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

FORM 10-Q

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2002

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 [NO FEE REQUIRED]**

Commission file number 0-13801

QUALITY SYSTEMS, INC.

(Exact name of Registrant as specified in its charter)

California	**95-2888568**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**
18191 Von Karman Avenue, Irvine California 92612	
(Address of Principal Executive Offices)	**(Zip Code)**

Registrant's telephone number, including area code: (949) 255-2600

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 twelve 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 ninety days. Yes ☒ No ☐

Indicate the number of shares outstanding of each of the Registrant's classes of Common Stock as of the latest practicable date: 6,122,953 shares of Common Stock, $.01 par value, as of August 8, 2002

PART I – CONSOLIDATED FINANICAL INFORMATION

Item 1. ***Financial Statements***

QUALITY SYSTEMS, INC.
CONSOLIDATED BALANCE SHEETS

(In thousands)	*June 30, 2002 (unaudited)*	*March 31, 2002*
ASSETS		
Current assets:		
Cash and cash equivalents	$ 28,862	$ 25,443
Short-term investments	--	255
Accounts receivable, net	13,245	13,695
Inventories, net	1,019	1,118
Deferred tax assets	1,368	1,368
Other current assets	955	1,013
Total current assets	45,449	42,892
Equipment and improvements, net	1,582	1,578
Capitalized software costs, net	2,125	2,103
Deferred tax assets	2,778	2,778
Goodwill, net	1,840	1,840
Other assets	1,022	952
Total assets	$ 54,796	$ 52,143
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 863	$ 2,657
Deferred service revenue	7,882	6,155
Other current liabilities	4,338	3,281
Total liabilities	13,083	12,093
Commitments and contingencies		
Shareholders' equity:		
Common stock, $0.01 par value, 20,000 shares authorized, 6,111 and 6,105 shares issued and outstanding, respectively	61	61
Additional paid-in capital	34,711	34,674
Retained Earnings	6,941	5,315
Total shareholders’ equity	41,713	40,050
Total liabilities and shareholders’ equity	$ 54,796	$ 52,143

See notes to consolidated financial statements.

QUALITY SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

(In thousands except per share amounts)	*Three Months Ended June 30,*	
	2002	*2001*
Net revenues:		
Sales of computer systems, upgrades and supplies	$ 6,425	$ 5,594
Maintenance and other services	5,882	5,315
	12,307	10,909
Cost of products and services	4,920	4,734
Gross profit	7,387	6,175
Selling, general and administrative expenses	3,673	3,245
Research and development costs	1,135	1,107
Income from operations	2,579	1,823
Investment income	104	206
Income before provision for income taxes	2,683	2,029
Provision for income taxes	1,057	771
Net income	$ 1,626	$ 1,258
Net income per share, basic	$ 0.27	$ 0.21
Net income per share, diluted	$ 0.26	$ 0.20
Weighted average shares outstanding - basic	6,106	5,989
Weighted average shares outstanding - diluted	6,332	6,173

See notes to consolidated financial statements.

QUALITY SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(In thousands)	*Three Months Ended June 30,*	
	2002	*2001*
Cash Flows from Operating Activities:		
Net Income	$ 1,626	$ 1,258
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	523	532
Loss (Gain) on short-term investments and other	20	(5)
Changes in:		
Accounts receivable	450	(247)
Inventories	99	175
Other current assets	58	(170)
Other assets	(85)	-
Accounts payable	(1,794)	(277)
Deferred service revenue	1,727	592
Other current liabilities	1,057	(14)
Net Cash Provided By Operating Activities	3,681	1,844
Cash Flows From Investing Activities:		
Proceeds from the sale of short term investments	235	-
Net additions to equipment and improvements	(209)	(87)
Additions to capitalized software costs	(325)	(305)
Net Cash Used In Investing Activities	(299)	(392)
Cash Flows from Financing Activities:		
Proceeds from exercise of stock options	37	31
Net Cash Provided by Financing Activities	37	31
Net Increase in Cash and Cash Equivalents	3,419	1,483
Cash and Cash Equivalents, beginning of period	25,443	18,471
Cash and Cash Equivalents, end of period	$ 28,862	$ 19,954

Supplemental Information – During the three months ended June 30, 2002 and 2001, the Company made income tax payments, net of refunds received, of $371,000 and $669,000, respectively.

See notes to consolidated financial statements.

QUALITY SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

The accompanying unaudited consolidated financial statements as of June 30, 2002 and the three months ended June 30, 2002 and 2001, have been prepared in accordance with the requirements of Form 10-Q and, therefore, do not include all information and footnotes which would be presented were such financial statements prepared in accordance with generally accepted accounting principles. These financial statements should be read in conjunction with the audited financial statements presented in the Company's Annual Report for the fiscal year ended March 31, 2002. In the opinion of management, the accompanying consolidated financial statements reflect all adjustments which are necessary for a fair presentation of the results of operations for the periods presented. The results of operations for such interim periods are not necessarily indicative of results of operations to be expected for the full year. Certain amounts in the accompanying consolidated financial statements have been reclassified to conform with the June 30, 2002 presentation.

2. Intangible Assets

The Company adopted Financial Accounting Standards Board No. 142 "Goodwill and Other Intangible Assets" ("FASB 142") effective April 1, 2001. In accordance with FASB 142, the Company does not amortize goodwill. The balance of goodwill is related to the Company's NextGen Healthcare Information Systems (NextGen) Division. In accordance with FASB 142, the Company has compared the fair value of the NextGen Division with the carrying amount of assets associated with the Division and determined that none of the goodwill recorded as of June 30, 2002 was impaired. The fair value of the NextGen Division was determined using a reasonable estimate of future cash flows of the Division and a risk adjusted discount rate to compute a net present value of future cash flows.

