BILLSERV INC
Form 10-K
April 15, 2003

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

FORM 10-K

|X|Annual Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2002

OR

|_| Transition Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934

Commission File No. 0-30152

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

Nevada	98-0190072
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

211 North Loop 1604, Suite 200, San Antonio, Texas 78232
(Address of principal executive offices, including Zip Code)

(210) 402-5000
(Registrant's telephone number, including area code)

Securities registered pursuant to section 12(b) of the Act: None

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

Common Stock, par value $.001 per share

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 |X| No |_|

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

The aggregate market value of common stock held by non-affiliates of the registrant as of March 17, 2003, was $3,212,012. As of March 17, 2003, 20,722,656 shares of the registrant's common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Definitive Proxy Statement for the Registrant's Annual Meeting of Stockholders to be held May 29, 2003, or as soon as practicable thereafter, are incorporated by reference in Part III of this Report.

BILLSERV, INC.

FORM 10-K
For the Year Ended December 31, 2002

INDEX

		Page
	PART I	
Item 1.	Business	3
Item 2.	Properties	11
Item 3.	Legal Proceedings	11
Item 4.	Submission of Matters to a Vote of Security Holders	11
	PART II	
Item 5.	Market for Registrant's Common Equity and Related Stockholder Matters	12
Item 6.	Selected Financial Data	13
Item 7.	Management's Discussion and Analysis of Financial Condition and Results of Operations	14
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk	26
Item 8.	Financial Statements and Supplementary Data	27
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	45
	PART III	
Item 10.	Directors and Executive Officers of the Registrant	46
Item 11.	Executive Compensation	46
Item 12.	Security Ownership of Certain Beneficial Owners and Management	46
Item 13.	Certain Relationships and Related Transactions	46
Item 14.	Controls and Procedures	47
	PART IV	
Item 14.	Exhibits, Financial Statement Schedules, and Reports on Form 8-K	48
Signatures		49
Certifications		50

FACTORS THAT MAY AFFECT FUTURE RESULTS

This Annual Report on Form 10-K and the documents incorporated herein by reference contains certain forward-looking statements within the meaning of the Federal Securities Laws. Specifically, all statements other than statements of historical facts included in this Annual Report on Form 10-K regarding our financial performance, business strategy and plans and objectives of management for future operations are forward-looking statements and based on our beliefs and assumptions. If used in this report, the words "anticipate," "believe," "estimate", "expect," "intend," and words or phrases of similar import are intended to identify forward-looking statements. Such statements reflect the current view of the Company with respect to future events and are subject to certain risks, uncertainties, and assumptions, including but without limitation, those risks and uncertainties contained in the Risk Factors section of Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, of this Annual Report on Form 10-K. Although we believe that our expectations are reasonable, we can give no assurance that such expectations will prove to be correct. Based upon changing conditions, any one or more of these events described herein as anticipated, believed, estimated, expected or intended may not occur. All prior and subsequent written and oral forward-looking statements attributable to the Company or persons acting on its behalf are expressly qualified in their entirety by this cautionary statement.

2

PART I

ITEM 1. BUSINESS

All references to "we," "us," "our," "Billserv" or the "Company" in this Annual Report on Form 10-K mean Billserv, Inc. and its consolidated subsidiaries. All references to "billers", "billing customers" or "customers" in this Annual Report on Form 10-K mean the companies that have contracted with us to receive services from us. All references to "consumers" in this Annual Report on Form 10-K mean the persons that are receiving bills from companies, including the companies that are billing customers of Billserv.

General

Billserv provides Electronic Bill Presentment and Payment ("EBPP") and related services to companies that generate recurring paper-based bills. EBPP is the process of sending bills to consumers securely through the Internet and processing Internet payment of bills utilizing an electronic transfer of funds. Our service offering allows companies to outsource their electronic billing process, providing them a single point of contact for developing, implementing and managing their EBPP process. Billserv offers services to consolidate billing information and then securely deliver an electronic bill to the biller's own Billserv-hosted payment Web site, the consumer's e-mail inbox and numerous Internet bill consolidation Web sites, such as those sponsored by financial institutions. Our EBPP services allow billers to establish an interactive, online relationship with their consumers by integrating Internet customer care and direct marketing with the electronic bill. We provide professional services to assist with the implementation and maintenance of an electronic bill offering. In addition, we offer consumer marketing support to assist billers in encouraging their consumers to switch from paper to electronic billing.

Billserv generates revenue by charging volume-based fees fixed under long-term contracts for transactions processed through its system, such as loading, delivering, viewing and paying bills, customer care interactions, handling payment returns and consolidating remittances. In certain instances, Billserv receives a fixed amount per e-bill delivered and made available to consumers regardless of whether they pay the e-bill using our services. Billserv also typically receives an up-front fee from a customer to cover the initial basic implementation of the contracted services. Billserv charges customers that contract for professional consulting services on a time and materials basis and charges license fees for the use of its proprietary gateway services technology and the CheckFree iSolutions software that is resold by Billserv as an authorized reseller in Australia only.

Our service offerings are supported by our systems infrastructure that integrates certain proprietary components with third party hardware and software platforms to offer our customers a scalable, branded and secure EBPP process. Our systems infrastructure utilizes IBM Netfinity file servers for processing and stores critical billing data on Network Appliance F760 external disk arrays. The operating software architecture of our system combines Microsoft Windows NT with IBM's DB2 database management system. We license software from CheckFree iSolutions, Inc. that we use to parse the detail of our customers' billing data print streams and create the electronic bill to be presented and also license software from ACI Worldwide that allows us to securely deliver electronic bills via e-mail. We have designed our systems infrastructure so that it is reliable, flexible, and expandable to meet growth demands without significant cost or changes. Our systems infrastructure allows us to work with our customers to build a customized EBPP service offering tailored to their specific needs.

We currently market our services through both direct sales efforts and organizations that resell our services to their customers and prospects. As of December 31, 2002, we have signed 119 billers, of which 106 are in a full production environment which means that the electronic billing services being provided are available to their target consumers and 13 are in various stages of implementation which means that the electronic billing product is still being developed and is not yet ready for general release to the billers' consumers. During 2002, 2001 and 2000, Billserv processed approximately 3,603,000, 2,045,000 and 448,000 electronic bill presentments, respectively, for its billing customers. We processed our first transactions for billing customers during the fourth quarter of 1999 so the number of transactions processed in 1999 was insignificant. Billserv's customers include companies operating in the insurance, student loan financing, utilities, waste management, telecommunications, media and cable industries. The Company was founded in July 1998 and is incorporated in the State of Nevada. Billserv operates primarily in the United States as a single operating segment, although it also operates in Australia and Canada on a limited basis. Foreign operations began in 2000; however, the impact financially of expanding internationally is not significant as of December 31, 2002.

Industry Background

As a paper-based process, bill presentment and payment are the most regular and critical functions in which most businesses engage. For many companies, particularly those generating recurring bills, the bill represents a critical touch point for maintaining and improving customer loyalty, and a valuable opportunity to increase revenues through up- and cross-selling. However, the paper-based bill delivery and payment process is expensive and less efficient for both businesses and consumers.

Additionally, paper-based bills are limited in their functionality. The potential for personalization is limited, and there are few opportunities for companies to engage in interactive communication with their consumers through the paper-based bill payment experience.

The majority of paper-based bills are recurring monthly or quarterly invoices mailed to consumers by communications companies (such as telephone and cable companies), utilities, newspapers and financial institutions such as banks and other lenders. Paper bills are prepared either by the company itself or by an outsourced bill fulfillment vendor. Creating and distributing a paper bill is a costly, multiple-step process that includes extracting relevant data from the internal accounts receivable system of the company, organizing the data into a billing format, printing and separating the bills, inserting the bills into envelopes, applying postage and mailing the bill to the consumer. Payments mailed by the consumer must then be received and processed manually by the biller or its lockbox provider in order to provide remittance information. This paper bill and payment process is less efficient than electronic bill delivery and payment, which eliminates or accelerates many of these steps.

Our Market Opportunity

Growth of the Internet and Electronic Commerce

The Internet has emerged as a significant global medium for communication, information and commerce. Because of the Internet's increasing adoption rate, businesses have a growing opportunity to conduct commerce and communicate with their consumers and business partners over the Internet. One of the consequences of the widespread growth and acceptance of Web use is that consumers are embracing the ability to conduct financial and other personal business over the Internet. Accordingly, we believe there is a substantial potential for growth in EBPP and related services.

The growth in the use of the Internet has also transformed the competitive landscape in many industries. To remain competitive, many companies are seeking to leverage the Internet to provide operational efficiencies, create new revenue opportunities and maximize the longevity and profitability of their customer relationships. Many companies, particularly those generating recurring paper-based bills, such as utilities and telecommunications providers, are increasingly recognizing that an Internet-based offering to the bill presentment and payment process can serve as the foundation for their broader Internet and customer relationship management strategies.

These companies currently recognize the bill as the critical touch point for maintaining and improving their customer relationships as well as providing the opportunity to increase revenue streams. EBPP enables companies to enhance this touch point by leveraging the capabilities of the Internet to promote customer loyalty, provide enhanced customer service, increase control over the critical billing process, enhance up- and cross-selling opportunities by utilizing the direct marketing and interactive capabilities of the Internet and improve the effectiveness of customer marketing by providing real-time market intelligence on consumers. Companies can also realize significant cost savings by moving to an electronic billing process from a paper-based system, especially given the recent trend of steadily rising postal rates.

Challenges for Companies in Adopting EBPP

While companies may recognize the critical role that EBPP will play in their mission critical Internet and customer relationship management strategies, they face significant challenges in the development, implementation and management of their EBPP offering. To execute a successful EBPP strategy, companies should purchase, successfully implement and maintain:

- Software that enables the company to parse and decode bill data print streams
- In-house servers that update and display bill content
- Automated clearinghouse software that enables the company to instruct its bank to electronically debit consumer accounts
- Messaging software that enables the company to communicate with multiple aggregators
- A dedicated interface with a major bank that enables the company to receive funds and data through automated clearinghouse transactions
- Lockbox software that enables the company to update internal accounts receivable files
- Customer support software and technical infrastructure that enables a company to support the EBPP process with Internet- enabled customer care

In addition, if companies want to be able to provide their consumers with wider access to their bills, they must make arrangements with multiple EBPP aggregators, such as CheckFree, Metavante and Mastercard RPPS, or front ends, such as Internet portals or financial institutions' Web sites that present bills to consumers in a consolidated manner, and manage those multiple relationships on an ongoing basis. EBPP aggregators are companies that have access to Web sites that function as portals to allow multiple bills generated by different billers to be delivered to and/or paid by consumers that access these sites. Such aggregators enhance the convenience of payment and management of e-bills via the Internet for consumers by giving them access to multiple bills at one secure site versus having to visit multiple biller-specific Web sites to view or pay each individual bill. Many companies lack the resources, expertise and/or inclination to develop, implement and manage their own EBPP offering in a

cost-effective manner. These issues are compounded by the current state of the EBPP industry, which can be characterized by rapid technological change, disparate standards and competing business models.

The Billserv Service Offering

Our services provide a comprehensive and cost-effective outsourced offering that enables any company producing recurring paper-based bills to offer EBPP services to their consumers and to utilize the electronic delivery and payment of bills to enhance business and customer relationship management strategies. Our offering allows our customers to provide EBPP services to their consumers, support the EBPP process with Internet customer care, and utilize the electronic delivery and payment of bills to reduce costs, create additional revenue streams, increase branding opportunities, enhance customer service and provide competitive differentiation. These service offerings are supported by our systems infrastructure that integrates certain proprietary components with third party hardware and software platforms to offer our customers a scalable, branded and secure EBPP process. By outsourcing the development, implementation and management of their entire EBPP process, our customers can realize the following benefits:

- Single Point of Contact - Our services offers a one-stop, comprehensive and cost-effective outsourced process for our customers' entire EBPP offering. We become our customers' single point of contact for implementing, developing and managing their entire EBPP offering.
- Speed to Market - Our services allows our customers to establish an EBPP offering in as little as 90 days, without diverting critical time and financial resources from their core competencies. The time-to-market of an EBPP offering is important to our customers because it enables them to rapidly address the opportunities presented by electronic delivery and payment of bills.
- Reduced Capital Requirements and Technology Risk - Outsourcing the design, development, installation and management of their entire EBPP process reduces the costs and administrative burden on our customers by eliminating the need to develop and manage an in-house system and by capitalizing on our economies of scale and implementation expertise.
- Broad Distribution - Our relationships with multiple EBPP aggregators and other front-ends enable our customers to publish their bills through multiple presenters and our Direct Delivery product enables the presentment of bills straight to the consumer's email inbox. These distribution channels provide our customers with the ability to offer their consumers numerous options of where and when to access and pay their bills.
- Enhanced Customer Service - Our services provide Internet-enabled customer support for the EBPP process and enables our customers to utilize the

electronic delivery and payment of bills to improve customer retention, increase customer loyalty and enhance customer relationships.

- Open System Architecture - Our systems infrastructure supports all of the data standards currently employed by aggregators and front-ends today, including Open Financial eXchange (OFX), eXtensible Markup Language (XML), Electronic Data Interchange (EDI) and others. This allows our customers to present their bills to any Internet bill presenters, regardless of the standard used.
- Scalability - We use IBM Netfinity line of servers that have the ability to handle large volumes of transactions with an upward growth path and clustering technology. Our current infrastructure has excess capacity to support new billers and increasing transaction volumes.
- Increased Revenue Streams - We believe that our EBPP strategy provides our customers with the potential for increased revenue opportunities by leveraging the capabilities of the Internet to support direct marketing and enable cross- and up-selling opportunities.
- Transparency - Our services are transparent to the consumer at all times, allowing our customers to maintain and build upon their brand recognition.
- Security - Our services enable our customers to have total control over their billing data at all times. In addition, we use digital certificates, data encryption, NT authentication and firewalls to protect billing data.
- Transaction-Based Pricing - Our customers typically pay an up-front fee that covers basic implementation of the contracted services. After the customer is in production, we assess transaction-based fees based on the number of electronic bills presented to and/or paid by their consumers, depending on the specific services that have been contracted by the customer. In virtually all cases, these transaction-based fees are significantly less than the cost to our customers of processing paper-based bills.

Our Strategy

Our goal is to be the leading outsourced service provider of EBPP and related services. In order to achieve this goal, we are implementing a strategy consisting of the following key elements:

Acquire Additional Billing Customers

We believe that establishing a large customer base that distributes a significant number of recurring paper-based bills is critical to the long-term success of our business. We intend to continue expanding our customer base, targeting those companies with a high

likelihood of generating significant revenue. We are actively building relationships with organizations that resell our services to their clients and prospects. Our partners leverage relationships with existing and prospective clients, using our EBPP capabilities as a means to retain or obtain new accounts, as well as enhance profit margins. This strategy allows us to take advantage of opportunities that arise from the sales activities of our resellers while expending limited resources on our direct sales efforts.

We qualify potential resellers based on their market orientation, national presence, account base, and sales capabilities. To date, we have signed multi-year agreements with several companies that have a national presence to resell our services on either a direct or referral basis. The reseller agreements generally provide for either wholesale pricing or commissions based on referred and qualified sales. If our services are resold on a direct basis, the reseller receives wholesale pricing from us for our services and negotiates terms with the biller directly. If our services are resold on a referral basis, we negotiate terms with the biller directly and the reseller earns a specified commission. These agreements vary in length from 5 to 7 years and the earliest expiration of any of these agreements is February 2005. Our reselling partners are generally leaders in their industries, with a strategic commitment to EBPP and electronic commerce. We will continue to add select partners when advantageous to us to expand horizontal and vertical coverage. Our direct sales staff promotes business with our partners on both the corporate level and a localized basis. Our direct sales development efforts are coordinated with resellers to achieve comprehensive coverage of targeted markets.

Positively Influence Consumer Adoption Rates

We believe that the rate at which consumers begin utilizing EBPP services, commonly referred to as the "consumer adoption rate," is a critical factor to the long-term success of our business. A major component of our growth strategy involves not only obtaining additional customers, but also actively assisting contracted billers in developing a strategy designed to encourage the highest possible acceptance of EBPP services by their consumers. This includes incorporating our adoption-building Preferred Enrollment Program as part of a customized EBPP offering purchased by our direct billing customers. This program consists of process and service offerings that build adoption at the time of new account acquisition and facilitate the accelerated conversion of existing paper-based consumers to EBPP services. Program components include Auto Enrollment of our customers' new customers, Online Demonstrations that walk consumers through the client's bill presentment and payment site, Online Enrollment Assistance to provide instant online help to consumers, and Instant Activation that allows consumers immediate access to view and pay bills online upon enrollment.

Additionally, we assign a dedicated Account Manager to each of our customers to assist them in maximizing consumer adoption of their EBPP services and help them realize a higher return on their investment. Our Account Managers work with their customers to develop a tailored marketing strategy designed to increase the EBPP adoption rate of their consumers. We assist our customers in carefully planning and strategizing on all facets of the marketing process that are funded by customers, including:

- Developing consumer enrollment materials, such as bill messages, bill inserts, direct mail letters and enrollment feedback letters
- Developing public relations materials regarding their EBPP services
- Planning an effective advertising campaign regarding their EBPP services, including broadcast and print advertisements
- Planning an Internet marketing campaign, including banner advertisements, online promotional tactics and cost analysis
- Assisting in the customer launch process
- Assisting in the development of a regional marketing strategy
- Developing cross-marketing and co-marketing opportunities with other billers, banks and bill payment Web sites

To date, we have seen positive results from marketing programs designed to enhance adoption rates. Billers that are marketing aggressively to their consumer base or have favorable consumer demographics, such as high Internet usage, are experiencing adoption rates of between 3% and 30%. These adoption rates are calculated by dividing the number of transactions for a given period such as a month by the total population of a billing customer's bills that are eligible for electronic presentment or payment during that same period. We do not differentiate between initial customer transactions and repeat customer transactions for purposes of calculating these adoption percentages and are therefore unable to measure customer adoption or attrition rates over time. Although an increase in the number of transactions does not necessarily mean that more individual consumers are using the EBPP services that we provide through our billing customers, it provides an indication of adoption growth since a low percentage of consumers would be expected to make multiple transactions during a month to pay a bill delivered monthly, for example. During 2002, we presented over 3.6 million electronic bills up from over 2 million in 2001 and 48,000 in 2000. New consumer enrollments rose to 504,000 for the year 2002 from 316,000 in 2001 and 101,000 in 2000.

Finally, connecting companies to customers through the widest array of Web sites from which to receive, view, pay and manage bills is also an important step towards realizing increased customer adoption. In this regard, the Company's maintenance of distribution agreements with all of the major aggregators in the EBPP industry demonstrates our commitment to proactively offer billers increased opportunities for their consumers to pay and manage their bills via the Internet. Our efforts to provide customers with distribution to all major aggregators will be a continuing focus for the Company.

