

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

FORM 10-K

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

For the fiscal year ended March 31, 2000

OR

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

For the transition period from \_\_\_\_\_ to

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 (I.R.S. Employer Identification No.)  
Incorporation or Organization)

17822 East 17th Street, Tustin, California 92780  
(Address of Principal Executive Offices) (Zip Code)

Registrant's telephone number, including area code: (714) 731-7171

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

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

Title of each class	Name of each exchange on which registered:
Common Stock, par value \$.01 per share	NA

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  No

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

State the aggregate market value of the voting stock held by non-affiliates of the registrant as of May 31, 2000: \$19,749,660. (\*)

Indicate the number of shares outstanding of each of the registrant's classes of common stock as of May 31, 2000: 6,212,966.

## DOCUMENTS INCORPORATED BY REFERENCE

The information required by Part III of the Form 10-K is incorporated by reference from Registrant's Definitive Proxy Statement for its 2000 annual meeting which is to be filed with the Commission on or before July 29, 2000.

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(\* ) For purposes of this report, in addition to those shareholders which fall within the definition of "affiliates" under Rule 405 of the Securities Act of 1933, as amended, holders of ten percent or more of the Registrant's Common Stock are deemed to be affiliates.

## Item 1. BUSINESS.

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Except for the historical information contained herein, the matters discussed in this Annual Report on Form 10-K, including discussions of the Registrant's product development plans, business strategies and market factors influencing the Registrant's results, are forward-looking statements that involve certain risks and uncertainties. Actual results may differ from those anticipated by the Registrant as a result of various factors, both foreseen and unforeseen, including, but not limited to, the Registrant's ability to continue to develop new products and increase systems sales in markets characterized by rapid technological evolution; consolidation within the Registrant's target marketplace and among the Registrant's competitors; and, competition from larger, better capitalized competitors. Many other economic, competitive, governmental and technological factors could impact the Registrant's ability to achieve its goals and interested persons are urged to review the risks described under "Item 1. Business. Risk Factors." and in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations." as well as in the Registrant's other public disclosures and filings with the Securities and Exchange Commission.

## COMPANY OVERVIEW.

Quality Systems, Inc. ("QSI") and its wholly-owned subsidiaries, Clinitec International, Inc. ("Clinitec") and MicroMed Healthcare Information Systems, Inc. ("MicroMed"), (collectively, the "Company") develop and market healthcare information systems that automate medical and dental group practices, physician hospital organizations ("PHOs"), management service organizations ("MSOs"), community health centers 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 provide its clients with the ability to redesign patient care and other workflow processes, improve productivity, reduce information processing and administrative costs, and provide multi-site access to patient information. The Company's proprietary software systems include general patient information, electronic medical records, appointment scheduling, billing, insurance claims submission and processing, managed care plan implementation and referral management, treatment outcome studies, treatment planning, drug formularies, dental charting, and letter generation. Several of the Company's proprietary software systems may be operated remotely using thin client connectivity or a standard web browser. In addition to providing fully integrated software information solutions to its clients, the Company offers comprehensive hardware and software installation services, maintenance and support services, system training services, and electronic insurance claims submission services.

The Company currently has an installed base of more than 600 healthcare information systems serving PHOs, MSOs, group practices, specialty practices, dental schools and other healthcare organizations, each of which consists of from one to 250 physicians or dentists. The Company believes that as healthcare providers are increasingly required to reduce costs while maintaining the quality of healthcare, the Company will be able to capitalize on its strategy of providing fully integrated information systems and superior client service.

QSI is a California Corporation formed in 1974 and was founded with an early focus on providing information systems and services primarily for dental group practices. QSI's initial "turnkey" systems were designed to improve productivity while reducing information processing costs and personnel requirements. In the mid-1980's, QSI capitalized on the opportunity presented by the increasing pressure of cost containment on physicians and healthcare organizations and further expanded its information processing systems into the broader medical market. Today, QSI primarily develops and provides integrated character-based healthcare information systems utilizing a UNIX\* operating system for both the medical and dental markets ("Legacy Product"). These expandable systems operate on a stand-alone basis or in a networked environment.