As of June 30, 2002, the Company had the following amounts related to intangible assets:

(In thousands)	*Gross Carrying Amount*	*Accumulated Amortization*	*Net Intangible Assets*
Developed technology (5 yrs)	$ 1,300	$(1,300)	$ 0
Capitalized software development (3 yrs)	$ 6,988	$(4,863)	$ 2,125
Total amortized intangible assets	$ 8,288	$(6,163)	$ 2,125

Aggregate amortization expense three months ended June 30, 2002	$ 318

The unamortized balance of capitalized software development costs is estimated to be amortized as follows:

For the year ended March 31,	*Estimated Amortization Expense (in thousands)*
2003	$ 851
2004	$ 817
2005	$ 457

3. Stock Repurchase Plan

In October 2001, the Company's Board of Directors authorized the repurchase on the open market of up to 5% of the shares of the Company's outstanding Common stock, subject to compliance with applicable laws and regulations. There is no requirement that the Company repurchase such shares. This stock repurchase authorization expires on the date of the fiscal 2003 Annual Shareholders Meeting, currently

scheduled for August 29, 2002. During the three months ended June 30, 2002, the Company did not repurchase any of its shares. Since the October 2001 authorization through June 30, 2002, no shares were repurchased.

4. Income Taxes

The provision for income taxes for the three months ended June 30, 2002 and 2001 differs from the expected combined statutory rates primarily due to the impact of the effect of varying state income tax rates.

5. Net Income Per Share

The following table reconciles the weighted average shares outstanding for basic and diluted net income per share for the periods indicated.

(in thousands except per share amounts)	*Three Months Ended June 30,*	
	2002	*2001*
Net income	$ 1,626	$ 1,258
Basic net income per common share:		
Weighted average of common shares outstanding	6,106	5,989
Basic net income per common share	$ 0.27	$ 0.21
Diluted net income per share:		
Weighted average of common shares outstanding	6,106	5,989
Effect of potentially dilutive securities (options)	226	184
Weighted average number of common and shares - Diluted	6,332	6,173
Diluted net income per common share	$ 0.26	$ 0.20

6. Operating Segment Information

The Company has prepared operating segment information in accordance with Statement of Accounting Standards ("SFAS") No. 131 "Disclosures About Segments of an Enterprise and Related Information" ("SFAS No. 131") to report components that are evaluated regularly by the Company's chief operating decision maker, or decision making group in deciding how to allocate resources and in assessing performance.

The Company's reportable operating segments include its NextGen Healthcare Information Systems Division and the QSI Division.

The disaggregated financial results of the segments reflect allocation of certain functional expense categories consistent with the basis and manner in which Company management internally disaggregates financial information for the purpose of assisting in making internal operating decisions. Certain corporate overhead costs are not allocated to the individual segments by Management. The Company evaluates performance based on stand-alone segment operating income. Because the Company does not evaluate performance based on return on assets at the operating segment level, assets are not tracked internally by segment. Therefore, segment asset information is not presented.

Operating segment data for the quarters ended June 30, 2001 and 2002 is as follows:

(In thousands)	*QSI Division*	*NextGen Healthcare Information Systems Division*	*Unallocated Corporate Expenses*	*Consolidated*
Quarter ended June 30, 2002				
Revenue	$ 4,229	$ 8,078	--	$ 12,307
Operating income (loss)	$ 1,166	$ 2,073	$ (660)	$ 2,579
Quarter ended June 30, 2001				
Revenue	$ 4,325	$ 6,584	--	$ 10,909
Operating income (loss)	$ 1,177	$ 1,050	$ (404)	$ 1,823

7. Composition of Accounts Receivable

Included in accounts receivable are amounts related to maintenance and services which were billed but not yet rendered as of the end of the period. Undelivered maintenance and services are included on the consolidated balance sheet as part of the deferred revenue balance.

(in thousands)	*June 30,*	
	2002	*2001*
ACCOUNTS RECEIVABLE:		
Accounts receivable, net of reserve for bad debts, excluding undelivered maintenance and services	$ 9,538	$ 10,403
Undelivered maintenance and services billed in advance, included in deferred revenue	3,707	3,292
Net accounts receivable	$ 13,245	$ 13,695

Item 2. *Management's Discussion and Analysis of Financial Condition and Results of Operations.*

Except for the historical information contained herein, the matters discussed in this Quarterly Report on Form 10-Q, including discussions of the Company's product development plans, business strategies and market factors influencing the Company's results, are forward-looking statements that involve certain risks and uncertainties. Actual results may differ from those anticipated by the Company as a result of various factors, both foreseen and unforeseen, including, but not limited to, the Company's ability to continue to develop new products and increase systems sales in markets characterized by rapid technological evolution, consolidation within the Company's target marketplace and among the Company's competitors, and competition from larger, better capitalized competitors. Many other economic, competitive, governmental and technological factors could impact the Company's ability to achieve its goals. Interested persons are urged to review the risks described below, as well as in the Company's other public disclosures and filings with the Securities and Exchange Commission.