Expand and Leverage Strategic Relationships and Partnerships

An important element of the Company's strategy is to strengthen and expand its relationships with strategic allies and partners to increase the market awareness, demand and acceptance of EBPP and value of Billserv's services. We have formed strategic relationships and partnerships with key technology providers and companies serving the EBPP industry to enable us to offer a high quality of service to our customers. Our key partners and providers include:

- Technology providers, such as International Business Machines Corporation ("IBM"), CheckFree i-Solutions and ACI Worldwide, that provide various hardware and software components of our service offering. We utilize IBM servers and software in our system infrastructure. We have an electronic billing services agreement with CheckFree licensing us to use their CheckFree i-Solutions software and are also a certified reseller of this software in Australia. CheckFree also owns approximately 5% of the Company and holds warrants to purchase additional shares of the Company's common stock. We have a license agreement with ACI for the use of their software and a referral agent agreement with ACI qualifying them as an authorized agent to earn commissions based on referring billers to us.

- Billing distribution partners, or aggregators, that provide the ability to distribute electronic bills to various Internet sites where consumers can receive, view, pay and manage bills as well as provide electronic payments and remittance information back to our billing customers. We have multi-year distribution agreements with all major EBPP aggregators including CheckFree, Metavante (includes Spectrum and Paytrust) and MasterCard RPPS that call for us to pay volume-based fees to the aggregators for bills delivered through the aggregators' networks. The terms of the distribution agreements vary from 2 years to 5 years. The aggregators help us to generate revenue by allowing us to provide our billing customers with access to a greater number of Web sites from which their consumers can view, pay and manage their bills, thus making our services more attractive and beneficial to billing customers. We charge our billing customers a transaction fee for bills delivered to their consumers through these aggregators.

- Payment processing partners, such as Bank One and Paymentech, Inc., that allow us access to the ACH and credit card clearing network, respectively, to facilitate the electronic transfer of funds between our billing customers and their consumers who utilize a biller direct Web site. Billserv has an agreement with Bank One to process ACH payments that has an unspecified term and can be terminated upon 30-day written notice. Billserv has an agreement with Paymentech, Inc. to process credit card payments that automatically renews annually unless 60-day notice is given prior to the end of the term. Through its contractual relationships with Bank One and Paymentech, Billserv is able to process ACH and credit card payment transactions on behalf of its billing customers. Billserv pays volume-based fees for debit and credit transactions initiated through these partners, and pays fees for other transactions such as returns, notices of change to bank accounts, test debits, file transmission and depository fees. Some of our billing customers do not rely exclusively on our services to process their electronic payments.

o Reselling partners which resell our EBPP services to their billing customer base under contractual agreements that provide for wholesale pricing or commissions based on referred sales. Under these agreements, these resellers are obligated to resell our EBPP services on a preferred basis.

A strategic ally can also provide our customers with additional resources and expertise, especially in vertical or geographic markets in which the partner has expertise, to help meet our customers' system definition and application development requirements. We intend to enhance the quality of our services by continuing to pursue and enter into strategic relationships and partnerships with companies that offer us the opportunity to benefit from the relationship.

Accelerate the Time to Market for our Customers

We believe that an important element of our service offering is our ability to assist our customers in accelerating the time to market of their EBPP services, thereby increasing the return on their investment. In order to help achieve this objective, we assign a dedicated Account Manager and technical project team from the beginning of the planning and implementation process for each customer to ensure that the project implementation is completed effectively and on time. The design of our service offering also contributes to an efficient and timely deployment. Our core system consists of four major proprietary gateways: financial, aggregator, biller and email, which support a variety of emerging standards for data exchange and enable us to offer a quick implementation. These interfaces give us the ability to integrate with our customers' legacy applications, without disrupting or changing their internal systems, as well as external software applications. The modular design and integrative features of our products and services allows our customers to choose from a menu of components and still have a system implemented in as little as 90 days. We believe that our system design and approach utilizing a dedicated team has a positive influence on the timing and effectiveness of the implementation of our EBPP services for our customers.

Pursue International Market Opportunities

We believe our services can be adapted for international customers. Although we have historically focused our marketing efforts in the United States, we also market our services in Canada and Australia. We plan on continuing to market our services outside the United States in the future. However, that expansion will take place in a fashion that brings strength of local country partnerships and minimizes the capital investment made by us to expand into these countries. For example, during 2001, the

Company acquired a 50% interest in a corporate joint venture operating in Australia to provide EBPP services. The equal partner in this venture is Salmat, a customer communications company in Australia specializing in document management services, letterbox delivery, data solutions, teleservices, fulfilment and customer targeting. The venture presented the first live electronic bill through a banking Web site in Australia for payment through BPAY, Australia's leading electronic bill payment service. We believe the demand for EBPP services is developing in Australia and presents a viable market opportunity through our partnership with Salmat.

Expand Service Utilization

Billserv is marketing a comprehensive offering that delivers a single, outsourced capability for developing customer relationships utilizing the electronic bill as a dynamic communication medium. By integrating our electronic billing capabilities with Internet-enabled direct marketing and communication ("IDMC") services and online real-time customer care support provided by our Internet Interaction Center ("IIC"), Billserv puts billers in direct, interactive contact with their consumers. We refer to this as a "Customer Communication Network". We are actively promoting our Customer Communication Networks to qualified prospective billers as well as converting existing customers to this enhanced service. In addition to the current components integrated into our service offering, we intend to add enhanced products and services that could further broaden the capabilities and revenue-generating potential of our offering. These enhanced offerings will primarily be in the areas of IDMC and customer relationship management services.

We believe that customer relationships can be enhanced through the effective use of our comprehensive EBPP services. Specifically, each time a consumer receives and pays a bill online or utilizes our customer care service, valuable data about the interaction is obtained and stored in a database. Critical information such as customer case histories, account balances and product configuration details is presented or "popped" onto the service representative's screen at the exact moment the consumer makes contact. As such, representatives are able to provide better service more quickly, and consumers feel as though our customer knows them individually and understands their particular needs. We are also able to utilize this information to better anticipate the needs of a consumer in advance of the next consumer contact. This information may also be used to assist our customers in identifying specific consumer needs and possible consumer segments that could be used to provide differentiated services such as direct marketing or specific product offers.

Components of the Billserv Service Offering

One of the key advantages of our service offering is that we have integrated certain proprietary components with third party software and hardware platforms that cover a wide variety of services and functionality. This integration enables us to be the single point of contact for all customer needs for designing, developing, implementing and managing their entire EBPP process. Our menu approach to offering our integrated products and services also allows us to tailor our EBPP services to our customers' business and marketing objectives. The components of our service offering, all of which are currently available to customers and have generated revenue to date, include:

eServ

eServ is our flagship product and the foundation for our comprehensive EBPP services. eServ provides our customers with a single offering for developing and managing their entire EBPP capabilities. With eServ we manage, on behalf of our customers, the multiple systems, delivery channels and relationships necessary for a successful EBPP offering. Our eServ product provides outsourced creation and management of presentment and payment processes for a biller direct site and all aggregator sites, as well as payment processing and full reporting and reconciliation capabilities. During the third quarter of 2002, we announced the rebranding and reorganization of our product line under the eServ brand name, which is a federally registered trademark owned by Billserv. This new organization and branding was done in order to consolidate our products under one identifiable and proprietary brand name, and distinguish our comprehensive customizable EBPP offering marketed under the eServ Select product group from our standard, parameter-driven EBPP offering marketed under the eServ Express product group. Our eServ offering includes eServ Direct Delivery, which is a delivery medium whereby the electronic bill is "pushed" directly to the consumer's email inbox. This service gives consumers the opportunity to view their bill and make payments directly from the email by clicking the "pay" button found within. Also included in our offering is eServ Insert, our targeted messaging and marketing tool that provides an interactive medium that can dynamically present customized communication campaigns and deliver preemptive customer care messages directly to consumers via the electronic bill statement.

eServ View and eServ Connect are our Internet-enabled customer care service products supporting the EBPP process. eServ View is a proprietary, multi-function, Web-based desktop browser product that provides access to the consumer's bill detail stored on our servers. We provide a tool for our client's customer service representatives ("CSRs") to deliver customer support to all consumers, including those not using the Internet. eServ Connect provides enhanced capabilities by utilizing licensed Internet collaboration software to enable interaction with consumers over the Internet in a variety of ways, such as email, Web collaboration (Web-chat) and voice-over Internet protocol ("VoIP"), and also provides capabilities for extended Customer Relationship Management ("CRM") services. We have developed proprietary customer relationship management software

applications that enable us to intelligently and efficiently analyze data obtained through the EBPP process. eServ Connect Outsource is available through our Internet Interaction Center ("IIC") to provide the client with essentially the same functionality as eServ Connect, using our employees to perform customer service on behalf of the client. This service can be a fully outsourced model in which our client chooses not to provide direct in-house services. Alternatively, this service model may be used as an after-hours support function that supplements and extends our client's existing service center hours of operation.

eConsulting

eConsulting is Billserv's professional services group that offers electronic billing, customer care, project management, and IT consulting services to both existing billing customers and the EBPP industry in general. Billserv's eConsulting group offers services ranging from project monitoring to complete turnkey project development and implementation. In addition, customers can gain access to Billserv's extensive and successful team to acquire data-centric (Internet-based) customer care knowledge.

eServ Gateway

Billserv's eServ Gateway offers billers who are already participating in EBPP a single distribution point to virtually all bill presentment and payment locations across the World Wide Web. The Gateway is designed to improve a biller's existing EBPP system, whether an in-house offering, biller direct site or limited distribution channel, by expanding the range of distribution partners. Billserv serves as the single point of contact to the numerous distribution channels, which gives billers a cost-effective means to make bills more accessible to consumers. Billserv's unique Gateway specifications may also be embedded as an OEM (Original Equipment Manufacturer) component within companies' software or service offerings, affording such vendors a cost-effective, proven method to give their clients and consumers the ability to make online payments, and view and pay bills through bank and internet payment portals.

bills.com

Billserv operates a consumer Web site, or portal, focused on providing bill presentment and payment services under the domain name www.bills.com. The bills.com strategy is to provide the consumer with an efficient and secure interface for viewing, paying and managing bills via the Internet. We also market this portal service to online financial services providers looking to provide EBPP capabilities as part of their service offering.

Product Development

Our total research and development expenses were $461,065, $760,082 and $767,751 for 2002, 2001 and 2000, respectively. We have created a proprietary technology infrastructure to support all of the components of our service offering. Our systems consist primarily of proprietary software applications that we have integrated with third party hardware and software platforms. We have designed our system so that it is reliable, flexible, and expandable to meet growth demands without significant cost or change. The combination of Microsoft Windows NT and IBM's DB2 database management system and use of redundant IBM Netfinity file servers provides for a reliable environment which is further enhanced by security measures taken such as the use of digital certificates, data encryption, NT authentication and firewalls to protect billing data. The IBM Netfinity line of servers have the ability to handle large volumes of transactions with an upward growth path and clustering technology that readily allows for expansion and scalability. Our support for open standards allows us to integrate with any third party print-stream parser, as well as in-house EBPP services. In addition, these widely used object oriented standards have provided us with a highly reusable and flexible modular system. Because of this reusability and flexibility, the business components can be constructed and modified to adapt to the rapidly developing EBPP industry without affecting the underlying software development.

The Company believes that its success will depend in part upon its ability to enhance existing products to meet the needs of the rapidly evolving EBPP market. The Company intends to continue to devote resources to enhancing its product offerings and offering higher levels of integration among its products. We also intend to continue to evaluate and enhance our systems as new technology is developed to maintain a competitive advantage.

Sales and Marketing

Our sales strategy targets both direct and indirect sales. Leads for sales are obtained through resellers, direct contact by our sales personnel, and our marketing efforts to existing customers led by our Account Management team. Billserv's direct sales effort is coordinated by a sales executive and supported by other employees who function in limited sales capacities. We also market our services through organizations that have exclusive reseller agreements with us to sell our EBPP services. Reselling partners generate and qualify sales leads, make initial contacts, assess client needs and recommend use of Billserv services when appropriate, and introduce Billserv at high levels within the customer organization.

Our marketing efforts are primarily EBPP adoption-focused. Our professional staff of Account Managers actively assists our customers in creating programs to encourage their consumers to utilize EBPP. The shared knowledge of our staff, combined with the cumulative experience of our entire customer base, enables them to provide valuable leadership as we work to build consumer adoption rates. We also participate in limited corporate marketing that promotes the Billserv brand.

Customers

Our primary market focus is on top-tier and middle-market companies generating high volumes of recurring (usually monthly) paper-based bills. The Company services billers in select vertical markets, such as utilities, telecom, cable, media and financial services industries, as well as the higher education market. All of our billing customers have signed long-term contracts, with generally three to five year terms, that provide for set-up fees in certain cases and volume-based transaction fees. The number of customers served by Billserv for the three years ended December 31, 2002, including additions and attrition, was as follows:

	Number at beginning of period	Additions	Attrition	Number at end of period
Year ended December 31, 2000	14	36	1	49
Year ended December 31, 2001	49	53	1	101
Year ended December 31, 2002	101	34	16	119

The attrition in 2002 is primarily attributable to the loss of certain customers serviced via resellers as a normal part of the resellers' account turnover and the migration of certain customers to in-house EBPP offerings after their billing agreements expired, such as Reliant Energy. EBPP services provided to Reliant Energy accounted for approximately 16%, 23% and 40% of total consolidated revenues for the years ended December 31, 2002, 2001 and 2000, respectively. This customer began developing an in-house EBPP offering during 2002 utilizing Billserv's transition plan that allows a customer to move from an outsourced offering provided by Billserv to an in-house offering of the customer's choosing. The resulting loss of transaction revenues were mitigated by fees generated from consulting services provided to Reliant Energy related to the transition of their EBPP capabilities to an in-house offering as well as transaction revenues for that portion of 2002 during which we provided this customer transaction services. Total revenues generated by this customer in 2002 were approximately equal to those in 2001 for both consulting and transaction services in the aggregate. We do not expect any significant revenues to be generated by Reliant Energy in 2003 and beyond. Also, 27% of total consolidated revenues for 2000 were attributable to a single customer for which we are no longer providing services.

Competition

The market for EBPP services is highly competitive. We compete primarily with companies that provide turnkey outsourced EBPP services for customers. These companies include Metavante, Princeton eCom Corporation, KUBRA and DST Output (formerly YourAccounts.com). In addition, we expect that other companies, such as traditional information technology services companies and systems integrators, may introduce services that compete with us. Remaining competitive in the EBPP market will require a continued investment in new technologies, marketing and a high level of customer service. We believe that the principal competitive factors in our market include:

- System reliability and performance
- Ability to provide a CRM component
- Price and other financial terms
- Technological support and customer service
- Time-to-market of implemented services
- Strategic relationships with aggregators, front-ends and technology providers
- Compliance with industry and technological standards

We also face potential competition from a number of other companies that compete with us indirectly. These include aggregators, such as CheckFree Corporation; EBPP front-ends, such as financial institutions and Internet portals; EBPP software providers, such as CheckFree I-solutions, eDocs and Avolent; and traditional bill printing companies, such as Electronic Data Systems Corporation, CSG Interactive LLC, and Cable Data. In addition, several companies are addressing the emergence of the Internet banking industry with service bureau offerings, which could include electronic bill presentment. These competitors have significant market presence and financial resources. If they enter our market, we may not have sufficient resources to continue to make the investments or achieve the technological advances necessary to compete successfully.

Trademarks

We own federally registered trademarks of the following marks: Billserv, Inc., Billserv, Inc. and design, Bills.com, Bills.com and design, eServ, and Click your bills goodbye. We have also secured the following domain name registrations:

bills.com	ebillepicenter.com
billserv.com	mybillers.com
billserv.cc	mypaymentbook.com
billserv.inc	mypaymentbook.org
billserv.org	mypaymentbook.net
billserv.law	payb2bbill.com
billserv.tech	securebills.com
billerregistry.com	securebills.cc
b2bpayserv.com	securebills.net
ebillcare.com	

We rely on a combination of copyright, trademark and trade secret laws, employee and third party nondisclosure agreements and other intellectual property protection methods to protect our services and related products.

Employees

As of December 31, 2002, we had 48 employees. We are not a party to any collective bargaining agreements. We believe that our relations with our employees are good.

ITEM 2. PROPERTIES

As of December 31, 2002, our headquarters and operations were housed in approximately 36,000 square feet of leased office space in San Antonio, Texas. The Company believes its existing facilities will be adequate to meet its anticipated needs for the foreseeable future.

ITEM 3. LEGAL PROCEEDINGS

There is no material litigation currently pending. We are not aware of any disputes that may lead to material litigation, except as follows:

Beginning in December 2000, the Company pledged certain funds held as money market funds and certificates of deposit to collateralize certain margin loans of three officers and an ex-officer of the Company. These funds are classified as Cash pledged as collateral for related party obligations on the Company's balance sheets at December 31, 2002 and 2001. The margin loans are from institutional lenders and are secured by shares of the Company's common stock held by these individuals. The Company's purpose in collateralizing the margin loans was to prevent the sale of the Company's common stock held by these officers while the Company was pursuing efforts to raise more capital through private equity placements. The sale of the Company's common stock may have hindered the Company's ability to raise capital in such a manner and compromised the Company's continuing efforts to secure additional financing. The total balance of the margin loans guaranteed by the Company was approximately $1.3 million at December 31, 2002. The Company believed it had the unrestricted legal right to use the pledged funds for its operations if necessary based on (i) its interpretation of the loan guarantee agreements, (ii) the market price of the Company's stock at the time of the pledge, and (iii) assurances the Company received from one of the institutional lenders that funds would be made available if needed. The institutional lenders holding the funds as collateral are disputing this claim, solely relying upon their strict interpretations of the Loan guarantee agreements. Subsequent to December 31, 2002, the lenders applied the pledged funds being held to satisfy the outstanding balances of the loans. In light of this action, the Company recognized a loss on the guarantees of $1,278,138 in the fourth quarter of 2002 and recorded a corresponding Payable under related party guarantees on the Company's balance sheet at December 31, 2002. The Company may institute litigation or arbitration concerning these matters, which may result in the assertion of claims by these officers under their employee agreements. The ultimate outcome of this matter cannot presently be determined.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

There were no matters submitted to a vote of the Company's stockholders during the fourth quarter of fiscal year 2002.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Market Information

Our common stock was traded on the National Association of Securities Dealers ("NASD") Over the Counter Bulletin Board ("OTC BB") through March 13, 2000 at which time our common stock was approved for trading on the NASDAQ Small Cap Market. Subsequently, our stock was approved for trading on the Nasdaq National Market on July 31, 2000 under the symbol "BLLS." On February 4, 2003, the Nasdaq National Market delisted our common stock because the Company did not meet the requirements for continued listing on the Nasdaq National Market. The Company's common shares were immediately eligible for quotation on the OTC BB effective at open of business February 4, 2003. The Company kept the letters BLLS as its ticker symbol.

The following table sets forth for the quarterly periods indicated the range of high and low closing prices of the common stock as reported.

	High	Low
2002		
First Quarter	$ 1.25	$ 0.90
Second Quarter	$ 1.70	$ 1.02
Third Quarter	$ 1.25	$ 0.52
Fourth Quarter	$ 0.70	$ 0.17
2001		
First Quarter	$ 5.38	$ 2.16
Second Quarter	$ 3.05	$ 1.88
Third Quarter	$ 2.20	$ 0.73
Fourth Quarter	$ 1.55	$ 0.80

Holders

As of March 17, 2003, 20,722,656 shares of common stock are outstanding, $.001 par value. As of March 17, 2003, there were approximately 5,784 stockholders of record of the common stock.

