

THE EYESHADE REPORT

March 15, 2002

<u>Company:</u> ACCLAIM ENTERTAINMENT, INC.	<u>Address and Phone:</u> One Acclaim Plaza Glen Cove, NY 11542 516-656-5000
Ticker: AKLM	Shares Out (basic): 79.5 M
Exchange: NMS	Float: 51.7 M
Market Cap: \$ 358 M	Short Interest: 9.4 M
P/S: 1.7	Closing Price: (3/15/02): \$ 4.50
P/E: 18	52 Week Range: \$ 0.72 - \$6.25

Description of Business: Acclaim Entertainment, Inc. (the “Company” or “AKLM”) develops and markets video and computer games on a world-wide basis for interactive entertainment consoles.

Summary

- Decline in cash flow from operations while net income increases.
- Quarterly revenue growth enhanced by change in quarter-end date and allowance decline.
- Reported net income and EPS enhanced by multiple factors.
- Increase in capitalized software costs and discrepancies re: past disclosures.
- Increase in accounts receivable (A/R) and decline in A/R information disclosed.
- Decline in allowances for returns and price concessions.
- Increase in inventory.
- Increase in prepaid expenses and “other” assets.
- Decline in gross profit margin.
- Additional share dilution.
- Related party transactions.
- Some customer concentration.
- Two of directors on audit committee are not completely independent.
- Auditor issues “going concern” opinion for two consecutive years.
- Positive Note – Convertible debt due March 1, 2002 satisfied.

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Financial Statement Review

Decline in cash flow from operations while net income increases – For the quarter ended December 2, 2001 (Q1 02), the Company reported year-over-year quarterly net income (“NI”) growth of 61%. However, cash flow from operations (“CFFO”) went from a positive \$5,247,000 in the year ago quarter to a negative \$11,677,000 in the most recent reported quarter.

(\$ - in 000's)	3 mos. to 12/2/00	3 mos. to 12/2/01	% change
NI	10,805	17,361	61%
CFFO	5,247	(11,677)	NM
CFFO – NI	(5,558)	(29,038)	(422%)

Quarterly revenue enhanced by change in quarter-end and allowance decline – For the quarter ended December 2, 2001, the Company reported a year-over-year quarterly revenue increase of 12%. However, the Company moved its quarterly closing dates from the Saturday closest to the last day of the calendar quarter to the Sunday closest to the last day of the calendar quarter effective for the first quarter of fiscal 2002.¹ This change contributed approximately \$2,600,000 of gross revenue to the quarter ended December 2, 2001 (Q1 02).

In addition, the Company stated that “...net revenues and net earnings increased by \$4,458,000 due to the Company’s reduction of the August 31, 2001 allowances for estimated returns and price concessions...”² in Q1 02. Without these two adjustments (Revenue w/o Adjustments), the year-over-year percentage growth in revenue would have been 3%.

(\$ - in 000's)	Q1 01	Q2 02	% change
Reported Revenue	72,039	81,011	12%
Revenue w/o Adjustments.	72,039	73,953	3%

The reported \$81 million in revenue was less than the \$86 million in revenue the Company forecast for Q1 02 in a press release dated October 24, 2001. Without the allowance adjustments and change in quarter-end, the revenue shortfall would have been even greater.³

¹ . The Company's fiscal year-end date (August 31) remains unchanged.

² . AKLM, 10-Q (12/2/01), p. 8. In fiscal 2001, net revenues increased by \$11,500 due to the Company's reduction of the August 31, 2000 accrued sales allowances for estimated price concessions. AKLM, 10-K/A (8/31/01), p. 28.

³ . In a press release dated January 10, 2002, the Company stated that it “... maintains its previously stated guidance for fiscal 2002 of first half net revenues of \$146.0 million, by increasing its second quarter fiscal year 2002 net revenue guidance by \$5.0 million to \$65.0 million.” With regard to where the Company might obtain the additional \$5 million in revenue, we note that the Company further stated: “The increase of \$5.0 million is attributable to the initial split shipment of Legends of Wrestling™ that occurred on the cusp of the first and second quarters of fiscal year 2002.” The Company further stated in its 10-Q for the

