CICERO INC
Form 10-Q
November 14, 2011

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark one)
þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2011.

o 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 0-26392

CICERO INC.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	11-2920559 (I.R.S Employer Identification Number)
8000 Regency Parkway, Suite 542, Cary, North Carolina (Address of principal executive offices)	27518 (Zip Code)

(919) 380-5000
(Registrant's telephone number, including area code)

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 þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non accelerated filer, or 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	o	Non accelerated filer	o
Accelerated Filer	o	Smaller reporting company	þ

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No o

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

47,444,524 shares of common stock, $.001 par value, were outstanding as of November 4, 2011.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CICERO INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands)

ASSETS	September 30, 2011 (unaudited)	December 31, 2010
Current assets:		
Cash and cash equivalents	$58	$43
Trade accounts receivable, net	457	137
Prepaid expenses and other current assets	299	279
Total current assets	814	459
Property and equipment, net	36	40
Intangible asset, net (Note 3)	905	1,430
Goodwill (Note 3)	2,832	2,832
Total assets	$4,587	$4,761
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Short-term debt (Note 4)	$5,928	$1,473
Accounts payable	3,751	2,782
Accrued expenses:		
Salaries, wages, and related items	1,292	1,251
Earn-out contingency (Note 2)	--	789
Other	410	316
Deferred revenue	777	374
Total current liabilities	12,158	6,985
Long-term debt (Note 5)	1,000	4,440
Total liabilities	13,158	11,425
Commitment and Contingencies (Note 9)		
Stockholders' deficit:		
Convertible preferred stock, $0.001 par value, 10,000,000 shares authorized Series A-1 – 1,542.6 shares issued and outstanding at September 30, 2011 and 1,543.6 shares issued and outstanding at December 31, 2010	--	--
Series B - 10,400 shares issued and outstanding at September 30, 2011 and at December 31, 2010	--	--
Common stock, $0.001 par value, 215,000,000 shares authorized at September 30, 2011 47,444,524 issued and outstanding at September 30, 2011and 47,098,185 issued and outstanding at December 31, 2010	47	47
Additional paid-in capital	232,468	232,369

Accumulated deficit	(241,086)	(239,080)
Total stockholders' deficit	(8,571)	(6,664)
Total liabilities and stockholders' deficit	$4,587	$4,761

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

CICERO INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share amounts)
(unaudited)

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Revenue:				
Software	$26	$45	$640	$952
Maintenance	390	365	1,158	1,037
Services	318	155	760	364
Total operating revenue	734	565	2,558	2,353
Cost of revenue				
Software	175	178	526	506
Maintenance	24	25	88	123
Services	271	245	806	685
Total cost of revenue	470	448	1,420	1,314
Gross margin	264	117	1,138	1,039
Operating expenses:				
Sales and marketing	403	418	1,321	1,510
Research and product development	239	232	710	662
General and administrative	271	305	884	979
Total operating expenses	913	955	2,915	3,151
Loss from operations	(649)	(838)	(1,777)	(2,112)
Other income/(expense):				
Interest expense	(287)	(221)	(651)	(561)
Gain on reversal of earn-out accrual	--	--	517	100
Net loss	$(936)	$(1,059)	$(1,911)	$(2,573)
8% preferred stock Series B dividend and deemed dividend on preferred stock	32	32	95	152
Net loss applicable to common stockholders	$(968)	$(1,091)	$(2,006)	$(2,725)
Loss per share applicable to common stockholders – basic and diluted	$(0.02)	$(0.02)	$(0.04)	$(0.06)
Weighted average shares outstanding – basic and diluted	47,445	47,098	47,306	47,098

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

CICERO INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Nine Months Ended September 30, 2011	2010
Cash flows from operating activities:		
Net loss	$(1,911)	$(2,573)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	542	512
Stock compensation expense	73	81
Amortization of debt discount	--	175
Provision for doubtful accounts	14	--
Gain on reversal of earn out contingency	(517)	--
Changes in assets and liabilities:		
Trade accounts receivable	(334)	(114)
Prepaid expenses and other assets	(20)	88
Accounts payable and accrued expenses	746	376
Deferred revenue	403	490
Net cash used in operating activities	(1,004)	(965)
Cash flows from investing activities:		
Purchases of equipment	(13)	(7)
Acquisition of SOAdesk assets	--	(300)
Net cash used in investing activities	(13)	(307)
Cash flows from financing activities:		
Issuance of series B convertible preferred stock	--	700
Borrowings under short and long-term debt	1,482	1,285
Repayments of short and long-term debt	(450)	(705)
Net cash provided by financing activities	1,032	1,280
Net increase in cash	15	8
Cash:		
Beginning of period	43	12
End of period	$58	$20

Non-Cash Investing and Financing Activities:

During March 2011, the Company converted $9 of interest payable to a private lender by issuing 145,339 shares of its common stock.

During May 2011, the Company converted $17 of note payable to a private lender by issuing 200,000 shares of its common stock.

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

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CICERO INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

NOTE 1. INTERIM FINANCIAL STATEMENTS

The accompanying financial statements for the three and nine months ended September 30, 2011 and 2010 are unaudited, and have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and note disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to those rules and regulations. Accordingly, these interim financial statements should be read in conjunction with the audited financial statements and notes thereto contained in Cicero Inc.'s (the "Company") Annual Report on Form 10-K for the year ended December 31, 2010, filed with the SEC on March 31, 2011. The results of operations for the interim periods shown in this report are not necessarily indicative of results to be expected for other interim periods or for the full fiscal year. In the opinion of management, the information contained herein reflects all adjustments necessary for a fair presentation of the interim results of operations. All such adjustments are of a normal, recurring nature.

The year-end condensed balance sheet data was derived from audited financial statements in accordance with the rules and regulations of the SEC, but does not include all disclosures required for financial statements prepared in accordance with accounting principles generally accepted in the United States of America.

The accompanying condensed consolidated financial statements include the accounts of the Company and its subsidiaries. All of the Company's subsidiaries are wholly owned for the periods presented.

Liquidity

The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The Company has incurred losses of $643,000 and $1,280,000 for the years ended December 31, 2010 and 2009, respectively, and has experienced negative cash flows from operations for each of the past three years. For the three and nine months ended September 30, 2011, the Company incurred losses of $936,000 and $1,911,000, respectively, and had a working capital deficiency of $11,344,000 as of September 30, 2011. Management believes that the Company has repositioned itself in the marketplace as a result of the acquisition of the assets of SOAdesk during January 2010 along with its key personnel. By combining the SOAdesk products with the Cicero legacy products, the Company is able to offer a complete Customer Experience Management suite of products. The new products have already received awards from within the industry and new customers have contracted to use the products, thereby generating new revenues. The Company will be looking to raise additional funds in the next several months however, there can be no assurance the Company will be able to do so, especially given the current state of the capital markets. The Company has extended the maturity dates of several debt obligations that were due in 2011 to 2012, to assist with liquidity and may attempt to extend these maturity dates further if necessary. Despite the recent additions of several new clients, the Company continues to struggle to gain additional sources of liquidity on terms that are acceptable to the Company. As such, there is substantial doubt of the Company’s ability to continue as a going concern.