Dividend Policy

We have never declared or paid cash or stock dividends and have no present plan to pay any such dividends in the foreseeable future, intending instead to reinvest our earnings, if any.

ITEM 6. SELECTED FINANCIAL DATA

The following selected consolidated financial data should be read in conjunction with the Consolidated Financial Statements and Notes thereto and "Management's Discussion and Analysis of Financial Condition and Results of Operations" appearing elsewhere in this Form 10-K.

Consolidated Statement Of Operations Data

	Year Ended December 31, 2002	Year Ended December 31, 2001	Year Ended December 31, 2000	Year End December 1999 (1
Revenues	$ 4,206,554	$ 2,968,678	$ 650,023	$ 55,43
Cost of revenues	4,690,344	4,995,161	3,690,843	127,34
Operating expenses:				
Research and development	461,065	760,082	767,751	906,53
Selling, general and administrative	4,822,459	6,423,315	8,264,657	3,737,92
Depreciation and amortization	1,658,886	1,555,626	940,995	270,90
Provision for impairment of assets	855,117	--	--	--
Non-cash expense related				

to the issuance of warrants	--	--	7,488,000	491,42
Total operating expenses	7,797,527	8,739,023	17,461,403	5,406,79
Other income (expense), net	(2,673,360)	359,800	546,173	5,74
Cumulative effect of a change in accounting principle	--	--	(52,273)	--
Net loss	$(10,954,677)	$(10,405,706)	$(20,008,323)	$ (5,472,94
Per share information:				
Net loss - basic and diluted	$ (0.53)	$ (0.58)	$ (1.35)	$ (0.5
Weighted average common shares outstanding - basic and diluted	20,591,304	18,017,051	14,793,622	10,876,09

Consolidated Balance Sheet Data

	2002	2001	2000	1999
Working capital (deficit)	$ (2,408,924)	$ 5,750,354	$ 5,291,006	$ 6,29
Current assets	$ 2,514,973	$ 7,255,124	$ 8,848,543	$ 7,49
Total assets	$ 4,709,263	$ 11,415,136	$ 15,290,542	$ 9,39
Long-term obligations, net of current portion	$ 39,168	$ --	$ 148,428	$ 25
Accumulated deficit	$(47,136,060)	$(36,181,383)	$(25,775,677)	$(5,76
Total stockholders' equity (deficit)	$ (345,270)	$ 9,748,566	$ 11,011,410	$ 7,93

(1) The accounting change related to SAB 101 has not been reflected in the financials prior to its adoption on January 1, 2000.

13

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

The following discussion and analysis should be read in conjunction with the Consolidated Financial Statements and Notes thereto, and other financial information included elsewhere in this Form 10-K. This report contains forward-looking statements that involve risks and uncertainties. Actual results in future periods may differ materially from those expressed or implied in such forward-looking statements as a result of a number of factors, including, but not limited to, the risks discussed under the heading "Risk Factors" and elsewhere in this Form 10-K.

Overview

Billserv was a development stage enterprise through December 31, 2001 and so has a limited operating history on which to base an evaluation of our businesses and prospects. The Company's principal activities during development included research and development, raising of capital and organizational activities. The Company has recently focused its activities in the areas of obtaining billing customers and implementing Electronic Bill Presentment and Payment ("EBPP") capabilities for those billers. Our prospects must be considered in light of the risks, expenses and difficulties frequently encountered by companies in their early stages of development, particularly companies in new and rapidly evolving markets such as electronic commerce. Such risks include, but are not limited to, an evolving and unpredictable business model and our ability to manage growth.

To address these risks, we must, among other things, maintain and increase our customer base; implement and successfully execute our business and marketing strategy; continue to develop and upgrade our technology and transaction-processing systems; provide superior customer service; respond to competitive developments; attract, retain and motivate qualified personnel; and respond to unforeseen industry developments and other factors. We cannot assure you that we will be successful in addressing such risks, and the failure to do so could have a material adverse effect on our business, prospects, financial condition and results of operations.

Since inception, we have incurred operating losses each quarter, and as of December 31, 2002, we have an accumulated deficit of $47.1 million. The Company expects to continue to incur losses for the foreseeable future as efforts to achieve profitability continue. We believe that our success will depend in large part on our ability to (a) drive the consumer adoption rate of EBPP, (b) continue to add quality billers to our significant client base, (c) meet evolving customer requirements and (d) adapt to technological changes in an emerging market. Accordingly, we intend to focus on activities that serve to encourage EBPP adoption by consumers and billers in order to increase revenue.

In keeping with this strategy, our sales focus has shifted to a more comprehensive offering that delivers a single, outsourced service offering for developing customer relationships utilizing the electronic bill as a dynamic communication medium. By integrating our electronic billing capabilities with online real-time customer care support and Internet-enabled direct marketing and communication, Billserv puts billers in direct, interactive contact with their consumers. Our selling strategy is a targeted approach with an emphasis on complementary marketing initiatives with our valued reseller and referral partners in order to maximize our leverage in the marketplace and limit the resources needed to obtain accounts through direct sales.

The Company also provides professional marketing consultations as a key element of its account management group to actively assist billers in creating programs to move their consumers to EBPP. Because growth of our revenues is dependent upon consumer acceptance of EBPP, we work directly with a client's marketing department to spur adoption rates and increase the number of EBPP transactions. Since we have a significant amount of investment in infrastructure and a certain level of fixed operating expenses, achieving profitability depends on the volume of transactions we process and the revenue we generate from these transactions, as well as other related services performed for our customers. During the third quarter of 2002, we announced the rebranding and reorganization of our product line under the eServ brand name, which is a federally registered trademark owned by Billserv. This new organization and branding was done in order to consolidate our products under one identifiable and proprietary brand name, and distinguish our comprehensive customizable EBPP offering marketed under the eServ Select brand name from our standard, parameter-driven EBPP offering marketed under the eServ Express brand name. There were no significant changes made to any of our service products as a result of this action. The components of our service offering, all of which are currently available to customers and have generated revenue to date, include:

- Internet billing services for EBPP through a Billserv-hosted payment Web site, secure direct delivery to the consumer's email inbox, or distribution via bill aggregators.
- Internet-enabled, interactive customer care services on an in-house or outsourced basis.
- Professional consulting services for EBPP billers or software vendors needing value-added resources to deliver customized EBPP services, including payment gateway services that provide billers who are already participating in EBPP using in-house software a single distribution point to virtually any bill presentment and payment location across the World Wide Web in addition to their

existing distribution points or biller direct site. Gateway technology may also be embedded as an OEM (original equipment manufacturer) component within vendors' software or service offerings to provide a cost-effective, proven method to give their clients and consumers the ability to make online payments, and view and pay bills anytime, anywhere through bank and Internet payment portals.

- Licensing of CheckFree e-billing software as an authorized reseller in Australia only.
- Online bill payment and management services for consumers through the bills.com Internet portal.

As a result of our limited operating history and the emerging nature of the markets in which we compete, we are unable to precisely forecast our revenues. Our current and future expense levels are based largely on our investment plans and estimates of future revenues. Revenue and operating results will depend on the volume of transactions processed and related services rendered. The timing of such services and transactions and our ability to fulfill a customer's demands are difficult to forecast. Although we systematically budget for planned outlays and maintain tight controls on our expenditures, we may be unable to adjust spending in a timely manner to compensate for any unexpected revenue shortfall. Accordingly, any significant shortfall in revenues in relation to our planned expenditures could have a material adverse effect on our business, prospects, financial condition and results of operations. Further, we may make certain pricing, service, marketing or acquisition decisions that could have a material adverse effect on each or all of these areas.

Critical Accounting Policies

General

Billserv's discussion and analysis of its financial condition and results of operations are based upon Billserv's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires Billserv to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, Billserv evaluates its estimates, including those related to the reported amounts of revenues and expenses, bad debt, investments, intangible assets, income taxes, and contingencies and litigation. Billserv bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ from these estimates under different assumptions or conditions.

Revenue Recognition

Prior to December 31, 1999, we recognized revenue generated from up-front fees upon completion of an implementation project. These up-front fees are charged for the work involved in implementing the basic functionality required to provide EBPP services to customers. These set-up procedures include tasks such as establishing connectivity, design and construction of the hosted Web site, and conversion of the paper bill print stream to an electronic format. In December 1999, the SEC issued SAB 101, which requires that revenue generated from up-front implementation fees that do not represent a separate earnings process to be recognized over the term of the related service contract. We adopted SAB 101 on January 1, 2000, and accordingly, revised our implementation fee revenue recognition policy to defer this type of revenue, while the related costs will be expensed as incurred. The cumulative effect of this accounting change totaled $52,273 and was recognized as a non-cash after-tax charge during the first quarter of 2000. The cumulative effect has been recorded as deferred revenue to be recognized as revenue over the remaining contractual service periods, which are primarily three to five years in length. At December 31, 2002, deferred revenue was $400,960. We anticipate that transaction fees and other services will make up a larger percentage of total revenue in future periods, which will further reduce the effect that deferring implementation fee revenue has on our current operating results. However, the volume of transactions and amount of related revenue we will generate in future periods is dependent upon, among other things, the rate at which consumers utilize EBPP.

Bad Debt

Billserv maintains an allowance for doubtful accounts for estimated losses resulting from the inability or failure of its customers to make required payments. The Company recorded bad debt expense of $30,000, $21,000 and $10,000 for 2002, 2001 and 2000, respectively, and recorded bad debt write-offs of $1,734 and $12,069 to its allowance for doubtful accounts in 2002 and 2001, respectively. There were no write-offs recorded to the allowance for doubtful accounts in 2000. At December 31, 2002 and 2001, the balance of the allowance for doubtful accounts was $47,197 and $18,931, respectively. If the financial condition of the Billserv's customers were to deteriorate, resulting in an impairment of their ability to make contractual payments, additional allowances may be required.

Valuation of Long-Lived and Intangible Assets

The Company assesses the impairment of long-lived and intangible assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors considered important which could trigger an impairment review include the following: significant underperformance relative to historical or projected future cash flows; significant changes in the manner of use of the assets or the strategy of the overall business; and significant negative industry trends. When management determines that the carrying value of long-lived and intangible assets may not be recoverable, impairment is measured as the

excess of the assets' carrying value over the estimated fair value. An impairment loss of $855,000 was recorded in 2002. No impairment losses were recorded in 2001 or 2000.

Income Taxes

The Company accounts for income taxes using the liability method in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("FAS 109"). The liability method provides that the deferred tax assets and liabilities are recorded based on the difference between the tax bases of assets and liabilities and their carrying amount for financial reporting purposes, as measured by the enacted tax rates and laws that will be in effect when the differences are expected to reverse. Deferred tax assets are carried on the balance sheet with the presumption that they will be realizable in future periods when pre-taxable income is generated. Predicting the ability to realize these assets in future periods requires a great deal of judgment by management. It is our judgment that we cannot predict with reasonable certainty that the tax assets carried on our balance sheet as of December 31, 2002 will be fully realized in future periods. FAS 109 requires a valuation allowance to reduce the deferred tax assets reported if, based on the weight of the evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. After consideration of all of the evidence, both positive and negative, management determined that a valuation allowance at December 31, 2002 is necessary to reduce the deferred tax assets to the amount that will more likely than not be realized. The change in valuation allowance for the current year is a net increase of $3.7 million. At December 31, 2002, the Company has available net operating loss carryforwards of approximately $34.8 million, which expire beginning in the year 2020.

Results of Operations

Billserv's revenues are principally derived from fees for implementing EBPP capabilities, processing EBPP transactions and providing related customer care, and consulting services. Billserv also became a licensed reseller of CheckFree's e-billing software in Australia during 2002. Revenues by type for the three years in the period ended December 31, 2002, are as follows:

	2002	2001	2000
Service revenues:			
Implementation revenues	$ 311,712	$ 502,753	$ 93,013
Transaction revenues	1,952,631	1,163,214	285,741
Consulting revenues	1,704,211	1,302,711	271,269
Total service revenues	3,968,554	2,968,678	650,023
Software license revenues	238,000	--	--
Total revenues	$4,206,554	$2,968,678	$650,023

Total revenues increased 42% to $4,206,554 in 2002 from $2,968,678 in 2001. Of the total increase from the prior year, 64% was attributable to the growth in transaction fee revenue, while growth in consulting revenues, which includes revenue from the licensing of the Company's gateway technology, accounted for 32% of the increase. These increases were due to an increase in the number of implemented billers and volume of transactions. As of December 31, 2002, we had 119 billers under contract who were in various stages of development, including 106 billers that were in full production or pilot stages, as compared to 84 billers in full production or pilot stages at December 31, 2001. The Company's first sale of a software license as a reseller of CheckFree's e-billing software in Australia also contributed $238,000 to the increase in revenue from the prior year. The sale was made to an Australian billing service provider that is also an equal partner with the Company in a joint venture formed to provide EBPP services to the Australian market. Total revenues increased 357% to $2,968,678 in 2001 from $650,023 in 2000. Of the increase from the prior year, 44% was attributable to the addition of a full year of consulting revenue in 2001 (professional consulting services were first offered to customers in the fourth quarter of 2000) with the remaining increase attributable to growth in transaction and related implementation fee revenue due to an increase in the number of implemented billers and volume of transactions. As of December 31, 2001, we had 101 billers under contract who were in various stages of development, including 84 billers that were in full production or pilot stages, as compared to 31 billers in full production or pilot stages at December 31, 2000.

During 2002, the Company entered into two separate nonmonetary transactions whereby the Company licensed the use of its gateway technology to certain third party software vendors to be used as an original equipment manufacturer ("OEM") component of their product offering in exchange for software products from those vendors. The Company accounted for these transactions in accordance with APB Opinion No. 29, "Accounting for Nonmonetary Transactions". These exchanges were determined to culminate the earning process because the technology exchanged by the Company was held for sale in the ordinary course of business and the products received by the Company were expected to be deployed and utilized as productive assets. The Company recognized revenue related to these transactions at the fair value of the software received, which was determined by reference to vendor-specific objective evidence, because it was more clearly evident than the value of the assets transferred. The value of the software received was estimated by comparison to third party evidence including vendor-specific established pricing lists and historical sales information and was more readily determinable because the Company did not have a history of

comparable cash sales of its payment gateway technology. The Company recognized $300,000 in a transaction where the Company's technology was exchanged for customer relationship management software and concurrent seat licenses to use in providing customer care services via the Internet or telephone. The Company also recognized $300,000 in a transaction where the Company's technology was exchanged for document archival and retrieval software to use in the storage of electronic billing statements. The carrying value of the gateway technology exchanged in both transactions was zero. The Company capitalized the software received and at the time of acquisition and subsequently recognized a loss on impairment of these assets which took the carrying amount of these assets to zero.

One billing customer accounted for approximately 16%, 23% and 40% of total consolidated revenues for the years ended December 31, 2002, 2001 and 2000, respectively. This customer began developing an in-house EBPP offering during 2002 utilizing Billserv's transition plan that allows the customer to move from an outsourced offering with Billserv to an in-house offering. The resulting loss of transaction revenues were mitigated by fees generated from consulting services provided to this customer related to transitioning their EBPP capabilities to an in-house offering such that total revenues generated by this customer in 2002 were approximately equal to those in 2001. We do not expect any significant revenues to be generated by this customer in 2003 and beyond. In addition, the Company recognized $173,000 of non-recurring revenue in 2000 attributable to a single customer for which we are no longer providing services.

Cost of revenues includes the cost of personnel dedicated to the design of electronic bill templates, creation of connections to third-party aggregators and payment processors, testing and quality assurance processes related to implementation and presentment, as well as professional staff dedicated to providing contracted services to EBPP customers under consulting arrangements. Cost of revenues also includes fees paid for presentation of consumer bills on Web sites powered by aggregators and processing of payments for EBPP transactions by third party providers. We have multi-year distribution agreements with all major EBPP aggregators, including CheckFree, Metavante (includes Spectrum and Paytrust) and MasterCard RPPS, which call for volume-based fees for bills delivered through the aggregators' networks. Through its contractual relationships with its payment processors, Billserv is able to process ACH and credit card payment transactions on behalf of its customers and their consumers. Billserv pays volume-based fees for debit and credit transactions initiated through these processors, and pays fees for other transactions such as returns, notices of change to bank accounts, test debits, file transmission and depository fees. Cost of revenues decreased 6% to $4,690,344 in 2002 from $4,995,161 for 2001. The decrease from 2001 is primarily due to cost reductions that were implemented in the second half of 2001, which included a decrease in the number of personnel employed to provide revenue-producing services from an average of 79 such employees for 2001 to 63 in 2002. The cost savings from the prior year period were partially offset by the cost of the CheckFree software license that was resold in 2002, which was $228,000. Cost of revenues increased 35% to $4,995,161 in 2001 from $3,690,843 for 2000. The increase from 2000 is primarily due to an increase in the number of personnel employed to provide revenue-producing services from an average of 54 such employees for 2000 to 79 in 2001.

General and administrative expenses include costs for the Company's human resources, finance, legal, facilities and executive management functions. These expenses decreased to $3,948,684 in 2002 from $4,338,374 for 2001 and were $3,677,834 in 2000. The decrease from 2001 to 2002 is attributable to cost reductions resulting from the restructuring and realignment of our organization during the latter half of 2001 to better position the Company for current economic and market conditions. During the third quarter of 2001, the Company downsized and realigned its organization to make more efficient use of its resources and better match the Company's infrastructure to market conditions and the current business environment since the overall growth of the economy and rate of technology spending by businesses had slowed. This realignment included the layoff of certain employees and reassignment of other employees to different functions to reduce our cash outflows and allow us to utilize our limited resources more prudently by eliminating functions that did not directly contribute to our goal of profitability. It also involved reorganizing the Company to promote better communication with customers and improve customer service. The increase in general and administrative expenses from 2000 to 2001 was principally due to increased facilities costs resulting from our move to new corporate headquarters. Total rent expense in 2000 was $681,000, and in 2001, the aggregate rent expense was approximately $1.2 million.

Selling and marketing expenses consist primarily of payroll and related expenses for personnel engaged in marketing and selling activities, as well as advertising services. These expenses decreased to $873,775 in 2002 from $2,084,941 for 2001 and $4,586,823 for 2000. The decrease in 2002 from 2001 was primarily the result of reductions in our direct sales staff, which contributed 77% to the decrease from the prior year, as well as lower related travel expenses and trade show participation, which contributed 18% to the decrease from the prior year. As we have increased our focus throughout 2002 on using strategic reseller partners to provide sales opportunities related to the deployment and use of our EBPP services, we have experienced a decrease in the amount of expenses related to our direct sales force. The decrease in selling and marketing expenses in 2001 from 2000 was primarily the result of lower advertising media costs related to promotion of the bills.com Web site as well as lower corporate marketing expenses, which contributed 66% to the decrease, and reductions in personnel and travel expenses, which contributed 27% to the decline in expenses in total. During the second quarter of 2000, bills.com was re-launched with a focus on making the Web site simpler and more secure for consumers to view, pay and manage their bills online. As part of this re-launch, we incurred approximately $1.2 million of expense in 2000 to develop and market this consumer payment portal. The increase in selling and marketing expenses in 2000 from $1,750,615 in 1999 was the result of the development and expansion initiatives of our sales and marketing departments as well as the advertising media costs associated with our bills.com promotion. We will

continue to analyze our sales and marketing efforts in order to control costs, increase the effectiveness of our sales force, and broaden our reach through reseller initiatives and advantageous alliances.