Company Overview

Quality Systems, Inc., through its NextGen Healthcare Information Systems, Inc. (NextGen[1]) and QSI (QSI) divisions (collectively, the "Company"), develop and market healthcare information systems that automate medical and dental group practices, physician hospital organizations ("PHOs"), management service organizations ("MSOs"), ambulatory care centers, community health centers, and medical and dental schools. In response to the growing need for more comprehensive, cost-effective information solutions for physician and dental practices, the Company's systems enable clients to redesign office workflow processes, improve productivity, reduce information processing and administrative costs, and utilize electronic medical records to store and access patient information. The Company's proprietary

[1] The Company's NextGen Division, formerly known as "MicroMed Healthcare Information Systems" or "MicroMed Division", changed its name in fiscal 2002.

software systems cover a number of important practice elements including, but not limited to, general patient information, electronic patient records, appointment scheduling, billing, insurance claims submission and processing, eligibility verification, managed care plan implementation, referral management, treatment outcome studies, treatment planning, drug formularies, dental charting, and letter generation. Several of the Company's software systems may be operated remotely using thin client connectivity or a standard web browser. In addition to providing fully integrated software solutions to its clients, the Company offers comprehensive hardware and software installation services, maintenance and support services, and system training services.

The Company currently has a base of approximately 700 clients, with each client generally including between one and 500 physicians or dentists. The Company believes that as healthcare providers are increasingly required to reduce costs and maintain the quality of healthcare, the Company will be able to capitalize on its strategy of providing fully integrated information systems and superior client service.

The Company, a California corporation formed in 1974, was founded with an early focus on providing information systems and services for dental group practices. In the mid-1980's, the Company capitalized on the increasing focus on medical cost containment and further expanded its information processing systems to serve the medical market. Today, the Company has dedicated products serving both the medical and dental markets.

The Company's QSI Division develops and markets dental practice management and medical practice management software suites utilizing a UNIX[2] operating system. Its Clinical Product Suite ("CPS") utilizes a Windows NT[3] operating system and can be fully integrated with the Company's dental practice management applications. CPS incorporates a wide range of clinical tools including, but not limited to, periodontal charting and digital imaging of X-ray and inter-oral camera images as part of an electronic patient record. In addition, the QSI Division develops and markets the Company's QUIC product suite which incorporates a variety of products that enhance the connectivity between provider and payor, and provider and patient. The QSINet Application Service Provider ("ASP")/Internet product offering is also developed and marketed in this Division. QSINet enables providers to extend patient appointment scheduling, electronic bill payment, and other functions to patients via the Internet.

The Company's NextGen Healthcare Information Systems, Inc. Division develops and sells proprietary electronic medical records software and practice management systems under the NextGen®[4] product name. Major product categories of the NextGen suite include Electronic Medical Records (NextGen^{emr}), Enterprise Practice Management (NextGen^{epm}), Enterprise Appointment Scheduling (NextGen^{eas}), Enterprise Master Patient Index (NextGen^{epi}), Managed Care, Electronic Data Interchange, System Interfaces, Internet Operability (NextGen^{web}), a Patient-centric and Provider-centric Web Portal Solution (NextMD.com[5]), and a handheld product (NextGen^{pda}). The Company's enterprise practice management and electronic medical records software packages can run via private intranet or via the Internet in an ASP environment.

Enhancements to these products continued during the quarter.

Risk Factors

Competition. The markets for healthcare information systems are intensely competitive, and the Company faces significant competition from a number of different sources. Several of the Company's competitors have significantly greater name recognition as well as substantially greater financial, technical, product development and marketing resources than the Company.

[2] UNIX is a registered trademark of AT&T Corporation.
[3] Microsoft Windows, Windows NT, Windows 95, Windows 98, and Windows 2000 are registered trademarks of Microsoft Corporation.
[4] NextGen is a registered trademark of NextGen Healthcare Information Systems, Inc.
[5] NextMD.com is a trademark of NextGen Healthcare Information Systems, Inc.

The Company competes in all of its markets with other major healthcare related companies, information management companies, systems integrators, and other software developers. Competitive pressures and other factors, such as new product introductions by the Company or its competitors, may result in price or market share erosion that could have a material adverse effect on the Company's business, results of operations and financial condition. Also, there can be no assurance that the Company's applications will achieve broad market acceptance or will successfully compete with other competing software products.

The Company's inability to make initial sales of its systems to either newly formed groups and/or healthcare providers that are replacing or substantially modifying their healthcare information systems could have a material adverse effect on the Company's business, results of operations and financial condition. If new systems sales do not materialize, the Company's maintenance revenues can be expected to decrease over time due to the combined effects of potential attrition of existing clients and a shortfall in new client additions.

Fluctuation in Quarterly Operating Results. The Company's revenues and operating results have fluctuated in the past, and may fluctuate in the future from quarter to quarter and period to period, as a result of a number of factors including, without limitation: the size and timing of orders from clients; the length of sales cycles and installation processes; the ability of the Company's clients to obtain financing for the purchase of the Company's products; changes in pricing policies or price reductions by the Company or its competitors; the timing of new product announcements and product introductions by the Company or its competitors; the availability and cost of system components; the financial stability of major clients; market acceptance of new products, applications and product enhancements; the Company's ability to develop, introduce and market new products, applications and product enhancements and to control costs; the Company's success in expanding its sales and marketing programs; deferrals of client orders in anticipation of new products, applications or product enhancements; changes in Company strategy; personnel changes; and general governmental and economic factors.

The Company's products are generally shipped as orders are received and accordingly, the Company has historically operated with minimal backlog. As a result, sales in any quarter are dependent on orders booked and shipped in that quarter and are not predictable with any degree of certainty. Further, the Company's systems can be relatively large and expensive and individual systems sales can represent a significant portion of the Company's revenues for a quarter such that the loss or deferral of even one such sale can have a significant adverse impact on the Company's quarterly profitability.

