VERSAR INC
Form 10-K/A
September 24, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K/A
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended
June 26, 2009
Commission File
No. 1-9309

(Exact name of registrant as specified in its charter)

DELAWARE	**54-0852979**
(State or other jurisdiction of Incorporation or organization)	(I.R.S. employer identification no.)
6850 Versar Center, Springfield, Virginia	**22151**
(Address of principal executive offices)	(Zip code)

(703) 750-3000
(Registrant s telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:

Common Stock, $.01 par value
(Title of Class)
NYSE Amex
(Name of each exchange on which registered)

Securities registered pursuant to Section 12(g) of Act: NONE
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes o No þ
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes o No þ
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes þ No o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes o No o
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. o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer o	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company þ

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No þ

The aggregate market value of the voting stock held by non-affiliates of the registrant as of December 31, 2008 was approximately $25,790,780.

The number of shares of Common Stock outstanding as of September 4, 2009 was 9,083,835.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s Proxy Statement to be filed with the Securities and Exchange Commission with respect to the 2009 Annual Meeting of Stockholders are incorporated by reference into Part III hereof.

Explanatory Note

Versar, Inc. is filing this amendment to Form 10-K for the fiscal year ended June 26, 2009, which was filed with the Securities and Exchange Commission on September 22, 2009, to correct the Report of Independent Registered Public Accounting Firm included on page F-1, which contained a typographical error. In accordance with the requirements of Rule 12b-15 under the Securities Exchange Act of 1934, Versar is filing with this Amendment the complete text of its audited financial statements.

Except for the corrected report described above, this Form 10-K/A does not modify or update other disclosures in the Versar, Inc. 2009 Form 10-K.

PART IV

Item 15. Exhibits and Financial Statement Schedules

(1) Financial Statements:

The consolidated financial statements and financial statement schedules of Versar, Inc. and Subsidiaries are filed as part of this report and begin on page F-1.

a) Report of Independent Registered Public Accounting Firm

b) Consolidated Balance Sheets as of June 26, 2009 and June 27, 2008

c) Consolidated Statements of Income for the Years Ended June 26, 2009, June 27, 2008, and June 29, 2007

d) Consolidated Statements of Changes in Stockholders Equity for the Years Ended June 26, 2009, June 27, 2008 and June 29, 2007

e) Consolidated Statements of Cash Flows for the Years Ended June 26, 2009, June 27, 2008, and June 29, 2007

f) Notes to Consolidated Financial Statements

(2) Financial Statement Schedules:

a) Schedule II Valuation and Qualifying Accounts for the Years Ended June 26, 2009, June 27, 2008 and June 29, 2007

All other schedules, except those listed above, are omitted because they are not applicable or the required information is shown in the consolidated financial statements or note thereto.

(3) Exhibits:

The exhibits to this Form 10-K are set forth in a separate Exhibit Index which is included on pages 30 through 32 of this report.

Exhibit Index

Item No.	Description	Reference
3.1	Restated Articles of Incorporation of Versar, Inc. filed as an exhibit to the Registrant s Registration Statement on Form S-1 effective November 20, 1986 (File No. 33-9391)	(A)
3.2	Amended and Restated By-Laws of Versar, Inc.	(AE)
4	Specimen of Certificate of Common Stock of Versar, Inc.	(A)
10.10	Incentive Stock Option Plan *	(B)
10.11	Executive Tax and Investment Counseling Program	(A)
10.12	Nonqualified Stock Option Plan *	(B)
10.105	4P Architect-Engineering Contract dated March 14, 2003	(W)
10.107	Line of Credit Commitment Letter, dated September 16, 2003 between the Registrant and United Bank	(W)
10.113	2002 Stock Incentive Plan*	(Y)
10.114	Employment Agreement dated February 8, 2005 between Versar, Inc. and Theodore M. Prociv*	(Z)
10.115	Form of Stock Option Agreement*	(Z)
10.116	Air National Guard Contract dated July 6, 2005	(Z)
10.117	2005 Stock Incentive Plan and definitions as approved by the Board of Directors on September 7, 2005 and by the stockholders on November 16, 2005	(AA)
10.123	Modification Agreement of the Revolving Commercial Note, dated September 24, 2007, between Registrant and United Bank	(AB)
10.124	Amendment to Employment Agreement dated February 8, 2005 between Versar, Inc. and Theodore M. Prociv, September 25, 2007*	(AB)
10.125	Amended and Restated Change of Control Severance Agreements dated March 17, 2008 between the Registrant and each of Lawrence W. Sinnott, James C. Dobbs, Paul W. Kendall, Michael Abram and Jeffrey A. Wagonhurst (In reliance on instruction 2 to Item 601 of Regulation S-K, the Registrant has filed the form of Change of Control Severance Agreement entered into with each of the individuals listed above).*	(AC)
10.126		(AD)

	Employment agreement between Charles S. Cox and Versar, Inc. entered into on February 2, 2009 and effective as of January 3, 2009.*	
10.127	Amendment to Employment Agreement dated September 3, 2008 between Versar, Inc. and Mr. Theodore M. Prociv.*	35-47
10.128	Form of Indemnification Agreement*	(AE)

Item No.	Description	Reference
21	Subsidiaries of the Registrant	48
23	Consent of Independent Registered Public Accounting Firm, Grant Thornton LLP to the incorporation by reference of the previously filed Forms S-8.**	49
31.1	Certifications by Theodore M. Prociv, Chief Executive Officer and President Pursuant to Securities Exchange Rule 13a-14**	50
31.2	Certifications by Lawrence W. Sinnott, Exec. Vice President, Chief Operating Officer, Chief Financial Officer and Treasurer pursuant to Securities Exchange Rule 13a-14**	51
32.1	Certifications Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 Of the Sarbanes-Oxley Act of 2002, for the period ending June 26, 2009 by Theodore M. Prociv, Chief Executive Officer and President**	52
32.2	Certifications Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 Of the Sarbanes-Oxley Act of 2002, for the period ending June 26, 2009 by Lawrence W. Sinnott, Exec. Vice President, Chief Operating Officer, Chief Financial Officer and Treasurer**	53

* Indicates management contract or compensatory plan or arrangement

** Filed with this Form 10-K/A. All other exhibits were previously filed.

(A) Incorporated by reference to the similarly numbered exhibit to the Registrant s Form S-1 Registration Statement effective November 20, 1986 (File No. 33-9391).

(B) Incorporated by reference to the similarly numbered exhibit to the Registrant s Form 10-K Annual Report for the Fiscal Year Ended June 30, 1987 filed with the Commission on September 28, 1987.

(W) Incorporated by reference to similarly numbered exhibit to the Registrant s Form 10-K Annual Report for Fiscal Year Ended June 30, 2003 filed with the Commission on September 26, 2003.

(Y) Incorporated by reference to similarly numbered exhibit to the Registrant s Form S-8 Registration Statement filed with the Commission on November 4, 2005 (File No. 333-129489).