Reported net income and EPS enhanced by multiple factors – Despite revenue for Q1 02 coming in at \$5 million less than the Company had predicted, its net income of \$17.4 million was slightly better than its estimate in its October 24, 2001 press release of \$17 million for the quarter. This represented year-over-year net income percentage growth of 61%. However, that growth was enhanced by the change in its quarter-end, the reduction in allowances for estimated returns and price concessions, a \$2.2 million decline in year-over-year research and development costs due to additional capitalized software development expenses,⁴ a reversal of \$4.4 million in previously accrued expenses⁵ and a small tax benefit rate (of .08%) versus an effective tax rate of 2.3% in the year ago quarter.⁶

By way of a hypothetical presentation only, we present in the following table an approximation of the Company's net income without the aforementioned factors.

quarter ended December 2, 2001 (filed on January 16, 2001), that the increase in inventory was due to "... an increase in the volume of shipments to distributors for which \$10.3 million of revenue recognition was deferred." AKLM, 10-Q (12/2/01), p. 25. We did not locate an explanation as to why the revenue recognition was deferred.

⁴ . Per the Company, the decrease in research and development expenses is due to the greater number of software titles in development meeting technological feasibility criteria which resulted in a \$3.6 million (the difference between the \$4.1million capitalized in Q1 02 and \$500,000 capitalized in Q1 01 per the Company's 10-Q for Q1 02) increase in the amount of software development costs capitalized, partially offset by an increase in costs associated with the greater number of software development personnel necessary to produce the increased number of software titles in development. As a percentage of net revenues, research and development expenses decreased to 12% for the quarter ended December 2, 2001 from 16% for the quarter ended December 2, 2000. AKLM, 10-Q (12/2/01), p. 22.

⁵ . The Company did increase its marketing expenses for media advertising by \$2 million in Q1 02 versus Q1 01. AKLM, 10-Q (12/2/01), p. 22. However, per the Company, fiscal year 2001 was a year in which the Company made the strategic decision to limit TV and print media advertising expenditures for software compatible with next-generation systems because the installed base in North America of the PlayStation 2 system was not sufficient (4.0 million units as of August 31, 2001) to warrant such expenditures. This action was the primary reason for the 56% reduction in marketing and selling expenses from \$40.0 million to \$31.6 million in fiscal 2001 from \$71.6 million in fiscal 2000. AKLM, 10-K (8/31/01), p. 28.

⁶ . The Company has a U.S. tax loss carryforward of \$201 million expiring in fiscal years 2011 through 2021. As of 8/31/01, it had a deferred tax asset of \$87,695,000 of which the Company had created a valuation allowance for the full amount. AKLM, 10-K (8/31/01), p. 59. Accordingly, the Company may record a tax benefit going forward until the valuation allowance is expired.

(\$ - in 000's)	3 mos. to 12/2/00	3 mos. to 12/2/01	% change
Reported Net Inc.	10,805	17,361	61%
Quarter-End		(650) ⁷	
Allowance reduction		(4,458) ⁸	
R & D expenses		(2,200) ⁹	
Accrued Expenses		(4,400)	
Additional tax due		(127) ¹⁰	
Adj. Net Income	10,805	5,526	(49%)

Despite the year-over-year increase in reported net income of 61%, the Company's reported diluted earnings per share ("EPS") only increased by 17% due to the additional diluted shares outstanding as of December 2, 2001 versus the year ago period. The increased number of shares outstanding also increased the decline in our adjusted EPS after removing the factors discussed previously in this section.

	3 mos. to 12/31/00	3 mos. to 12/31/01	% change
Reported EPS (Diluted)	.18	.21	17%
Adj. EPS (Diluted)	.18	.07	(61%)
Diluted shares out	60,028	82,671	

Increase in capitalized software development costs and discrepancies re: past disclosures thereof – In its 10-K for the year ended August 31, 2001, the Company reported that it capitalized no (0) software development costs in the fiscal year ended August 31, 2000 and it capitalized \$7,404,000 in the fiscal year ended August 31, 2001.¹¹

⁷ . Calculated by taking the reported addition to revenue due to quarter end change (\$2,600,000) times the Company's operating margin (25%).

⁸ . We are deducting the full amount of the allowance reversal because the Company stated that "... net revenues and net earnings increased by \$4,458,000 due to the Company's reduction of the August 31, 2001 allowance for estimated returns and price concessions...". AKLM, 10-Q (12/2/01), p. 8 (emphasis supplied).

⁹ . This figure is the difference between the reported expense for R & D in Q1 02 versus Q1 01.