Clients often defer systems purchases until the Company's quarter end, so quarterly results generally cannot be predicted and frequently are not known until the quarter has concluded.

The Company's sales are dependent upon a client's initial decision to replace, or substantially modify its existing information system, and subsequently a decision as to which products and services to purchase. These are major decisions for healthcare providers, and accordingly, the sales cycle for the Company's systems can vary significantly and typically ranges from three to twelve months from initial contact to contract execution/shipment.

Because a significant percentage of the Company's expenses are relatively fixed, a variation in the timing of systems sales and installations can cause significant variations in operating results from quarter to quarter. As a result, the Company believes that interim period-to-period comparisons of its results of operations are not necessarily meaningful and should not be relied upon as indications of future performance. Further, the Company's historical operating results are not necessarily indicative of future performance for any particular period.

The Company recognizes revenue pursuant to Statement of Position ("SOP") No. 97-2, "Software Revenue Recognition" ("SOP 97-2"). Additionally, in December 1999, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin ("SAB") No. 101, "Revenue Recognition in Financial Statements" ("SAB 101"). SAB 101 summarizes the staff's views in applying generally accepted accounting principles to revenue recognition in financial statements. SAB 101 became effective for the Company in the third quarter of fiscal 2001.

There can be no assurance that the application and subsequent interpretation of these pronouncements will not further modify the Company's revenue recognition policies, or that such modifications would not have a material adverse effect on the operating results reported in any particular quarter.

There can be no assurance that the Company will not be required to adopt changes in its licensing or services practices to conform to SOP 97-2 or SAB 101, or that such changes, if adopted, would not result in delays or cancellations of potential sales of the Company's products.

Due to all of the foregoing factors, it is possible that in some future quarter(s) the Company's operating results may be below the expectations of public market analysts and investors. In such event, the price of the Company's Common Stock would likely be materially adversely affected.

Dependence on Principal Product and New Product Development. The Company currently derives substantially all of its net revenues from sales of its healthcare information systems and related services. The Company believes that a primary factor in the market acceptance of its systems has been its ability to meet the needs of users of healthcare information systems. The Company's future financial performance will depend in large part on the Company's ability to continue to meet the increasingly sophisticated needs of its clients through the timely development, successful introduction and implementation of new and enhanced versions of its systems and other complementary products. The Company has historically expended a significant percentage of its net revenues on product development and believes that significant continuing product development efforts will be required to sustain the Company's growth.

There can be no assurance that the Company will be successful in its product development efforts, that the market will continue to accept the Company's existing products, or that new products or product enhancements will be developed and implemented in a timely manner, meet the requirements of healthcare providers, or achieve market acceptance. If new products or product enhancements do not achieve market acceptance, the Company's business, results of operations and financial condition could be materially adversely affected. At certain times in the past, the Company has also experienced delays in purchases of its products by clients anticipating the launch of new products by the Company. There can be no assurance that material order deferrals in anticipation of new product introductions will not occur.

Technological Change. The software market generally is characterized by rapid technological change, changing customer needs, frequent new product introductions, and evolving industry standards. The introduction of products incorporating new technologies and the emergence of new industry standards could render the Company's existing products obsolete and unmarketable. There can be no assurance that the Company will be successful in developing and marketing new products that respond to technological changes or evolving industry standards. New product development depends upon significant research and development expenditures which depend ultimately upon sales growth. Any material weakness in revenues or research funding could impair the Company’s ability to respond to technological advances in the marketplace and to remain competitive. If the Company is unable, for technological or other reasons, to develop and introduce new products in a timely manner in response to changing market conditions or customer requirements, the Company's business, results of operations and financial condition may be materially adversely affected.

In response to increasing market demand, the Company is currently developing new generations of certain of its software products. There can be no assurance that the Company will successfully develop these new software products or that these products will operate successfully, or that any such development, even if successful, will be completed concurrently with or prior to introduction of competing products. Any such failure or delay could adversely affect the Company's competitive position and/or could make the Company's current products obsolete.

Litigation. The Company faces one private Federal securities litigation action (see “Part II – Other Information, Item 1. Litigation.”). At this time it is not reasonably possible to estimate the damage, or the range of damages, if any, that the Company might incur in connection with this action. However, the uncertainty associated with substantial unresolved litigation may have an adverse impact on the Company's business. In particular, such litigation could impair the Company's relationships with existing customers and its ability to obtain new customers. Defending such litigation may result in a diversion of

management's time and attention away from business operations, which could have a material adverse effect on the Company's business, results of operations and financial condition. Such litigation may also have the effect of discouraging potential acquirers from bidding for the Company or reducing the consideration such acquirers would otherwise be willing to pay in connection with an acquisition.

There can be no assurance that such litigation will not result in liability in excess of the Company's insurance coverage, that the Company's insurance will cover such claims or that appropriate insurance will continue to be available to the Company in the future at commercially reasonable rates.

Proprietary Technology. The Company is heavily dependent on the maintenance and protection of its intellectual property and relies largely on license agreements, confidentiality procedures, and employee nondisclosure agreements to protect its intellectual property. The Company's software is not patented and the Company believes that existing copyright laws offer only limited practical protection.

There can be no assurance that the legal protections and precautions taken by the Company will be adequate to prevent misappropriation of the Company's technology or that competitors will not independently develop technologies equivalent or superior to the Company's. Further, the laws of some foreign countries do not protect the Company's proprietary rights to as great an extent as do the laws of the United States and are often not enforced as vigorously as those in the United States.