During fiscal 1998, QSI released a new product, the Clinical Product Suite ("CPS"), a comprehensive dental solution designed specifically for the large dental group practice environment. CPS integrates the dental Legacy Product with a computer-based clinical information system that incorporates a wide range of clinical tools, including electronic charting of dental procedures, treatment plans and existing conditions; periodontal charting, via light-pen, voice-activation, or keyboard entry, for full periodontal examinations and PSR scoring; digital imaging of x-ray and intra-oral camera images; computer-based patient education modules; full access to patient information, treatment plans, and insurance plans; and document and image scanning for digital storage and linkage to the electronic patient record. CPS incorporates a Windows-based client/server technology consisting of one or more file servers together with any combination of desktops or laptops. The file server(s) used in connection with CPS utilize(s) a Windows NT\*\* operating system. Based on the server configuration chosen, CPS is scalable from one to hundreds of workstations.

QSI's wholly owned subsidiaries, Clinitec and Micromed, develop and sell both proprietary electronic medical records software and practice management systems under the product name of NextGen\*\*\*. Major product categories of the NextGen suite of applications 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), and a Patient-centric and Provider-centric Web Portal Solution (NextMD).

NextGen-emr allows healthcare providers to create and maintain medical records using a series of user-definable clinical "templates." Data is generally captured using a light pen or a mouse, and entries are then turned into sentences and/or paragraphs to create documentation. NextGen-emr also supports the scanning and annotation of paper documents, photographs and X-rays, and contains many other advanced features. NextGen-emr is marketed both in conjunction with the Company's practice management software offerings as well as on a stand-alone basis where NextGen-emr may interface with other practice management systems. The Company believes that it currently provides a comprehensive information management solution for the medical marketplace.

\* UNIX is a registered trademark of AT&T Corporation.

\*\* Microsoft Windows, Windows NT, Windows 95 and Windows 98 are registered Trademarks of Microsoft Corporation.

\*\*\* NextGen is a registered trademark of Clinitec International, Inc.

NextGen-epm has been developed with a client/server architecture; a GUI design utilizing either Windows 95, Windows 98, Windows 2000, or Windows NT operating system platforms; and, a platform independent relational database that is ANSI SQL-compliant. NextGen-epm is designed to provide a flexible, enterprise-wide solution employing a master patient index.

Recognizing the need and benefits to be obtained by using its software in conjunction with the capabilities of the Internet, the Company enhanced its enterprise practice management and electronic medical software packages in Fiscal 2000 to enable them to be run via Private Intranet or the Internet in an Application Services Provider (ASP) environment.

Additionally, in April 2000, the Company announced the launch of an Internet-based consumer health portal, NextMD.com. NextMD.com will be a vertical portal for the healthcare industry, linking patients with their physicians, insurers, laboratories, and online pharmacies, while providing a centralized source of health-oriented information for both consumers and medical professionals. Patients whose physicians are linked to the portal will be able to request appointments, send appointment changes or cancellations, receive test results online, request prescription refills, view and/or pay their statements, and communicate with their physicians, all in a secure, online environment. The Company's NextGen suite of information systems will be linked to NextMD.com, integrating a number of these features with physicians' existing systems.

#### INDUSTRY BACKGROUND.

To compete in the changing healthcare environment, physicians and other outpatient care providers are increasingly joining and affiliating with other physicians, managed care organizations, hospitals and other enterprises to form larger healthcare organizations such as PHOs, MSOs and health maintenance organizations ("HMOs"). These organizations are designed to take advantage of anticipated economies of scale associated with managing healthcare services for large patient populations across inpatient and outpatient settings while achieving improved quality, reduced costs and strengthened negotiating positions with managed care entities. Similarly, the dental profession has recently seen consolidation of dental practices driven by many of the same factors as in the medical profession. The consolidation occurring among medical and dental providers, respectively, has created business organizations which require more sophisticated computer information systems.