Research and development expenses consist primarily of the cost of personnel devoted to the design of new processes that will improve our electronic presentment and payment abilities and capacities, integration of third-party applications, new customer care services, additional business-to-consumer applications, and services for direct marketing opportunities. These expenses decreased to $461,065 in 2002 after remaining relatively flat in 2001 and 2000 at $760,082 and $767,751, respectively, due to a focus on our core competencies in order to implement and service existing products. During the earlier stages of our Company, we applied additional resources to design and develop our base technology infrastructure and operating systems. All research and development costs are expensed as incurred. We plan to minimize our research and development activities in the foreseeable future, as we intend to concentrate our limited resources on generating revenue and servicing existing customers.

Depreciation and amortization was $1,658,886, $1,555,626 and $940,995 for 2002, 2001 and 2000, respectively. The increase from 2001 was the result of writing off $207,000 of leasehold improvements related to our corporate office facility due to the cancellation of the related lease in March 2003. This increase was partially offset by lower depreciation related to certain assets that became fully depreciated during 2002. The increase from 2000 to 2001 reflected the capital expenditures made in prior years for infrastructure and operating systems in support of our growth strategy. We purchased approximately $402,000, $723,000 and $3.7 million of property and equipment during 2002, 2001 and 2000, respectively, but do not anticipate making significant capital expenditures in 2003.

During the fourth quarter of 2002, the Company performed an impairment review because the uncertainty of the Company's ability to continue as a going concern due to decreased liquidity indicated that the carrying value of certain long-lived assets may not be recoverable. The Company determined that customer relationship management software and document archival and retrieval software with a carrying amount of $855,117 were no longer recoverable and recorded a non-cash charge of $855,117, which is included as a component of operating income in the accompanying consolidated statement of operations. Fair value was based on the expected future cash flows to be generated by these assets, which was zero because of the Company's inability to deploy and utilize the assets to provide revenue-generating services, due to the Company's limited resources and lack of liquidity.

Non-cash expense related to the issuance of warrants relates to expenses recognized for warrants issued in consideration for services. In accordance with accounting principles generally accepted in the United States, we expensed the fair value of these warrant issuances, which was calculated using the Black-Scholes option-pricing model, and recorded the related credit to paid-in capital. During 2000, we recognized $7.5 million of expense associated with the issuance of 1.3 million warrants to CheckFree as consideration for entering into an extended biller service provider agreement. Under this agreement, which expires in February 2005, CheckFree provides us with electronic bill presentment services for volume-based fees. The related warrant expense was recognized immediately instead of being deferred and recognized over the life of the agreement because the warrants were fully vested at the date of grant and CheckFree did not have to perform under the agreement to earn the warrants. We may also recognize warrant costs in future periods based on CheckFree's ability to earn incentive warrants on up to 2,801,903 additional shares, of which 1,000,000 are exercisable at $11.375 per share and 1,801,903 are exercisable at $14.219 per share. The incentive warrants vest pro rata upon the achievement of a target level of 200 referred billers, each generating approximately 500,000 paper-based bills per month, to the Company by CheckFree and will occur on the first through fifth anniversaries of the agreement. All incentive warrants that are not vested by the fifth anniversary will expire at that time. As of December 31, 2002, none of these incentive warrants were vested and management of the Company is unable to assess the likelihood of whether or when any of these incentive warrants will be earned by CheckFree and the related expenses incurred.

Net other expense was $2,673,360 in 2002 compared to net other income of $359,800 in 2001 and $546,173 in 2000. The increase in other expenses from 2001 to 2002 is primarily attributable to $1.4 million of interest and other expenses related to the convertible debt issuance in 2002 and a $1.3 million loss on related party loan guarantees as well as lower interest income earned in 2002 as a result of lower invested balances and market interest rates. The decrease in net other income from 2000 to 2001 is primarily attributable to lower interest income earned in 2001 as a result of lower invested balances and market interest rates.

The increase in net loss to $10,954,677 in 2002 from $10,405,706 in 2001 was primarily due to non-operating expenses recognized in 2002, including $1.4 million of interest and other expenses related to the Laurus debt and a $1.3 million loss on related party loan guarantees. The decrease in net loss to $10,405,706 in 2001 from $20,008,323 in 2000 was primarily due to $7.5 million of expenses recognized in 2000 related to the issuance of warrants to CheckFree as consideration for entering into an extended biller service provider agreement. The increase in net loss in 2000 from $5,472,948 in 1999 was due to the warrant expense in 2000 as well as an overall increase in expenses as a result of employee growth from 50 employees at December 31, 1999 to 141 at December 31, 2000 and expansion of the Company's operations.

18

Liquidity and Capital Resources

At December 31, 2002, the Company's principal source of liquidity consisted of $286,000 of cash and cash equivalents, compared to $4.2 million of cash and cash equivalents and $237,000 in short-term investments at December 31, 2001. The Company has incurred substantial losses since inception and has experienced a material shortfall from anticipated revenues, which has led to a significant decrease in its cash position and a deficit in working capital. Also, the Company defaulted under its convertible debt agreement during the fourth quarter of 2002 and was unsuccessful in its attempt to access its funds held as collateral to guarantee certain executive margin loans after attempting to retrieve such funds during the fourth quarter of 2002. Consequently, the Company believes that its current available cash and cash equivalents along with anticipated revenues may be insufficient to meet its anticipated cash needs for the foreseeable future. Accordingly, the Company reduced its workforce by 36 employees in November 2002 and is currently aggressively pursuing strategic alternatives, including investment in or sale of the Company. The satisfactory completion of a sale or additional investment in the Company is essential or the Company has no other alternative that will provide sufficient cash flows to meet current operating requirements. The sale of additional equity or convertible debt securities would result in additional dilution to the Company's stockholders, and debt financing, if available, may involve restrictive covenants which could restrict operations or finances. There can be no assurance that financing will be available in amounts or on terms acceptable to the Company, if at all. If the Company cannot raise funds, on acceptable terms, or achieve positive cash flow, it may not be able to continue to exist, conduct operations, grow market share, take advantage of future opportunities or respond to competitive pressures or unanticipated requirements, any of which would negatively impact its business, operating results and financial condition.

Beginning in December 2000, the Company pledged certain funds held as money market funds and certificates of deposit to collateralize certain margin loans of three officers and an ex-officer of the Company. These funds are classified as Cash pledged as collateral for related party obligations on the Company's balance sheets at December 31, 2002 and 2001. The margin loans are from institutional lenders and are secured by shares of the Company's common stock held by these individuals. The Company's purpose in collateralizing the margin loans was to prevent the sale of the Company's common stock held by these officers while the Company was pursuing efforts to raise more capital through private equity placements. The sale of the Company's common stock may have hindered the Company's ability to raise capital in such a manner and compromised the Company's continuing efforts to secure additional financing. The total balance of the margin loans guaranteed by the Company was approximately $1.3 million at December 31, 2002. The Company believed it had the unrestricted legal right to use the pledged funds for its operations if necessary based on (i) its interpretation of the loan guarantee agreements, (ii) the market price of the Company's stock at the time of the pledge, and (iii) assurances the Company received from one of the institutional lenders that funds would be made available if needed. The institutional lenders holding the funds as collateral are disputing this claim, solely relying upon their strict interpretations of the Loan guarantee agreements. Subsequent to December 31, 2002, the lenders applied the pledged funds being held to satisfy the outstanding balances of the loans. In light of this action, the Company recognized a loss on the guarantees of $1,278,138 in the fourth quarter of 2002 and recorded a corresponding Payable under related party guarantees on the Company's balance sheet at December 31, 2002. The Company may institute litigation or arbitration concerning these matters, which may result in the assertion of claims by these officers under their employee agreements. The ultimate outcome of this matter cannot presently be determined.

Net cash used in operating activities was $5.6 million, $9.0 million and $11.0 million for 2002, 2001 and 2000, respectively. Net cash used in operating activities was primarily attributable to operating net losses generated by development stage activities and overhead costs. We plan to focus on expending our resources prudently given our current state of liquidity and do not expect to achieve positive cash flow from operations for 2003 as a result of lower than anticipated revenue growth.

Net cash used in investing activities was $143,000 in 2002 and was primarily used for purchases of computer equipment. Net cash provided by investing activities for 2001 was $1.5 million and reflected sales and maturities of marketable securities of $2.0 million and purchases of property and equipment of $723,000. Net cash used in investing activities was $6.4 million in 2000 and was primarily used for purchases of investments and equipment and to make deposits for leases. We do not anticipate making significant capital expenditures during 2003.

Net cash provided by financing activities of $1.9 million for 2002 resulted primarily from $1.5 million of borrowings under a convertible debt agreement and the return of $707,000 that had been pledged as collateral for margin loans of officers. Net cash provided by financing activities of $6.5 million for 2001 resulted from proceeds, net of issuance costs, of $9.2 million from the issuance of common stock private placement offerings in March and November 2001. The $1.5 million repayment of the outstanding line of credit in January 2001 and additional pledge of $1.0 million as collateral for margin loans of officers reduced the amount of net cash provided by financing activities. Net cash provided by financing activities of $15.6 million for 2000 resulted from proceeds, net of issuance costs, of $9.5 million from the purchase of common stock by CheckFree and $6.1 million from the exercise of warrants issued in the October and December 1999 private equity placements. In addition, the Company drew $1.5 million on its line of credit in 2000. The initial pledge of $1.0 million as collateral for margin loans of officers reduced the amount of net cash provided by financing activities.

In June 2000, the Company executed a working capital line of credit agreement with a bank in the amount of $1,500,000. Advances under the line of credit accrued interest at the prime rate minus 0.25%, with repayment terms of monthly interest-only payments and principal due in July 2001. The line of credit was secured by certain investments of the Company. The Company borrowed $1,500,000 on this line of credit for the security deposit and leasehold improvements of the Company's corporate headquarters and repaid the entire outstanding balance plus accrued interest in January 2001. The line of credit expired in July 2001 and was not renewed. In March 2002, the Company executed a working capital line of credit agreement with a bank in the amount of $700,000. The Company borrowed $645,000 under this line of credit during the first six months of 2002. In September 2002, the Company repaid the outstanding balance in full, including accrued interest, and terminated the line of credit. Advances under the line of credit accrued interest at the prime rate minus 0.25%, with repayment terms of monthly interest-only payments and principal due in June 2003. As part of the line of credit agreement, the Company had to maintain a minimum restricted cash balance of $800,000 with the bank.

On July 25, 2002, the Company executed a financing agreement with Laurus Master Fund, Ltd. ("Laurus") in exchange for a $1.5 million convertible note and a four-year warrant to purchase 300,000 shares of the Company's common stock at exercise prices of $0.936 for the first 150,000 shares, $0.975 for the next 50,000 shares, and $1.17 for the remaining 100,000 shares. Laurus may convert the convertible note, which bears interest at 7% annually, at any time into shares of the Company's common stock at a fixed conversion price of $0.78, subject to certain restrictions in the purchase agreement.

The Company may pay the principal and interest on the convertible note, which has a one-year term, in cash, shares of its common stock or a combination of cash and stock. If common stock is used to pay the note, the conversion price will be the lesser of (i) $0.78 or (ii) 88% of the average of the 7 lowest closing prices during the 22 trading days prior to the date the Company gives notice of payment. Accrued interest and one-ninth of the principal is due on the first business day of each calendar month beginning on November 1, 2002 and continuing until the maturity date of July 1, 2003. If the required principal payment is made in cash, the principal amount paid will be 105% of the amount due. The Company granted Laurus a security interest in all of its assets. As of the date of this report, the Company has not made any principal payments to Laurus and is in default under the note. A penalty of 20% of the outstanding principal amount, or $300,000, has been assessed to the Company for being in default, and is included in the balance of Short-term borrowings on the Company's balance sheet at December 31, 2002.

The Company recorded a debt discount as a result of the issuance of the warrant to Laurus of approximately $259,000, which was being charged to interest expense over the term of the convertible note using the effective yield method. Upon the Company's default under the note during the fourth quarter of 2002, the remaining balance of the discount was charged to interest expense. Furthermore, the Company recorded an additional debt discount as a result of the beneficial conversion feature of approximately $283,000, which was charged to interest expense at the date of issuance. The amount related to the beneficial conversion feature was determined by dividing the note proceeds allocated to the convertible security of approximately $1,241,000 by the number of shares into which the note is convertible, or 1,923,077 shares based on the fixed conversion price of $0.78 per common share. The resulting effective conversion price of $0.65 per common share was then compared to the fair value of the Company's stock, which was $0.93 per common share on the issuance date. The difference of $0.28 per common share between the fair value of the stock and the effective conversion price was then multiplied by 1,009,586, which was the number of shares the note was convertible into at the date of issuance, taking into account the limitation on the number of shares that Laurus could convert at that time. The agreement stipulates that Laurus may not convert that amount of the note that would result in beneficial ownership of more than 4.9% of the outstanding common shares of the Company on the date of conversion. The conversion limitation becomes null and void upon an event of default under the note and may be raised if the Company chooses to redeem the outstanding principal amount of the note in cash and Laurus elects to convert the note instead. The limitation may also be raised if the Company were to issue additional common shares for any reason, thus increasing the number of outstanding shares. Due to the Company's default under the note during the fourth quarter of 2002, the 4.9% limitation became null and void and additional interest expense of approximately $256,000 was recognized at a rate of $0.28 per common share for the 913,491 additional shares that the note became convertible into upon default.

The Company agreed to file with the Securities and Exchange Commission, and have declared effective by November 25, 2002, a registration statement registering the resale of the shares of the Company's common stock issuable upon conversion or payment of the note and exercise of the warrant. As of the date of this report, the Company has filed a registration statement but it has not yet been declared effective.

Effect of New Accounting Pronouncements

In July 2001, the Financial Accounting Standards Board ("FASB") issued Statement No. 142, "Goodwill and Other Intangible Assets" ("FAS 142"), which addresses the recognition and measurement of other intangible assets acquired outside of a business combination whether acquired individually or with a group of assets. In accordance with FAS 142, goodwill and certain intangible assets are no longer amortized, but are subject to at least an annual assessment of impairment. The Company adopted this statement on January 1, 2002. The provisions of FAS 142 did not have an impact on the Company's consolidated financial statements.

In August 2001, the FASB issued Statement No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("FAS 144"). FAS 144 clarifies the accounting for the impairment of long-lived assets and for long-lived assets to be disposed of, including the disposal of business segments and major lines of business. FAS 144 became effective for the Company in the first quarter of 2002. During the fourth quarter of 2002, the Company performed an impairment review because the uncertainty of the Company's ability to continue as a going concern due to decreased liquidity indicated that the carrying value of certain long-lived assets may not be recoverable. The Company determined that customer relationship management software and document archival and retrieval software with a carrying amount of $855,000 were no longer recoverable and recorded a non-cash charge of $855,000, which is included as a component of operating income in the accompanying consolidated statement of operations. Fair value was based on the expected future cash flows to be generated by these assets, which was zero because of the Company's inability to deploy and utilize the assets to provide revenue-generating services, due to the Company's limited resources and lack of liquidity.

In November 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"). FIN 45 requires that a liability be recorded in the guarantor's balance sheet upon issuance of a guarantee. In addition, FIN 45 requires disclosures about the guarantees that an entity has issued. The initial recognition and initial measurement provisions of FIN 45 are applicable on a prospective basis to guarantees issued or modified after December 31, 2002, irrespective of the guarantor's fiscal year-end. The initial recognition and initial measurement provisions of FIN 45 are not expected to have a material impact on the Company's consolidated financial statements. The disclosure requirements of FIN 45 are effective for financial statements of interim or annual periods ending after December 15, 2002; therefore, the Company has included the disclosures herein as required.

In December 2002, the FASB issued Statement No. 148, "Accounting for Stock-Based Compensation, Transition and Disclosure" ("FAS 148"). FAS 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. FAS 148 also requires that disclosures of the pro forma effect of using the fair value method of accounting for stock-based employee compensation be displayed more prominently and in a tabular format. Additionally, FAS 148 requires disclosure of the pro forma effect in interim financial statements. The transition and annual disclosure requirements of FAS 148 are effective for fiscal years ended after December 15, 2002. The interim disclosure requirements of FAS 148 are effective for interim periods beginning after December 15, 2002. The adoption of the provisions of FAS 148 did not have an impact on the Company's consolidated financial statements, however, the Company has modified its disclosures as provided for in the new standard.

Risk Factors

There are many factors that affect the Company's business and the results of its operations, some of which are beyond its control. The following is a description of some of the important factors that may cause the actual results of the Company's operations in future periods to differ materially from those currently expected or desired.

Future Capital Needs; Uncertainty of Additional Financing

The Company currently plans to meet its capital requirements primarily through issuance of equity securities or new borrowing arrangements, and in the longer term, revenue from operations. Due to a material shortfall from anticipated revenues and the inability to access its funds held as collateral to guarantee certain executive margin loans, the Company believes that its current available cash and cash equivalents and investment balances along with anticipated revenues may be insufficient to meet its anticipated cash needs for the foreseeable future. Accordingly, the Company reduced its workforce by 36 employees in November 2002 and is currently aggressively pursuing strategic alternatives, including investment in or sale of the Company. The sale of additional equity or convertible debt securities would result in additional dilution to our shareholders, and debt financing, if available, may involve restrictive covenants that could restrict our operations or finances. There can be no assurance that financing will be available in amounts or on terms acceptable to the Company, if at all. If the Company cannot raise funds on acceptable terms, or achieve positive cash flow, it may not be able to continue to exist, conduct operations, grow market share, take advantage of future opportunities or respond to competitive pressures or unanticipated requirements, any of which would negatively impact its business, operating results and financial condition.

Lack of Profitability; Uncertainty of Future Profitability

The Company was organized in 1998 and began operations as a public company in 1999 offering electronic billing services to other companies. The Company has not been profitable since inception and may never achieve profitability. As of December 31, 2002, the Company's accumulated deficit was $47.1 million. Because we have a relatively limited history in a rapidly evolving and dynamic market, it is difficult to predict our future operating results. Therefore, all historical information included herein may not necessarily be indicative of the results of operations, financial position and cash flows of the Company in the future.

Uncertain Reliability, Growth and Consumer Acceptance of the Internet, Internet Technology, and Electronic Commerce

The electronic commerce market is a relatively new and growing service industry. If the electronic commerce market fails to grow or grows slower than anticipated, or if the Company, despite an investment of significant resources, is unable to adapt to meet changing customer requirements or technological changes in this emerging market, or if the Company's services and related products do not maintain a proportionate degree of acceptance in this growing market, the Company's business, operating results, and financial condition could be materially adversely affected. Additionally, the security and privacy concerns of existing and potential customers may inhibit the growth of the electronic commerce market in general, and the Company's customer base and revenues in particular. Similar to the emergence of the credit card and automatic teller machine ("ATM") industries, the Company and other organizations serving the electronic commerce market must educate users that electronic transactions use encryption technology and other electronic security measures that make electronic transactions more secure than paper-based transactions. While the Company believes that it is utilizing proven applications designed for premium data security and integrity to process electronic transactions, there can be no assurance that the Company's use of such applications will be sufficient to address the changing market conditions or the security and privacy concerns of existing and potential customers. Adverse publicity raising concerns about the safety or privacy of electronic transactions, or widely reported breaches of the Company's or another provider's security, have the potential to undermine consumer confidence in the technology and thereby have a materially adverse effect on the Company's business. In addition, there can be no guarantee that the Internet will continue to grow in acceptance or maintain its reliability, or that new technologies will not supplant the Internet in part or in whole.