(Z) Incorporated by reference to similarly numbered exhibit to the Registrant s Form 10-K Annual Report for Fiscal Year Ended July 1, 2005 filed with the Commission on October 4, 2005.

(AA) Incorporated by reference to similarly numbered exhibit to the Registrant s Form 10-K Annual Report for Fiscal Year Ended June 30, 2006 filed with the Commission on September 19, 2006.

(AB) Incorporated by reference to similarly numbered exhibit to the Registrant s Form 10-K Annual Report for Fiscal Year Ended June 29, 2007 filed with the Commission on September 27, 2007.

(AC) Incorporated by reference to the exhibit to the Registrant s Form

8-K Current Report dated April 2, 2008 filed with the Commission on April 4, 2008.

(AD) Incorporated by reference to the exhibit to the Registrant s Form 8-K Current Report dated February 2, 2009 filed with the Commission on February 6, 2009.

(AE) Incorporated by reference to the exhibit to the Registrant s Form 8-K Current Report dated May 6, 2009 filed with the Commission on May 11, 2009.

SIGNATURES

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

VERSAR, INC.
(Registrant)

Date: September 24, 2009

/S/ Paul J. Heoper
Paul J. Hoeper
Chairman and Director

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant in the capacities and on the dates indicated.

SIGNATURES	TITLE	DATE
/S/ Paul J. Hoeper	Chairman and Director	September 24, 2009
Paul J. Hoeper		
/S/ Theodore M. Prociv	Chief Executive Officer, President, and	September 24, 2009
Theodore M. Prociv	Director	
/S/ Lawrence W. Sinnott	Executive Vice President, Chief	September 24, 2009
Lawrence W. Sinnott	Operating Officer, Chief Financial Officer, Treasurer, and Principal Accounting Officer	
/S/ Michael Markels, Jr.	Chairman Emeritus and Director	September 24, 2009
Michael Markels, Jr.		
/S/ Robert L. Durfee	Director	September 24, 2009
Robert L. Durfee		
/S/ James L. Gallagher	Director	September 24, 2009
James L. Gallagher		

SIGNATURES	TITLE	DATE
/S/ James V. Hansen	Director	September 24, 2009
James V. Hansen		
/S/ Amoretta M. Hoeber	Director	September 24, 2009
Amoretta M. Hoeber		
/S/ Amir A. Metry	Director	September 24, 2009
Amir A. Metry		
/S/ Anthony L. Otton	Director	September 24, 2009
Anthony L. Otten		

Report of Independent Registered Public Accounting Firm

Board of Directors and
Shareholders of Versar, Inc.

We have audited the accompanying consolidated balance sheets of Versar, Inc. (a Delaware corporation) and subsidiaries as of June 26, 2009 and June 27, 2008, and the related consolidated statements of income, stockholders equity, and cash flows for each of the three years in the period ended June 26, 2009. Our audits of the basic financial statements included the financial statement schedule listed in the index appearing under Item 15(2)(a). These financial statements and financial statement schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Versar, Inc. as of June 26, 2009 and June 27, 2008 and the results of their operations and their cash flows for each of the three years in the period ended June 26, 2009 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

/S/ Grant Thornton LLP
McLean, Virginia
September 21, 2009

VERSAR, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(In Thousands, except per share amounts)

	June 26, 2009	June 27, 2008
ASSETS		
Current assets		
Cash and cash equivalents	$ 8,400	$ 11,938
Accounts receivable, net	27,695	21,596
Prepaid expenses and other current assets	1,207	1,080
Deferred income taxes	720	1,015
Total current assets	38,022	35,629
Property and equipment, net	2,348	2,152
Deferred income taxes	765	517
Goodwill	776	776
Other assets	683	754
Total assets	$ 42,594	$ 39,828
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable	$ 7,405	$ 7,731
Billings in excess of revenue		156
Accrued salaries and vacation	1,959	1,719
Accrued bonus	1,358	2,066
Other liabilities	1,787	1,686
Total current liabilities	12,509	13,358
Other long-term liabilities	1,431	1,417
Total liabilities	13,940	14,775
Commitments and contingencies		
Stockholders equity		
Common stock, $.01 par value; 30,000,000 shares authorized; 9,193,635 shares and 9,059,135 shares issued; 9,074,300 shares and 8,975,101 shares outstanding	92	91
Capital in excess of par value	27,734	27,115
Retained earnings (accumulated deficit)	1,615	(1,554)
Treasury stock, at cost (119,335 and 84,034 shares, respectively)	(706)	(578)
Accumulated other comprehensive loss	(81)	(21)
Total stockholders equity	28,654	25,053

Total liabilities and stockholders equity	$ 42,594	$ 39,828

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

VERSAR, INC. AND SUBSIDIARIES
Consolidated Statements of Income
(In thousands, except per share amounts)

	Years Ended June 26, 2009	June 27, 2008	June 29, 2007
GROSS REVENUE	$ 112,196	$ 115,602	$ 102,726
Purchased services and materials, at cost	60,583	68,507	62,750
Direct costs of services and overhead	37,133	33,307	29,154
GROSS PROFIT	14,480	13,788	10,822
Selling, general and administrative expenses	8,876	8,297	6,669
OPERATING INCOME	5,604	5,491	4,153
OTHER EXPENSE			
Loss on marketable securities	328		
Interest expense (income)	36	(173)	(24)
INCOME BEFORE INCOME TAXES	5,240	5,664	4,177
Income tax expense (benefit)	2,071	2,273	(1,105)
NET INCOME	$ 3,169	$ 3,391	$ 5,282
NET INCOME PER SHARE BASIC	$ 0.35	$ 0.38	$ 0.64
NET INCOME PER SHARE DILUTED	$ 0.35	$ 0.36	$ 0.62
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING BASIC	9,123	8,932	8,201
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING DILUTED	9,150	9,331	8,466

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

VERSAR, INC.
Consolidated Statements of Changes in Stockholders Equity
(In thousands)
Years Ended June 26, 2009, June 27, 2008, and June 29, 2007

	Common Stock Shares	Common Stock Amount	Capital in Excess of Par Value	(Accumu-Lated Deficit) Retained Earnings	Treasury Shares	Treasury Stock	Accumu-lated Other Compre-hensive Income (Loss)	Total Stock-holders Equity
Balance, July 1, 2006	8,145	$ 81	$ 22,790	$ (10,227)	(16)	$ (72)	$	$ 12,572
Exercise of stock options	231	2	713					715
Issuance of restricted stock	21	1	84					85
Exercise of stock warrants	180	2	717					719
Stock exchange	129	1	327					328
Treasury stock					(38)	(327)		(327)
Share-based compensation			48					48
Net income				5,282				5,282
Balance, June 29, 2007	8,706	87	24,679	(4,945)	(54)	(399)		19,422
Exercise of stock options	275	3	1,052					1,055
Issuance of restricted stock	78	1	507					508
Treasury stock					(30)	(179)		(179)
Share-based compensation			303					303
Tax benefit from exercise of stock options			574					574
Comprehensive Income								
Net income				3,391				3,391
Other Comprehensive							(21)	(21)