¹⁰ . This figure was calculated by subtracting all the items listed in the prior rows of this table from the Company's reported earnings before taxes (\$17,222,000) and multiplying that number (\$5,514,000) by Q1 01 effective tax rate of 2.3%.

¹¹ . AKLM, 10-K (8/31/01), p. 33. The Company's policy is to capitalize software development costs once technological feasibility of the product is established. Prior to establishing technological feasibility, software development costs are expensed to research and development. Subsequent to establishing technological feasibility but before general release of the software, development costs are capitalized. The Company amortizes capitalized software development costs for a product and records in cost of revenues the greater of the amount computed using the ratio that current gross revenues for that product bear to the total of current and anticipated future gross revenues for that product or using the straight-line method over the estimated economic life of the product up to a maximum of three months. AKLM, 10-K (8/31/01), p. 49. The Company states that the average life cycle of a new title is largely dependent on its initial success and generally ranges from less than three months to upwards of twelve to eighteen months, with the majority of sales occurring in the first thirty to one hundred and twenty days after release. AKLM, 10-K

In examining the Company's 10-Q's from the fiscal year ended August 31, 2001, the Company reported no capitalization of software costs in the quarter ended December 2, 2000 (Q1 01) or in the quarter ended March 3, 2001 (Q2 01). For the quarter ended June 2, 2001 (Q3 01), it capitalized \$2,946,000 in software development costs. In the quarter ended August 31, 2001 (Q4 01), it capitalized \$4,458,000 in software development costs.¹²

In the quarter ended December 2, 2001 (Q1 02), it capitalized \$4,149,000 in software development costs.

(\$ - 000's)	FY 96	FY 97	FY 98	FY 99	FY 00	FY 01	Q1 02
Capitol. Software	*	*	*	*	0	7,404	4,149

* Unknown

However, also in its quarter ended December 2, 2001 (Q1 02), it changed the presentation in its statement of cash flows from investing activities to include capitalization of software development costs for the year ago period (Q1 01) of \$500,000. In its original 10-Q from Q1 01, the Company did not record any capitalization of software development costs. The Company's 10-Q from December 2, 2000 shows only \$72,000 expensed to acquire fixed assets and \$1,000 gain from the disposal of assets in the statement of cash flows from investing activities. Therefore, there is no account that could include a \$500,000 capitalized software development cost from the original 10-Q for Q1 01.

In addition, we note that the Company may have capitalized software development costs prior to fiscal year 2000, however, we did not find any evidence thereof from the financial statements in the Company's 10-K's in searching as far back as fiscal year 1995.

The were only two indications we found of the possibility of software development costs capitalized in years prior to fiscal year 2000:

- 1.) A note in the Company's 10-K for the period ended August 31, 1996 indicated that \$8,000,000 in capitalized software development costs were being written off that year,¹³ and
- 2.) The mention in the Company's 10-K for fiscal year 1996 that by letter dated April 15, 1996, the Company's then-auditor, Grant Thornton LLP ("GT"), advised the

(8/31/01), p. 5. Hence, once amortization of software development costs begins it should result in full amortization for the product relatively quickly. However, we do not have sufficient information to opine as to whether the Company is amortizing its development costs at an appropriate rate.

¹². Capitalizing software development costs is not a GAAP violation. However, companies have discretion in choosing whether to expense or capitalize certain development costs. The more that is capitalized, the less expense is recorded on a company's income statement.

¹³. AKLM, 10-K (8/31/96), p. 75.

Company that they had noted certain internal control structure matters that related to significant deficiencies in the design or operation of the Company's internal control structure, relating to the quality and depth of financial management, analysis of significant estimates, lack of internal audit function and accounting for capitalized software costs, that, in their judgment, could adversely affect the Company's ability to record, process, summarize and report financial data consistent with the assertions of management in the Company's financial statements.

We did not locate any assurance that the issues raised in the Grant Thornton letter were resolved. We note that on July 24, 1996, at the recommendation of its Audit Committee, the Board of Directors of AKLM adopted a resolution (i) not to retain Grant Thornton LLP as the Company's independent auditors for the fiscal year ending August 31, 1996 and (ii) to engage KPMG Peat Marwick LLP ('KPMG')¹⁴ as the Company's independent auditors for the fiscal year ending August 31, 1996. GT was so advised on July 25, 1996.¹⁵

Increase in accounts receivable (A/R) and decline in A/R information disclosed – For the quarter ended December 2, 2001 (Q1 02), the Company's accounts receivable ("A/R") increased by 167% from the year ago quarter, while its revenue increased 12%. Sequentially, A/R increased by 61% while revenue increased by 74%.