As the managed care environment continues to expand as many experts expect, more healthcare provider organizations enter into contracts, and often multiple contracts, which define the terms under which care is administered. The expansion in the number of managed care and third-party payor organizations, as well as additional government regulation and changes in reimbursement models, has greatly increased the complexity of pricing policies, billing procedures and reimbursement policies impacting medical and dental practices. To operate effectively, healthcare provider organizations must efficiently manage patient care and other workflow processes which increasingly extend across multiple care locations and business entities.

To compete under the constraints of managed care while maintaining quality of services, healthcare provider organizations have placed increasing demands on their information systems. Initially, these information systems automated financial and administrative functions. As it became necessary to manage patient flow processes, the need arose to integrate "back-office" data with such clinical information as patient test results and office visits. Particularly for larger organizations and group practices, the Company believes information systems must allow enterprise-wide exchange of patient information incorporating administrative, financial and clinical information from multiple entities, while focusing on the primary care provider. In addition, large healthcare organizations increasingly require information systems that can deliver high performance in environments with multiple concurrent computer users.

Many existing healthcare information systems, including numerous systems currently utilized by the solo practitioner and small group practices, were designed for limited administrative tasks such as billing and scheduling and can neither accommodate multiple computing environments nor operate effectively across multiple locations and entities. As the healthcare industry continues to evolve, physician and dental groups and other healthcare organizations will increasingly require systems that compile structured clinical information from multiple sources and enable measurement of treatment outcomes and management of clinical processes. The Company believes that systems which integrate this patient clinical data with administrative, financial and other practice management data to maintain patient flow while continuing to reduce costs and improve quality of care are best positioned to succeed in the evolving managed care environment.

As healthcare organizations transition to new computer platforms and newer technologies, experts believe such organizations will be migrating toward the implementation of enterprise-wide, patient-centered computing systems embedded with automated patient medical records. These organizations cannot afford significant downtime or reeducation, nor can they prudently risk choosing a system that has not proven its ability to handle high volume processing with continuous dependability. The Company believes, therefore, that successful systems vendors in the market most likely will have a sufficient installed base and adequate resources to offer high quality, fully integrated products together with the value-added services needed to expand and support growing clients throughout this evolutionary process.

#### PRODUCTS.

In response to the growing need for more comprehensive, cost-effective healthcare information solutions for physician and dental practices, the Company's systems provide its clients with the ability to redesign patient care and other workflow processes while improving productivity through multi-site and multi-user access to patient information. Utilizing proven third-party hardware solutions combined with the Company's proprietary software configured to maximize the efficiency of a healthcare organization's information processing requirements, the Company's solutions enable an integration of a variety of administrative and clinical information operations. Leveraging over 20 years of experience in the healthcare information services industry, the Company believes that it continues to distinguish its solutions by providing its clients with sophisticated, full-featured software systems along with comprehensive systems implementation, maintenance and support.

## PRACTICE MANAGEMENT SYSTEMS.

The Legacy Product consists primarily of proprietary healthcare software applications together with third party hardware and other non-industry specific software. The systems range in capacity from one to hundreds of users, allowing the Company to address the needs of both small and large organizations. The systems are modular in design and may be expanded to grow with changing client requirements.

The software configuration for a typical Legacy Product system includes a basic medical or dental application and additional software to meet identified needs of each client. The basic Legacy Product software automates many aspects of group practice management, including general patient registration, appointment scheduling, billing, insurance claims submission and processing, and treatment planning. Add-on applications include such modules as outside referral management for managed care, patient eligibility, electronic insurance claims and electronic patient statements processing, and various proprietary and third party accounting and word-processing packages.

A typical Legacy Product system also consists of third party hardware components, including one or more central processing units, disk drives, magnetic tape units, video display terminals, PCs, and printers together with telecommunications equipment, which the client often purchases as a turnkey system from the Company.

The Legacy Product system primarily uses the IBM RS6000\* central processing unit and IBM'S AIX\*\* version of the UNIX operating system as a platform for its application software enabling a wide range of flexible and functional systems. The hardware components, as well as the requisite operating system licenses, are purchased from manufacturers or distributors of those components. QSI assembles and tests the hardware components and incorporates the Legacy Product software and other third party packages into completed systems tailored to accommodate particular client requirements. The Company continually evaluates the hardware components of its systems with a view toward utilizing hardware that is functional, reliable and cost-effective.