Income								
Foreign currency translations Adjustments								
Total Comprehensive Income								3,370
Balance, June 27, 2008	9,059	91	27,115	(1,554)	(84)	(578)	(21)	25,053
Exercise of stock options	26		48					48
Issuance of restricted stock	109	1	691					692
Treasury stock					(35)	(128)		(128)
Tax shortfall in exercise of stock options			(120)					(120)
Comprehensive Income								
Net income				3,169				3,169
Other comprehensive income								
Foreign currency translations Adjustments							(60)	(60)
Total Comprehensive Income								3,109
Balance, June 26, 2009	9,194	$ 92	$ 27,734	$ 1,615	(119)	$ (706)	$ (81)	$ 28,654

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

VERSAR, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
(In thousands)

	Years Ended		
	June 26, 2009	June 27, 2008	June 29, 2007
Cash flows from operating activities			
Net income	$ 3,169	$ 3,391	$ 5,282
Adjustments to reconcile net income to net cash (used in) provided by continuing operations			
Depreciation and amortization	958	876	687
Loss on sale of property and equipment	1		19
Provision for doubtful accounts receivable	155	1	336
Loss on marketable securities	328		
Loss (gain) on life insurance policy cash surrender value	116	29	(39)
Deferred tax (benefit) expense	(114)	1,952	(1,200)
Share-based compensation	692	811	132
Tax benefits on share-based compensation		(574)	
Changes in assets and liabilities			
(Increase) decrease in accounts receivable	(6,256)	909	(6,616)
(Increase) decrease in prepaid expenses and other assets	60	199	187
(Decrease) increase in accounts payable	(260)	(2,723)	4,504
Increase in accrued salaries and vacation	240	115	130
(Decrease) increase in other liabilities	(823)	(12)	2,320
Net cash (used in) provided by continuing operations	(1,734)	4,974	5,742
Changes in net assets/liabilities of discontinued operations			(285)
Net cash (used in) provided by operating activities	(1,734)	4,974	5,457
Cash flows from investing activities			
Purchase of property and equipment	(1,172)	(722)	(693)
Purchase of marketable securities	(3,000)		
Proceeds from sale of marketable securities	2,672		
Premium paid on life insurance policies	(38)	(39)	(43)
Short term financing loan	(200)		
Net cash used in investing activities	(1,538)	(761)	(736)
Cash flows from financing activities			
Purchase of treasury stock	(128)	(179)	(327)
Proceeds from exercise of options and warrants	48	1,055	1,762
Tax benefit on exercise of share-based compensation		574	

Net cash (used in) provided by financing activities	(280)	1,450	1,435
Effect of exchange rate changes	14	(21)	
Net (decrease) increase in cash and cash equivalents	(3,538)	5,642	6,156
Cash and cash equivalents at the beginning of the year	11,938	6,296	140
Cash and cash equivalents at the end of the year	$ 8,400	$ 11,938	$ 6,296
Supplementary disclosure of cash flow information:			
Cash paid during the period for			
Interest	$ 60	$ 57	$ 70
Income Taxes	$ 1,762	$ 199	$ 55

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

VERSAR, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE A SIGNIFICANT ACCOUNTING POLICIES

Principles of consolidation and business operations: Versar, Inc., a Delaware corporation organized in 1969 (the Company or Versar), is a project and program management firm that provides the government, municipalities, and the private sector with value-added, high quality innovative solutions for infrastructure, facilities management, construction, environmental quality, professional services, defense and homeland security needs. Versar operates in four primary business segments: (1) Program Management, (2) Compliance and Environmental Programs, (3) Professional Services, and (4) National Security. The accompanying consolidated financial statements include the accounts of Versar, Inc. and its wholly-owned subsidiaries (Versar or the Company). All significant intercompany balances and transactions have been eliminated in consolidation. The Company s major business segments are Program Management, Compliance and Environmental Programs, Professional Services, and National Security (see Note B). The Company has evaluated subsequent events through September 21, 2009, the date in which the financial statements were issued.

Accounting estimates: The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which require 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 may differ from those estimates.

Contract accounting: Contracts in process are stated at the lower of actual cost incurred plus accrued profits or incurred costs reduced by progress billings. The Company records income from major fixed-price contracts, extending over more than one accounting period, using the percentage-of-completion method. During performance of such contracts, estimated final contract prices and costs are periodically reviewed and revisions are made as required. The effects of these revisions are included in the periods in which the revisions are made. On cost-plus-fee type contracts, revenue is recognized to the extent of costs incurred plus a proportionate amount of fee earned, and on time-and-material contracts, revenue is recognized to the extent of billable rates times hours delivered plus material and other reimbursable costs incurred. Losses on contracts are recognized when they become known. Disputes arise in the normal course of the Company s business on projects where the Company is contesting with customers for collection of funds because of events such as delays, changes in contract specifications and questions of cost allowability or collectibility. Such disputes, whether claims or unapproved change orders in the process of negotiation, are recorded at the lesser of their estimated net realized value or actual costs incurred and only when realization is probable and can be reliably estimated. Claims against the Company are recognized where loss is considered probable and reasonably determinable in amount. Management reviews outstanding receivables on a regular basis and assesses the need for reserves taking into consideration past collection history and other events that bear on the collectibility of such receivables.

Pre-contract costs: Costs incurred by Versar prior to the execution of a contract, including bid and proposal costs, are expensed when incurred regardless of whether the bid is successful.

Depreciation and amortization: Property and equipment are carried at cost. Depreciation and amortization are computed on a straight-line basis over the estimated useful lives of the assets. Assets are evaluated in accordance with SFAS 144 Accounting for Impairment or Disposal of Long Lived Assets and written down to fair value when appropriate.

Goodwill and other intangible assets: The carrying value of goodwill is approximately $776,000 which relates to the acquisition of Versar Global Solutions, Inc., which is now part of the Program Management business segment. In performing its goodwill impairment analysis, management has utilized a market-based valuation approach to determine the estimated fair value of the Program Management business segment. Management engages outside professionals and valuation experts annually, to assist in performing this analysis and would test more often if events or circumstances warrant it. The Company has elected to perform the annual goodwill impairment review on June 30 of each year. An analysis was performed on public companies and company transactions to prepare a market-based valuation. Based upon the analysis, the estimated fair value of the Program Management business segment exceeds the carrying value of the net assets of $12.7 million. Therefore, management concluded that the goodwill was not impaired.

Direct costs of services and overhead: These expenses represent the cost to Versar of direct and overhead staff, including recoverable overhead costs and unallowable costs that are directly attributable to contracts performed by the Company.