The Company does not believe that its operations or products infringe on the intellectual property rights of others. However, there can be no assurance that others will not assert infringement or trade secret claims against the Company with respect to its current or future products or that any such assertion will not require the Company to enter into a license agreement or royalty arrangement with the party asserting the claim. As competing healthcare information systems increase in complexity and overall capabilities and the functionality of these systems further overlaps, providers of such systems may become increasingly subject to infringement claims. Responding to and defending any such claims may distract the attention of Company management and have a material adverse effect on the Company's business, results of operations and financial condition. In addition, claims may be brought against third parties from which the Company purchases software, and such claims could adversely affect the Company's ability to access third party software for its systems.

Ability to Manage Growth. The Company has in the past experienced periods of growth which have placed, and may continue to place, a significant strain on the Company's non-cash resources. The Company also anticipates expanding its overall software development, marketing, sales, client management and training capacity. In the event the Company is unable to identify, hire, train and retain qualified individuals in such capacities within a reasonable timeframe, such failure could have a material adverse effect on the Company. In addition, the Company's ability to manage future increases, if any, in the scope of its operations or personnel will depend on significant expansion of its research and development, marketing and sales, management, and administrative and financial capabilities. The failure of the Company's management to effectively manage expansion in its business could have a material adverse effect on the Company's business, results of operations and financial condition.

Dependence Upon Key Personnel. The Company's future performance also depends in significant part upon the continued service of its key technical and senior management personnel, many of whom have been with the Company for a significant period of time. The Company does not maintain key man life insurance on any of its employees. Because the Company has a relatively small number of employees when compared to other leading companies in the same industry, its dependence on retaining its employees is particularly significant. The Company is also dependent on its ability to attract high quality personnel, particularly in the areas of sales and applications development.

The industry in which the Company operates is characterized by a high level of employee mobility and aggressive recruiting of skilled personnel. There can be no assurance that the Company's current employees will continue to work for the Company.

The loss of the services of key employees could have a material adverse effect on the Company's business, results of operations and financial condition. Furthermore, the Company may need to grant

additional stock options to key employees and provide other forms of incentive compensation to attract and retain such key personnel.

Product Liability. Certain of the Company's products provide applications that relate to patient clinical information. Any failure by the Company's products to provide accurate and timely information could result in claims against the Company. In addition, a court or government agency may take the position that the Company's delivery of health information directly, including through licensed practitioners, or delivery of information by a third party site that a consumer accesses through the Company's web sites, exposes the Company to malpractice or other personal injury liability for wrongful delivery of healthcare services or erroneous health information. The Company maintains insurance to protect against claims associated with the use of its products, but there can be no assurance that its insurance coverage would adequately cover any claim asserted against the Company. A successful claim brought against the Company in excess of its insurance coverage could have a material adverse effect on the Company's business, results of operations and financial condition. Even unsuccessful claims could result in the Company's expenditure of funds in litigation and management time and resources.

There can be no assurance that the Company will not be subject to product liability claims, that such claims will not result in liability in excess of its insurance coverage, that the Company's insurance will cover such claims or that appropriate insurance will continue to be available to the Company in the future at commercially reasonable rates. Such claims could have a material adverse affect on the Company's business, results of operations and financial condition.

Uncertainty in Healthcare Industry; Government Regulation. The healthcare industry is subject to changing political, economic and regulatory influences that may affect the procurement processes and operation of healthcare facilities. During the past several years, the healthcare industry has been subject to an increase in governmental regulation of, among other things, reimbursement rates and certain capital expenditures.

In the past, various legislators have announced that they intend to examine proposals to reform certain aspects of the U.S. healthcare system including proposals which may increase governmental involvement in healthcare, lower reimbursement rates and otherwise change the operating environment for the Company's clients. Healthcare providers may react to these proposals, and the uncertainty surrounding such proposals, by curtailing or deferring investments, including those for the Company's systems and related services. Cost-containment measures instituted by healthcare providers as a result of regulatory reform or otherwise could result in a reduction in the allocation of capital funds. Such a reduction could have an adverse effect on the Company's ability to sell its systems and related services. On the other hand, changes in the regulatory environment have increased and may continue to increase the needs of healthcare organizations for cost-effective data management and thereby enhance the overall market for healthcare management information systems. The Company cannot predict what impact, if any, such proposals or healthcare reforms might have on the Company's business, financial condition and results of operations.

Certain healthcare professionals who use the Company's Internet-based products will directly enter health information about their patients including information that constitutes a record under applicable law that the Company will store on the Company's computer systems. Numerous federal and state laws and regulations, the common law, and contractual obligations govern collection, dissemination, use and confidentiality of patient-identifiable health information, including:

- State privacy and confidentiality laws;
- The Company's contracts with customers and partners;
- State laws regulating healthcare professionals;
- Medicaid laws; and
- The Heath Insurance Portability and Accountability Act of 1996 ("HIPAA") and related rules proposed by the Heath Care Financing Administration; and Health Care Financing Administration standards for Internet transmission of health data.

The U.S. Congress has been working to finalize proposed legislation that would establish a new Federal standard for protection and use of health information. Any failure by the Company or by its personnel or partners to comply with any of these legal or other requirements may result in a material liability to the Company.

Although the Company has systems in place for safeguarding patient health information from unauthorized disclosure, these systems may not preclude claims against the Company for violation of applicable law or other requirements. Other third party sites or links that consumers access through the Company's web sites also may not maintain systems to safeguard this health information, or may circumvent systems the Company put in place to protect the information from disclosure. In addition, future laws or changes in current laws may necessitate costly adaptations to the Company's systems.