NextGen-epm expands the Company's practice management system product line that historically has been primarily character-based software solutions. NextGen-epm has been developed using a GUI client/server platform for compatibility with Windows 95, Windows 98, Windows 2000, and Windows NT operating systems and a relational database that is ANSI SQL-compliant. NextGen-epm, which has been designed initially for healthcare provider networks, is scalable and includes a master patient index, enterprise-wide appointment scheduling with referral tracking, clinical support, and centralized or decentralized patient financial management based on either a managed care or fee-for-service model.

NextGen-epm is designed to be used on any computer that supports Windows 95, Windows 98, Windows 2000, or Windows NT operating systems. The system's three-tiered architecture allows work to be performed on the database server, the application server and the client workstation.

\* RS6000 is a registered trademark of International Business Machines Corporation.

\*\* AIX is a registered trademark of International Business Machines Corporation.

To date, the Company generally has made hardware recommendations for NextGen-epm to its clients based upon information provided by each client. However, the client is responsible for the ultimate selection, installation, and integration of the hardware that each client purchases directly from third party suppliers other than the Company.

Recognizing the need and benefits to be obtained by using its software in conjunction with the capabilities of the Internet, the Company enhanced its NextGen-epm in Fiscal 2000 to enable NextGen-epm to be run via private Intranet or the Internet in an Application Services Provider (ASP) environment.

The Company has previously released an Internet dental practice management product, QSINET that includes such features as patient registration, scheduling, collections and receivables tracking, treatment planning, and management reporting. QSINET connects dental groups to the extensive and growing electronic commerce network enabling users to process insurance claims and patient statements more rapidly and also allows the practice to communicate with its patients via e-mail for appointment reminders, treatment recalls, and other patient notifications. The system can be accessed using a personal computer with Internet access. In addition, the Company has also provided an Intranet solution to several of its clients based on the QSINET product. The Company does not generally provide any hardware in connection with its Internet/intranet products.

#### CLINICAL SYSTEMS.

Clinitec provides software applications that are complementary to, and interface with, the Company's medical practice management offerings. The applications incorporated into the Company's practice management solutions (such as scheduling, eligibility, billing and claims processing) are augmented by clinical information captured by NextGen-emr, including services rendered and diagnoses used for billing purposes.

NextGen-emr was developed with a client/server architecture and a graphical user interface ("GUI") utilizing Microsoft Windows 95, Windows 98, Windows 2000, or Windows NT on each workstation and either Windows NT, UNIX or Novell\* on the server. NextGen-emr maintains data using an industry standard relational database engine such as Microsoft SQL Server\*\*, INFORMIX\*\*\* or Oracle\*\*\*\*. The system is scalable from one to hundreds of workstations.

NextGen-emr stores and maintains clinical data including:

- - Data captured using user-customized input "templates";
- - Scanned or electronically acquired images, including x-rays and photographs;
- - Data electronically acquired through interfaces with clinical instruments;
- - Other records, documents or notes, including electronically captured handwriting and annotations; and
- - Digital voice recordings.

\* Novell is a registered trademark of Novell, Inc.

\*\* Microsoft is a registered trademark and SQL Server is a registered trademark of Microsoft Corporation.

\*\*\* INFORMIX is a registered trademark of Informix Corporation.

\*\*\*\* Oracle is a registered trademark of Oracle Corporation.

NextGen-emr also offers a workflow module, prescription management, automatic document and letter generation, patient education, referral tracking, interfaces to billing and lab systems, physician alerts and reminders, and powerful reporting and data analysis tools.

NextGen-emr is sold either as a combination of software and services, or as a turnkey system including computer hardware, which can include network servers, PC workstations, tape back-up units, printers, scanners and requisite operating system software. Computer hardware for turnkey systems is purchased for resale by the Company from third party manufacturers or distributors.