(\$ - 000's)	Q4 01	Q1 02	% change	Q1 01	Q1 02	% change
A/R	49,074	79,188	61%	29,706	79,188	167%
Revenue	46,529	81,011	74%	72,039	81,011	12%

Quarterly days' sales in accounts receivable ("DSO" – defined as accounts receivable divided by quarterly revenue/days in the quarter)¹⁶ increased to 88 days from 37 days in the year ago quarter, but down from 95 days in the prior quarter.

	Q4 00	Q1 01	Q2 01	Q3 01	Q4 01	Q1 02
Qtr. DSO	21.36	37.11	34.25	49	94.92	87.98

The Company stated that its accounts receivable increase in Q1 02 was partially attributable to an "... increase in the average time it took to collect accounts receivable."¹⁷

Decline in Accounts Receivable disclosures – The Company factors the majority of its North American accounts receivable.¹⁸ Up through its fiscal year end August 31,

¹⁴ . KPMG is still the Company's auditor. KPMG issued a "going concern" opinion of AKLM for the last two fiscal years. In fiscal year 2001, AKLM paid KPMG audit fees of \$389,000 and non-audit fees of \$391,973. AKLM, Proxy Statement (filed 12/21/01), p. 28.

¹⁵ . AKLM, 10-K (8/31/96), p. 77.

¹⁶ . All calculations in the table assume 90 days in each quarter.

¹⁷ . AKLM, 10-Q (12/2/01), p. 29.

2001, the Company disclosed the amount of receivables assigned to a factor and the amount of advances from the factor in the notes to its 10-K's and 10-Q's. The Company reduces its accounts receivable on its balance sheet by the amount advanced by the factor.

However, beginning with its 10-Q for the quarter ended December 2, 2001, the Company stopped disclosing the amount of receivables assigned to a factor and the amount advanced from the factor. Therefore, we do not know to what degree, if any, the large increase in accounts receivable in Q1 02 may have resulted from a change in the amount of accounts receivable the Company's bank was willing to factor.

Decline in allowance for returns and price concessions – For the quarter ended December 2, 2001, the Company's allowance for returns and price concessions ("Allowance")¹⁹ declined by double-digit amounts sequentially and year-over-year, while its accounts receivable increased by double-digit amounts over those same time periods.

(\$ - 000's)	Q4 01	Q1 02	% change	Q1 01	Q1 02	% change
A/R	49,074	79,188	61%	29,706	79,188	167%
Allowance	16,847	13,808	(18%)	37,313	13,808	(63%)

In addition, the Allowance level at December 2, 2001 represents the lowest dollar amount and the lowest percentage of Allowance to accounts receivable, net ("All./A/R") at any time in the periods examined in the following tables.

(\$ - in 000's)	Q2 02	Q3 01	Q4 01	Q1 02
Allowance	34,791	24,796	16,847	13,808
A/R, net	15,344	21,035	49,074	79,188
All./A/R	227%	118%	34%	17%

(\$ - in 000's)	Q2 00	Q3 00	Q4 00	Q1 01
Allowance	41,764	29,563	39,083	37,313
A/R, net	51,879	11,423	3,958	29,706
All./A/R	81%	259%	987%	126%

¹⁸ . We were unable to ascertain from the Company's 10-K whether the North American receivables were factored with recourse. The Company also has an international factoring agreement in the United Kingdom, wherein its A/R are factored with recourse. AKLM, 10-K (8/31/01), p. 37.

¹⁹ . The Company states that it grants price concessions to its key customers who are major retailers that control the market access to the consumer, when those concessions are necessary to maintain its relationships with the retailers and access to its retail channel customers. The Company admits that in the past, during platform transitions, it has had to increase its price concessions granted to its retailer customers. Coupled with more competitive pricing, if the Company's allowances for returns and price concessions are exceeded, its financial condition and results of operations will be negatively impacted, as has occurred in the past. AKLM, 10-Q (12/2/01), p. 30.