HIPAA mandates the use of national standards for transmissions of certain patient healthcare information, and prescribes security measures to protect the confidentiality of such information as well as other patient record privacy and security provisions within two years after the adoption of final regulations by the Department of Health and Human Services ("HHS"). These proposed regulations will establish new federal standards for privacy of health information. The Company anticipates that these regulations will directly affect the Company's products and services, but the Company cannot fully predict the impact at this time. The Company's intention is to modify its products and services as necessary to facilitate client compliance with the final regulations, but there can be no assurance that the Company will be able to do so in a timely manner. Achieving compliance with these regulations could be costly and distract management's attention and other resources from the Company's historical business, and any noncompliance by the Company could result in civil and criminal penalties. In addition, development of related Federal and state regulations and policies on confidentiality of health information could negatively affect the Company's business.

In addition, the Company's software may be subject to regulation by the U.S. Food and Drug Administration (the "FDA") as a medical device. Such regulation could require the registration of the applicable manufacturing facility and software and hardware products, application of detailed record-keeping and manufacturing standards, and FDA approval or clearance prior to marketing. An approval or clearance requirement could create delays in marketing, and the FDA could require supplemental filings or object to certain of these applications, the result of which could have a material adverse effect on the Company's business, financial condition and results of operations.

Critical Accounting Policies

The discussion and analysis of the Company's financial condition and results of operations is based upon the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires Management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. On an on-going basis, Management evaluates estimates, including those related to revenue recognition, uncollectible accounts receivables, and intangible assets for, reasonableness. Management bases its estimates on historical experience and on various other assumptions that management believes 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 may differ from these estimates under different assumptions or conditions.

The Company believes revenue recognition, the allowance for doubtful accounts, and goodwill impairment are among the most critical accounting policies that impact its consolidated financial statements.

Revenue Recognition. The Company's revenues are primarily generated from the sale of software licenses, maintenance fees, and EDI services. Revenue recognition is governed by Statement of Position 97-2, "Software Revenue Recognition" ("SOP 97-2"). Per SOP 97-2, if the arrangement does not require significant production, modification, or customization of software, revenue should be recognized when all of the following criteria are met:

- persuasive evidence of an arrangement exists;
- delivery has occurred;
- the vendor's fee is fixed or determinable; and
- collectibility is probable.

In accordance with generally accepted accounting principles in the United States of America, the recognition of software license revenues is based on Management's assessment that the above criteria have been met. In general, the first two criteria are met with a signed contract and evidence that the Company has shipped its software to the customer. In those cases where undelivered elements of a system sale exists, the Company defers revenue related to the undelivered element based on vendor specific objective evidence of each element's fair value. The Company bases each element's fair value on its price list which is used in pricing all contracts. Discounts for individual elements are aggregated, and the total discount is allocated back to the individual elements in its proportion of fair value to the total contract fair value. The Company determines that the fee is fixed or determinable based on the contract terms, which specify payment terms tied to dates and not to any future deliverables. Probability of collection is based on a credit review of new customers. The timing or amount of revenue recognition may have been different if different assessments of the above criteria had been made at the time transactions were recorded in revenue.

Valuation Allowances. The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of customers to make required payments. If the financial condition of customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

Goodwill Impairment. The Company's long-lived assets include goodwill of $1.8 million as of June 30, 2002 and 2001, respectively. The Company adopted SFAS No. 142 "Goodwill and Other Intangible Assets" ("SFAS 142") effective April 1, 2001. The statement applies to the amortization of goodwill and other intangible assets. The Company has ceased amortizing amounts related to goodwill effective April 1, 2001. The balance of goodwill is related to the Company's NextGen Division. The Company has compared the fair value of the NextGen Division with the carrying amount of assets associated with the Division and determined that none of the goodwill recorded as of June 30, 2002 was impaired. The fair value of the NextGen Division was determined using a reasonable estimate of future cash flows of the Division and a risk adjusted discount rate to compute a net present value of future cash flows.

The process of evaluating goodwill for impairment involves the determination of the fair value of the relevant Company business segments. Inherent in such fair value determinations are certain judgments and estimates, including the interpretation of current economic indicators and market valuations, and assumptions about the Company's strategic plans with regard to operations. To the extent additional information arises or the strategies of the Company change, it is possible that the Company's conclusion regarding goodwill impairment could change and result in a material effect on its financial position or results of operations.

Results of Operations

The following table sets forth for the periods indicated, the percentage of net revenues represented by each item in the Company's Consolidated Statements of Income.

	Three Months Ended June 30,	
	2002	*2001*
Net Revenues:		
Sales of computer systems, upgrades and supplies	52.2%	51.3%
Maintenance and other services	47.8	48.7
	100.0	100.0
Cost of Products and Services	40.0	43.4
Gross Profit	60.0	56.6
Selling, General and Administrative Expenses	29.8	29.7
Research and Development Costs	9.2	10.1

Income from Operations	21.0	16.7
Investment Income	0.8	1.9
Income before Provision for Income Taxes	21.8	18.6
Provision for Income Taxes	8.6	7.1
Net Income	13.2%	11.5%

For the Three-Month Periods Ended June 30, 2002 and 2001

The Company's net income for the three months ended June 30, 2002 was $1,626,000 or $0.27 per share on a basic and $.26 per share on a diluted basis, as compared to a net income of $1,258,000, or $0.21 per share on a basic and $0.20 on a diluted basis, for the three months ended June 30, 2001.