Recognizing the need and benefits to be obtained by using its software in conjunction with the capabilities of the Internet, the Company enhanced the NextGen-emr application in Fiscal 2000 to enable NextGen-emr to be run via private Intranet or the Internet in an Application Services Provider (ASP) environment.

Additionally, in April 2000, the Company announced the launching of an Internet-based consumer health portal, NextMD.com. NextMD.com will be a vertical portal for the healthcare industry, linking patients with their physicians, insurers, laboratories, and online pharmacies, while providing a centralized source of health-oriented information for both consumers and medical professionals. Patients whose physicians are linked to the portal will be able to request appointments, send appointment changes or cancellations, receive test results on-line, request prescription refills, view and/or pay their statements, and communicate with their physicians, all in a secure, on-line environment. The Company's NextGen suite of information systems will be linked to NextMD.com, integrating a number of these features with physicians' existing systems.

The Company's dental charting software system, the Clinical Product Suite, (CPS) is a comprehensive dental solution designed specifically for the large dental group practice environment. CPS integrates the dental Legacy Product with a computer-based clinical information system that incorporates a wide range of clinical tools, including:

- - Electronic charting of dental procedures, treatment plans and existing conditions;
- - Periodontal charting, via light-pen, voice-activation, or keyboard entry, for full periodontal examinations and PSR scoring;
- - Digital imaging of x-ray and intra-oral camera images;
- - Computer-based patient education modules, viewable chairside to enhance case presentation;
- - Full access to patient information, treatment plans, and insurance plans via a fully integrated interface with the dental Legacy Product; and
- - Document and image scanning for digital storage and linkage to the electronic patient record.

The result is a comprehensive clinical information management system that saves time, reduces costs, improves case presentation, and enhances the delivery of dental services and quality of care. Clinical information is managed and maintained electronically thus forming an electronic patient record that allows for the implementation of the "chartless" office.

CPS incorporates a Windows-based client/server technology consisting of one or more file servers together with any combination of one or more desktop, laptop, or pen-based PC workstations. The file server(s) used in connection with CPS utilize(s) a Windows NT operating system and the hardware is typically a Pentium\* based single or multi-processor platform. Based on the server configuration chosen, CPS is scalable from one to hundreds of workstations. A typical configuration may also include redundant disk storage, magnetic tape units, intra and extra oral cameras, digital x-ray components, digital scanners, conventional and flat screen displays, and printers. The hardware components, including the requisite operating system licenses, are purchased from third party manufacturers or distributors either directly by the customer or by the Company for resale to the customer.

#### ELECTRONIC DATA INTERCHANGE.

The Company makes available electronic data interchange (EDI) capabilities and services to its customers which increase the utility of the system for these customers. These EDI capabilities and services facilitate the sharing of information across multiple business entities to increase office efficiency; reduce processing time and shorten accounts receivable days; and reduce the possibilities of errors. The EDI capabilities encompass direct interfaces between the Company's products and external third-party systems, as well as transaction-based services. Services include:

- - Electronic claims submission through the Company's relationships with a number of national claims clearinghouses;
- - Electronic patient statements, appointment reminder cards, recall cards, patient letters, and other correspondence;
- - Electronic insurance eligibility verification;
- - Electronic posting of remittances from insurance carriers into the accounts receivable application.

#### SALES AND MARKETING.

The Company sells and markets its products nationwide through a direct sales force. The Company's sales and marketing employees identify and contact prospective clients by a variety of means, including referrals from existing clients and contacts at professional society meetings and seminars with persons involved in group practices as well as trade journal advertising, direct mail advertising, and telemarketing.

These sales employees are knowledgeable about medical and dental group healthcare entities, as well as computer applications. Typically, sales employees make presentations to potential clients by demonstrating the system and its capabilities on the prospective client's premises.

\* Pentium is a registered trademark of Intel Corporation

The Company's sales cycle can vary significantly and typically ranges from three to 12 months from initial contact to contract execution. Systems are normally delivered to a customer within 30 to 60 days of receipt of a system order, and therefore, the Company does not believe data pertaining to backlog is meaningful. As part of the fees paid by its clients, the Company receives up-front licensing fees and a monthly or quarterly service fee based on system configuration.