Use of Accounting Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual amounts could differ from these estimates. Significant estimates include the recoverability of long-lived assets, valuation and recoverability of goodwill, stock based compensation, deferred taxes and related valuation allowances and valuation of equity instruments.

Financial Instruments:

The carrying amount of the Company's financial instruments, representing accounts receivable, accounts payable and short-term debt approximate their fair value due to their short term nature.

The fair value and carrying amount of long-term debt were as follows:

	September 30, 2011	December 31, 2010
Fair Value	$853,288	$4,244,579
Carrying Value	1,000,000	4,440,000

Valuations for long-term debt are determined based on borrowing rates currently available to the Company for loans with similar terms and maturities.

Stock-Based Compensation

The Company adopted Financial Accounting Standards Board ("FASB") guidance now codified as ASC 718 "Compensation – Stock Compensation" which addresses the accounting for stock-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. The Company uses the Black-Scholes option-pricing model to determine the fair-value of stock-based awards under ASC 718. The Company issued 600,000 options in the first nine months of 2011. The Company recognized stock-based compensation expense of $29,000 and $73,000 for the three and nine months ended September 30, 2011, respectively. This is comprised of $20,000 and $46,000 for the three and nine months ended September 30, 2011, respectively in connection with outstanding options and $9,000 and $27,000 for the three and nine months ended September 30, 2011, respectively, for the 549,360 shares of restricted stock reserved for Mr. John Broderick, the Company's CEO, in accordance with his 2007 employment agreement. The Company recognized $49,000 and $54,000 for the three and nine months ended September 30, 2010, respectively

The following table sets forth certain information as of September 30, 2011 about shares of the Company's common stock, par value $.001 (the "Common Stock"), outstanding and available for issuance under the Company's existing equity compensation plans: the Cicero Inc. 2007 Employee Stock Option Plan, the Cicero Inc. 1997 Stock Option Incentive Plan and the Outside Director Stock Option Plan. The Company's stockholders approved all of the Company's stock-based compensation plans.

	Shares
Outstanding on January 1, 2011	3,503,157
Granted	600,000
Exercised	--
Forfeited	(4,143)
Outstanding on September 30, 2011	4,099,014
Weighted average exercise price of outstanding options	$ 0.46
Aggregate Intrinsic Value	$ 15,760
Shares available for future grants on September 30, 2011	423,190

Recently Adopted Accounting Pronouncements

In September 2011, the FASB issued Accounting Standards Update No. 2011-08, Intangibles—Goodwill and Other (Topic 350)—Testing Goodwill for Impairment (ASU 2011-08), to simplify how entities test goodwill for impairment. ASU 2011-08 allows entities to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If greater than 50 percent likelihood exists that the fair value is less than the carrying amount then a two-step goodwill impairment test as described in Topic 350 must be performed. The guidance provided by this update becomes effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial position and results of operations.

In December 2010 the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2010-28, "Intangibles – Goodwill and other (Topic 350): When to perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts". ASU 2010-28 modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts by requiring an entity to perform step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. This update will be effective for fiscal years beginning after December 15, 2010. The adoption of this standard did not have a material impact on the Company's consolidated financial positions and results of operations.

Reclassification

Certain accounts in the prior annual year- end balance sheet have been reclassified for comparative purposes to conform with the presentation in the current interim financial statements. These reclassifications have no effect on previously reported loss.

NOTE 2. SOAdesk ACQUISITION

On January 15, 2010, the Company entered into an Asset Purchase Agreement with SOAdesk, LLC ("SOAdesk") and Vertical Thought, Inc. ("VTI" and, together with SOAdesk, the "Sellers"), pursuant to which the Company acquired the Sellers' "United Desktop" and "United Data Model" software technology, as well as substantially all of the other assets owned by the Sellers directly or indirectly used (or intended to be used) in or related to Sellers' business of providing customer interaction consulting and technology services for organizations and contact centers throughout the world (the "Business"). The Company also assumed certain liabilities of the Sellers related to the Business, as described in the Asset Purchase Agreement.

The aggregate consideration payable by the Company to the Sellers consisted of the following:

$300,000 paid in cash to the Sellers on the closing date;

an unsecured convertible note in the aggregate principal amount of $700,000, payable to SOAdesk, with an annual interest rate of 5% and an original maturity date of March 31, 2010. On March 31, 2010, the maturity date of the unsecured Convertible Note was extended from March 31, 2010 to September 30, 2010 and was secured by shares of the Company's Series B Preferred Stock (the "Convertible Note"). At September 30, 2010, the maturity date was extended from September 30, 2010 to March 31, 2011. In March 2011, the maturity date was further extended from March 31, 2011 to March 31, 2012;

$525,000, payable in cash to SOAdesk on March 31, 2010 (subsequently converted into a new convertible promissory note as stated below);

an unsecured convertible note in the aggregate principal amount of $1,000,000, due in November 2015, payable to SOAdesk and convertible into shares of the Company's Common Stock; and

certain earn-out contingencies of $2,410,000 based on product and enterprise revenue performance targets being met.

The terms of the Asset Purchase Agreement were amended on March 31, 2010, and the Company issued a new $525,000 convertible promissory note to SOAdesk in lieu of the $525,000 payment. This new note, which carries an annual interest rate of 5%, is convertible into shares of the Company's Series B Preferred Stock (Note 6) at the holder's option and originally matured on June 30, 2010. The Company paid principal in the amount of $100,000 in April 2010. On June 30, 2010, the new convertible note was amended to extend the maturity date from June 30, 2010 to September 30, 2010. As of September 30, 2010, the new convertible note was further amended to extend the maturity date from September 30, 2010 to March 31, 2011. The Company paid principal in the amount of $4,000 in May 2011. The total outstanding debt as of September 30, 2011 is $421,000. In March 2011, the Company and SOAdesk LLC agreed to extend the maturity date until March 31, 2012 and the Company issued a five-year warrant to SOAdesk to purchase up to 100,000 shares of its common stock at an exercise price of $0.08 per share. In accordance with ASC 470-20 "Debt with Conversion and Other Options", the Company has determined the embedded conversion option is beneficial and has intrinsic value to the holder. The total debt discount to be recognized was $175,000 and the Company had reduced the Note by that amount and increased Additional Paid in Capital by the same amount. As of December 31, 2010, the Company had fully amortized the debt discount of $175,000 in the statement of operations.