Notes receivable: Include short term receivables made in order to accelerate and advance the Company s business and business opportunities.

VERSAR, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Income taxes: The Company recognizes deferred tax liabilities and assets for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of certain assets and liabilities. A valuation allowance is established, as necessary, to reduce deferred income tax assets to the amount expected to be realized in future periods.

Asset retirement obligation: During fiscal year 2007, the Company recorded an asset retirement obligation associated with the estimated clean-up costs for its chemical laboratory in its National Security business segment. In accordance with SFAS 143, the Company estimated the costs to clean up the laboratory and return it to its original state at a present value of approximately $497,000. The Company currently estimates the amortization and accreation expense to be between $180,000 to $190,000 per year over the next 1 1/2 years. The Company is currently pursuing reimbursement for such costs and other costs from the U.S. Army as a significant portion of the chemical agent that was used in the chemical laboratory was government owned. If the Company determines that the estimated clean up cost is larger than expected or the likelihood of recovery from the U.S. Army is remote, such adjustments will be reflected when they become known in accordance with SFAS 143. At June 26, 2009, the Company has accrued approximately $586,000 long-term liability to clean up the chemical laboratory.

Share-based compensation: The Company records share based compensation in accordance with Financial Accounting Standards Board (FASB) SFAS No. 123 (Revised 2004), Share-Based Payment (SFAS 123(R)). This statement requires companies to recognize the cost of employee services received in exchange for awards of equity instruments based on the grant-date fair value of those awards (the fair-value-based method).

As of June 26, 2009, options to purchase common stock under the plans were substantially vested except for options to purchase 10,000 shares of common stock, which will vest based on the achievement of market and service conditions.

The Company did not record share-based compensation expense related to the vesting of the previously granted stock options in its fiscal year 2009. The Company recorded approximately $4,000 and $18,000 of share-based compensation expenses for fiscal years 2008 and 2007, respectively.

The Company awarded 125,000 shares, 121,500 shares and 42,000 shares of restricted stock to directors and employees in fiscal years 2009, 2008 and 2007, respectively. Share-based compensation expense related to restricted stock for fiscal years 2009, 2008 and 2007 was approximately $692,000, $807,000 and $114,000, respectively.

Net income per share: Basic net income per common share is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted net income per common share also includes common equivalent shares outstanding during the period, if dilutive. The Company s common equivalent shares consist of shares to be issued under outstanding stock options and shares of unvested restricted stock.

VERSAR, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The following is a reconciliation of weighted average outstanding shares for purposes of calculating basic net income per share compared to diluted net income per share, in thousands:

		Years Ended	
	June 26, 2009	June 27, 2008	June 29, 2007
		(In thousands)	
Weighted average number of shares outstanding basic	9,123	8,932	8,201
Effect of assumed exercise of stock options and vesting of restricted stock	27	399	265
Weighted average number of shares outstanding diluted	9,150	9,331	8,466

For fiscal years 2009, 2008 and 2007, options to purchase approximately 169,000, 10,000 and 30,000 shares, respectively, were not included in the computation of diluted earnings per share because the effect would be anti-dilutive.

Deferred compensation: The Company permitted certain employees to defer a portion of their compensation, during fiscal years 1988 through 1991, to provide for future annual payments, including interest. Interest is accrued on a monthly basis at the amount stated in each employee s agreement. The Company had liabilities for deferred compensation of $604,000 and $636,000 at June 26, 2009 and June 27, 2008, respectively, which are included in other long-term liabilities on the accompanying consolidated balance sheets. Versar purchased key-man life insurance policies to fund the amounts due under the deferred compensation agreements. The cash surrender value of the policies was $487,000 and $566,000 at June 26, 2009 and June 27, 2008, respectively. The face value of the life insurance policies is in excess of the deferred compensation liability.

Cash and cash equivalents: All investments with an original maturity of three months or less when purchased are considered to be cash equivalents.

Foreign Currency Translation: The financial position and results of operations of the Company s foreign affiliates are translated using the local currency as the functional currency. Assets and liabilities of the affiliates are translated at the exchange rate in effect at year-end. Income statement accounts are translated at the average rate of exchange prevailing during the year. Translation adjustments arising from the use of differing exchange rates from period to period are included in accumulated other comprehensive income in stockholders equity. Gains and losses resulting from foreign currency transactions included in operations are not material for the periods presented. At June 26, 2009, the Company has approximately $540,000 of cash held in foreign banks.

Fair value of financial instruments: The carrying amounts of Versar s cash and cash equivalents, accounts receivable, accounts payable and amounts included in other current assets and current liabilities that meet the definition of a financial instrument approximate fair value because of the short-term nature of these amounts.

Classification: Certain prior year information has been reclassified to conform to current year presentation.

New accounting pronouncements: In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141(R),*Business Combinations* (SFAS 141(R)). SFAS 141(R) changes the requirements for an acquiring entity s recognition and measurement of the assets acquired and liabilities assumed in a business combination. This statement is effective for fiscal years beginning after December 15, 2008. This standard will have an impact on accounting for business combinations but the effect is dependent upon acquisitions at that time.

VERSAR, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

In April 2009, the FASB issued FSP FAS 141(R)-1, Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies, (FSP FAS 141(R)-1). The FSP FAS 141(R)-1 amends and clarifies Statement of Financial Accounting Standards (SFAS) No. 141 (revised 2007), Business Combinations. FSP FAS 141(R)-1 is effective for assets or liabilities arising from contingencies in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. FSP FAS 141(R)-1 will have an impact on accounting for business combinations but the effect is dependent upon acquisitions at that time.

In September 2006, the Financial Accounting Standard Board (FASB) issued SFAS No. 157, *Fair Value Measurements* (SFAS 157), which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. In February 2008, FASB issued FASB Staff Position (FSP) No. FAS 157-2, *Effective Dates of FASB Statement No. 157*, which deferred the effective date of SFAS 157 for all nonrecurring fair value measurements of nonfinancial assets and liabilities until fiscal years beginning after November 15, 2008. Our adoption of SFAS 157 on December 29, 2008 was limited to financial assets and liabilities and had no impact on our consolidated financial statements. We do not believe this standard will have an effect on the non-financial assets and non-financial liabilities in our consolidated financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160,*Noncontrolling Interests in Consolidated Financial Statements An Amendment of ARB No. 51* (SFAS 160). SFAS 160 establishes new accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 is effective for fiscal years beginning on or after December 15, 2008. The Company does not believe the adoption of SFAS 160 will have a material impact on its consolidated financial statements.