Uncertain Growth of Proportion of Electronic Remittances

The Company's future financial performance will be materially affected by the percentage of bill payments that can be cleared electronically. As compared with making payment by paper check or by draft, the Company believes that electronic payments: (i) cost much less to complete; (ii) give rise to fewer errors, which are costly to resolve; and (iii) generate far fewer customer inquiries and therefore consume fewer customer care resources. Accordingly, the Company's inability to continue to decrease the percentage of remittances effected by paper documents would result in flat or decreased margins, and a reversal of the current trend toward a smaller proportion of paper-based payments would have a material adverse effect upon the Company's business, operating results, and financial condition.

Risk of Inability to Adapt to Rapid Technological Change; Risk of Delays

The Company's success is highly dependent on its ability to develop new and enhanced services, and related products that meet changing customer requirements. The market for the Company's services, however, is characterized by rapidly changing technology, evolving industry standards, emerging competition and frequent new and enhanced software, service and related product introductions. In addition, the software market is subject to rapid and substantial technological change. The Company, to remain successful, must be responsive to new developments in hardware and semiconductor technology, operating systems, programming technology and computer capabilities. In many instances, the new and enhanced services, products, and technologies are in the emerging stages of development and marketing, and are subject to the risks inherent in the development and marketing of new software, services, and products. The Company may not successfully identify new service opportunities, and develop and bring new and enhanced services and related products to market in a timely manner; there can be no assurance that any such services, products or technologies will develop or will be commercially successful, that the Company will benefit from such developments or that services, products or technologies developed by others will not render the Company's services and related products noncompetitive or obsolete. If the Company is unable, for technological or other reasons, to develop and introduce new services and products in a timely manner in response to changing market conditions or customer requirements, or if new or enhanced software, services and related products do not achieve a significant degree of market acceptance, the Company's business, operating results and financial condition would be materially adversely affected.

Changes in Regulation of Electronic Commerce and Related Financial Services

Management believes that the Company is not required to be licensed by the Office of the Comptroller of the Currency, the Federal Reserve Board, or other federal or state agencies that regulate or monitor banks or other types of providers of electronic commerce services. There can be no assurance that a federal or state agency will not attempt to regulate providers of electronic commerce services, such as the Company, which could impede the Company's ability to do business in the regulator's jurisdiction. The Company is subject to various laws and regulations relating to commercial transactions generally, such as the Uniform Commercial Code, and may be subject to the electronic funds transfer rules embodied in Regulation E, promulgated by the Federal Reserve Board. Given the expansion of the electronic commerce market, the Federal Reserve Board might revise Regulation E or adopt new rules for electronic funds transfer affecting users other than consumers. Because of growth in the electronic commerce market, Congress has held hearings on whether to regulate providers of services and transactions in the electronic commerce market, and it is possible that Congress or individual states could enact laws regulating the electronic commerce market. If enacted, such laws, rules and regulations could be imposed on the Company's business and industry and could have a material adverse effect on the Company's business, operating results and financial condition.

Uncertainty of ACH Access

Billserv has a contractual relationship with Bank One, which is an Originating Depository Financial Institution ("ODFI") in the Automated Clearinghouse (ACH) Network. The ACH Network is a nationwide batch-oriented electronic funds transfer system that provides for the interbank clearing of electronic payments for participating financial institutions. An ODFI is a participating financial institution that must abide by the provisions of the ACH Operating Rules and Guidelines. Through its relationship with Bank One, Billserv is able to process payment transactions on behalf of its customers and their consumers by submitting payment instructions to Bank One in a prescribed ACH format. Billserv pays volume-based fees to Bank One for debit and credit transactions processed through Bank One each month, and pays fees for other transactions such as returns, notices of change to bank accounts, test debits, file transmission and depository fees. These fees are part of Billserv's cost structure. If the Federal Reserve rules were to change to further restrict or modify access to the ACH, the Company's business could be materially adversely affected.

Competition in Electronic Commerce and Related Financial Services

Portions of the electronic commerce market are becoming increasingly competitive. The Company expects to face growing competition in certain areas of the EBPP market. Although few companies have focused their efforts as service bureau consolidators in the EBPP industry, new service bureau companies could emerge and compete for billers of all sizes. The Company believes that software providers, consumer front ends, banks and Internet portals may provide increasingly competitive billing services for billers of all sizes. In addition, a number of banks have developed, and others in the future may develop, home banking services in-house. The Company believes that banks may also compete for the EBPP business of billers. The Company expects competition to increase from both established and emerging companies and that such increased competition could materially adversely affect the Company's business, operating results and financial condition. Moreover, the Company's current and potential competitors, many of whom have greater financial, technical, marketing and other resources than the Company, may respond more quickly than the Company to new or emerging technologies or could expand to compete directly against the Company in any or all of its target markets. Accordingly, it is possible that current or potential competitors could rapidly acquire market share. There can be no assurance that the Company will be able to compete against current or future competitors successfully or that competitive pressures faced by the Company will not have a material adverse effect on its business, operating results and financial condition.

Dependence on Key Personnel

The Company's success depends to a significant degree upon the continued contributions of its key management, marketing, service and related product development and operational personnel, including its Chairman and Chief Executive Officer, Michael R. Long; its President and Chief Operating Officer, Louis A. Hoch; its Executive Vice President and Chief Financial Officer, Terri A. Hunter; and its Senior Vice President of Sales and Marketing, Tony L. Diamond. The Company's operations could be affected adversely if, for any reason, any of these officers ceased to be active in the Company's management. The Company maintains proprietary nondisclosure and non-compete agreements with all of its key employees. The success of the Company depends to a large extent upon its ability to retain and continue to attract highly skilled personnel. Competition for employees in the electronic commerce industry is intense, and there can be no assurance that the Company will be able to attract and retain enough qualified employees. If the Company experiences significant growth, it may become increasingly difficult to hire, train and assimilate the new employees needed. The Company's potential inability to retain and attract key employees could have a material adverse effect on the Company's business, operating results and financial condition.

Potential Fluctuations in Quarterly Results

The Company's quarterly results of operations may fluctuate significantly as a result of a number of factors, including changes in the Company's pricing policies or those of its competitors, relative rates of acquisition of new customers, delays in the introduction of new or enhanced services, software and related products by the Company or by its competitors or market acceptance of such services and products, other changes in operating expenses, personnel changes and general economic conditions. These factors will impact the Company's operating results. Fluctuations in operating results could result in volatility in the price of the Company's common stock.

Risk of Product Defects

The software products utilized by the Company could contain errors or "bugs" that could adversely affect the performance of services or damage a user's data. In addition, as the Company increases its share of the electronic commerce services market, software reliability and security demands will increase. The Company attempts to limit its potential liability for warranty claims through technical audits and limitation-of-liability provisions in its customer agreements. There can be no assurance that the measures taken by the Company will prove effective in limiting the Company's exposure to warranty claims. Despite the existence of various security precautions, the Company's computer infrastructure may also be vulnerable to viruses or similar disruptive problems caused by its customers or third parties gaining access to the Company's processing system.

Erosion of Revenue from Services

One of the Company's customers that accounted for approximately 16%, 23% and 40% of total consolidated revenues for the years ended December 31, 2002, 2001 and 2000, respectively, began developing an in-house EBPP offering during 2002. To the extent that this expected loss of revenue is not mitigated by fees generated from consulting services provided to this customer related to the transition of their EBPP capabilities to an in-house offering, the Company's revenues and profits will be adversely affected. The profitability of the Company's business depends, to a substantial degree, upon billers electing to continue to periodically renew contracts and receive services under existing contracts. In the event that a substantial number of these customers were to decline to renew these contracts or choose to discontinue receiving services for any reason, the Company's revenues and profits would be adversely affected. Sales of the Company's services are dependent upon customer demand for the services, which is affected by pricing decisions, the competition of similar products and services, and reputation of the products and services for performance. Most of the Company's services are likely to be sold within the utilities and financial services industries, and poor performance by the Company in performing its services would have the potential to undermine the Company's reputation and affect future sales of other services. A substantial decrease in revenue from services would have a material adverse effect upon the Company's business, operating results and financial condition.

Risk of Loss from Returned Transactions, Merchant Fraud or Erroneous Transmissions

The Company relies upon the Federal Reserve's ACH for electronic fund transfers and conventional paper check and draft clearing systems for settlement of payments by check or drafts. In its use of these established payment clearance systems, the Company generally bears the same credit risks normally assumed by other users of these systems arising from returned transactions caused by insufficient funds, stop payment orders, closed accounts, frozen accounts, unauthorized use, disputes, theft or fraud. In addition, the Company also assumes the risk of merchant fraud and transmission errors when it is unable to have erroneously transmitted funds returned by an unintended recipient. Merchant fraud includes such actions as inputting false sales transactions or false credits.

Risk of System Failure

The Company's operations are dependent on its ability to protect its computer equipment against damage from fire, earthquake, power loss, telecommunications failure or similar event. Any damage or failure that causes interruptions in the Company's operations could have a material adverse effect on the Company's business, operating results and financial condition. The Company's property and business interruption insurance may not be adequate to compensate the Company for all losses that may occur.

Limited Protection of Proprietary Services

The Company regards some of its services as proprietary and relies primarily on a combination of trademark and trade secret laws, employee and third party non-disclosure agreements, and other intellectual property protection methods to protect its services. Existing intellectual property laws afford only limited protection, and it may be possible for unauthorized third parties to copy the Company's services and related products or to reverse engineer or obtain and use information that the Company regards as proprietary. There can be no assurance that the Company's competitors will not independently develop services and related products that are substantially equivalent or superior to those of the Company.

Volatility of Stock Price

The market price of the Company's common stock is subject to significant fluctuations in response to variations in quarterly operating results, the failure of the Company to achieve operating results consistent with securities analysts' projections of the Company's performance, and other factors. The stock market has experienced extreme price and volume fluctuations and volatility that has particularly affected the market prices of many technology, emerging growth and developmental stage companies. Such fluctuations and volatility have often been unrelated or disproportionate to the operating performance of such companies. Factors such as announcements of the introduction of new or enhanced services or related products by the Company or its competitors, announcements of joint development efforts or corporate partnerships in the electronic commerce market, market conditions in the technology, banking, telecommunications and other emerging growth sectors, and rumors relating to the Company or its competitors may have a significant impact on the market price of the Company's common stock.

Control by Principal Stockholders

As of December 31, 2002, the directors and officers of the Company and their affiliates collectively own approximately 10% of the outstanding shares of the Company's common stock. As a result, these stockholders are able to exercise significant influence over matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions. Such concentration of ownership may have the effect of delaying or preventing a change in control of the Company.

Shares Eligible for Future Sale; Possible Adverse Effect on Market Price

As of December 31, 2002, the Company had 20,603,799 shares of common stock outstanding. The Company anticipates that it may need future equity financing to meet certain operational and strategic requirements. Such future equity financing may have a significant dilutive effect on the Company's stock price.

Anti-Takeover Provisions; Certain Provisions of Nevada Law; Certificate of Incorporation, Bylaws, and Stockholder Rights Plan

On October 4, 2000, the Company approved a stockholder rights plan to protect stockholders in the event of an unsolicited attempt to acquire the Company in a manner that would not be in the best interests of its stockholders. This stockholder rights plan could have the effect of making it more difficult for a third party to acquire, or of discouraging a third party from attempting to acquire, control of the Company. The Company's Board of Directors is also classified into three classes of directors serving staggered three-year terms. Such classification of the Board of Directors expands the time required to change the composition of a majority of directors and may tend to discourage a proxy contest or other takeover bid for the Company. The issuance of common stock under a stockholder rights plan could decrease the amount of earnings and assets available for distribution to the holders of the Company's common stock or could adversely affect the rights and powers, including voting rights, of the holders of the Company's common stock. In certain circumstances, such issuance could have the effect of decreasing the market price of the Company's common stock.

Difficulty in Management of Growth

The Company may experience a period of rapid growth that could place a significant strain on its resources. The Company's ability to manage growth successfully will require the Company to continue to improve its operational, management and financial systems and controls as well as to expand its work force. A significant increase in the Company's customer base would necessitate the hiring of a significant number of additional customer care and technical support personnel as well as computer software developers and technicians, qualified candidates for which, at the time needed, may be in short supply. In addition, the expansion and adaptation of the Company's computer and administrative infrastructure will require substantial operational, management and financial resources. Although the Company believes that its current infrastructure is adequate to meet the needs of its customers in the foreseeable future, there can be no assurance that the Company will be able to expand and adapt its infrastructure to meet additional demand on a timely basis, at a commercially reasonable cost, or at all. If the Company's management is unable to manage growth effectively, hire needed personnel, expand and adapt its computer infrastructure or improve its operational, management, and financial systems and controls, the Company's business, operating results, and financial condition could be materially adversely affected.

Acquisition-Related Risks

In the future, the Company may pursue acquisitions of complementary service or product lines, technologies or businesses. Future acquisitions by the Company could result in potentially dilutive issuance of equity securities, the incurrence of debt and contingent liabilities, and amortization expenses related to goodwill and other intangible assets, any of which could materially adversely affect the Company's business, operating results and financial condition. In addition, acquisitions involve numerous risks, including difficulties in the assimilation of the operations, technologies, services and products of the acquired companies, the diversion of management's attention from other business concerns, risks of entering markets in which the Company has no or limited direct prior experience, and the potential loss of key employees of the acquired company. From time to time, the Company evaluates potential acquisitions of businesses, services, products or technologies. The Company has no present commitments or agreements with respect to any material acquisition of other businesses, services, products or technologies. In the event that such an acquisition were to occur, however, there can be no assurance that the Company's business, operating results and financial condition would not be materially adversely affected.

Unlikely Payment of Dividends

The Company has paid no cash dividends and has no present plan to pay cash dividends, intending instead to reinvest its earnings, if any. However, payment of future cash dividends will be determined from time to time by its Board of Directors, based upon its future earnings, financial condition, capital requirements and other factors. The Company is not presently subject to any restriction on its present or future ability to pay such dividends.

Dependence Upon Contracts with Billers

The Company's business is dependent upon performing under the terms of agreements with billers. Although the Company is unaware of any circumstance that would prevent the operational ability to perform these agreements, there can be no assurance that the Company might not be able to fully perform under these agreements or that other factors may prevent billers from processing billing information through the Company.

Dependence Upon Contracts with Trading Partners

The Company's business is dependent upon executing and maintaining agreements with distribution and payment partners, such as CheckFree Services Corporation and Paymentech, Inc., to provide dependable financial services for consumers of billers. Such financial services include ACH processing through the client's bank and delivery of good funds to the Company for remittance to the billers. There can be no assurance that any of the distribution or payment partners will be able to perform under these agreements in the future.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's exposure to market risk for changes in interest rates relates primarily to the Company's current investment portfolio. Certain of the Company's marketable securities are designated as "available for sale" and accordingly are presented at fair value on the balance sheets. The Company generally invests its excess cash in high-quality short-term fixed income securities. Fixed-rate securities may have their fair market value adversely impacted by a rise in interest rates, and the Company may suffer losses in principal if forced to sell securities that have declined in market value due to changes in interest rates.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Report of Independent Auditors 28

Consolidated Balance Sheets as of December 31, 2002 and 2001 29

Consolidated Statements of Operations for the years ended December 31, 2002, 2001 and 2000 30

Consolidated Statement of Changes in Shareholders' Equity (Deficit) for the years ended December 31, 2002, 2001 and 2000 31

Consolidated Statements of Cash Flows for the years ended December 31, 2002, 2001 and 2000 32

Notes to Consolidated Financial Statements 33

27

REPORT OF INDEPENDENT AUDITORS

To Board of Directors and Shareholders of Billserv, Inc.

We have audited the accompanying consolidated balance sheets of Billserv, Inc. and subsidiaries as of December 31, 2002 and 2001, and the related consolidated statements of operations, changes in shareholders' equity, and cash flows for the three years in the period ended December 31, 2002. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Billserv, Inc. and subsidiaries at December 31, 2002 and 2001, and the consolidated results of their operations and their cash flows for the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States.

The accompanying financial statements of Billserv, Inc. have been prepared assuming that Billserv, Inc. will continue as a going concern. As more fully described in Note 18, the Company has incurred substantial losses since inception and has experienced a material shortfall in anticipated revenues, which has led to a significant decrease in its cash position and a deficit in working capital. These conditions raise substantial doubt about the Company's ability to continue as a going concern. The financial statements of Billserv, Inc. do no include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of this uncertainty.

ERNST & YOUNG LLP

San Antonio, Texas
April 1, 2003

28

BILLSERV, INC.
CONSOLIDATED BALANCE SHEETS

	December 31, 2002	December 31, 2001
Assets:		

Cash and cash equivalents	$ 286,105	$ 4,173,599
Cash pledged as collateral for related party obligations	1,311,984	2,018,951
Investments restricted as collateral for capital leases	--	236,948
Accounts receivable, net	659,074	437,677
Prepaid expenses and other	257,810	225,795
Related party notes receivable	--	162,154
Total current assets	2,514,973	7,255,124
Property and equipment, net of accumulated depreciation and amortization of $3,747,539 and $2,718,953 for 2002 and 2001, respectively	2,171,790	3,701,205
Intangible asset, net of accumulated amortization of $52,500 and $37,500 for 2002 and 2001, respectively	22,500	37,500
Other assets	--	421,307
Total assets	$ 4,709,263	$ 11,415,136
Liabilities and shareholders' equity (deficit):		
Current liabilities:		
Accounts payable	$ 797,211	$ 201,513
Accrued expenses and other current liabilities	707,741	664,200
Payable under related party guarantees	1,278,138	--
Current portion of obligations under capital leases	31,315	148,228
Current portion of deferred revenue	309,492	490,829
Short-term borrowings	1,800,000	--
Total current liabilities	4,923,897	1,504,770
Obligations under capital leases, less current portion	39,168	--
Deferred revenue, less current portion	91,468	161,800
Shareholders' equity (deficit):		
Common stock, $.001 par value, 200,000,000 shares authorized; 20,603,799 issued and outstanding at December 31, 2002, 20,538,526 issued and outstanding at December 31, 2001	20,604	20,539
Additional paid-in capital	46,770,186	45,909,410
Accumulated deficit	(47,136,060)	(36,181,383)
Total shareholders' equity (deficit)	(345,270)	9,748,566
Total liabilities and shareholders' equity (deficit)	$ 4,709,263	$ 11,415,136

See notes to consolidated financial statements

BILLSERV, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

	Year ended December 31, 2002	Year ended December 31, 2001	Year ended December 31, 2000

Service revenues	$ 3,968,554	$ 2,968,678	$ 650,023
Software license revenues	238,000	--	--
Total revenues	4,206,554	2,968,678	650,023
Cost of service revenues	4,462,344	4,995,161	3,690,843
Cost of software license revenues	228,000	--	--
Total cost of revenues	4,690,344	4,995,161	3,690,843
Gross margin	(483,790)	(2,026,483)	(3,040,820)
Operating expenses:			
General and administrative	3,948,684	4,338,374	3,677,834
Selling and marketing	873,775	2,084,941	4,586,823
Research and development	461,065	760,082	767,751
Depreciation and amortization	1,658,886	1,555,626	940,995
Provision for impairment of assets	855,117	--	--
Non-cash expense related to the issuance of warrants	--	--	7,488,000
Total operating expenses	7,797,527	8,739,023	17,461,403
Operating loss	(8,281,317)	(10,765,506)	(20,502,223)
Other income (expense), net:			
Interest income	81,799	355,262	687,724
Interest expense	(1,114,798)	(40,079)	(140,651)
Equity in earnings (loss) of unconsolidated subsidiary	(7,729)	7 ,676	--
Loss on related party guarantees	(1,278,138)	--	--
Other income (expense)	(354,494)	36,941	(900)
Total other income (expense), net	(2,673,360)	359,800	546,173
Loss before income taxes and cumulative effect of accounting change	(10,954,677)	(10,405,706)	(19,956,050)
Income taxes	--	--	--
Net loss before cumulative effect of accounting change	(10,954,677)	(10,405,706)	(19,956,050)
Cumulative effect of a change in accounting principle, net of taxes	--	--	(52,273)
Net loss	$(10,954,677)	$(10,405,706)	$(20,008,323)
Net loss per common share before cumulative effect of accounting change- basic and diluted	$ (0.53)	$ (0.58)	$ (1.35)
Cumulative effect of accounting change- basic and diluted	--	--	--
Net loss per common share - basic and diluted	$ (0.53)	$ (0.58)	$ (1.35)
Weighted average common shares outstanding - basic and diluted	20,591,304	18,017,051	14,793,622

See notes to consolidated financial statements.