(\$ - in 000's)	Q2 99	Q3 99	Q4 99	Q1 00
Allowance	45,827	41,828	39,614	55,113
A/R, net	23,595	24,353	84,430	82,904
All./A/R	194%	72%	47%	66%

(\$ - in 000's)	Q2 98	Q3 98	Q4 98	Q1 99
Allowance	24,678	27,486	37,260	37,360
A/R, net	31,076	43,631	39,177	55,624
All./A/R	79%	63%	95%	67%

(\$ - in 000's)	Q2 97	Q3 97	Q4 97	Q1 98
Allowance	28,100	22,035	18,780	31,152
A/R, net	48,732	23,740	18,729	38,494
All./A/R	58%	93%	100%	81%

Increase in inventory – For the quarter ended December 2, 2001 (Q1 02), the Company's inventory increased by 88% from the year ago quarter, while its revenue increased 12%. Sequentially, inventory increased by 144% while revenue increased by 74%.

(\$ - 000's)	Q4 01	Q1 02	% change	Q1 01	Q1 02	% change
Inventory	4,043	9,880	144%	5,258	9,880	88%
Revenue	46,529	81,011	74%	72,039	81,011	12%

Quarterly days' sales in inventory ("DSI" – defined herein as ending inventory divided by quarterly cost of goods sold²⁰/number of days in the quarter²¹) rose to 33 days from 30 days in the prior quarter and 22 days in the year ago quarter.

	Q4 00	Q1 01	Q2 01	Q3 01	Q4 01	Q1 02
Qtr. DSI	25.87	21.72	26	69.31	29.96	32.76

The Company stated that the increase in inventory was due to "... an increase in the volume of shipments to distributors for which \$10.3 million of revenue recognition was deferred."²²

Increase in prepaid expenses and "other" assets – For the quarter ended December 2, 2001 (Q1 02), the Company's prepaid expenses ("Pre. Exp." – a current asset on the Company's balance sheet) increased by 273% from the year ago quarter.

²⁰ . Calculated by subtracting the quarterly depreciation and amortization found on the Company's statement of cash flows from operations from the cost of revenue.

²¹ . All calculations in the table assume 90 days in each quarter.

²² . AKLM, 10-Q (12/2/01), p. 29.

The Company's "other" assets ("Oth. Ast." – a long-term asset on the Company's balance sheet) increased 1,149% from the year ago quarter, while its revenue increased 12%. Sequentially, prepaid expenses increased by 46%, other assets increased by 17% and revenue increased by 74%.

(\$ - 000's)	Q4 01	Q1 02	% change	Q1 01	Q1 02	% change
Pre. Exp.	4,816	7,043	46%	1,887	7,043	273%
Oth. Ast.	8,255	9,679	17%	775	9,679	1,149%
Revenue	46,529	81,011	74%	72,039	81,011	12%

We were unable to ascertain if any of the increase in these assets was related to the capitalization of items previously expensed. The Company attributed the increase in prepaid expenses to "... a change in the timing of prepaid royalty and prepaid insurance payments."²³

Decline in gross profit margin – For the quarter ended December 2, 2001, the Company's gross profit margin ("GPM" - calculated as gross profit, plus depreciation and amortization included in cost of revenue, divided by revenue), declined to 66.5% from 69.8% in the year ago quarter.

	Q1 01	Q2 01	Q3 01	Q4 01	Q1 02
GPM	69.75%	71.73%	84.4%	73.9%	66.5%

Additional share dilution – In a press release dated January 10, 2002, the Company projected fiscal year 2002 revenue of \$301 million, with net income of \$38.6 million and earnings per share (EPS) of \$0.44. This was based on a weighted average of 88.1 million fully diluted shares.

As of the quarter ended December 2, 2001 (Q1 02), the Company had fully diluted shares of 82,671,000. On February 13, 2002, the Company issued a press release that stated it had arranged a private placement of common stock in the amount of 7.2 million shares to a small group of private investors.²⁴ The fully diluted shares outstanding as of December 2, 2001 plus the shares issued in the private placement total 89.9 million shares, though averages will be used in calculating the amount outstanding for the entire fiscal year and the Company retired \$12.2 million in convertible debt obligation (that we presume was used in calculating fully diluted shares previously) on or about March 1, 2002 by way of a cash payment.²⁵

²³ . AKLM, 10-Q (12/2/01), p. 29.

²⁴ . Total gross proceeds from the offering were \$21.5 million, or \$2.99 per share. On February 12, 2002, the Company's stock closed at \$3.32 per share, its lowest closing price for the month of February 2002.