The Company was obligated to make additional payments of up to $2,410,000 over an 18 month period from January 15, 2010 through July 31, 2011, based upon the achievement of certain revenue performance targets. Such payments are payable quarterly during the eighteen month period over which the performance targets are being measured. The earn-out award is to be calculated, subject to adjustment, based upon the cumulative effect of achieved revenue performance targets during the applicable earn-out period. The obligation was determined by management after consultation with an independent appraiser using the income approach methodology analyzing the Company's discounted cash flow and management's input on probability of attaining the different revenue performance targets. As of March 31, 2011, the Company had determined that the earn-out targets originally recorded as part of the acquisition will not be completely met. The Company has therefore recorded a gain of $517,000 in the first quarter of 2011, in addition to the $1,050,000 gain recorded in the fourth quarter of 2010, in the statement of operations from the reversal of part of the earn-out accrual. At September 30, 2011 the Company has recorded $843,000 in accounts payable for the earn-out earned through July 31, 2011.

We account for contingent consideration payable to sellers of the acquired assets in accordance with the provisions of ASC Topic 805 "Business Combinations" to ensure that we account for any post combination payments made to sellers of acquired businesses as either additional purchase consideration or compensation based upon the (i) economic form of the transaction and (ii) subsequent involvement (if any) of the sellers in the business on a post combined basis. The following information was determined by the Company in consultation with an independent appraiser.

Consideration:		
Cash paid	$	300,000
Convertible notes payable		2,225,000
Earn-out contingency		2,410,000
Total Consideration	$	4,935,000
Allocated to:		
Software	$	2,103,000
Goodwill ($422,000 is deductible for tax purposes)		2,832,000
	$	4,935,000

Simultaneously with the acquisition of the assets of SOAdesk LLC, the Company also closed an initial round of Series B Convertible Preferred Stock, of approximately $1,560,000 including $700,000 in cash, the cancellation of $710,000 of existing indebtedness and the cancellation of a note of $150,000 to memorialize an advance of payment for Series B Stock prior to issuance. The Series B Convertible Preferred Stock bears an annual dividend of 8% and provides warrants to purchase common stock of the Company at a strike price of $0.25 per share. The Series B stock may convert into common stock at a conversion rate of $0.15 per share. Of the $1.56 million raised, the Company's Chairman, Mr. John Steffens invested $910,000 through a combination of cash and debt retirement. Dividends accrued at September 30, 2011 amounted to $212,000.

NOTE 3. GOODWILL AND OTHER INTANGIBLE ASSETS

The Company accounts for goodwill in accordance ASC Topic 350 “Intangibles – Goodwill and Other” which requires that goodwill and intangible assets with indefinite lives be tested for impairment annually or on an interim basis if events or circumstances indicate that the fair value of an asset has decreased below its carrying value.

Goodwill includes the excess of the purchase price over the fair value of net assets acquired of $2,832,000 in connection with the SOAdesk LLC acquisition in Note 2. The Codification requires that goodwill be tested for impairment at the reporting unit level. Application of the goodwill impairment test requires judgment, including the identification of reporting units, assigning assets and liabilities to reporting units, assigning goodwill to reporting units, and determining the fair value. Significant judgment is required to estimate the fair value of reporting units which includes estimating future cash flows, determining appropriate discount rates and other assumptions. Changes in these estimates and assumptions could materially affect the determination of fair value and/or goodwill impairment.

The Company will review for possible goodwill impairment by comparing the fair value of the reporting unit to the carrying value of the respective net assets. If the fair value exceeds the carrying values of the net assets, no goodwill impairment is deemed to exist. If the fair values of the reporting unit do not exceed the carrying values of the net assets, goodwill is tested for impairment and written down to its implied value if it is determined to be impaired. The Company performs an evaluation of its goodwill on an annual basis and on an interim basis if there has been a triggering event or other indication of impairment.

Based upon our annual evaluation testing performed in December 2010, we have determined that the fair value of goodwill exceeded the carrying value of the net assets acquired. Because of market conditions and/or potential changes in strategy and product portfolio, it is possible that forecasts used to support asset carrying values may change in the future, which could result in non-cash charges that would adversely affect our results of operations and financial condition. Additionally, the Company cannot predict the occurrence of unknown events that might adversely affect the reportable value of its goodwill.

The Company’s intangible asset with a finite life in the amount of $2,103,000 is being amortized over its estimated useful life of 3 years for software acquired from SOAdesk LLC. Amortization expense for the three and nine months ended September 30, 2011, was $175,000 and $525,000, respectively, resulting in a net intangible asset of $904,000 at September 30, 2011. Amortization expense for the three and nine months ended September 30, 2010 was $175,000 and $497,000, respectively. At September 30, 2011, the estimated future amortization expense for each of the succeeding years is as follows: $175,000 for the remaining three months of 2011, $701,000 for fiscal year 2012, and $28,000 for fiscal year 2013. Actual amortization expense to be reported in future periods could differ from these estimates as a result of new intangible asset acquisitions, changes in useful lives or other relevant factors.

NOTE 4. SHORT TERM DEBT

Short-term debt, and notes payable to related party consist of the following (in thousands):

	September 30, 2011	December 31, 2010
Term loan (a)	$ 671	$ 671
Note payable – asset purchase agreement (b)	1,121	--
Note payable – related party (c)	2,699	9
Other short-term debt (d)	1,437	793
	$ 5,928	$ 1,473

a) In October 2007, the Company entered into an unsecured note, with Blue Phoenix Solutions in the principal amount of $1,021,000 with interest at LIBOR plus 1% (approximately 1.76% at September 30, 2011) maturing in December 2011. Interest is payable quarterly.

(b) At September 30, 2011, the Company was indebted to SOAdesk LLC for the remaining portion of the related debt of $1,121,000. In May 2011, the Company paid $4,000 against the principal. (See Note 5)

(c) At September 30, 2011, the Company was indebted to John L. (Launny) Steffens, the Chairman of the Board of Directors, for the remaining portion of the related debt of $1,665,000. (See Note 5)

During 2011, the Company entered into various short term notes payable with John L. (Launny) Steffens, the Chairman of the Board of Directors, for various working capital needs. The Notes bear interest at 12% per year and are unsecured and have various due dates through February 2012. At September 30, 2011, the Company was indebted to Mr. Steffens in the amount of $1,025,000.

From time to time the Company entered into promissory notes with one of the Company's directors and the former Chief Information Officer, Anthony Pizi. The notes bear interest at 12% per annum. As of September 30, 2011 and December 31, 2010, the Company was indebted to Anthony Pizi in the amount of $9,000.

