the financial statement close process, the convertible debentures and share capital processes as it applies to non-routine and highly complex financial transactions, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Arotech Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

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

Edgar Filing: AROTECH CORP - Form 10-K/A

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

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The following material weaknesses have been identified and included in management's assessment. Management identified material weaknesses for inadequate controls related to the financial statement close process, convertible debentures and share capital processes as it applies to non-routine and highly complex financial transactions. The material weaknesses arise from insufficient staff with technical accounting expertise to independently apply the Company's accounting policies, as they relate to non-routine and highly complex transactions, in accordance with U.S. generally accepted accounting principles ("GAAP"). Management has identified that due to the reasons described above, the Company did not consistently follow established internal control over financial reporting procedures related to the analysis, documentation and review of selection of the appropriate accounting treatment for non-routine and highly complex transactions. These material weaknesses resulted in a restatement of the 2003 consolidated financial statements and quarterly unaudited consolidated financial statements for each of the quarters through September 30, 2004 and related to the errors in the appropriate accounting treatment to be applied to (i) re-pricing of warrants and grant of additional warrants to certain investors and others, and (ii) amortization of debt discount arising from the allocation of the debt discount between the convertible debentures and their detachable warrants. The net effect of these errors, which generally related to the timing and characterization of certain non-cash expenses, was (i) to increase net loss attributable to common stockholders for 2003 by approximately \$579,000 and to decrease net loss for the first half of 2004 by approximately \$608,000, and (ii) to decrease net loss attributable to common stockholders for the nine and three months ended September 30, 2004 by approximately \$1,583,778 and \$976,129, respectively. The above material weaknesses resulted in the material misstatement of amount of convertible debentures, finance expenses related to convertible debentures and stockholders' equity.

These material weaknesses were considered in determining the nature, timing, and extent of audit tests applied in our audit of the December 31, 2004 consolidated financial statements, and this report does not affect our report dated March 24, 2005 on those consolidated financial statements.

As indicated in the accompanying "Report of Management on Internal Control Over Financial Reporting," management's assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the internal controls of Armour of America Inc., a wholly-owned subsidiary whose total assets and total revenues represent 4% and 5%, respectively, of the related consolidated financial statement amounts as of and for the year ended December 31, 2004, which was acquired by the Company in a purchase business combination during 2004. Our audit of internal control over financial reporting of Arotech Corporation also did not include an evaluation of the internal control over financial reporting of Armour of America Inc.

-2-

In our opinion, management's assessment that Arotech Corporation did not maintain effective internal control over financial reporting as of December 31,

Edgar Filing: AROTECH CORP - Form 10-K/A

2004, is fairly stated, in all material respects, based on the COSO control criteria. Also, in our opinion, because of the effect of the material weakness described above on the achievement of the objectives of the control criteria, Arotech Corporation has not maintained effective internal control over financial reporting as of December 31, 2004, based on the COSO control criteria.

Tel-Aviv, Israel
April 21, 2005

KOST, FORER, GABBAY & KASIERER
A Member of Ernst & Young Global

-3-

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) The following documents are filed as part of this amended report:

(3) Exhibits - The following Exhibits are either filed herewith or have previously been filed with the Securities and Exchange Commission and are referred to and incorporated herein by reference to such filings:

Exhibit No. -----	Description -----
*23.1.....	Consent of Kost, Forer, Gabbay & Kassierer, a member of Ernst & Young Global
*31.1.....	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
*31.2.....	Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

*Filed herewith

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this amended report to be signed on its behalf by the undersigned, thereunto duly authorized, on May 2, 2005.

AROTECH CORPORATION

By: /s/ Robert S. Ehrlich

Name: Robert S. Ehrlich
Title: Chairman, President and
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this amended report has been signed below by the following persons on behalf of

Edgar Filing: AROTECH CORP - Form 10-K/A

the registrant and in the capacities and on the dates indicated.

Signature -----	Title -----
/s/ Robert S. Ehrlich ----- Robert S. Ehrlich	Chairman, President, Chief Executive Officer and Director (Principal Executive Officer)
/s/ Avihai Shen ----- Avihai Shen	Vice President - Finance (Principal Financial Officer)
/s/ Danny Waldner ----- Danny Waldner	Controller (Principal Accounting Officer)
/s/ Steven Esses ----- Steven Esses	Executive Vice President, Chief Operating Officer and Director
----- Dr. Jay M. Eastman	Director
/s/ Lawrence M. Miller ----- Lawrence M. Miller	Director
/s/ Jack E. Rosenfeld ----- Jack E. Rosenfeld	Director
----- Bert W. Wasserman	Director
/s/ Edward J. Borey ----- Edward J. Borey	Director

EXHIBIT INDEX

Exhibit Number -----	Description -----
23.1	Consent of Kost, Forer, Gabbay & Kassierer, a member of Ernst & Young Global
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section

Edgar Filing: AROTECH CORP - Form 10-K/A

302 of the Sarbanes-Oxley Act of 2002