²⁵ . Press release dated March 1, 2002.

Related party transactions - In July 2001, Gregory Fischbach (a founder, Co-Chairman of the Board, President, CEO and 11% stockholder of the Company) and James Scoroposki (a founder, Co-Chairman of the Board, Senior Executive V.P., Secretary, Treasurer and 11% stockholder of the Company) each exercised a warrant (granted in 1991) to purchase 750,000 shares of Common Stock for total consideration of \$1,815,000 of which \$1,797,450 was paid with a note held by AKLM and the remainder was paid in cash. The \$1,797,450 note receivable accrues interest as calculated under the terms of the Company's revolving credit and security agreement with its primary lender, and both the principal amount and interest accrued thereon are payable in July 2002, or when the shares acquired upon exercise of the warrant are sold, whichever is earlier. As of the date of the Company's Proxy Statement, the full amount of \$1,797,450 is outstanding for each of Messrs. G. Fischbach and Scoroposki.²⁶

Again in October 2001, Gregory Fischbach and James Scoroposki each exercised a warrant (granted in 1991) to purchase 562,500 shares of the Company's common stock for aggregate consideration of \$3,375,000 of which \$3,352,500 was paid with a note held by AKLM (the remainder was paid in cash).²⁷ Per the 10-Q filed for the quarter ended December 2, 2001, the full amount of \$1,676,250 (i.e., a total amount of \$3,352,500) is still outstanding for each of Messrs. G. Fischbach and Scoroposki.

In March 2001, the Company's lead lender entered into participation agreements with certain investors under and pursuant to the terms of the revolving credit and security agreement between the Company and the lender. Following the participation, the lender advanced \$9.5 million to the Company pursuant to the revolving credit and security agreement for working capital purposes. As an inducement to the investors to effect the participation, the Company issued to the investors five-year warrants to purchase up to an aggregate of 2,375,000 shares of common stock of the Company exercisable at an initial price of \$1.25 per share.²⁸ Separate entities owned by each of Gregory Fischbach and James Scoroposki, officers and directors of the Company, received warrants to purchase 625,000 shares of common stock of the Company in connection with the pro rata allocation of their \$2.5 million investment in the participation. James Scibelli, a director of the Company, received warrants to purchase 125,000 shares of common stock in connection with the pro rata allocation of his \$500,000 investment in the participation.

In each of the second and third quarters of fiscal 2001, Gregory Fischbach and James Scoroposki together loaned the Company a total of \$2.2 million, which loans were repaid in the second and third quarters of fiscal 2001, respectively. It was no clear from

²⁶ . AKLM, Proxy Statement (filed 12/21/01), p. 29.

²⁷ . The warrants were originally issued in reliance upon the exemption from registration provided under Section 4(2) of the Securities Act of 1933. The \$3,352,500 notes receivable accrue interest as calculated under the terms of the Credit Agreement with the Bank and both the principal amount and interest accrued thereon are payable October 2002, or when the shares acquired upon exercise of the warrants are sold, whichever is earlier. AKLM, 10-Q (12/2/01), p. 37.

²⁸ . During the month of March 2001, the Company's stock closed at prices ranging from \$0.78 to \$1.50.

the Company's proxy statement whether these loans were related to the loans described in the previous paragraph.²⁹

In August 2000, the Company wrote off notes receivable, including accrued interest, of \$2,843,000 due from an entity, which was deemed uncollectible; two directors of the Company serve as directors of such entity, one of which serves as the Company's nominee at the request of the Company's Board of Directors.³⁰

Some customer concentration - The Company markets its products primarily to mass merchandise companies, large retail toy store chains, department stores and specialty stores. Sales to two customers represented 12% and 11% of revenues for the year ended August 31, 2001, sales to two customers represented 11% and 10% of revenues for the year ended August 31, 2000 and sales to two customers represented 14% and 11% of revenues for the year ended August 31, 1999.

In addition, the Company is substantially dependent on Nintendo and Sony as the sole manufacturers of the software developed by the Company for Nintendo's and Sony's hardware platforms and on Nintendo, Sony and Sega as the sole licensors of the proprietary information and technology needed to develop software for each manufacturer's platforms. For the years ended August 31, 2001, 2000 and 1999, the Company derived 13%, 40% and 64% of its gross revenues, respectively, from sales of Nintendo-compatible software, 74%, 32% and 27% of its gross revenues, respectively, from sales of software for PlayStation and 9%, 21% and less than 1% of its gross revenues, respectively, from sales of Sega-compatible software.³¹

Two of directors on audit committee are not completely independent - The audit committee is composed of the following outside directors: Messrs. James Scibelli (chair), Kenneth L. Coleman, Robert Groman, Esq. and Michael Tannen.