BILLSERV, INC.
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY (DEFICIT)

	Common Stock Shares	Common Stock Amount	Additional Paid - In Capital	Accumulated Deficit	C
Balance at December 31, 1999	13,113,065	$13,113	$13,695,584	$ (5,767,354)	
Exercise of warrants	1,514,136	1,514	6,094,984	--	
Exercise of stock options	3,700	4	13,527	--	
Issuance of common stock, net of issuance costs	896,969	897	9,466,355	--	
Value of common stock warrants granted in connection with issuance of common stock	--	--	7,488,000	--	
Comprehensive loss:					
Unrealized gain on investments	--	--	--	--	
Net loss for the year ended December 31, 2000	--	--	--	(20,008,323)	
Comprehensive loss					
Balance at December 31, 2000	15,527,870	15,528	36,758,450	(25,775,677)	
Exercise of stock options	8,000	8	34,992	--	
Issuance of common stock, net of issuance costs	5,002,656	5,003	9,115,968	--	
Comprehensive loss:					
Unrealized gain on investments	--	--	--	--	
Net loss for the year ended December 31, 2001	--	--	--	(10,405,706)	
Comprehensive loss					
Balance at December 31, 2001	20,538,526	20,539	45,909,410	(36,181,383)	
Issuance of common stock	65,273	65	63,170	--	
Value of beneficial conversion feature granted in connection with issuance of debt	--	--	538,461	--	
Value of common stock warrants granted in connection with issuance of debt	--	--	259,145	--	
Comprehensive loss:					
Net loss for the year ended December 31, 2002	--	--	--	(10,954,677)	
Balance at December 31, 2002	20,603,799	$20,604	$46,770,186	$(47,136,060)	

See notes to consolidated financial statements.

BILLSERV, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	2002	2001
Cash flows from operating activities:		
Net loss	$(10,954,677)	$(10,405,706)
Adjustments to reconcile net loss to net cash used in operating activities:		
Issuance of common stock warrants and convertible debt	797,606	--
Amortization of financing costs	237,649	--
Depreciation and amortization	1,658,886	1,555,626
Loss on related party guarantees	1,278,138	--
Loss on impairment of assets	855,117	--
Non-cash exchange of assets	(600,000)	--
Loss on renegotiation of facilities leases	478,653	--
(Gain) loss on disposition	20,999	(36,070)
Equity in (earnings) loss of unconsolidated subsidiary	7,729	(7,676)
Cumulative effect of change in accounting principle	--	--
Changes in current assets and current liabilities:		
(Increase) decrease in accounts receivable	(221,397)	344,860
(Increase) decrease in related party notes receivable	162,154	121,584
Decrease in prepaid expenses and other	7,702	377,551
Increase (decrease) in accounts payable and accrued expenses	893,818	(757,863)
Increase (decrease) in deferred revenue	(251,669)	(173,371)
Net cash used in operating activities	(5,629,292)	(8,981,065)
Cash flows from investing activities:		
Purchases of property and equipment	(401,904)	(722,748)
Purchase of investments	--	--
Proceeds from sales and maturities of investments	--	2,028,680
Long-term deposits, net	255,503	218,641
Other investing activities	3,874	2,577
Net cash provided by (used in) investing activities	(142,527)	1,527,150
Cash flows from financing activities:		
Proceeds from notes payable	2,145,000	--
Principal payments for notes payable	(645,000)	(1,500,000)
Financing costs, net	(237,649)	--
Principal payments for capital lease obligations	(148,228)	(181,328)
Exercise of warrants	--	--
Cash pledged as collateral for related party obligations	706,967	(1,018,951)
Issuance of common stock, net of issuance costs	63,235	9,155,971
Net cash provided by financing activities	1,884,325	6,455,692

Net decrease in cash and cash equivalents	(3,887,494)	(998,223)
Cash and cash equivalents, beginning of period	4,173,599	5,171,822
Cash and cash equivalents, end of period	$ 286,105	$ 4,173,599
Supplemental information:		
Cash paid for interest	$ 39,264	$ 52,027
Non-cash investing and financing activities:		
Purchases of equipment under capital leases	$ 70,483	$ --

See notes to consolidated financial statements.

32

BILLSERV, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2002, 2001 AND 2000

NOTE 1. Description of Business and Summary of Significant Accounting Policies

Description of Business

Billserv, Inc., formerly known as billserv.com, Inc., and its subsidiaries (collectively, "Billserv" or "the Company"), provide electronic bill presentment and payment ("EBPP") services to companies generating recurring bills, primarily in the United States. The Company also provides related consulting and Internet-based customer care interaction services. In addition, the Company operates an Internet bill presentment and payment portal for consumers under the domain name www.bills.com.

Basis of Presentation

The Company remained a development stage company through December 31, 2001, as recurring revenue related to EBPP activity had not reached a significant level. Based on revenue growth, the Company was no longer considered to be a development stage enterprise in 2002.

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year presentation. These reclassifications had no impact on operating loss as previously reported.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, bills.com, Inc. and billserv.com-canada, Inc. All significant intercompany accounts and transactions have been eliminated.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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 results could differ from those estimates.

Cash and Cash Equivalents

The Company considers all highly liquid investments purchased with maturities of three months or less to be cash equivalents.

Concentration of Credit Risk

Financial instruments that potentially expose the Company to credit risk consist of cash and cash equivalents, investments and accounts receivable. The Company is exposed to credit risk on its cash, cash equivalents and investments in the event of default by the financial institutions or the issuers of these investments to the extent of the amounts recorded on the balance sheet in excess of amounts that are insured by the FDIC. Trade receivables potentially subject the Company to concentrations of credit risk. The Company's customer base operates in a variety of industries and is geographically dispersed, however, the relatively small number of customers increases the risk. The Company closely monitors extensions of credit and has not experienced significant credit losses in the past. Credit losses have been provided for in the consolidated financial statements and have been within management's expectations. The Company recorded bad debt expense of $30,000, $21,000 and $10,000 for 2002, 2001 and 2000, respectively, and recorded bad debt write-offs of $1,734 and $12,069 to its allowance for doubtful accounts in 2002 and 2001, respectively. There were no write-offs recorded to the allowance for doubtful accounts in 2000. At December 31, 2002 and 2001, the balance of the allowance for doubtful accounts was $47,197 and $18,931, respectively.

One billing customer accounted for approximately 16%, 23% and 40% of total consolidated revenues for the years ended December 31, 2002, 2001 and 2000, respectively. This customer developed an in-house EBPP offering during 2002 utilizing Billserv's transition plan that allows the customer to move from an outsourced offering with Billserv to an in-house offering. The resulting loss of transaction revenues was mitigated by fees generated from consulting services provided to this customer related to transitioning their EBPP capabilities to an in-house offering. In addition, the Company recognized $173,000 of non-recurring revenue in 2000 attributable to a single customer for which we are no longer providing services.

33

Fair Value of Financial Instruments

Cash and cash equivalents, accounts receivable, accounts payable, accrued liabilities and short-term borrowings are reflected in the accompanying consolidated financial statements at cost, which approximates fair value because of the short-term maturity of these instruments.

Investments

The Company's investments consist primarily of commercial paper, repurchase agreements and investment-grade corporate bonds. The Company classifies these investments as "available-for-sale," "trading" or "held-to-maturity" securities in accordance with Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities." The Company has not had any investments classified as "trading" or "held-to-maturity" securities. Investments classified as "available-for-sale" securities are carried at fair value, with unrealized holding gains and losses reported as a separate component of shareholders' equity (See Note 2). Realized gains and losses on sales of available-for-sale securities are determined based on the amortized cost of such securities using the specific identification method.

Property and Equipment

Property and equipment are stated at cost. Depreciation and amortization are computed on a straight-line method over the estimated useful lives of the related assets, ranging from three to seven years. Leasehold improvements are amortized over the lesser of the estimated useful lives or remaining lease period. Expenditures for maintenance and repairs are charged to expense as incurred.

Impairment of Long-Lived Assets

The Company periodically reviews the carrying value of its long-lived assets, including property, plant and equipment, whenever events or changes in circumstances indicate that the carrying value may not be recoverable. To the extent fair value of a long-lived asset, determined based upon the estimated future cash inflows attributable to the asset, less estimated future cash outflows, are less than the carrying amount, an impairment loss is recognized.

Intangible Asset

The cost of the intangible asset is being amortized on a straight-line basis over a five-year period.

Revenue Recognition

Revenue consists of implementation fees, hosting and transaction fees, fees for consulting services and license revenue from the resale of third party software. The Company typically receives an up-front fee for the work involved in implementing the basic functionality required to provide electronic bill presentment and payment services to a customer. Revenue from such implementation fees is recognized over the term of the related service contract, generally three to five years. Hosting and transaction fees are generated through the electronic presentment of bills, processing of bill payments, and handling of customer care interactions for billing customers and are recognized as revenue as the related services are provided. Consulting fees are earned for professional services provided to EBPP billers or vendors and are recognized as services are rendered. Revenue from the resale of software licenses is recognized when persuasive evidence of an agreement exists, delivery of the product has occurred, the fee is fixed or determinable, and collection is probable.

Research and Development Costs

Research and development costs are expensed as incurred.

Advertising Costs

The cost of advertising is expensed as incurred. The Company incurred $6,000, $19,000 and $1,394,000 in advertising costs for the years ended December 31, 2002, 2001 and 2000, respectively.

Foreign Operations

Foreign operations began in 2000, however the impact financially of expanding internationally is not material to the Company's financial position or results of operations as of December 31, 2002. Australia and Canada are the only foreign countries in which the Company is currently operating. The Company's Australia operations include a 50% interest in a corporate joint venture to provide EBPP services. The Company accounts for this investment under the equity method. At December 31, 2002, the investment in this joint venture was zero. The Company has no material additional contractual commitments to this joint venture

and no dividends have been received from this joint venture. Gains and losses resulting from foreign currency transactions denominated in a currency other than the functional currency are included in income and have not been significant to the Company's consolidated operating results in any year.

Income Taxes

Income taxes are determined using the liability method (see Note 12). Under this method, deferred tax assets and liabilities are recorded based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

Comprehensive Loss

The Company's comprehensive loss is comprised of net loss and unrealized gains and losses on investments classified as available-for-sale.

Stock-Based Compensation

The Company applies the intrinsic value method in accounting for its stock option and stock purchase plans. Accordingly, no compensation expense has been recognized for options granted with an exercise price equal to market value at the date of grant or in connection with the employee stock purchase plan. Had compensation expense been recorded based on the fair value at the grant date for 2002, 2001 and 2000 stock option grants, net loss and net loss per share would approximate the pro forma amounts below:

	2002	2001	2000
Pro forma net loss	$(12,539,041)	$(13,188,701)	$(23,778,759)
Pro forma net loss per common share - basic and diluted	$ (0.61)	$ (0.73)	$ (1.61)

The effects of applying SFAS 123 in this pro forma disclosure are not indicative of future amounts. Additional awards in future years are anticipated.

Net Loss Per Share

Basic and diluted losses per common share are calculated by dividing net loss by the weighted average number of common shares outstanding during the period. Common stock equivalents, which consist of stock options and warrants and the convertible debt, were excluded from the computation of the weighted average number of common shares outstanding for purposes of calculating diluted loss per common share because their effect was antidilutive. See Notes 10, 13 and 14 for disclosure of securities that could potentially dilute basic EPS in the future that were not included in the computation of diluted EPS because to do so would have been antidilutive for the periods presented.

Recent Accounting Pronouncements

In July 2001, the Financial Accounting Standards Board ("FASB") issued Statement No. 142, "Goodwill and Other Intangible Assets" ("FAS 142"), which addresses the recognition and measurement of other intangible assets acquired outside of a business combination whether acquired individually or with a group of assets. In accordance with FAS 142, goodwill and certain intangible assets are no longer amortized, but are subject to at least an annual assessment of impairment. The Company adopted this statement on January 1, 2002. The provisions of FAS 142 did not have an impact on the Company's consolidated financial statements.

In August 2001, the FASB issued Statement No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("FAS 144"). FAS 144 clarifies the accounting for the impairment of long-lived assets and for long-lived assets to be disposed of, including the disposal of business segments and major lines of business. FAS 144 became effective for the Company in the first quarter of 2002. During the fourth quarter of 2002, the Company performed an impairment review because the uncertainty of the Company's ability to continue as a going concern due to decreased liquidity indicated that the carrying value of certain long-lived assets may not be recoverable. The Company determined that customer relationship management software and document archival and retrieval software with a total carrying amount of $855,000 were no longer recoverable and recorded a non-cash charge of $855,000, which is included as a component of operating income in the accompanying consolidated statement of operations. Fair value was based on the expected future cash flows to be generated by these assets, which was zero because of the Company's inability to deploy and utilize the assets to provide revenue-generating services, due to the Company's limited resources and lack of liquidity.

In November 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"). FIN 45 requires that a liability be recorded in the guarantor's balance sheet upon issuance of a guarantee. In addition, FIN 45 requires disclosures about the guarantees that an entity has issued. The initial recognition and initial measurement provisions of FIN 45 are applicable on a prospective basis to guarantees issued or modified after December 31, 2002, irrespective of the guarantor's fiscal year-end. The initial recognition and initial measurement provisions of FIN 45 are not expected to have a material impact on the Company's consolidated financial statements. The disclosure requirements of FIN 45 are effective for financial statements of interim or annual periods ending after December 15, 2002; therefore, the Company has included the disclosures herein as required.

In December 2002, the FASB issued Statement No. 148, "Accounting for Stock-Based Compensation, Transition and Disclosure" ("FAS 148"). FAS 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. FAS 148 also requires that disclosures of the pro forma effect of using the fair value method of accounting for stock-based employee compensation be displayed more prominently and in a tabular format. Additionally, FAS 148 requires disclosure of the pro forma effect in interim financial statements. The transition and annual disclosure requirements of FAS 148 are effective for fiscal years ended after December 15, 2002. The interim disclosure requirements of FAS 148 are effective for interim periods beginning after December 15, 2002. The adoption of the provisions of FAS 148 did not have an impact on the Company's consolidated financial statements, however, the Company has modified its disclosures as provided for in the new standard.

NOTE 2. Financial Instruments

There were no available-for-sale investments held at December 31, 2002. The following is a summary of available-for-sale investments at December 31, 2001:

	December 31, 2001		
	Amortized Cost	Gross unrealized gains	Fair value
Time deposits	$ 236,948	$ 0	$ 236,948

The securities included in the table above with fair values totaling $236,948 at December 31, 2001 are classified as short-term investments restricted as collateral for capital leases in the accompanying consolidated balance sheets (see Note 8). All short-term investments mature within one year.

NOTE 3. Cumulative Effect of Accounting Change

In December 1999, the SEC issued Staff Accounting Bulletin No. 101 ("SAB 101"), "Revenue Recognition in Financial Statements," which provides guidance on the recognition, presentation and disclosure of revenue in financial statements. The implementation of SAB 101 requires the Company's revenue generated from up-front implementation fees that do not represent a separate earnings process to be recognized over the term of the related service contract. Prior to December 31, 1999, the Company recognized revenue generated from such up-front fees upon completion of an implementation project. The Company adopted SAB 101 as of January 1, 2000, and accordingly, changed its revenue recognition policy for up-front implementation fees. The cumulative effect of this accounting change totaled $52,273. This amount was recognized as a non-cash after-tax charge during the first quarter of 2000. The cumulative effect was recorded as deferred revenue and is being recognized as revenue over the remaining contractual service periods.

NOTE 4. Issuance of Capital Stock

Private Placements

In October 1999 and December 1999, the Company issued 1,404,637 and 732,000 shares of common stock, respectively, under a private placement offering (the "1999 Offering"). The shares were issued at $3.25 and $5.50 per share, respectively, which represented a discount upon the average reported closing sale price of the common stock for the ten business days immediately preceding the closing date. Net proceeds totaled approximately $7,907,000, net of offering costs of $684,000, which included $526,000, or 6.5% of the 1999 Offering, paid to the placement agent. Of the shares issued in October 1999, 153,846 were issued in satisfaction of a $500,000 short-term note payable (See Note 10).

In accordance with the terms of the 1999 Offering, a registration statement on Form SB-2 was filed with the SEC registering 3,782,360 shares of common stock. This registration statement became effective on January 18, 2000. The registered shares include the 2,136,637 shares issued in October and December 1999 and 1,645,723 shares which were issuable upon exercise of warrants to purchase common stock issued to the holders of the shares issued in October and December 1999.

On June 2, 2000, the Company entered into an extended biller service provider agreement with CheckFree Investment Corporation, CheckFree Services Corporation and CheckFree Holdings Corporation ("CheckFree"). As part of this agreement, CheckFree purchased 879,121 shares of the Company's common stock at $11.375 per share totaling $10.0 million. Offering proceeds to the Company, net of issuance costs, were approximately $9.5 million. In connection with this transaction, the Company also issued warrants to purchase 2,179,121 shares of common stock, and warrants to purchase up to an additional 2,801,903 shares if certain criteria are met (See Note 14).