Several clients have purchased the Company's practice management system and, in turn, are providing either time-share or billing services to local single and group practice practitioners. Under the time-share or billing service agreements, the client provides the use of its system for a fee to one or more practitioners. Although the Company does not receive a fee directly from the client's customers, implementation of such arrangements has resulted in the purchase of additional system capacity by the client offering the services, as well as new system purchases made by the client's customers should such customers decide to perform the practice management functions in-house.

The Company continues to concentrate its sales and marketing efforts on medical and dental practices, dental schools, physician clinics, MSOs, PHOs and community health centers.

MSOs and PHOs to which the Company has sold systems provide use of the Company's software to those group and single physician practices associated with the organization or hospital on either a service basis or by directing the Company to contract with those practices for the sale of stand-alone systems.

The Company has also entered into marketing assistance agreements with certain of its clients pursuant to which the clients allow the Company to demonstrate to potential clients the use of systems on the existing clients' premises. In addition, the Company has established certain of its clients as dealers for its systems. Through this arrangement to date, the dealer markets and sells the Legacy Product to prospects in a local territory. These prospects are generally smaller healthcare facilities than those actively pursued by the Company. The Company's PC-based Legacy Products are well suited to this dealer marketing. In addition, the dealer typically provides a variety of ongoing services for its clients. Dealers are compensated based on system size and profitability, and the services which they perform in place of the Company.

The Company often assists prospective clients in identifying third party sources for financing the purchase of the Company's systems. The financing usually is obtained by the client directly from institutional lenders and typically takes the form of a loan from the institution secured by the system to be purchased or a leasing arrangement.

The Company has numerous clients and does not believe that the loss of any single client would have a material adverse effect on the Company. No client accounted for ten percent or more of net revenues during fiscal years ended March 31, 2000, 1999 or 1998.

## CUSTOMER SERVICE AND SUPPORT.

The Company believes its success is attributable in part to its exceptional customer service and support. The Company offers support to its clients seven days a week, 24 hours a day. All of the Legacy Product systems have a dedicated computer port for dial-up remote access facilitating rapid response by technicians to system inquiries. Most inquiries can be resolved without the need to dispatch technicians to the client location. These support services also provide the Company with the opportunity to monitor changes in each client's information processing requirements and to recommend the purchase of system hardware or software enhancements designed to satisfy these additional requirements. The Company believes that its commitment to provide extensive support has contributed significantly to the development of its business.

The Company's continuing system support staff is comprised of specialists who are knowledgeable in the area of hardware and software technology as well as in the day-to-day operations of a group practice. This system support ranges from correcting minor procedural problems in the client's system to performing complex database reconstructions or software updates. The Company also utilizes an automated online support system for the Legacy Product which assists clients in resolving minor problems and facilitates automated electronic retrieval of problems and symptoms following a client's call to the automated support system. Additionally, this online support system maintains a complete call record at both the client's facility and the Company.

The Company offers its clients support services for most system components, including hardware and software maintenance, for a fixed monthly or quarterly fee. The Company also subcontracts, in certain instances, with IBM to perform specific hardware maintenance tasks under the Company's direction. This arrangement has provided the Company with economies of scale associated with IBM's service infrastructure while still maintaining service standards.

## IMPLEMENTATION AND TRAINING.

The Company offers implementation and training services and believes that its system delivery, implementation and support services are key elements of successful client relationships. When a client signs a contract for the purchase of a system, a client manager/implementation specialist, trained in medical and/or dental group practice procedures, is assigned to assure that the client is fully informed of system options and that the proper software system configuration is installed. This information is determined through discussions with the client and observation of the client's practice. Once the set of software features is established, the software configuration unique to a given client can be created in an automated fashion.

Before activation of the client's practice management system, Company personnel typically convert, or assist in conversion of, the relevant client data onto the system. Usually, the data is converted electronically from another computer system enabling a quick, cost-effective and accurate conversion. The system is then subjected to extensive testing which includes processing representative data using the client's system configuration. One or more Company trainers experienced in group practice procedures are assigned to conduct an intensive training program for the client's employees.