In April 2008, the Financial Accounting Standards board issued FASB Staff Position (FSP) FAS 142-3, Determination of the Useful Life of Intangible Assets, to provide guidance for determining the useful life of recognized intangible assets and to improve consistency between the period of expected cash flows used to measure the fair value of a recognized intangible asset and the useful life of the intangible asset as determined under FASB Statement 142, Goodwill and Other Intangible Assets. The FSP requires that an entity consider its own historical experience in renewing or extending similar arrangements. However, the entity must adjust that experience based on entity-specific factors included in Statement 142. If the Company lacks historical experience to consider for similar arrangements, it would consider assumptions that market participants would use about renewal or extension, as adjusted for the entity-specific factors under Statement 142. The Company will adopt FSP FAS 142-3 in fiscal year 2010. The Company believes that upon adoption, FSP FAS 142-3 will not have an effect on the Company s financial statements.

In November 2008, the Financial Accounting Standards Board ratified a consensus opinion reached by the Emerging Issues Task Force (EITF) on EITF Issue 08-6, Equity Method Investment Accounting Considerations, to clarify accounting and impairment considerations involving equity method investments after the effective date of both FASB Statement 141 (revised 2007), Business Combinations, and FASB Statement 160, Noncontrolling Interests in Consolidated Financial Statements. EITF Issue 08-6 includes the Task Force s conclusions on how an equity method investor should (1) initially measure its equity method investment, (2) account for impairment charges recorded by its investee, and (3) account for shares issued by the investee. EITF Issue 08-6 is effective for fiscal years beginning on or after December 15, 2008. The Company adopted EITF Issue 08-6 effective June 26, 2009 on a prospective basis. The Company does not currently have any investments that are accounted for under the equity method, and as a result, does not expect the standard to have a significant effect on its financial statements.

In May 2009, the FASB issued SFAS No. 165, Subsequent Events, (SFAS No. 165). SFAS No. 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS No. 165 is effective for interim and annual periods ending after June 15, 2009.

VERSAR, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

In June 2009, the FASB issued SFAS No. 168, The FASB Accounting Standards CodificationTM and the Hierarchy of Generally Accepted Accounting Principles   a replacement of FASB Statement No. 162, (SFAS No. 168). SFAS No. 168 establishes that the FASB Accounting Standards CodificationTM (Codification) will become the source for authoritative United States generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. Effective for financial statements issued for interim and annual periods ending after September 15, 2009 the Codification will supersede all then-existing non-SEC accounting and reporting standards. Effective for the first quarter of 2010 references to legacy GAAP will be replaced by references to the Codification, where appropriate.

NOTE B BUSINESS SEGMENTS

The Company evaluates and measures the performance of its business segments based on gross revenue, gross profit and operating income. As such, selling, general and administrative expenses, interest and income taxes have not been allocated to the Company s business segments.

The Company s business is currently operated through four business segments as follows: Program Management, Compliance and Environmental Programs, Professional Services, and National Security.

These segments were segregated based on the nature of the work, business processes, customer base and the business environment in which each of the segments operates.

The Program Management business segment manages larger more complex projects with business processes and management unique to the rest of the Company. The Compliance and Environmental Programs business segment provides regulatory and environmental consulting support to several federal government and municipal agencies. The Professional Services business segment provides outsourced personnel to various government agencies providing our clients with cost-effective resources. The National Security business segment provides unique solutions to the federal government including testing and evaluation and personal protective solutions.

VERSAR, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Summary of financial information for each of the Company s segments follows:

	Years Ended June 26, 2009	June 27, 2008 (In thousands)	June 29, 2007
GROSS REVENUE			
Program Management	$ 71,526	$ 68,896	$ 58,765
Compliance and Environmental Programs	19,649	30,429	29,839
Professional Services	11,476	8,101	7,318
National Security	9,545	8,176	6,804
	$ 112,196	$ 115,602	$ 102,726
GROSS PROFIT (A)			
Program Management	$ 10,467	$ 9,398	$ 7,037
Compliance and Environmental Programs	884	2,390	2,313
Professional Services	1,734	1,290	1,257
National Security	1,395	710	215
	$ 14,480	$ 13,788	$ 10,822
Selling, general and administrative expenses	(8,876)	(8,297)	(6,669)
OPERATING INCOME	$ 5,604	$ 5,491	$ 4,153

(A) Gross Profit is defined as gross revenue less purchased services and materials and direct costs of services and overhead.

	Years Ended June 26, 2009	June 27, 2008
	(In thousands)	
IDENTIFIABLE ASSETS		
Program Management	$ 19,531	$ 11,405
Compliance and Environmental Programs	5,910	8,762
Professional Services	2,561	1,554

National Security	2,447	2,693
Corporate and Other	12,145	15,414
Total Assets	$ 42,594	$ 39,828

VERSAR, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE C CUSTOMER INFORMATION

A substantial portion of the Company s service revenue is derived from contracts with the U.S. Federal government as follows:

	Years Ended		
	June 26, 2009	June 27, 2008	June 29, 2007
		(In Thousands)	
U.S. Department of Defense	$ 92,583	$ 88,245	$ 65,997
U.S. Environmental Protection Agency	1,891	2,399	2,753
Other U.S. Government Agencies	2,576	3,657	16,512
Total U.S. Federal Government	$ 97,050	$ 94,301	$ 85,262

Majority of the Department of Defense works are to support the reconstruction of Iraq and Afghanistan with the U.S. Air Force and U.S. Army. Revenue was approximately $63 million, $62 million and $40 million for fiscal years 2009, 2008 and 2007, respectively.

NOTE D NOTES RECEIVABLE

In June 2009, the company agreed to provide short term interim financing of $400,000 to General Power Green Energy, LLC (GPC) to cover project start up costs. The project is to construct a green 25 mega watts co-generation plant by burning landfill gas in turbine engines equipped with a steam generation unit. The note carries an annual interest rate of 10 percent and is due by March 31, 2010 or earlier upon project financing. In addition, Versar will provide the program management and construct the facility. Versar also received a 7.5% ownership interest in connection with the loan. The Company has not valued the 7.5% ownership interest due to the fact that GPC is in its developmental stage. The fair value of the equity interest could not be determined at this time. Approximately, $200,000 of the note was funded in late June 2009 and the balance in July 2009. The notes receivable is included in the June 26, 2009 balance sheet as part of the other current assets.

NOTE E ACCOUNTS RECEIVABLE

	Years Ended	
	June 26, 2009	June 27, 2008
	(In thousands)	
Billed receivables		
U.S. Government	$ 9,516	$ 10,312
Commercial	8,483	2,063
Unbilled receivables		
U.S. Government	9,742	9,282
Commercial	423	282
	28,164	21,939
Allowance for doubtful accounts	(469)	(343)
	$ 27,695	$ 21,596

Unbilled receivables represent amounts earned which have not yet been billed and other amounts which can be invoiced upon completion of fixed-price contract milestones, attainment of certain contract objectives, or completion of federal and state governments incurred cost audits. Management anticipates that such unbilled

VERSAR, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

receivables will be substantially billed and collected in fiscal year 2010, therefore, they have been presented as current assets in accordance with industry practice.