(d) At September 30, 2011, the Company was indebted to certain investors for the remaining portion of the related long term debt of several secured Promissory notes of $650,000. (See Note 5)

The Company does not have a revolving credit facility and from time to time has issued a series of short term promissory notes with private lenders and employees, which provide for short term borrowings, both secured by accounts receivable and unsecured. The notes in the amount of $787,000 bear interest between 10% and 36% per annum and are payable on demand.

A note for $300,000 in principal, which is included in the $787,000 above, was due and outstanding under the Note agreement. The Company has contacted the lender to discuss a payment plan regarding the accrued interest payable under the Note or possible termination of the Note.

NOTE 5. LONG-TERM DEBT

Long-term loan and notes payable to related party consist of the following (in thousands):

	September 30, 2011	December 31, 2010
Note payable – asset purchase agreement (a)	$ --	$ 1,125
Note payable – related party (b)	--	1,665
Other long-term debt (c)	1,000	1,650
	$ 1,000	$ 4,440

a) In January 2010, per the Asset Purchase Agreement, the Company issued into an unsecured convertible promissory note with SOAdesk for $700,000 with an annual interest rate of 5%. The note was to mature on June 30, 2010 but was subsequently amended to extend the maturity date to September 30, 2010 and to securitize it with shares of the Company's Series B Preferred Stock. As of September 30, 2010, the maturity date was extended to March 31, 2011. In March 2011, the Company and SOAdesk LLC agreed to extend the maturity on the note to March 31, 2012 and the outstanding amount has been reclassified to short term debt as of September 30, 2011. (Note 4) The note is convertible into shares of Series B Convertible Preferred Stock at the rate of one share per every $150 of principal and interest due under the note. The Company is obligated to repay any principal of the loan with fifty percent of any gross proceeds of any Series B Preferred capital raise through maturity of the note. The note is convertible at the holder's option at any time or at maturity.

Also, as part of the Asset Purchase Agreement, the Company was to pay to the shareholders of SOAdesk LLC the sum of $525,000 on March 31, 2010. In March 2010, the terms of the Asset Purchase Agreement were amended and the Company issued a new $525,000 convertible promissory note to SOAdesk in lieu of the $525,000 payment originally due on March 31, 2010. This new note, which carries an annual interest rate of 5%, is secured by shares of the Company's Series B Preferred Stock. The note was to mature on June 30, 2010 but was subsequently amended to extend the maturity date to September 30, 2010. As of September 30, 2010, the maturity date was further extended to March 31, 2011. In March 2011, the Company and SOAdesk LLC agreed to extend the maturity on the note until March 31, 2012 and the Company issued a five-year warrant to SOAdesk to purchase up to 100,000 shares of its common stock at an exercise price of $0.08 per share. The note is convertible into shares of Series B Convertible Preferred Stock at the rate of one share per every $150 of principal and interest due under the note. The Company is obligated to repay any principal of the loan with fifty percent of any gross proceeds of any Series B Preferred capital raise through maturity of the note. The note is convertible into Series B Preferred Stock at the holder's option at any time or at maturity. In April 2010, the Company paid $100,000 against the principal resulting in the amount due of $425,000 at December 31, 2010 and the outstanding amount has been reclassified to short term debt as of September 30, 2011. (Note 4). In accordance with ASC 470-20 "Debt with Conversion and Other Options", the Company has determined the embedded conversion option is beneficial and has intrinsic value to the holder. The total debt discount to be recognized is $175,000 and the Company has reduced the Note by that amount and increased Additional Paid in Capital by the same amount. As of December 31, 2010, the Company has amortized $175,000 in the statement of operations.

b) From time to time during 2010, the Company entered into several short term notes payable with John L. (Launny) Steffens, the Chairman of the Board of Directors, for various working capital needs. The Notes bear interest at 12% per year and are unsecured. At December 31, 2010, the Company was indebted to Mr. Steffens in the amount of $1,665,000. In March 2011, the Company and Mr. Steffens agreed to extend the maturity on the notes until March 31, 2012 and the outstanding amount has been reclassified to short term debt as of September 30, 2011. (Note 4).

c) In March 2009, the Company entered into several secured Promissory Notes with certain investors in the aggregate amount of $750,000. The Notes bear interest at 15% and mature on January 31, 2012. The Notes are secured by the amount due under the Company's support contract with Merrill Lynch. In addition, each investor was issued a warrant to purchase common stock of the Company. Under the terms of the warrant, which expires in five years, each Note holder is entitled to purchase 1,000 shares of Cicero common stock for every $1,000 of principal due under the Note. The exercise price on the warrant is $0.20 per share. The shares of common stock underlying the warrants have registration rights and a cashless exercise provision in the event no registration statement is effective for resales, if required. The Company has allocated the proceeds received from the Note and Warrant Offering based on relative fair value and is amortizing such amount under the terms of the notes as additional interest expense in the amount of $50,349. In February 2010, the Company reduced the principal indebtedness by $100,000. At September 30, 2011, the Company was indebted to these investors in the amount of $650,000 of which amount has been reclassified to short term debt. (Note 4)

In January 2010, as part of the Asset Purchase Agreement, the Company entered into an unsecured Convertible Promissory Note with SOAdesk in the amount of $1,000,000. The note bears interest at 5% and is due November 14, 2015. The note is only convertible into shares of the Company's common stock at the rate of one share for every $0.15 of principal and interest due under the note. The note is convertible at the option of the holder with one-third convertible in January 2011, two-thirds convertible in January 2012, and the entire note convertible in January 2013 or at maturity.

NOTE 6. STOCKHOLDER'S EQUITY

During March 2011, the Company converted $9,000 of interest payable to a private lender by issuing 145,339 shares of its common stock.

During May 2011, the Company converted $17,000 of note payable to a private lender by issuing 200,000 shares of its common stock.

NOTE 7. INCOME TAXES

The Company accounts for income taxes in accordance with FASB guidance now codified as ASC 740 "Income Taxes". The Company's effective tax rate differs from the statutory rate primarily due to the fact that no income tax benefit was recorded as a result of the net loss for the first nine months of fiscal year 2011 or 2010. Because of the Company's recurring losses, the deferred tax assets have been fully offset by a valuation allowance.

NOTE 8. LOSS PER SHARE

Basic loss per share is computed based upon the weighted average number of common shares outstanding. Diluted loss per share is computed based upon the weighted average number of common shares outstanding and any potentially dilutive securities. Potentially dilutive securities outstanding during the periods presented include stock options, warrants and preferred stock.