Net Revenues. Net revenues for the three months ended June 30, 2002 increased 13% to $12.3 million from $10.9 million for the three months ended June 30, 2001. Sales of computer systems, upgrades and supplies increased 15% to $6.4 million from $5.6 million while net revenues from maintenance and other services grew 11% to $5.9 million from $5.3 million during the comparable period. The increase in net revenues from sales of computer systems, upgrades and supplies was principally the result of an increase in sales of the Company's NextGen^{emr} and NextGen^{epm} software. The increase in maintenance and other services revenue resulted principally from an increase in maintenance revenues generated from the Company's expanded client base, and secondarily from an increase in revenues generated from the Company's electronic data interchange services.

Cost of Products and Services. Cost of products and services for the three months ended June 30, 2002 rose 4% to $4.9 million from $4.7 million in the prior year quarter. Cost of products and services as a percentage of net revenues decreased from 43.4% to 40.0%. The dollar increase in the cost of products and services was a result of the impact of higher labor costs associated with installation as well as increased amortization of software development expenses partially offset by a slight reduction in hardware costs. The cost of products and services as a percentage of net revenues decreased in the quarter ended June 30, 2002, largely as a result of a reduction in hardware cost of products and services as a percentage of total revenue.

Selling, General and Administrative Expenses. Selling, general and administrative expenses for the three months ended June 30, 2002 increased 13.2% to approximately $3.7 million as compared to $3.2 million for the three months ended June 30, 2001. Selling, general and administrative expenses as a percentage of net revenues were virtually unchanged at 29.8% as compared to 29.7% in the year earlier quarter. The increase in the dollar amount of such expenses resulted primarily from increased staffing and compensation expenses, as well as increased sales and marketing expenses at the Company's NextGen Division, and higher corporate expenses.

Research and Development Costs. Research and development costs for the three months ended June 30, 2002 increased by 2.5% to $1,135,000 from $1,107,000 in the prior year's quarter. The modest increase in research and development costs is attributed primarily to increased investments in the NextGen^{emr} and NextGen^{epm} product suites. Research and development costs as a percentage of net revenues declined to 9.2% as compared to 10.1% for the quarter ended June 30, 2001. This decline was driven by the fact that revenues grew faster than the increase in research and development expense. The Company has, over time, changed the mix of its overall research and development expenditures to increase funds available for the NextGen Division while correspondingly decreasing the level of expenditure at its QSI Division. This has facilitated increased research and development spending at the NextGen Division while moderating the overall growth rate of research and development costs.

Investment Income. Investment income for the three months ended June 30, 2002 decreased by 49.5% from approximately $206,000 to $104,000. Investment income in the quarter declined due to the lower interest rates earned on the Company's balances during the quarter vis a vis the year earlier quarter. The decrease in interest income was partially offset by higher cash balances.

Provision for Income Taxes. The provision for income taxes for the three months ended June 30, 2002 was approximately $1,057,000 as compared to approximately $771,000 for the three months ended

June 30, 2001. The provision for income taxes for the three months ended June 30, 2002 and 2001 differs from the combined statutory rates primarily due to the impact of the effect of varying state income tax rates. The increase in the tax rates on a year over year basis is due, in part, to a change in the mix of Company sales generated in states with higher state tax rates.

Liquidity and Capital Resources

The following table presents selected financial statistics and information for each of the past two quarters ended June 30, (in thousands):

(in thousands)	*Quarter Ended June 30,*	
	2002	*2001*
Cash and cash equivalents	$28,862	$19,954
Net increase in cash and cash equivalents during the quarter	$ 3,419	$ 1,483
Net income during the quarter	$ 1,626	$ 1,258
Net cash provided by operations during the quarter	$ 3,681	$ 1,844
Number of days of sales outstanding at start of quarter	104	114
Number of days of sales outstanding at end of quarter	98	114

The Company's principal source of cash was cash provided by operations. The Company was able to generate operating cash flows significantly in excess of net income in the quarter ended June 30, 2002 primarily as a result of improved turnover of accounts receivable. Provided turnover of accounts receivable and revenues and profitability remain consistent with the quarter ended June 30, 2002, the Company anticipates being able to continue to generate cash from operations primarily from the net income of the company.

Cash and cash equivalents increased $3,419,000 between March 31, 2002 and June 30, 2002 primarily as a result of cash provided by operating activities. Cash and cash equivalents increased approximately $1,483,000 during the three months ended June 30, 2001, also primarily as a result of cash generated by operating activities. Also, during the quarter ended June 30, 2002, the Company liquidated approximately $235,000 in short-term equity investments, and moved those funds into accounts in cash and cash equivalent accounts.

Net cash used in investing activities for the three months ended June 30, 2002 and 2001 was $299,000 and $392,000 respectively. Net cash used in investing activities for the three months ended June 30, 2002 consisted of additions to equipment and improvements and capitalized software and was partially offset by the proceeds from the sale of short term investments. Net cash used in investing activities for the three months ended June 30, 2001 consisted of additions to equipment and improvements and capitalized software. Management currently anticipates that additions to equipment and improvements for fiscal 2003 will be in excess of expenditures made during fiscal 2002 due to the relocation of the Company's principal administrative offices in California and the principal office of the Company's NextGen division.

At June 30, 2002, the Company had cash and cash equivalents of $28.9 million. Except for the Company's intention to expend funds for the development of complementary products to its existing product line, new versions of certain of its products for the client-server environment to take advantage of more powerful technologies and to enable a more seamless integration of the Company's products, and certain investments in furniture, fixtures, and equipment related to its relocation to new facilities in California and Pennsylvania, the Company has no other significant capital commitments.