In March 2001, the Company issued 2,885,462 shares of common stock under a private placement offering. The shares were issued at an undiscounted price of $2.50 per share. Net proceeds totaled approximately $6.6 million, net of offering costs of approximately $565,000, which included approximately $540,000, or 7.5% of the Offering, paid to the placement agent. The Company subsequently filed a registration statement with the SEC to register the shares issued in this offering.

In November 2001, the Company issued 2,000,000 shares of common stock under a private placement offering (the "2001 Offering"). The shares were issued at an undiscounted price of $1.25 per share. Net proceeds totaled approximately $2.3 million, net of offering costs of approximately $211,000, which included approximately $200,000, or 8% of the Offering, paid to the placement agent. The Company subsequently filed a registration statement with the SEC to register the shares issued in this offering. In connection with this transaction, the Company also issued warrants to purchase 2,000,000 shares of common stock (See Note 14).

NOTE 5. Property and Equipment

The following is a summary of property and equipment at December 31, 2002 and 2001:

	December 31, 2002	December 31, 2001
Furniture and fixtures	$ 1,069,687	$ 1,285,440
Equipment	3,201,484	2,983,164
Software	1,612,707	1,613,759
Leasehold improvements	35,451	537,795
	5,919,329	6,420,158
Less: accumulated depreciation and amortization	(3,747,539)	(2,718,953)
Total property and equipment, net	$ 2,171,790	$ 3,701,205

For 2002, 2001 and 2000, the Company recorded $1,643,886, $1,540,626 and $925,995, respectively, of depreciation expense related to fixed assets, including amortization expense related to capital leases. Amortization expense related to intangible assets in 2002, 2001 and 2000 was $15,000 each year.

NOTE 6. Other Assets

At December 31, 2001, other assets included a cash deposit of approximately $413,000 related to the lease for the Company's corporate headquarters.

NOTE 7. Accrued Expenses

Accrued expenses consist of the following balances:

	December 31, 2002	December 31, 2001
Accrued salaries	$185,178	$257,843

Accrued vacation	80,517	122,501
Accrued property taxes	84,018	99,338
ESPP withholdings	6,710	40,745
Other accrued expenses	351,318	143,773
Total	$707,741	$664,200

NOTE 8. Obligations Under Capital Leases

Property held under capital leases is stated at the present value of minimum lease payments at the inception of the related leases. Property held under a capital lease is amortized on a straight-line basis over the estimated useful life of the assets. Amortization of property held under capital leases is included with depreciation expense. At December 31, 2002 and 2001, there was $70,483 and $498,946, respectively, of office and computer equipment held under capital leases. All of the Company's capital leases at December 31, 2001 were secured by certificates of deposit totaling approximately $237,000.

The following is a schedule of future minimum lease payments under capital leases for the year ending December 31, 2003, together with the present value of the minimum lease payments as of December 31, 2002:

Year ending December 31,	
2003	$ 32,534
2004	21,062
2005	19,307
Total minimum lease payments	72,903
Less: amount representing interest	(2,420)
	70,483
Less: current portion	(31,315)
Obligations under capital leases	$ 39,168

NOTE 9. Operating Leases

In March 2000, the Company entered into a five-year operating lease for its corporate headquarters at a rate of $98,000 per month. The lease required an initial cash deposit of approximately $516,000. In May 2002, the lease agreement for the office space the Company utilizes for its headquarters and operations was amended. The amendment reduced the leased space to approximately 36,000 square feet and lowered the annual rent to approximately $677,000 from $1,175,000. In return, the Company surrendered its prepaid rent, which was included in other assets, to the lessor. Subsequent to December 31, 2002, the lessor terminated this amended lease for nonpayment of rent and executed a monthly lease with no renewal option for approximately 25,000 square feet with the Company. Including the write-off of affected leasehold improvements, the Company recognized total charges related to these lease amendments of $686,000 for the year ended December 31, 2002. Additionally, the Company leases office equipment under non-cancelable operating leases. Rental expense under operating leases for the year ended December 31, 2002, 2001 and 2000, was $998,000, $1,245,000 and $681,000, respectively. Future minimum lease payments required under operating leases, by year and in the aggregate, consist of the following at December 31, 2002:

Year ending December 31,	
2003	$ 214,407
2004	9,382
2005	1,940
Total minimum lease payments	$ 225,729

NOTE 10. Debt

Line of Credit

In June 2000, the Company executed a working capital line of credit agreement with a bank in the amount of $1,500,000. Advances under the line of credit accrued interest at the prime rate minus 0.25%, with repayment terms of monthly interest-only payments and principal due in July 2001. The line of credit was secured by certain investments of the Company. The Company borrowed $1,500,000 on this line of credit for the security deposit and leasehold improvements of the Company's corporate headquarters and repaid the entire outstanding balance plus accrued interest in January 2001. The line of credit expired in July 2001 and was not renewed. In March 2002, the Company executed a working capital line of credit agreement with a bank in the amount of $700,000. The Company borrowed $645,000 under this line of credit during the first six months of 2002. In September 2002, the Company repaid the outstanding balance in full, including accrued interest, and terminated the line of credit. Advances under the line of credit accrued interest at the prime rate minus 0.25%, with repayment terms of monthly interest-only payments and principal due in June 2003. As part of the line of credit agreement, the Company had to maintain a minimum restricted cash balance of $800,000 with the bank.

Convertible Debt

On July 24, 2002, the Company executed a financing agreement with Laurus Master Fund, Ltd. ("Laurus") in exchange for a $1.5 million convertible note and a four-year warrant to purchase 300,000 shares of the Company's common stock at exercise prices of $0.936 for the first 150,000 shares, $0.975 for the next 50,000 shares, and $1.17 for the remaining 100,000 shares. Laurus may convert the convertible note, which bears interest at 7% annually, at any time into shares of the Company's common stock at a fixed conversion price of $0.78, subject to certain restrictions in the purchase agreement.

The Company may pay the principal and interest on the convertible note, which has a one-year term, in cash, shares of its common stock or a combination of cash and stock. If common stock is used to pay the note, the conversion price will be the lesser of (i) $0.78 or (ii) 88% of the average of the 7 lowest closing prices during the 22 trading days prior to the date the Company gives notice of payment. Accrued interest and one-ninth of the principal is due on the first business day of each calendar month beginning on November 1, 2002 and continuing until the maturity date of July 1, 2003. If the required principal payment is made in cash, the principal amount paid will be 105% of the amount due. The Company granted Laurus a security interest in all of its assets. Currently, the Company has not made any principal payments to Laurus and is in default under the note. A penalty of 120% of the outstanding principal amount, or $300,000, has been assessed to the Company for being in default, and is included in the balance of short-term borrowings on the Company's balance sheet at December 31, 2002.

The Company recorded a debt discount as a result of the issuance of the warrant to Laurus of approximately $259,000, which was being charged to interest expense over the term of the convertible note using the effective yield method. Upon the Company's default under the note during the fourth quarter of 2002, the remaining balance of the discount was charged to interest expense. Furthermore, the Company recorded an additional debt discount as a result of the beneficial conversion feature of approximately $283,000, which was charged to interest expense at the date of issuance. The amount related to the beneficial conversion feature was determined by dividing the note proceeds allocated to the convertible security of approximately $1,241,000 by the number of shares into which the note is convertible, or 1,923,077 shares based on the fixed conversion price of $0.78 per common share. The resulting effective conversion price of $0.65 per common share was then compared to the fair value of the Company's stock, which was $0.93 per common share on the issuance date. The difference of $0.28 per common share between the fair value of the stock and the effective conversion price was then multiplied by 1,009,586, which was the number of shares the note was convertible into at the date of issuance, taking into account the limitation on the number of shares that Laurus could convert at that time. The agreement stipulates that Laurus may not convert that amount of the note that would result in beneficial ownership of more than 4.9% of the outstanding common shares of the Company on the date of conversion. The conversion limitation becomes null and void upon an event of default under the note and may be raised if the Company chooses to redeem the outstanding principal amount of the note in cash and Laurus elects to convert the note instead. The limitation may also be raised if the Company were to issue additional common shares for any reason, thus increasing the number of outstanding shares. Due to the Company's default under the note during the fourth quarter of 2002, the 4.9% limitation became null and void and additional interest expense of approximately $256,000 was recognized at a rate of $0.28 per common share for the 913,491 additional shares that the note became convertible into upon default.

During 2002, the Company capitalized $238,000 in financing costs related to the issuance of the Laurus debt that were being charged to interest expense over the term of the convertible note using the effective yield method. Upon default under the note in the fourth quarter of 2002, the remaining unamortized balance was charged to interest expense.

The Company agreed to file with the Securities and Exchange Commission, and have declared effective by November 25, 2002, a registration statement registering the resale of the shares of the Company's common stock issuable upon conversion or payment of the note and exercise of the warrant. Currently, the Company has filed a registration statement but it has not yet been declared effective.

NOTE 11. Related Party Transactions and Guarantees

From time to time, the Company has made loans to certain officers of the Company. These amounts are included in Related Party Notes Receivable. The highest aggregate amount outstanding of loans due from officers (including an ex-officer of the Company) was $162,000 during 2002 and $230,000 during 2001 and 2000.

On September 30, 1999, the Company loaned $25,000 to an officer of the Company. The loan was repaid in full, including interest at 8% annually, during 2000.

In December 2000, an officer of the Company borrowed approximately $20,000 that bears interest at a rate of 8% annually. The loan was repaid in full during 2001.

On August 16, 2000, an officer of the Company borrowed approximately $60,000 that bears interest at a rate of 8% annually. At December 31, 2001, $46,000 was outstanding under this loan. In May 2002, this officer repaid the balance of this loan in full,

including accrued interest. On December 21, 2000, the Company entered into a 30-day promissory note with the same officer for $125,000. The promissory note was repaid in full in January 2001, including interest at a rate of 8% annually.

During 2000, an officer of the Company borrowed approximately $35,000, of which $25,000 was outstanding at December 31, 2000. During 2001, the Company loaned an additional $94,000 to this officer prior to his resignation from the Company. At December 31, 2001, the Company had an aggregate of $115,000 in notes receivable bearing interest at 8% annually from this ex-officer. In March 2002, this ex-officer repaid the balance of these loans in full, including accrued interest.

Beginning in December 2000, the Company pledged certain funds held as money market funds and certificates of deposit to collateralize certain margin loans of three officers and an ex-officer of the Company. These funds are classified as cash pledged as collateral for related party obligations on the Company's balance sheets at December 31, 2002 and 2001. The margin loans are from institutional lenders and are secured by shares of the Company's common stock held by these individuals. The Company's purpose in collateralizing the margin loans was to prevent the sale of the Company's common stock held by these officers while the Company was pursuing efforts to raise more capital through private equity placements. The sale of the Company's common stock may have hindered the Company's ability to raise capital in such a manner and compromised the Company's continuing efforts to secure additional financing. The total balance of the margin loans guaranteed by the Company was approximately $1.3 million at December 31, 2002. The Company believed it had the unrestricted legal right to use the pledged funds for its operations if necessary based on (i) its interpretation of the loan guarantee agreements, (ii) the market price of the Company's stock at the time of the pledge, and (iii) assurances the Company received from one of the institutional lenders that funds would be made available if needed. The institutional lenders holding the funds as collateral are disputing this claim, solely relying upon the strict interpretation of the loan guarantee agreements. During the fourth quarter of 2002, the Company sought partial release of the funds for operating purposes and was denied. Subsequent to December 31, 2002, the lenders applied the pledged funds being held to satisfy the outstanding balances of the loans. In light of this action, the Company recognized a loss on the guarantees of $1,278,138 in the fourth quarter of 2002 and recorded a corresponding payable under related party guarantees on the Company's balance sheet at December 31, 2002. The Company may institute litigation or arbitration concerning these matters, which may result in the assertion of claims by these officers under their employee agreements. The ultimate outcome of this matter cannot presently be determined.

NOTE 12. Income Taxes

Deferred income taxes reflect the net tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets and liabilities as of December 31 are as follows:

	2002	2001
Deferred Tax Assets:		

Warrant expense	$ 3,166,992	$ 2,713,006
Deferred revenue	136,326	221,894
Start-up and organizational costs	90,632	167,042
Accrued expenses	36,481	42,748
Research credit	38,153	38,153
Amortization	12,325	8,925
Allowance for doubtful accounts	16,047	6,437
Trademark cost	583	636
Other	2,729	2,710
Impairment of assets	290,740	--
Loss on related party guarantees	434,567	--
Net operating loss	11,818,879	9,195,720
	16,044,454	12,397,271
Valuation allowance	(15,921,467)	(12,221,101)
Total Deferred Tax Asset	122,987	176,170
Deferred Tax Liabilities:		
Depreciation	30,835	104,773
Prepaid expenses	85,352	61,987
Equity in earnings of investee	--	2,610
Other	6,800	6,800
Total Deferred Tax Liabilities	122,987	176,170
Net Deferred Tax Asset (Liability)	$ --	$ --

40

For the years ended December 31, 2002, 2001 and 2000, the Company generated net operating losses for tax purposes of approximately $7.7 million, $10.6 million, and $12.0 million, respectively. The losses for the years ended December 31, 2002, 2001 and 2000 expire in 2023, 2022 and 2021, respectively. The Company also has a research and development credit of approximately $38,000 that expires in 2015. Legislation regarding the research and development tax credit extended that utilization period. However, use of the credit is suspended during certain periods. The Company intends to utilize the research and development credit during the applicable periods. For financial reporting purposes, a valuation allowance of approximately $15.9 million has been recognized to offset the deferred tax assets related to various temporary differences at December 31, 2002.

For the period from inception (July 30, 1998) through December 31, 2002, the Company has net operating loss carryforwards for tax purposes of approximately $34.8 million that begin to expire in the year 2020. In October 1999, the Company issued common stock pursuant to a private placement offering. As a result, an ownership change occurred under Section 382 that limits the utilization of pre-change net operating loss carryforwards. Approximately $3.5 million of the total net operating loss is subject to the Section 382 limitations.

The reconciliation of income tax computed at the U.S. federal statutory tax rates to income tax expense is as follows:

	2002	2001	2000

Tax at US statutory rate -- 34%	$(3,724,590)	$(3,537,940)	$(6,802,830)
Valuation allowance	3,700,366	3,421,050	6,809,538
Permanent and other differences	24,224	116,890	31,445
Research credit	--	--	(38,153)
Income tax expense	$ --	$ --	$ --

NOTE 13. Employment Benefit Plans

Stock Option Plans

The Board of Directors and stockholders approved the 1999 Employee Comprehensive Stock Plan ("Employee Plan") to provide qualified incentive stock options ("ISOs") and non-qualified stock options ("NQSOs") as well as restricted stock to key employees. Under the terms of the Employee Plan, the exercise price of incentive stock options must be equal to 100% of the fair market value on the date of grant (or 110% of fair market value in the case of an ISO granted to a 10% stockholder/grantee). There is no price requirement for NQSOs, other than that the option price must exceed the par value of the common stock. The Company has reserved 5,000,000 shares of its common stock for issuance pursuant to the Employee Plan.

The 1999 Non-Employee Director Plan ("Director Plan") was approved by the Board of Directors and stockholders in 1999. Under the Director Plan, which is administered by a committee of no less than two board members and two disinterested persons, non-employee directors may be granted options to purchase shares of common stock at 100% of fair market value on the date of grant. The Company has reserved 1,000,000 shares of its common stock for issuance pursuant to the Director Plan.

In May 2002, the Company tendered an offer to employees and non-employee directors to cancel certain outstanding stock options under a stock option exchange program. In return for voluntarily canceling certain stock options, employees and non-employee directors were granted an equal number of stock options promptly after six months and one day from the cancellation date. The exercise price of the new options granted was equal to the fair market value of the Company's common stock on the grant date. The program is not expected to result in any additional compensation expense or variable plan accounting. In connection with this offer, 754,925 options were canceled on June 11, 2002 and 513,150 options were granted on December 13, 2002 at an exercise price of $0.26 per share.

41

Activity under the Employee Plan and Director Plan for the three years in the period ended December 31, 2002 is as follows:

	Number Of Shares	Weighted Average Exercise Price
Outstanding, December 31, 1999	1,064,300	$3.86
Granted	2,075,075	5.56
Cancelled	(236,500)	5.42
Exercised	(3,700)	3.66

Outstanding, December 31, 2000	2,899,175	4.95
Granted	2,045,162	0.97
Cancelled	(646,032)	4.67
Exercised	(8,000)	4.38
Outstanding, December 31, 2001	4,290,305	3.10
Granted	3,104,250	0.23
Cancelled	(1,632,906)	5.09
Exercised	--	--
Outstanding, December 31, 2002	5,761,649	$0.99

There was an aggregate of 179,617 and 1,197,995 options to purchase the Company's common stock available for future grants under the Employee and Director Plans at December 31, 2002 and 2001, respectively. Exercisable stock options amounted to 1,604,492 at a weighted average price of $2.33 and 1,089,059 at a weighted average price of $4.62 at December 31, 2002 and 2001, respectively.

Summarized information about stock options outstanding at December 31, 2002 is as follows:

	Options Outstanding			Options Exerci	
Range of Exercise Prices	Options Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number of Options	We A Exer
$0.18 - $0.52	2,945,750	9.99	$0.20	--	
$0.81 - $1.02	1,514,200	8.85	$0.86	536,539	$
$1.55 - $2.09	723,898	8.05	$2.03	507,852	$
$2.75 - $3.81	393,267	6.19	$2.83	389,567	$
$4.13 - $11.25	184,534	6.73	$6.73	170,534	$
	5,761,649	9.08	$0.99	1,604,492	$

The weighted average fair value of stock options at date of grant was $0.17, $0.73 and $4.20 per option for options granted during fiscal years 2002, 2001, and 2000, respectively. The fair value of each option granted was estimated using the Black-Scholes option-pricing model, utilizing the following assumptions:

	2002	2001	2000
Dividend yield	None	None	None
Expected volatility	128%	119%	118%
Risk-free interest rate	1.80%	3.40%	5.22%
Expected life	3.74	3.95	3.98

Employee Stock Purchase Plan

The Company established the 1999 Employee Stock Purchase Plan ("ESPP") under the requirements of Section 423 of the Internal Revenue Code (the "Code") to allow eligible employees to purchase the Company's common stock at regular intervals. Participating employees may purchase common stock through voluntary payroll deductions at the end of each participation period at a purchase price equal to 85% of the lower of the fair market value of the common stock at the beginning or the end of the participation period. Common stock reserved for future employee purchases under the plan aggregated 799,685 shares at December 31, 2002. The first offering period under the ESPP began January 1, 2000. A total of 65,273, 117,194 and 17,848 shares were issued under the ESPP in 2002, 2001 and 2000, respectively, at prices ranging from $0.92 per share to $6.56 per share.

401(k) Plan

In May 1999, the Company adopted a defined contribution plan (the "401(k) Plan") pursuant to Section 401(k) of the Code. All eligible full and part-time employees of the Company who meet certain age requirements may participate in the 401(k) Plan. Participants may contribute between 1% and 15% of their pre-tax compensation, but not in excess of the maximum allowable under the Code. The 401(k) Plan allows for discretionary and matching contributions by the Company. The Company made no contributions during fiscal 2002, 2001 or 2000.