The following table sets forth the potential shares that are not included in the diluted loss per share calculation because to do so would be anti-dilutive for the periods presented (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Stock options	4,099	3,599	4,099	3,599
Warrants	3,888	3,989	3,888	3,989
Preferred stock, common share equivalent	11,943	11,944	11,943	11,944

Options and warrants to purchase shares of common stock are excluded from the calculation of diluted earnings per share when their inclusion would have an anti-dilutive effect on the calculation. No options and warrants were included for the three and nine months ended September 30, 2011 and 2010, respectively. The weighted average number of common shares is increased by the number of dilutive potential common shares issuable on the exercise of options less the number of common shares assumed to have been purchased with the proceeds from the exercise of the options pursuant to the treasury stock method; those purchases are assumed to have been made at the average price of the common stock during the respective period.

NOTE 9. CONTINGENCIES

The Company, from time to time, is involved in legal matters arising in the ordinary course of its business including matters involving proprietary technology. While management believes that such matters are currently not material, there can be no assurance that matters arising in the ordinary course of business for which the Company is or could become involved in litigation, will not have a material adverse effect on its business, financial condition or results of operations.

Under the indemnification clause of the Company's standard reseller agreements and software license agreements, the Company agrees to defend the reseller/licensee against third party claims asserting infringement by the Company's products of certain intellectual property rights, which may include patents, copyrights, trademarks or trade secrets, and to pay any judgments entered on such claims against the reseller/licensee. There were no claims against the Company as of September 30, 2011.

NOTE 10. SUBSEQUENT EVENTS

The Company evaluates events that have occurred after the balance sheet date but before the financial statements are issued. Based upon the evaluation, the Company did not identify any recognized or non-recognized subsequent events that would have required adjustment or disclosure in the condensed consolidated financial statements.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

Cicero, Inc. (the "Company") provides businesses the ability to maximize every interaction from intra-company back office applications to those that take place between employees, customers and vendors while extending the value of the best of breed applications in which businesses have already invested. The Company provides an innovative and unique combination of application and process integration, automation, presentation and real-time analysis, all without changes to the underlying applications or requiring costly development expenditures. The Company's business integration software addresses the emerging need for companies' information systems to deliver enterprise-wide views of their business information processes. In addition to software solutions, the Company also provides technical support, training and consulting services as part of its commitment to providing customers with industry-leading solutions. The Company's consulting team has in-depth experience in developing successful enterprise-class solutions as well as valuable insight into the business information needs of customers in the largest Fortune 500 corporations worldwide.

The Company focuses on the customer experience management market with emphasis on desktop integration and business process automation with its Cicero XM™ products. Cicero XM enables businesses to transform human interaction across the enterprise. Cicero XM enables the flow of data between different applications, regardless of the type and source of the application, eliminating redundant entry and costly mistakes. Cicero XM automates up and down-stream process flows, enforcing compliance and optimizing handle time and provides a task-oriented desktop, reducing training time and enabling delivery of best in class service. Cicero XM captures real-time information about each interaction, guiding the business user through an activity and capturing usage data to spot trends and forecast problems before they occur.

Cicero XM software offers a proven, innovative departure from traditional, costly and labor-intensive enterprise application integration solutions. The Company provides non-invasive application integration, reduces enterprise integration implementation cost and time, and extends companies' Service-Oriented Architecture ("SOA") to the desktop. Cicero XM also enables customers to transform applications, business processes and human expertise into a seamless, cost effective business solution that provides a cohesive, task-oriented and role-centric interface that works the way people think.

By using Cicero XM technology, companies can decrease their customer management costs, improve their customer service, maximize the lifetime value of existing customers, and more efficiently cross-sell the full range of their products and services resulting in an overall increase in return on their information technology investments. In addition, the Company's software enables organizations to reduce the business risks inherent in replacement or re-engineering of mission-critical applications and extend the productive life and functional reach of their application portfolio.

The Company provides an integrated toolkit called Cicero XM Studio that provides an intuitive integration and development environment, which simplifies the integration of complex multi-platform applications. Cicero XM provides a unique approach that allows companies to organize components of their existing applications to better align them with tasks and operational processes. In addition, the Company's software solutions can streamline end-user tasks by providing a single, seamless user interface for simple access to multiple systems or be configured to display one or more composite applications to enhance productivity. Our technology enables automatic information sharing among line-of-business applications and tools. It is ideal for deployment in contact centers where its highly productive, task-oriented user interface promotes business user efficiency. By integrating diverse applications across multiple operating systems, Cicero is ideal for the financial services, insurance, telecommunications, intelligence, security, law enforcement, governmental and other industries requiring a cost-effective, proven application integration solution.

In addition to software products, the Company also provides technical support, training and consulting services as part of its commitment to providing its customers industry-leading integration solutions. The Company's consulting team has in-depth experience in developing successful enterprise-class solutions as well as valuable insight into the business information needs of customers in the Global 5000. We offer services around our integration software products.

This Quarterly Report on Form 10-Q contains forward-looking statements relating to such matters as anticipated financial performance, business prospects, technological developments, new products, research and development activities, liquidity and capital resources and similar matters. The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. In order to comply with the terms of the safe harbor, the Company notes that a variety of factors could cause its actual results to differ materially from the anticipated results or other expectations expressed in the Company's forward-looking statements. These risk and uncertainties include, among others, the following:

- We have a history of losses and expect that we will continue to experience losses through at least the fourth quarter of 2011;
- We develop new and unproven technology and products;
- We depend on an unproven strategy for ongoing revenue;
- Economic conditions could adversely affect our revenue growth and cause us not to achieve desired revenue;
- The so-called "penny stock rule" could make it cumbersome for brokers and dealers to trade in our common stock, making the market for our common stock less liquid which could cause the price of our stock to decline;
- Because we cannot accurately predict the amount and timing of individual sales, our quarterly operating results may vary significantly, which could adversely impact our stock price;
- Loss of key personnel associated with Cicero XM development could adversely affect our business;
- Different competitive approaches or internally developed solutions to the same business problem could delay or prevent adoption of Cicero XM;
- Our ability to compete may be subject to factors outside our control;
- The markets for our products are characterized by rapidly changing technologies, evolving industry standards, and frequent new product introductions;
- We may face damage to the reputation of our software and a loss of revenue if our software products fail to perform as intended or contain significant defects;
- We may be unable to enforce or defend our ownership and use of proprietary and licensed technology; and
- Our business may be adversely impacted if we do not provide professional services to implement our solutions.

Reference should be made to such factors and all forward-looking statements are qualified in their entirety by the above cautionary statements. Although we believe that these forward-looking statements are based upon reasonable assumptions, we can give no assurance that our goals will be achieved. Given these uncertainties, readers of this Quarterly Report on Form 10-Q are cautioned not to place undue reliance on these forward-looking statements. These forward-looking statements are made as of the date of this quarterly report. We assume no obligation to update or revise them or provide reasons why actual results may differ.