The program may include a combination of computer assisted instruction ("CAI") for certain of the Company's products, remote training techniques and training classes conducted by Company staff at the client's office(s). CAI consists of workbooks, computer interaction and self-paced instruction. CAI is also offered to clients, for an additional charge, after the initial training program is completed for the purpose of training new and additional employees. Remote training allows a trainer at the Company office to train one or more people at a client site via telephone and computer connection, thus allowing an interactive and office-specific mode of training without the expense and time required for travel. In addition, the Company's on-line "help" documentation feature facilitates client training as well as ongoing support.

#### COMPETITION.

The market for medical group practice management systems is intensely competitive and the Company faces significant competition from a number of different sources. The industry is highly fragmented and includes numerous competitors, none of which the Company believes dominates the overall market for medical group practice management systems. In addition, several of the Company's competitors have significantly greater financial, technical, product development and marketing resources than the Company. The Company believes its principal competitive advantages are the features and capabilities of its products and services, its high level of customer support and its extensive experience in the industry.

There can be no assurance that the NextGen suite of applications will achieve broad market acceptance or will successfully compete with other Windows-based practice management software products.

To date, the Company has not encountered substantial competition for its dental practice management and clinical products in the Company's primary niche market of dental group practices consisting of six or more dentists. The Company is anticipating that market competition in this dental group practice niche market will increase as new competitors enter the marketplace. The Company believes that numerous firms sell computerized data processing systems to group dental practices consisting of five or fewer dentists.

The market for electronic medical records systems is highly competitive and subject to rapid changes in technology. The Company expects that market competition will increase as new competitors enter the marketplace. The industry is highly fragmented and includes numerous competitors, none of which the Company believes dominates the electronic medical records market. Many of the Company's competitors have substantially greater name recognition and technical, marketing and financial resources. The Company believes its principal competitive advantages are the features and flexibility of its NextGen products. There can be no assurance that future competition or new product introductions in the electronic medical records market will not have a material adverse effect on the Company's business, financial condition and results of operations. There can be no assurance that the NextGen suite of applications will achieve broad market acceptance.

Competitive pressures and other factors, such as new product introductions by the Company or its competitors, may result in price erosion that could have a material adverse effect on the Company's business, financial condition and results of operations. Furthermore, the Company also competes in all of its markets indirectly and to varying degrees with other major healthcare related companies, information management companies and systems integrators generally, and other software developers which may more directly enter the markets in which the Company competes. There can be no assurance that future competition will not have a material adverse effect on the Company's business, financial condition and results of operations.

#### PRODUCT ENHANCEMENT AND DEVELOPMENT.

The healthcare information management and computer software and hardware industries are characterized by rapid technological change requiring the Company to engage in continuing efforts to improve its systems. During fiscal years 2000, 1999 and 1998 the Company expended approximately \$4.9 million, \$4.8 million and \$4.9 million, respectively, on research and development activities including capitalized software amounts of \$1.1 million, \$1.2 million and \$1.9 million, respectively. In addition, many of the Company's product enhancements have resulted from software development work performed under contracts with its clients. To the extent that the Company fails to achieve technological advances comparable to those made by others in the computer and healthcare information management industries, its products and services may become obsolete.

#### GOVERNMENTAL 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. 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.

The Health Insurance Portability and Accountability Act of 1996 (HIPAA) mandates the use of national standards for transmissions of certain patient healthcare information, prescribed security measures to protect the confidentiality of such information, and other provisions within two years after the adoption of final regulations by the Department of Health and Human Services ("HHS"). The Company is following the progress of the HHS implementation of HIPAA, but at this time, it is uncertain what regulations will be ratified by HHS and the impact of those regulations on the Company's products and services and on the products and services offered by our business partners.

Our intention is to modify our products and services as necessary to become compliant with the final regulations but there can be no assurance that the Company will be able to do so in a timely manner.

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 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.

#### EMPLOYEES.

As of May 31, 2000, the Company employed 232 persons of which 228 were full-time employees. Systems analysts, programmers and qualified sales and marketing personnel are in short supply and, consequently, competition for such individuals is intense. The Company believes that its future success depends in part upon recruiting and retaining qualified marketing and technical personnel as well as other employees. The Company considers its employee relations to be good.