NOTE 14. Stock Warrants

On May 18, 1999, the Company contracted with an investment bank to provide strategic and financial advisory services. In exchange for these advisory services, a warrant to purchase 111,085 shares of the Company's common stock at an exercise price of $6.75 per share (which represents the average closing price of the stock over the twenty day period preceding May 18, 1999) was issued. The warrant is exercisable for five years. This warrant was issued in accordance with an exemption under Section 4(2) of the Securities Act of 1933, as amended, because the transaction is by an issuer not involving a public offering. Using the fair value-based method of accounting, the Company recorded $356,583 of expense and a corresponding credit to additional paid-in capital related to the issuance of this warrant.

As part of the August 1999 debt issuance, the Company issued a warrant to the accredited investor for the purchase of 41,237 shares of the common stock at an exercise price of $6.0625, which represents the average reported closing sale price of the common stock for the ten business days immediately preceding the loan agreement. The warrant is immediately exercisable and carries a term of five years and piggyback registration rights. Using the fair value-based method of accounting, the Company recorded $134,845 of expense and a corresponding credit to paid-in-capital related to the issuance of this warrant.

In connection with the 1999 Offering (see Note 4), the Company issued warrants to the twenty-one investors to purchase 1,404,637 shares of common stock at $3.75 per share, or one warrant for each share issued. The warrants are exercisable for three years from the date of issuance, or until October 14, 2002. The Company has the right to call the exercise of the warrants at any time after six months after the date of the issuance and after the closing price of the common stock exceeds $12.00 for a period of twenty consecutive trading days. Upon such call notice, the holders of the warrants must exercise the warrants within thirty days, after which time they may be redeemed for $.05 per warrant. As part of the compensation for acting as placement agent for the 1999 Offering, the Company issued warrants to the investment banker for the purchase of 36,924, 600, 18,900, 19,950, 8,890 and 3,500 shares of common stock. The warrants are immediately exercisable, carry a five year term, exercise prices of $3.25, $3.25, $8.00, $7.44, $7.41, and $7.31, respectively, piggyback registration rights, and cashless exercise provision.

In connection with the CheckFree investment (see Note 4), the Company issued

CheckFree warrants to purchase 2,179,121 shares at $11.375 per share for entering into the extended biller service provider agreement and investing $10.0 million. The Company recorded $7,488,000 of expense and a corresponding credit to additional paid-in capital related to the estimated fair value of 1.3 million of these warrants, which were issued as consideration for entering into the extended biller service provider agreement. Under this agreement, which expires in February 2005, CheckFree provides the Company with electronic bill presentment services for volume-based fees. The related warrant expense was recognized immediately instead of being deferred and recognized over the life of the agreement because the warrants were fully vested at the date of grant and CheckFree did not have to perform under the agreement to earn the warrants. Also, CheckFree has the ability to earn incentive warrants on up to 2,801,903 additional shares, of which 1,000,000 are exercisable at $11.375 per share and 1,801,903 are exercisable at $14.219 per share. The incentive warrants vest upon the achievement of certain target levels of referred billers to the Company by CheckFree and will occur on the first through fifth anniversaries of the agreement. All incentive warrants that are not vested by the fifth anniversary will expire at that time. Assuming certain of these warrants vest, the Company will record a charge for the fair value of the warrants based on a Black Scholes valuation, which will take into consideration the market value of the Company's stock, the strike price of the warrants, the volatility of the Company's stock price and the applicable risk-free interest rate at the measurement date. As of December 31, 2002, none of these incentive warrants have vested.

In connection with the 2001 Offering (see Note 4), the Company issued warrants to the eighteen investors to purchase 2,000,000 shares of common stock at $1.80 per share, or one warrant for each share issued. The warrants are exercisable for five years from the date of issuance, or until November 27, 2006. The Company has the right to call the exercise of the warrants at any time after six months after the date of the issuance and after the closing price of the common stock exceeds $5.40 for a period of twenty consecutive trading days. Upon such call notice, the holders of the warrants must exercise the warrants within thirty days, after which time they may be redeemed for $.05 per warrant.

In connection with the July 2002 convertible debt issuance (see Note 10), the Company issued a warrant to purchase 300,000 shares of the Company's common stock at exercise prices of $0.936 for the first 150,000 shares, $0.975 for the next 50,000 shares, and $1.17 for the remaining 100,000 shares. The warrant is immediately exercisable and has a term of four years. Using the fair value-based method of accounting, the Company recorded $259,000 of expense and a corresponding credit to paid-in-capital during 2002 related to the issuance of this warrant.

At December 31, 2002, the outstanding vested warrants to purchase common stock are as follows:

Shares of Common Stock	Exercise Price	Aggregate Exercise Price	Expiration Date
41,237	$ 6.06	$ 250,000	08/05/2004
250	3.25	813	10/14/2004
280	8.00	2,240	12/15/2004
8,890	7.41	65,875	12/20/2004
3,500	7.31	25,585	12/22/2004
2,179,121	11.38	24,798,397	06/02/2010
2,000,000	1.80	3,600,000	11/27/2006
150,000	0.936	140,400	07/24/2006
50,000	0.975	48,750	07/24/2006

100,000	1.17	117,000	07/24/2006
---------		------------	
4,533,278		$ 29,049,060	
=========		============	

NOTE 15. Common Stock Listing

Billserv common stock began trading on the OTC BB operated by the National Association of Securities Dealers ("NASD") on December 3, 1998. The NASD adopted eligibility rules in 1999, which required clearance of comments by the SEC on all SEC filings. The Company filed its initial filing on Form 10 with the SEC on June 10, 1999 but, as of October 7, 1999, the SEC had not cleared its comment period. In accordance with the OTC BB's phase-in schedule for the new eligibility rules, the listing on the OTC BB was terminated. The Company's common stock was quoted in the National Quotation Board's Electronic Pink Sheets until December 7, 1999, when the SEC cleared the comment period and the stock was relisted and traded on the OTC BB through March 13, 2000 at which time the stock was approved for trading on the NASDAQ Small Cap Market. Subsequently the stock was approved for trading on the NASDAQ National Market on July 31, 2000, under the symbol "BLLS". On February 4, 2003, the Nasdaq National Market ("NNM") delisted the Company's common stock because the Company did not meet the requirements for continued listing on the NNM. The Company's common shares were immediately eligible for quotation on the OTC BB effective at open of business February 4, 2003. The Company kept the letters BLLS as its ticker symbol.

NOTE 16. Nonmonetary Transactions

During 2002, the Company entered into two separate nonmonetary transactions whereby the Company licensed the use of its Application Service Provider ("ASP") payment gateway technology to certain third party software vendors to be used as an original equipment manufacturer ("OEM") component of their product offering in exchange for software products from those vendors. The Company accounted for these transactions in accordance with APB Opinion No. 29, "Accounting for Nonmonetary Transactions". These exchanges were determined to culminate the earning process because the technology exchanged by the Company was held for sale in the ordinary course of business and the products received by the Company were expected to be deployed and utilized as productive assets. The Company recognized revenue related to these transactions at the fair value of the software received, which was determined by reference to vendor-specific objective evidence, because it was more clearly evident than the value of the assets transferred. The value of the software received was estimated by comparison to third party evidence including vendor-specific established pricing lists and historical sales information and was more readily determinable because the Company did not have a history of comparable cash sales of its payment gateway technology. The Company recognized $300,000 in a transaction where the Company's technology was exchanged for customer relationship management software and concurrent seat licenses to use in providing customer care services via the Internet or telephone. The Company also recognized

$300,000 in a transaction where the Company's technology was exchanged for document archival and retrieval software to use in the storage of electronic billing statements. The carrying value of the gateway technology exchanged in both transactions was zero. The Company capitalized the software received at the time of acquisition and subsequently recognized a loss on impairment of these assets which took the carrying amount of these assets to zero (see Note 1).

NOTE 17. Quarterly Financial Data (Unaudited)

Selected quarterly financial data for 2002 and 2001 is presented below.

	2002			
	First	Second	Third	Fourth
Revenue	$ 1,129,672	$ 1,342,413	$ 827,736	$ 906,733
Gross margin	(75,424)	(109,647)	(274,711)	(24,008)
Net loss	$ (1,892,630)	$ (2,149,182)	$ (2,275,705)	$ (4,637,160)
Net loss per common share- basic and diluted (a)	$ (0.09)	$ (0.10)	$ (0.11)	$ (0.23)
Weighted average shares	20,577,813	20,581,126	20,602,074	20,603,799

	2001			
	First	Second	Third	Fourth
Revenue	$ 509,409	$ 690,062	$ 831,893	$ 937,314
Gross margin	(722,907)	(536,188)	(474,507)	(292,881)
Net loss	$ (3,234,305)	$ (2,576,973)	$ (2,478,390)	$ (2,116,038)
Net loss per common share- basic and diluted (a)	$ (0.21)	$ (0.14)	$ (0.13)	$ (0.11)
Weighted average shares	15,697,051	18,490,631	18,535,923	19,299,313

(a) Earnings per common share are computed independently for each of the quarters presented. Therefore, the sum of the quarterly loss per common share information may not equal the annual loss per common share.

NOTE 18. Going Concern

The Company has incurred substantial losses since inception and has experienced a material shortfall from anticipated revenues, which has led to a significant decrease in its cash position and a deficit in working capital. Also, the Company defaulted under its convertible debt agreement during the fourth quarter of 2002 (see Note 10) and was unsuccessful in its attempt to access its funds held as collateral to guarantee certain executive margin loans (see Note 11) after attempting to retrieve such funds during the fourth quarter of 2002. Consequently, the Company believes that its current available cash along with anticipated revenues may be insufficient to meet its anticipated cash needs for the foreseeable future. Accordingly, the Company reduced expenditures for operating requirements, including a reduction of 36 employees in its workforce in November 2002, and is currently aggressively pursuing strategic alternatives, including investment in or sale of the Company. The satisfactory completion of a sale or additional investment in the Company is essential or the Company has no other alternative that will provide sufficient cash flows to meet current operating requirements. The sale of additional equity or convertible debt securities would result in additional dilution to the Company's stockholders, and debt financing, if available, may involve restrictive covenants which could restrict operations or finances. There can be no assurance that financing will be available in amounts or on terms acceptable to the Company, if at all. If the Company cannot raise funds, on acceptable terms, or achieve positive cash flow, it may not be able to continue to exist, conduct operations, grow market share, take advantage of future opportunities or respond to competitive pressures or unanticipated requirements, any of which would negatively impact its business, operating results and financial condition.

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

None.

PART III

Certain information required by Part III is omitted from this Report in that we will file our definitive Proxy Statement for our Annual Meeting of Stockholders to be held May 29, 2003, or as soon as practicable thereafter, pursuant to Regulation 14A of the Securities and Exchange Act of 1934 (the "Proxy Statement") not later than 120 days after the end of the fiscal year covered by this Report, and certain information included in the Proxy Statement is incorporated herein by reference.

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

There is incorporated in this Item 10, by reference, that portion of the Company's definitive proxy statement for the 2003 Annual Meeting of Stockholders, which appears therein under the captions "Item 1: Election of Directors," "Information Concerning Directors," and "Section 16(a) Beneficial Ownership Reporting Compliance."

ITEM 11. EXECUTIVE COMPENSATION

There is incorporated in this Item 11, by reference, that portion of the Company's definitive proxy statement for the 2003 Annual Meeting of Stockholders, which appears under the caption "Compensation of Executive Officers."

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

There is incorporated in this Item 12, by reference, that portion of the Company's definitive proxy statement for the 2003 Annual Meeting of Stockholders, which appears under the caption "Beneficial Ownership of Certain Stockholders, Directors and Executive Officers."

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

On June 2, 2000, the Company entered into an extended biller service provider agreement with CheckFree Investment Corporation, CheckFree Services Corporation and CheckFree Holdings Corporation ("CheckFree"). As part of this agreement, CheckFree purchased 879,121 shares of the Company's common stock at $11.375 per share totaling $10.0 million. Offering proceeds to the Company, net of issuance costs, were approximately $9.5 million. In connection with the CheckFree investment, the Company issued to CheckFree warrants to purchase 2,179,121 shares at $11.375 per share, thereby causing CheckFree to beneficially own more than 5% of the Company's common stock. During 2001 and 2000, the Company paid CheckFree approximately $175,000 and $100,000 for implementation and distribution services related to the Company's provision of EBPP services to billers.

On January 4, 2001, the Company retained PMG Capital to act as its placement agent in connection with one or more private placement transactions, as well as to perform other investment, strategic and financial advisory services for the Company for a one-year term. As compensation for providing these services, the Company paid PMG Capital a $50,000 initial retainer and a $5,000 monthly retainer through August 2001. Under the agreement, the Company was obligated to pay PMG Capital a fee equal to 7.5% of the total amount raised in a private placement transaction.

Mr. Louis Hoch, President, Chief Operating Officer and a Director of the Company, borrowed approximately $60,000 at a rate of 8% and entered into a 30-day promissory note for $125,000 at a rate of 8% on August 16, 2000 and December 21, 2000, respectively. The largest amount owed to the Company by Mr. Hoch during 2001 was approximately $184,000. Mr. Hoch used the proceeds of the $60,000 loan for usual and customary living expenses. At December 31, 2001, approximately $46,000 was outstanding under this loan. The $125,000 30-day promissory note was incurred to allow Mr. Hoch to pay down a margin loan to an institutional lender. This margin loan was secured by shares of the Company's stock held by Mr. Hoch. The promissory note was repaid in full in January 2001, including accrued interest.

Mr. David Jones, a former Executive Vice President and Director of the Company, borrowed approximately $35,000 at a rate of 8% during 2000, of which $25,000 was outstanding at December 31, 2000. During 2001, the Company loaned an additional $94,000 at a rate of 8% to Mr. Jones prior to his resignation from the Company. Mr. Jones used the proceeds of these loans for usual and customary living expenses and to pay down a margin loan to an institutional lender. At December 31, 2001, the Company had an aggregate of $115,000 in notes receivable bearing interest at 8%, which was the largest amount owed to the Company by Mr. Jones during 2001. In March 2002, Mr. Jones repaid the balance of these loans in full, including accrued interest.

ITEM 14. CONTROLS AND PROCEDURES

Within the 90 days prior to the filing date of this Annual Report on Form 10-K, an evaluation was performed under the supervision and with the participation of the Company's management, including the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rules 13a-14 and 15d-14 of the Securities Exchange Act of 1934). Based on that evaluation, the Company's CEO and CFO concluded that the Company's disclosure controls and procedures were effective in ensuring that material information relating to the Company with respect to the period covered by this report was made known to them. Since the date of their evaluation, there have been no significant changes in the Company's internal controls or in other factors that could significantly affect these controls, including any corrective actions with regard to significant deficiencies and material weaknesses.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K.

(a) Documents filed as a part of this Report

(1) Financial Statements

The financial statements listed in the index under Part II, Item 8 hereof are filed as part of this Report.

(2) Financial Statement Schedules

All financial statement schedules called for by Form 10-K are omitted because they are inapplicable or the required information is shown in the financial statements, or notes thereto, included herein.

(3) Exhibits

The exhibits listed below are filed as part of or incorporated by reference in this Report.

Exhibit	Description
3.1	Articles of Incorporation, as amended (incorporated by reference to such exhibit in the Registrant's Registration Statement on Form SB-2, filed December 29, 1999)
3.2	By-laws, as amended (incorporated by reference to such exhibit in the Registrant's Registration Statement on Form SB-2, filed December 29, 1999)
4.1	Rights Agreement, dated October 4, 2000 (incorporated by reference to such exhibit in the Registrant's Registration Statement on Form 8-A, filed October 11, 2000)
10.1	1999 Employee Comprehensive Stock Plan, as amended (incorporated by reference to such exhibit in the Registrant's Registration Statement on Form S-8, filed February 11, 2002)
10.2	1999 Non-Employee Director Plan (incorporated by reference to such exhibit in the Registrant's Definitive Proxy Statement, filed November 22, 1999)
10.3	1999 Employee Stock Purchase Plan (incorporated by reference to such exhibit in the Registrant's Definitive Proxy Statement, filed November 22, 1999)
10.4	Form of Employment Agreement dated May 31, 2001, between the Company and Executive Officers of the Company (incorporated by reference to such exhibit in the Registrant's Annual Report on Form 10-K, filed April 1, 2002)
21.1	Subsidiaries of the Registrant (incorporated by reference to such exhibit in the Registrant's Annual Report on Form 10-K, filed April 1, 2002)
23.1	Consent of Ernst & Young LLP, Independent Auditors (filed herewith)
99.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith)

(b) Reports on Form 8-K

The Company did not file any reports on Form 8-K during the quarter ended December 31, 2002.

SIGNATURES

Pursuant to the requirements of Section 13 and 15(d) of the Securities Exchange

Act of 1934, the registrant has duly caused this registration statement to be signed on its behalf by the undersigned, thereunto duly authorized.

Billserv, Inc.

By: /s/ Michael R. Long

Michael R. Long
Chairman of the Board and
Chief Executive Officer

Date: April 15, 2003

Pursuant to the requirements of Section 13 and 15(d) of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on April 15, 2003.

By: /s/ Michael R. Long

Michael R. Long
Chairman of the Board and
Chief Executive Officer
(principal executive officer)

By: /s/ Louis A. Hoch

Louis A. Hoch
President, Chief Operating
Officer and Director

By: /s/ Terri A. Hunter

Terri A. Hunter
Executive Vice President,
Chief Financial Officer
(principal financial
and accounting officer)
and Director

By: /s/ Peter G. Kirby

Peter G. Kirby
Director

49

CERTIFICATIONS

I, Michael R. Long, certify that:

1. I have reviewed this annual report on Form 10-K of Billserv, Inc.;

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material

respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and

c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: April 15, 2003

/s/ Michael R. Long

Michael R. Long
Chief Executive Officer

50

I, Terri A. Hunter, certify that:

1. I have reviewed this annual report on Form 10-K of Billserv, Inc.;

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and

c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: April 15, 2003

/s/ Terri A. Hunter

Terri A. Hunter
Chief Financial Officer

EXHIBIT 23.1

CONSENT OF INDEPENDENT AUDITORS

We consent to the incorporation by reference in the Registration Statements (Form S-3 Nos. 333-59042, 333-64508 and 333-75906) of Billserv, Inc.; (Form S-8 Nos. 333-30962 and 333-82530) pertaining to the 1999 Employee Comprehensive Stock Plan of Billserv, Inc.; (Form S-8 No. 333-30960) pertaining to the 1999 Non-Employee Director Plan of Billserv, Inc.; and (Form S-8 No. 333-30958) pertaining to the Employee Stock Purchase Plan of Billserv, Inc. of our report dated April 1, 2003 with respect to the consolidated financial statements of Billserv, Inc. included in the Annual Report (Form 10-K) for the year ended December 31, 2002.

/s/ Ernst & Young LLP

Ernst & Young LLP

San Antonio, Texas
April 14, 2003

EXHIBIT 99.1

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Billserv, Inc. (the "Company") on Form 10-K for the period ending December 31, 2002 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), we, Michael R. Long, Chief Executive Officer, and Terri A. Hunter, Chief Financial Officer, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: April 15, 2003

/s/ Michael R. Long

Michael R. Long
Chief Executive Officer

Date: April 15, 2003

/s/ Terri A. Hunter

Terri A. Hunter
Chief Financial Officer