NOTE F PROPERTY AND EQUIPMENT

	Estimated Useful Life in Years	Years Ended June 26, 2009	June 27, 2008
		(In thousands)	
Furniture and fixtures	10	$ 824	$ 827
Equipment	3 to 10	7,762	7,029
Capital leases	Life of lease	568	568
Leasehold improvements	Shorter of lease term or asset life	2,184	2,115
		11,338	10,539
Accumulated depreciation and amortization		(8,990)	(8,387)
		$ 2,348	$ 2,152

Depreciation and amortization of property and equipment was $958,000, $876,000 and $687,000 for the years ended June 26, 2009, June 27, 2008 and June 29, 2007, respectively.

Maintenance and repair expense approximated $233,000, $268,000 and $251,000 for the years ended June 26, 2009, June 27, 2008 and June 29, 2007, respectively.

NOTE G MARKETABLE SECURITIES

During the first quarter of fiscal year 2009, the Company recorded a $352,000 loss on marketable securities the Company was holding in the FISCO Income Plus Fund. The FISCO fund received an immediate demand margin call from its broker, UBS. Rather than allow the fund the customary time to satisfy the margin call at the end of the day, UBS demanded the fund cover all calls and puts at high premiums immediately or indicated it would take control and start liquidating the fund. The fund has terminated its relationship with UBS and transferred the assets to a new custodian. The fund has taken legal action against UBS to cover its losses. The Company will participate in any recovery from any such action. The Company has liquidated its remaining assets from marketable securities and moved them to cash with its primary bank due to the volatile nature of the market. During the remaining periods of fiscal year 2009, the Company recovered $24,000 of the initial loss before the funds were liquidated from the FISCO fund. A loss on marketable securities of $328,000 is reflected in the consolidated statement of income for the year ended June 26, 2009, as a result of the liquidation of the FISCO fund.

NOTE H DEBT

The Company has a line of credit facility with United Bank (the Bank) that provides for advances up to $7.5 million based upon qualifying receivables. Interest on borrowings is based upon the prime rate of interest less $^1/2$%. Borrowing rates at June 26, 2009 and June 27, 2008 were 2.75% and 4.5%, respectively. The Company currently has a letter of credit of $455,147, which serves as collateral for surety bond coverage provided by the Company s insurance carrier against project construction work. The letter of credit reduces the Company s borrowing base on the line of credit. The line of credit capacity at of June 26, 2009 was approximately $7.0 million.

VERSAR, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Obligations under the credit facility are guaranteed by the Company and each subsidiary individually and collectively are secured by accounts receivable, equipment and intangibles, plus all insurance policies on property constituting collateral. The line of credit matures in November 2009. The Company is in the process of renewing the new credit facility with United Bank. The Company has obtained a commitment letter from United Bank to extend its line of credit to September 30, 2010. The line of credit is and will continue to be subject to certain covenants related to the maintenance of financial ratios. These covenants require a minimum tangible net worth of $22.5 million; a maximum total liabilities to tangible net worth ratio not exceed 2.5 to 1; and a minimum current ratio of at least 1.25 to 1. Borrowings under the extended line of credit will be at prime less $^1/2$% with a floor interest rate of 3.5%. Failure to meet the covenant requirements gives the Bank the right to demand outstanding amounts due under the line of credit, which may impact the Company s ability to finance its working capital requirements. As of June 26, 2009, the Company had no outstanding borrowings and was in compliance with the financial covenants.

NOTE I STOCK OPTIONS

In fiscal year 2009, the Company awarded 125,000 shares of restricted stock at a fair market value of approximately $621,000 to executive officers, employees and directors. The awards vest over a period of 4.5 months to 16.5 months. Stock-based compensation expense relating to vested stock options and restricted stock awards totaled approximately $692,000, $811,000 and $132,000 for fiscal years 2009, 2008 and 2007 and was included in the direct costs of services and overhead lines of the Consolidated Statements of Income. During fiscal year 2009, incentive stock options to purchase 6,000 shares of common stock and non-qualified stock options to purchase 20,000 shares of common stock with intrinsic value of approximately $6,200 and $42,000, respectively, were exercised. At June 26, 2009, there were approximately 39,000 shares of restricted stock valued at $181,000 to be amortized over the next 12 months.

In November 2005, the stockholders approved the Versar, Inc. 2005 Stock Incentive Plan (the 2005 Plan). The 2005 Plan provides for grants of incentive awards, including stock options, SARS, restricted stock, restricted stock units and performance based awards, to directors, officers and employees of the Company and its affiliates as approved from time to time by the Company s Compensation Committee. Only employees may receive stock options classified as incentive stock options , also known as ISO s . The per share exercise price for options and SARS granted under the 2005 Plan may not be less than the fair market value of the common stock on the date of grant. A maximum of 400,000 shares of common stock may be awarded under the 2005 Plan. No single director, officer, or employee may receive awards of more than 100,000 shares of common stock during the term of the 2005 Plan. The ability to make awards under the 2005 Plan will terminate in November 2015. As of June 26, 2009, approximately 90,000 shares are available for future grant under the 2005 Plan.

The Company also maintains the Versar 2002 Stock Incentive Plan (the 2002 Plan), the Versar 1996 Stock Option Plan (the 1996 Plan) and the Versar 1992 Stock Option Plan (the 1992 Plan).

Under the 2002 Plan, restricted stock and other types of stock-based awards were granted to any employee, service provider or director to whom a grant was approved from time to time by the Company s Compensation Committee. A service provider is defined for purposes of the 2002 Plan as an individual who is neither an employee nor a director of the Company or any of its affiliates but who provides the Company or one of its affiliates substantial and important services. As of June 26, 2009, there were vested stock options to purchase 282,970 shares of common stock outstanding under the 2002 Plan.

Under the 1996 Plan, options were granted to key employees, directors and service providers at the fair market value on the date of grant. Each option expires on the earlier of the last day of the tenth year after the date of grant or after expiration of a period designated in the option agreement. The 1996 Plan has expired and no additional options may be granted under this plan. The Company will continue to maintain the plan until all previously granted options have been exercised, forfeited or expire. As of June 26, 2009, there were vested stock options to purchase 153,761 shares of common stock outstanding under the 1996 Plan.

VERSAR, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Under the 1992 Plan, options were granted to key employees at the fair market value on the date of grant and became exercisable during the five-year period from the date of the grant at 20% per year. Options were granted with a ten year term and expire if not exercised by the tenth anniversary of the grant date. The 1992 Plan has expired and no additional options may be granted under this plan. The Company will continue to maintain the plan until all previously granted options have been exercised, forfeited or expire. As of June 26, 2009, there were vested stock options to purchase 83,500 shares of common stock outstanding under the 1992 Plan.