RESULTS OF OPERATIONS

The table below presents information for the three months ended September 30, 2011 and 2010 (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Total revenue	$734	$565	$2,558	$2,353
Total cost of revenue	470	448	1,420	1,314
Gross margin	264	117	1,138	1,039
Total operating expenses	913	955	2,915	3,151
Loss from operations	$(649)	$(838)	$(1,777)	$(2,112)

Revenue. The Company has three categories of revenue: software products, maintenance, and services. Software products revenue is comprised primarily of fees from licensing the Company's proprietary software products. Maintenance revenue is comprised of fees for maintaining, supporting, and providing periodic upgrades to the Company's software products. Services revenue is comprised of fees for consulting and training services related to the Company's software products.

The Company's revenues vary from quarter to quarter, due to market conditions, the budgeting and purchasing cycles of customers and the effectiveness of the Company’s sales force. The Company typically does not have any material backlog of unfilled software orders and product revenue in any quarter is substantially dependent upon orders received in that quarter. Because the Company's operating expenses are relatively fixed over the short term, variations in the timing of the recognition of revenue can cause significant variations in operating results from quarter to quarter.

We generally recognize revenue from software license fees when our obligations to the customer are fulfilled, which is typically upon delivery or installation. Revenue related to software maintenance contracts is recognized ratably over the terms of the contracts. Revenues from services are recognized on a time and materials basis as the services are performed and amounts due from customers are deemed collectible and non-refundable. Within the revenue recognition rules pertaining to software arrangements, certain assumptions are made in determining whether the fee is fixed and determinable and whether collectability is probable. Should our actual experience with respect to collections differ from our initial assessment, there could be adjustments to future results.

THREE MONTHS ENDED SEPTEMBER 30, 2011 COMPARED WITH THE THREE MONTHS ENDED SEPTEMBER 30, 2010.

Total Revenues. Total revenues increased $169,000, or 29.9%, from $565,000 to $734,000, for the three months ended September 30, 2011 as compared with the three months ended September 30, 2010. The increase is due primarily to an increase in revenue in maintenance and consulting revenue partially offset by a decrease in software sales.

Total Cost of Revenue. Total cost of revenue increased $22,000, or 4.9%, from $448,000 to $470,000, for the three months ended September 30, 2011 as compared with the three months ended September 30, 2010. The increase is primarily attributable to an increase in professional services expenses due to an increase in headcount in late fiscal 2010 and an increase in professional services travel expenses.

Total Gross Margin. Gross margin was $264,000, or 36.0%, for the three months ended September 30, 2011 as compared to the gross margin of $117,000, or 20.7% for the three months ended September 30, 2010. The increase in gross margin is primarily due to the increase in total sales partially offset by the higher cost of revenue from higher consulting expenses.

Total Operating Expenses. Total operating expenses decreased $42,000, or 4.4%, from $955,000 to $913,000 for the three months ended September 30, 2011, as compared with the three months ended September 30, 2010. The decrease in total operating expenses is primarily attributable to lower personnel costs, employee stock option expense and advertising expenses in the third quarter of 2011.

Software Products.
Software Product Revenue. The Company earned $26,000 in software product revenue for the three months ended September 30, 2011 as compared to $45,000 in software revenue for the three months ended September 30, 2010, a decrease of $19,000.

Software Product Gross Margin Loss. The gross margin loss on software products for the three months ended September 30, 2011 was 573.1% compared with a gross margin loss of 295.6% for the three month ended September 30, 2010. The decrease in gross margin is primarily due to a decrease in software revenue while the related cost remains consistent with the prior quarter due to the amortization of the acquired SOAdesk software.

Maintenance.
Maintenance Revenue. Maintenance revenue for the three months ended September 30, 2011 increased by approximately $25,000, or 6.8%, from $365,000 to $390,000 as compared to the three months ended September 30, 2010 due to additional software sales in fiscal 2010 over fiscal 2009.

Maintenance Gross Margin. Gross margin on maintenance products for the three months ended September 30, 2011 was 93.8% compared with 93.2% for the three months ended September 30, 2010. Cost of maintenance is comprised of personnel costs and related overhead for the maintenance and support of the Company's software products. The increase of gross margin is due to the increase in maintenance revenue and decrease in headcount.

Services.
Services Revenue. Services revenue increased $163,000, or 105.2%, from $155,000 to $318,000 for the three months ended September 30, 2011 as compared with the three months ended September 30, 2010. The increase in services revenues is primarily attributable to an increase in consulting engagements in the first nine months of 2011.

Services Gross Margin (Loss). Services gross margin was 14.8% for the three months ended September 30, 2011 compared with gross margin loss of (58.1%) for the three months ended September 30, 2010. The increase in gross margin was primarily attributable to the increase in consulting revenue partially offset by the increase in consulting expenses from an increase in headcount.

Operating Expenses:
Sales and Marketing. Sales and marketing expenses primarily include personnel costs for salespeople, marketing personnel, travel and related overhead, as well as trade show participation and promotional expenses. Sales and marketing expenses for the three months ended September 30, 2011 decreased by approximately $15,000, or 3.6%, from $418,000 to $403,000 as compared with the three months ended September 30, 2010. The decrease is primarily attributable to decrease in advertising expenses and a decrease in headcount.

Research and Development. Research and product development expenses primarily include personnel costs for product developers and product documentation and related overhead. Research and development expense increased by approximately $7,000, or 3.0%, from $232,000 to $239,000 for the three months ended September 30, 2011 as compared to the three months ended September 30, 2010. The increase in costs for the quarter is primarily due to an increase in headcount.

General and Administrative. General and administrative expenses consist of personnel costs for the legal, financial, human resources, and administrative staff, related overhead, and all non-allocable corporate costs of operating the Company. General and administrative expenses for the three months ended September 30, 2011 decreased by approximately $34,000, or 11.1%, from $305,000 to $271,000 over the same period in the prior year. The decrease is primarily attributable to a decrease in headcount at the end of the third quarter of 2010 and the timing of certain professional service fees being recognized in 2011.

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Provision for Taxes. The Company's effective income tax rate differs from the statutory rate primarily because an income tax expense/benefit was not recorded as a result of the loss incurred in the third quarter of 2011 and 2010. Because of the Company's recurring losses, the deferred tax assets have been fully offset by a valuation allowance.

Impact of Inflation. Inflation has not had a significant effect on the Company's operating results during the periods presented.

NINE MONTHS ENDED SEPTEMBER 30, 2011 COMPARED WITH THE NINE MONTHS ENDED SEPTEMBER 30, 2010.

Total Revenues. Total revenues increased $205,000, or 8.7%, from $2,353,000 to $2,558,000, for the nine months ended September 30, 2011 as compared with the nine months ended September 30, 2010. The increase is due to an increase in maintenance and consulting revenue partially offset by a decrease in software revenue.