The Company believes that its cash and cash equivalents on hand at June 30, 2002, together with cash flows from operations, if any, will be sufficient to meet its working capital and capital expenditure requirements for the balance of fiscal 2003.

Item 3. ***Qualitative and Quantitative Disclosures About Market Risk***

The Company has a significant amount of cash and short-term investments with maturities less than three months. This cash portfolio exposes the Company to interest rate risk as short-term investment rates can be volatile. Given the short-term maturity structure of the Company's investment portfolio, the Company believes that it is not subject to principal fluctuations and the effective interest rate of the Company's portfolio tracks closely to various short-term money market interest rate benchmarks.

PART II – OTHER INFORMATION

Item 1. ***Litigation.***

On April 22, 1997, a purported class action entitled JOHN P. CAVENY v. QUALITY SYSTEMS, INC., ET AL. was filed in the Superior Court of the State of California for the County of Orange, in which Mr. Caveny, on behalf of himself and all others who purchased the Company's Common Stock between June 26, 1995 and July 3, 1996, alleges that the Company, and Sheldon Razin, Robert J. Beck, Gregory S. Flynn, Abe C. LaLande, Donn Neufeld, Irma G. Carmona, John A. Bowers, Graeme H. Frehner, and Gordon L. Setran (all of the foregoing individuals were either officers, directors or both during the period from June 26, 1995 through July 3, 1996), as well as other defendants not affiliated with the Company, violated California Corporations Code Sections 25400 and 25500, California Civil Code Sections 1709 and 1710, and California Business and Professions Code Sections 17200 et. seq., by issuing positive statements about the Company that allegedly were knowingly false, in part, in order to assist the Company and the individual defendants in selling Common Stock at an inflated price in the Company's March 5, 1996 public offering and at other points during the class period. The complaint seeks compensatory and punitive damages in unspecified amounts, disgorgement, declaratory and injunctive relief, and attorneys' fees.

The Company and the other named defendants successfully demurred to the plaintiffs' claim under California Civil Code Sections 1709 and 1710, and that claim, which served as the only basis for plaintiffs' request for punitive damages, has been dismissed from both actions.

On January 25, 1999, the court denied plaintiffs' motion to certify the class representative and class legal counsel. Plaintiffs appealed that decision as to class legal counsel. On February 25, 2000, the Fourth District Court of Appeals affirmed the order disqualifying the class legal counsel. On May 9, 2000, the Court of Appeals issued its Remittur certifying its decision as final.

In May 2000, plaintiffs associated in additional class legal counsel, and moved for approval by the court. Upon defendants' objection, the court on August 17, 2000, denied plaintiffs' motion, and ordered plaintiffs to retain new class counsel.

At the end of November 2000, the plaintiffs retained new class counsel who substituted in for plaintiffs' previous class counsel. The Company and the other named defendants did not oppose plaintiffs' motion for approval of the new class counsel. On January 24, 2001, the court granted the motion to certify class legal counsel.

On March 27, 2001, the court approved a notice of class certification to be mailed to shareholders who are potential class members. Between April 9, 2001 and May 9, 2001, class notice was mailed to potential class members.

Merits-related discovery in the action, which had been stayed pending the appointment of class counsel, is now ongoing. In March 2002, defendant Graeme H. Frehner and certain other defendants not affiliated with the Company were dismissed from the action with prejudice by stipulated order. The parties are scheduled to appear in court for the next status conference on October 22, 2002. Trial in the action has been set for March 24, 2003.

In Management's opinion the outcome of this case is uncertain, and therefore no accrual has been made to the financial statements.

On May 14, 1997, a second purported class action entitled WENDY WOO v. QUALITY SYSTEMS, INC., ET AL. was filed in the same court, essentially repeating the allegations in the Caveny lawsuit and seeking identical relief. This action has for all purposes been consolidated with the Caveny action.

The Company is a party to various other legal proceedings incidental to its business, none of which are considered by the Company to be material.

Item 2. ***Changes in Securities and Use of Proceeds.***
None.

Item 3. ***Defaults Upon Senior Securities.***
None.

Item 4. ***Submissions of Matters to a Vote of Securities Holders.***
None.

Item 5. ***Other Information.***
None.

Item 6. ***Exhibits and Reports on Form 8-K.***
Exhibits:
99.1 Officers' Certification

Reports on Form 8-K:
None.

Pursuant to the requirements of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

QUALITY SYSTEMS, INC.

Date: August 12, 2002 By: /s/ LOUIS SILVERMAN
Louis Silverman
Chief Executive Officer

Date: August 12, 2002 By: /s/ PAUL HOLT
Paul Holt
Chief Financial Officer; Principal Accounting Officer

EXHIBIT 99.1

CERTIFICATIONS OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER 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 quarterly report on Form 10-Q of Quality Systems, Inc. (the "Company") for the quarterly period ended June 30, 2002 (the "Report"), the undersigned hereby certifies in his capacity as Chief Executive Officer of the Company, 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, as amended; and

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

Dated: August 12, 2002

By: /s/ LOUIS SILVERMAN
Louis Silverman
Chief Executive Officer

In connection with the quarterly report on Form 10-Q of Quality Systems, Inc. (the "Company") for the quarterly period ended June 30, 2002 (the "Report"), the undersigned hereby certifies in his capacity as Chief Financial Officer of the Company, 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, as amended; and

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

Dated: August 12, 2002

By: /s/ PAUL HOLT
Paul Holt
Chief Financial Officer