Total incentive stock options granted under the 2002, 1996, and 1992 Plans are as follows:

	Optioned Shares	Weighted-Average Option Price Per Share	Total
	(In thousands, except per share price)		
Outstanding at June 30, 2006	1,026	$ 3.13	$ 3,210
Exercised	(332)	2.87	(952)
Cancelled	(27)	3.72	(99)
Reclassified to non-qualified	(12)	3.50	(42)
Outstanding at June 29, 2007	656	$ 3.23	$ 2,117
Exercised	(219)	3.58	(784)
Cancelled	(7)	4.10	(27)
Outstanding at June 27, 2008	430	$ 3.03	$ 1,306
Exercised	(6)	2.19	(13)
Cancelled	(3)	3.45	(10)
Outstanding at June 26, 2009	421	$ 3.05	$ 1,283

Details of total exercisable incentive stock options at June 26, 2009 are as follows:

Number of Shares Underlying Options	Range of Option Price	Weighted-Average Option Price	Weighted-Average Remaining Life	Number of Shares Underlying Exercisable Options
		(In thousands, except as noted)		
261	$1.81 to $2.80	2.50	2.7-years	261
113	$3.40 to $3.82	3.73	5.1-years	113

47	$4.00 to $4.95		4.38	5.5-years	47
421		$	3.05	3.9-years	421

VERSAR, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Aggregate intrinsic value for all shares under the incentive stock option plan at June 26, 2009 is approximately $483,000.

Total non-qualified stock options granted under the 2002, 1996, and 1992 plans as follows:

	Optioned Shares	Weighted-Average Option Price Per Share	Total
	(In thousands, except per share price)		
Outstanding at June 30, 2006	203	$ 3.24	$ 659
Exercised	(29)	3.16	(92)
Cancelled	(14)	2.77	(37)
Reinstated	10	3.49	33
Reclassified from ISO	12	3.50	42
Outstanding at June 29, 2007	182	$ 3.32	$ 605
Granted	10	7.77	78
Exercised	(51)	4.87	(248)
Outstanding at June 27, 2008	141	$ 3.07	$ 435
Exercised	(20)	$ 1.75	(35)
Outstanding at June 26, 2009	121	$ 3.31	$ 400

Details of total exercisable Non-Qualified Stock Options at June 26, 2009 are as follows:

Number of Shares Underlying Options	Range of Option Price	Weighted-Average Option Price	Weighted-Average Remaining Life	Number of Shares Underlying Exercisable Options
(In thousands, except as noted)				
55	$ 1.81 to $2.80	1.91	3.5-years	55
27	$ 3.10 to $3.65	3.35	3.4-years	27
29	$ 4.14 to $4.58	4.35	5.5-years	29
10	$7.77	7.77	8.4-years	
121		$ 3.31	4.3-years	111

No stock options have been granted under the 2005 plan. Since its adoption, the Company has moved to granting restricted stock and restricted stock units in lieu of stock options.

The Company recorded share-based compensation expense related to the vesting of the previously granted stock options in its consolidated financial statements of approximately $4,000 and $18,000 for fiscal years 2008 and 2007, respectively. The Company did not record any share-based compensation expenses related to the vesting of previously granted stock options in fiscal year 2009. Had the remaining unvested options to purchase 10,000 shares of common stock vested in fiscal year 2009, the Company would have recorded approximately $42,000 share based compensation expense. The aggregate intrinsic value for all shares under the non-qualified plan at June 26, 2009 is

VERSAR, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

approximately $109,000. Aggregate intrinsic value for vested shares under the non-qualified plan at June 26, 2009 is approximately $145,000.

NOTE J INCOME TAXES

The income tax expense (benefit) applicable to income from continuing operations consists of the following:

	Years Ended		
	June 26, 2009	June 27, 2008	June 29, 2007
		(In thousands)	
Current			
Federal	$ 1,945	$ 274	$ 85
State	198	47	10
Foreign	42		
Deferred			
Federal	(225)	1,528	1,404
State	115	421	350
Foreign	(4)	3	
Valuation Allowance			(2,954)
	$ 2,071	$ 2,273	$ (1,105)

Deferred tax assets are comprised of the following (in thousands):

	June 26, 2009	June 27, 2008
Deferred Tax Assets:		
Employee benefits	$ 299	$ 295
Bad debt reserves	173	130
All other reserves	296	275
Alternative minimum tax credits		134
Net operating losses	86	196
State tax net operating losses		112
Depreciation	335	432
Accrued expenses	461	242
Other	202	132
Total Deferred Tax Assets	1,852	1,948
Valuation Allowance	(48)	(47)
Deferred Tax Liabilities:		
Goodwill	(189)	(177)

Asset retirement obligation	(79)	(189)
Foreign	(51)	(3)
Net Deferred Tax Assets	$ 1,485	$ 1,532

VERSAR, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Given the Company s history of earnings and improved projected pre-tax income for future periods, management concluded in fiscal year 2007 that it was more likely than not the U.S. deferred tax assets will be realized in future periods. As such, the valuation allowance was no longer necessary on the U.S. deferred tax assets and was reversed in fiscal year 2007. As of the end of fiscal years 2009 and 2008, the Company had a valuation allowance of approximately $48,000 and $47,000, respectively, related to deferred tax assets in certain foreign jurisdictions as it is not more likely than not that the deferred tax assets will be realized. The Company has established a valuation allowance on its Philippine operations as it is not more likely than not that the deferred tax assets will be realized for these operations in future periods as current projections indicate periods of pre-tax loss.

At June 26, 2009, the Company has net operating loss carryforwards of approximately $103,000 for federal income tax purposes, which will expire in the years 2010 through 2012.

In accordance with FASB Financial Interpretation No. 48 Accounting for Uncertainty in Income Taxes, the Company recognizes income tax benefits in its financial statements only when it is more likely than not that the tax positions creating those benefits will be sustained by the taxing authorities based on the technical merits of those tax positions. At June 26, 2009, the Company did not have any uncertain tax positions. The Company still has the 2008, 2007 and 2006 tax years open to audit in most jurisdictions.

The Company recognizes interest expense and penalties as a component of general and administrative expense.

A reconciliation of the Company s income tax expense (benefit) to the federal statutory rate is as follows:

	Years Ended		
	June 26, 2009	June 27, 2008	June 29, 2007
		(In thousands)	
Expected provision at federal statutory rate	$ 1,782	$ 1,923	$ 1,447
Change in valuation allowance	1	47	(2,954)
State income tax expense	204	221	183
Permanent items	35	27	40
Change in tax rates	42		
NOL adjustments and other	7	55	179
	$ 2,071	$ 2,273	$ (1,105)

Income taxes paid for the years ended June 26, 2009, June 27, 2008 and June 29, 2007 were $1,762,000, $199,000 and $55,000, respectively.

NOTE K EMPLOYEE SAVINGS AND STOCK OWNERSHIP PLAN

The Company continues to maintain a 401(k) Plan, which permits voluntary participation upon employment. The 401(k) Plan was adopted in accordance with Section 401(k) of the Internal Revenue Code.