Total Cost of Revenue. Total cost of revenue increased $106,000, or 8.1%, from $1,314,000 to $1,420,000, for the nine months ended September 30, 2011 as compared with the nine months ended September 30, 2010. The increase is primarily attributable to an increase in professional services expenses due to an increase in head count in late fiscal 2010.

Total Gross Margin. Gross margin was $1,138,000, or 44.5%, for the nine months ended September 30, 2011 as compared to the gross margin of $1,039,000, or 44.2% for the nine months ended September 30, 2010. The increase in gross margin is primarily due to the increase in total sales partially offset by the higher cost of revenue from higher consulting expenses primarily from an increase in headcount.

Total Operating Expenses. Total operating expenses decreased $236,000, or 7.5%, from $3,151,000 to $2,915,000 for the nine months ended September 30, 2011, as compared with the nine months ended September 30, 2010. The decrease in total operating expenses is primarily attributable to lower commissions and advertising expenses in first nine months of 2011 and one time only expenses associated with the acquisition of assets from SOAdesk LLC in the first quarter of 2010.

Software Products.
Software Product Revenue. The Company earned $640,000 in software product revenue for the nine months ended September 30, 2011 as compared to $952,000 in software revenue for the nine months ended September 30, 2010, a decrease of $312,000.

Software Product Gross Margin. The gross margin on software products for the nine months ended September 30, 2011 was 17.8% compared with a gross margin of 46.8% for the nine months ended September 30, 2010. The decrease in gross margin is primarily due to a decrease in software revenue while the related cost remains consistent with prior quarter due to the amortization of the acquired SOAdesk software.

Maintenance.
Maintenance Revenue. Maintenance revenue for the nine months ended September 30, 2011 increased by approximately $121,000, or 11.7%, from $1,037,000 to $1,158,000 as compared to the nine months ended September 30, 2010 due to additional software sales in fiscal 2010 over 2009.

Maintenance Gross Margin. Gross margin on maintenance products for the nine months ended September 30, 2011 was 92.4% compared with 88.1% for the nine months ended September 30, 2010. Cost of maintenance is comprised of personnel costs and related overhead for the maintenance and support of the Company's software products. The increase of gross margin is due to the increase in maintenance revenue and decrease in headcount.

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Services.
Services Revenue. Services revenue increased $396,000, or 108.8%, from $364,000 to $760,000 for the nine months ended September 30, 2011 as compared with the nine months ended September 30, 2010. The increase in services revenues is primarily attributable to increase in consulting engagements in fiscal 2010 and the first nine months of 2011.

Services Gross Margin Loss. Services gross margin loss was 6.1% for the nine months ended September 30, 2011 compared with gross margin loss of 88.2% for the nine months ended September 30, 2010. The increase in gross margin was primarily attributable to the increase in services revenue.

Operating Expenses:
Sales and Marketing. Sales and marketing expenses primarily include personnel costs for salespeople, marketing personnel, travel and related overhead, as well as trade show participation and promotional expenses. Sales and marketing expenses for the nine months ended September 30, 2011 decreased by approximately $189,000, or 12.5%, from $1,510,000 to $1,321,000 as compared with the nine months ended September 30, 2010. The decrease is primarily attributable to lower commissions and a decrease in advertising expenses and headcount.

Research and Development. Research and product development expenses primarily include personnel costs for product developers and product documentation and related overhead. Research and development expense increased by approximately $48,000, or 7.3%, from $662,000 to $710,000 for the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010. The increase in costs for the quarter is primarily due to an increase in headcount and outside professional services.

General and Administrative. General and administrative expenses consist of personnel costs for the legal, financial, human resources, and administrative staff, related overhead, and all non-allocable corporate costs of operating the Company. General and administrative expenses for the nine months ended September 30, 2011 decreased by approximately $95,000, or 9.7%, from $979,000 to $884,000 over the same period in the prior year. The decrease is primarily attributable to a decrease in headcount at the end of the third quarter of 2010 and the decrease due to one-time expenses incurred in relation to the acquisition of assets of SOAdesk LLC in 2010.

Provision for Taxes. The Company’s effective income tax rate differs from the statutory rate primarily because an income tax expense/benefit was not recorded as a result of the loss incurred in the first nine months of 2011 and 2010. Because of the Company’s recurring losses, the deferred tax assets have been fully offset by a valuation allowance.

Impact of Inflation. Inflation has not had a significant effect on the Company’s operating results during the periods presented.

LIQUIDITY AND CAPITAL RESOURCES

Cash

Cash and cash equivalents increased to $58,000 at September 30, 2011 from $43,000 at December 31, 2010, an increase of $15,000.

Net cash used in Operating Activities. Cash used in operations for the nine months ended September 30, 2011 was $1,004,000 compared to $965,000 for the nine months ended September 30, 2010. Cash used in operations for the nine months ended September 30, 2011 was primarily due to the loss from operations, a gain of $517,000 from the write off of the remaining earn out contingency, an increase in accounts receivable of $334,000, and an increase in prepaid assets of $20,000 partially offset by depreciation and amortization of $542,000, stock compensation of

$73,000, bad debt write off of $14,000, an increase in accounts payable and accrued expenses of $746,000 and an increase in deferred revenue from maintenance contracts of $403,000.

Net cash used in Investing Activities. The Company purchased $13,000 worth of equipment during the nine months ended September 30, 2011 versus $7,000 during the nine months ended September 30, 2010. Additionally during the first nine months ended September 30, 2010, the Company acquired the assets of SOAdesk which included a $300,000 cash payment.

Net cash provided by Financing Activities. Net cash provided by financing activities for the nine months ended September 30, 2011 was approximately $1,032,000 as compared with approximately $1,280,000 for the nine months ended September 30, 2010. Cash generated by financing activities for the nine months ended September 30, 2011 was comprised primarily from the cash received from short term borrowings of $1,482,000 offset by repayment of $450,000 of short term debt.

Liquidity

The Company funded its cash needs during the nine months ended September 30, 2011 with cash on hand from December 31, 2010, the revenue generated in the first nine months of 2011 and debt raised during the first nine months of 2011.

During 2011, the Company entered into various short term notes payable with John L. (Launny) Steffens, the Chairman of the Board of Directors, for various working capital needs. The Notes bear interest at 12% per year and are unsecured. At September 30, 2011, the Company was indebted to Mr. Steffens in the amount of $1,025,000.

In April 2010, the Company issued to a certain accredited investor 1,333 shares of Series B Convertible Preferred Stock at $150 per share for a total of $200,000. The Series B Convertible Preferred Stock bears an annual dividend of 8%. The Series B stock may convert into common stock at a conversion rate of $0.15 per share. As part of the Series B stock offering, the Company also issued warrants to purchase common stock of the Company at a strike price of $0.25 per share. The warrants expire in five years. 333,333 warrants were issued to this investor.