Mr. Scibelli received compensation from the Company in connection with his investment banking services in several financing transactions in fiscal 2001. Mr. Groman is president of the law firm of Groman, Ross & Tisman, P.C., which performs legal services for the Company and, per the Company, will continue to do so for fiscal 2002.

Despite Mr. Scibelli's receipt of compensation, the Company stated that Mr. Scibelli was authorized by the Board of Directors pursuant to Nasdaq rules to serve on the Audit Committee given his extensive knowledge of the Company's operations and industry and extensive background in finance.³² We found no explanation regarding Mr. Groman's status.

²⁹ . AKLM, Proxy Statement (filed 12/21/01), p. 29.

³⁰ . AKLM, 10-KA (8/31/01), p. 43.

³¹ . AKLM, 10-KA (8/31/01), p. 43.

³² . AKLM, Proxy Statement (filed 12/21/01), p. 28.

Until his retirement in June 2001, Mr. Coleman was Executive Vice President of Global Sales, Service and Marketing for Silicon Graphics, Inc. in Mountain View, California. Mr. Tannen has produced feature films for Warner Bros. and Tri-Star Pictures; television specials for HBO, PBS and the BBC and is currently a partner in a media investment firm. We found no details regarding the finance or accounting backgrounds for either Messrs. Coleman or Tannen in the Company's Proxy Statement.³³

Auditor issues “going concern” opinion for two consecutive years – For the past two fiscal years (ending August 31, 2000 and 2001) the Company's independent auditors' report, as prepared by KPMG LLP, included an explanatory paragraph relating to substantial doubt as to the Company's ability to continue as a going concern, due to its working capital and stockholders' deficits at August 31, 2001 and the recurring use of cash in operating activities.

Positive Note – Debt due March 1, 2002 satisfied – The Company had some 10% convertible notes that were due March 1, 2002 (the balance due on these notes was \$29.2 million as of December 2, 2001). In a press release dated March 1, 2002, the Company announced that it had repaid the outstanding principal balance plus accrued interest on those notes.³⁴

³³ . AKLM, Proxy Statement (filed 12/21/01).

³⁴ . The Company announced that \$3.0 million of the debt was reduced in early January 2002 by converting to equity (press release 1/10/02 – no details provided regarding any charges taken related to the conversion); another \$1.3 million was reduced by conversion in January 2002 (press release dated 1/18/02 – no details provided regarding any charges taken related to the conversion); \$3.4 million was reduced by conversion in February 2002 (press release dated 2/6/02 – Company to record extraordinary loss on the early retirement of \$180,000 in Q2 02, reflecting fair market value of the shares (\$3,728,000) over the principal amount of the notes retired plus accrued interest); \$9.3 million was reduced by conversion in February 2002 (press release dated 2/13/02 - Company to record extraordinary loss on the early retirement of \$1 million in Q2 02, reflecting fair market value of the shares (\$10.8 million) over the principal amount of the notes retired plus accrued interest), the remaining \$12.2 million was repaid (press release dated 3/1/02).

1-Year Stock Chart



Chart courtesy of StockCharts.com (<http://stockcharts.com>).

12 Month Short Interest Data (as of the 15th of each month)*

Settlement Date	Short Interest	% change	Ave. Dly. Vol.	Days to Cover
February 2002	9,429,169	30.66	1,725,980	5.46
January 2002	7,216,370	(1.30)	1,314,888	5.49
December 2001	7,311,744	21.89	2,062,804	3.54
November 2001	5,998,486	26.62	1,305,833	4.59
October 2001	4,737,376	27.39	771,562	6.14
September 2001	3,718,779	25.23	802,822	4.63
August 2001	2,969,453	24.59	970,582	3.06
July 2001	2,383,472	16.37	1,381,840	1.72
June 2001	2,048,130	15.04	2,073,687	1.00
May 2001	1,780,351	(35.79)	1,071,902	1.66
April 2001	2,772,532	(23.14)	360,105	7.70
March 2001	3,607,440	(2.73)	151,317	23.84

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