Under the 401(k) Plan, participants may elect to defer up to 50% of their salary through contributions to the plan, which are invested in selected mutual funds or used to buy insurance. The Company matches 100% of the first 3% and 50% of the next 2% of the employee qualified contributions for a total match of 4%. The employer contribution may be made in the Company s stock or cash. In fiscal years 2009, 2008 and 2007, the Company made cash contributions of $828,000, $729,000 and $649,000, respectively. All contributions to the 401(k) Plan vest immediately.

VERSAR, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

In January 2005, the Company established an Employee Stock Purchase Plan (ESPP) under Section 423 of the United States Internal Revenue Code. The ESPP allows eligible employees of the Company and its designated affiliates to purchase, through payroll deductions, shares of common stock of the Company from the open market.

The Company will not reserve shares of authorized but unissued common stock for issuance under the ESPP. Instead, a designated broker will purchase shares for participants on the open market. Eligible employees may purchase the shares at a discounted rate equal to 95% of the closing price of the Company s shares on the NYSE AMEX on the purchase date.

GEOMET, a wholly-owned subsidiary of Versar, maintained a profit-sharing retirement plan for the benefit of its employees until January 2008. Under the plan, contributions were made at the discretion of GEOMET s Board of Directors. No contributions have been made to this plan since fiscal year 1998. Vesting occurred over time, such that an employee is 100% vested after seven years of participation. In January 2008, the GEOMET profit sharing plan was terminated and merged into the Company s 401(k) plan.

NOTE L COMMITMENTS AND CONTINGENCIES

Versar has a substantial number of U.S. Government contracts, and certain of these contracts are cost reimbursable. Costs incurred on these contracts are subject to audit by the Defense Contract Audit Agency (DCAA). All fiscal years through 2006 have been audited and closed. Management believes that the effect of disallowed costs, if any, for the periods not yet audited and settled with DCAA will not have a material adverse effect on the Company s consolidated financial position and results of operations.

The Company leases approximately 145,000 square feet of office space, as well as data processing and other equipment under agreements expiring through 2020. Minimum future obligations under operating and capital leases are as follows:

Years Ending June 30,		Total Amount (In thousands)
2010	$	2,777
2011		2,129
2012		1,937
2013		1,955
2014		1,633
2015 and thereafter		2,354
	$	12,785

Certain of the lease payments are subject to adjustment for increases in utility costs and real estate taxes. Total office rental expense approximated $2,845,000, $2,513,000 and $2,111,000, for 2009, 2008 and 2007, respectively. Lease concessions and other tenant allowances are amortized over the life of the lease on a straight line basis. For leases with fixed rent escalations, the total lease costs including the fixed rent escalations are totaled and the total rent cost is recognized on a straight line basis over the life of the lease.

On February 8, 2005, Versar, Inc. entered into an employment agreement with its Chief Executive Officer (CEO), Mr. Theodore M. Prociv. The agreement provides for base compensation of $285,000 and certain benefits that the CEO is entitled to under various termination conditions. The agreement was originally scheduled to expire on December 1, 2006 and was extended to December 1, 2007 in September 2006 and to December 1, 2008 in

VERSAR, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

September 2007. On September 3, 2008, the Compensation Committee extended Mr. Prociv s agreement for an additional year to December 1, 2009 and approved base salary of $355,000 for the year extension.

On February 2, 2009, Versar, Inc. entered into an employment agreement with Charles S. Cox, a Senior Vice President and head of the Company s international operations effective as of January 3, 2009. The agreement has a term of one year from its effective date and provides for base compensation of $390,000, which includes a base salary and certain additions for overseas service.

Legal Proceedings

Versar and its subsidiaries are parties from time to time to various legal actions arising in the normal course of business. The Company believes that any ultimate unfavorable resolution of these legal actions will not have a material adverse effect on its consolidated financial condition and results of operations.

NOTE M SUBSEQUENT EVENTS

Subsequent to the end of fiscal year 2009, the Company agreed to provide $750,000 of short term financing to Lemko Corporation to enable them to buy long lead telecommunication equipment for several upcoming projects. Lemko and Versar had earlier announced a joint initiative to pursue the rural broadband telecommunications market. The note bears an annual interest rate of 12% and is due by May 31, 2010. The note is secured by the equipment inventory. The note also has a conversion feature to a senior convertible debenture, which must be addressed by October 2009, or the remaining terms and conditions will remain in effect. The Company is currently evaluating this feature.

In fiscal year 2009, the Company announced that its international subsidiary, VIAP, Inc. entered into a joint venture with Technical Resources International Limited (TRIL) to create a business venture to provide project and program management to private entities in the United Arab Emirates and other Gulf Cooperation Countries. The new Company, VIAP Technical Resources, LTD will be 50% owned by VIAP and 50% by TRIL. The joint venture did not have any assets or operations as of year end. The Company will assess the accounting and reporting requirements for this joint venture under SFAS 160.

VERSAR, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE N QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

Unaudited quarterly financial information for fiscal years 2009 and 2008 is as follows (in thousands, except per share amounts):

	Fiscal Year 2009				Fiscal Year 2008			
Quarter Ending	June 26	Mar 27	Dec 26	Sep 26	Jun 27	Mar 28	Dec 28	Sep 28
Gross Revenue	$ 27,380	$ 31,851	$ 27,967	$ 24,998	$ 28,491	$ 28,874	$ 29,355	$ 28,882
Gross Profit	3,742	4,355	3,205	3,178	3,426	3,796	3,067	3,499
Operating income	1,625	1,830	1,007	1,142	1,011	1,546	1,211	1,723
Net income	$ 954	$ 1,125	$ 565	$ 525	$ 716	$ 913	$ 745	$ 1,017
Net income per share diluted	$ 0.10	$ 0.12	$ 0.06	$ 0.06	$ 0.08	$ 0.10	$ 0.08	$ 0.11
Weighted average number of shares outstanding diluted	9,307	9,199	9,112	9,198	9,406	9,257	9,231	9,268

Quarterly earnings per share data may not equal annual total due to fluctuations in common shares outstanding.

Schedule II

VERSAR, INC. AND SUBSIDIARIES
Valuation and Qualifying Accounts

	BALANCE AT BEGINNING OF YEAR	ADDITIONS CHARGED TO COSTS AND EXPENSES	CHARGE OFF	BALANCE AT END OF YEAR
ALLOWANCE FOR DOUBTFUL ACCOUNTS				
2007	348,501	335,518	(310,043)	373,976
2008	373,976	1,479	(32,492)	342,963
2009	342,963	154,477	(28,297)	469,143
DEFERRED TAX VALUATION ALLOWANCE				
2007	2,954,000		(2,954,000)	
2008		47,000		47,000
2009	47,000	1,000		48,000

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