In January 2010, the Company issued to certain accredited investors 9,067 shares of Series B Convertible Preferred Stock at $150 per share for a total of $1,360,000 including $500,000 in cash, the cancellation of $710,000 of existing indebtedness and the cancellation of a note of $150,000 to memorialize an advance of payment for Series B Stock prior to issuance. The Series B Convertible Preferred Stock bears an annual dividend of 8%. The Series B stock may convert into common stock at a conversion rate of $0.15 per share. As part of the Series B stock offering, the Company also issued warrants to purchase common stock of the Company at a strike price of $0.25 per share. 2,266,667 warrants were issued to these investors. Of the $1,360,000 in Series B Convertible Preferred Stock issued, the Company’s Chairman, Mr. John Steffens invested $910,000 through a combination of $200,000 in cash and $710,000 in the conversion of debt.

In March 2009, the Company entered into several secured Promissory Notes with certain investors in the aggregate amount of $750,000. The Notes bear interest at 15% and mature on January 31, 2012. The Notes are secured by the amount due the Company under its support agreement with Merrill Lynch. In addition, each investor was issued a warrant to purchase common stock of the Company. Under the terms of the warrant, which expires in five years, each Note holder is entitled to purchase 1,000 shares of Cicero common stock for every $1,000 of principal due under the Note. The exercise price on the warrant is $0.20 per share. The shares of common stock underlying the warrants have registration rights and a cashless exercise provision in the event no registration statement is effective for resale, if required.

The Company maintains a Note Agreement with an Investor in which the Company may from time to time borrow up to $500,000. The borrowings are secured by any outstanding receivables at the time of the loans. The loans bear interest at 36% per annum. At September 30, 2011, $300,000 was due and outstanding under the Note agreement. The Company has contacted the lender to discuss a payment plan regarding the accrued interest payable under the Note or possible termination of the Note.

In October 2007, the Company and BluePhoenix entered into a Note payable in the amount of $1,021,000, bearing interest at LIBOR plus 1.0% and maturing on December 31, 2011. In addition, BluePhoenix acquired 2,546,149 shares of the Company’s common stock in exchange for $650,000 paid to Bank Hapoalim to retire that indebtedness. Of the new note payable to BluePhoenix, approximately $350,000 was due on January 31, 2009 and the balance is due on December 31, 2011. In March 2008, the Company and BluePhoenix agreed to accelerate the principal reduction payment of $350,000 due on January 31, 2009 and $200,000 was paid in March 2008. The Company paid $100,000 in January 2009. BluePhoenix agreed to convert $50,000 of the repayment into 195,848 shares of the Company’s common stock in July 2008. As of September 30, 2011, a total of $671,000 was due under the Note.

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In October 2007, the Company entered into a Long Term Promissory Note in the amount of $300,000 with Mr. John L Steffens, our chairman. The Note bears interest at 3% per annum and had an original maturity date of October 30, 2009. In order to bring the interest rate on the Note in compliance with arm's length transactions, the Company also issued 188,285 warrants to purchase the Company's common stock at $0.18 each. The warrants were valued using the Black- Scholes method and a fair value of $34,230 was charged to stock compensation expense in the fourth quarter of 2007. The warrants expire in 10 years. The Company used the proceeds from that loan to pay down the debt to Bank Hapoalim as noted above. In March 2009, the Company and Mr. Steffens agreed to extend the maturity on the above Note to October 2010. In January 2010, Mr. Steffens agreed to convert his note into Series B Convertible Preferred Stock.

The Company has incurred losses of approximately $643,000 and $1,280,000 in the past two years and has experienced negative cash flows from operations for each of the past three years. For the three and nine months ended September 30, 2011, the Company incurred an additional loss of approximately $936,000 and $1,911,000, respectively, and has a working capital deficiency of approximately $11,344,000. Management feels that the Company has repositioned itself in the marketplace as a result of the acquisition of the assets of SOAdesk along with its key personnel. By combining the SOAdesk products with the Cicero legacy products, the Company is able to offer a complete Customer Experience Management suite of products. The new products have already received awards from within the industry and new customers have contracted to use the products, thereby generating new revenues. The Company will be looking to raise additional funds in the next several months; however there can be no assurance the Company will be able to do so, especially given the current state of the capital markets. The Company has extended the maturity dates of several debt obligations that were due in 2011 to 2012, to assist with liquidity and may attempt to extend these maturities again if necessary. Despite the recent additions of several new clients, the Company continues to struggle to gain additional sources of liquidity on terms that are acceptable to the Company. As such, there is substantial doubt of the Company's ability to continue as a going concern.

OFF-BALANCE SHEET ARRANGEMENTS

The Company does not have any off balance sheet arrangements. We have no unconsolidated subsidiaries or other unconsolidated limited purpose entities, and we have not guaranteed or otherwise supported the obligations of any other entity.

RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS

In September 2011, the FASB issued Accounting Standards Update No. 2011-08, Intangibles—Goodwill and Other (Topic 350)—Testing Goodwill for Impairment (ASU 2011-08), to simplify how entities test goodwill for impairment. ASU 2011-08 allows entities to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If greater than 50 percent likelihood exists that the fair value is less than the carrying amount then a two-step goodwill impairment test as described in Topic 350 must be performed. The guidance provided by this update becomes effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial position and results of operations.

In December 2010 the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2010-28, "Intangibles – Goodwill and other (Topic 350): When to perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts". ASU 2010-28 modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts by requiring an entity to perform step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. This update is effective for fiscal years beginning after December 15, 2010. The adoption of this standard did not have a material impact on the Company's consolidated financial positions and results of operations.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

ITEM 4. CONTROLS AND PROCEDURES

a) Evaluation of Disclosure Controls and Procedures.

We maintain "disclosure controls and procedures," as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, or the Exchange Act, that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. Our disclosure controls and procedures have been designed to meet reasonable assurance standards. Additionally, in designing disclosure controls and procedures, our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures as required by Exchange Act Rule 13a-15(b) as of the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures are effective at the reasonable assurance level.

(b) Changes in Internal Controls.

There were no changes in our internal control over financial reporting that occurred during the fiscal quarter ended September 30, 2011 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Not Applicable.

ITEM 1A. RISK FACTORS

Not Applicable.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

See Footnote 4 with regards to a $300,000 Note agreement.

ITEM 4. [RESERVED]

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

Exhibit No.	Description
31.1	Certification of Chief Executive Officer/Chief Financial Officer pursuant to Rule 13a-14(a) (filed herewith).
32.1	Certification of John P. Broderick pursuant to 18 USC § 1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002 (filed herewith).

SIGNATURE

Pursuant to the requirements 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.

CICERO INC.

Date: November 14, 2011	By:	/s/ John P. Broderick John P. Broderick Chief Executive Officer and Chief Financial Officer