#### RISK FACTORS.

##### COMPETITION.

The market for healthcare information systems is intensely competitive and the Company faces significant competition from a number of different sources. The electronic medical records market, in particular, is subject to rapid changes in technology and the Company expects that competition in this portion of the market will increase as new competitors enter the marketplace. In addition, 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.

The industry is highly fragmented and includes numerous competitors, none of which the Company believes dominates the overall market for either group practice management or clinical systems.

Furthermore, the Company also competes indirectly and to varying degrees with other major healthcare related companies, information management companies generally, and other software developers which may more directly enter the markets in which the Company competes.

There can be no assurance that future competition or new product introductions will not have a material adverse effect on the Company's business, results of operations and financial condition. 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.

In addition, the Company believes that once a healthcare provider has chosen a particular healthcare information system vendor, the provider will, for a period of time, be more likely to rely on that vendor for its future information system requirements. Furthermore, if the healthcare industry continues to undergo further consolidation as it has recently experienced, each sale of the Company's systems will assume even greater importance to the Company's business, results of operations and financial condition. 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, maintenance service revenues can be expected to decrease over time due to the effect of failure to capture new maintenance revenues therefrom in combination with attrition of existing maintenance revenues associated with the Company's current clients whose systems become obsolete or are replaced by competitors' products.

#### FLUCTUATION IN QUARTERLY OPERATING RESULTS.

The Company's revenues and operating results have in the past fluctuated, and may in the future fluctuate, 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 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. Furthermore, 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 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 initial contact with a potential customer depends in significant part on the customer's decision to replace, or substantially modify, its existing information system. How and when to implement, replace or substantially modify an information system are major decisions for healthcare providers. Accordingly, the sales cycle for the Company's systems can vary significantly and typically ranges from three to 12 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.

Through March 31, 1998, the Company recognized revenue in accordance with the provisions of the American Institute of Certified Public Accountants ("AICPA") Statement of Position No. 91-1, "Software Revenue Recognition" ("SOP 91-1"). The AICPA has adopted Statement of Position No. 97-2, "Software Revenue Recognition" ("SOP 97-2"), that supersedes SOP 91-1 and became effective for the Company on April 1, 1998. There can be no assurance that application and subsequent interpretations of this pronouncement by the Company, its independent auditors or the Securities and Exchange Commission 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 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 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 amount 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 or new products, or that 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 will be materially adversely affected.

In response to increasing market demand, the Company is currently developing new generations of certain of its software products designed for the client-server and Internet/intranet environments. There can be no assurance that the Company will successfully develop these new software products or that these products will operate successfully on the principal client-server operating systems, which include UNIX, Microsoft Windows, Windows NT, Windows 95 and Windows 98, or that any such development, even if successful, will be completed concurrently with or prior to introduction by competitors of products designed for the client-server and Internet/intranet environments. Any such failure or delay could adversely affect the Company's competitive position or could make the Company's current products obsolete.

**LITIGATION.**

The Company faces several Federal and State securities actions (see "Item 3. Legal Proceedings."). 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 such actions. However, the uncertainty associated with substantial unresolved litigation may be expected to 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 will likely 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 acquirors from bidding for the Company or reducing the consideration such acquirors would otherwise be willing to pay in connection with an acquisition.

**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 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 experienced periods of growth has increased personnel, which has placed, and may continue to place, a significant strain on the Company's 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 maintaining its employees is particularly significant. The Company is also dependent on its ability to attract and retain high quality personnel, particularly highly skilled software engineers for applications development.

The industry 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.

Loss of 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 our delivery of health information directly, including through licensed physicians, 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.

Certain physicians or other 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, such as physicians, pharmacists and nurse practitioners;
- - Medicaid laws;
- - The Health Insurance Portability and Accountability Act of 1996 and related rules proposed by the Health Care Financing Administration; and Health Care Financing Administration standards for Internet transmission of health data.

The U.S. Congress has been considering proposed legislation that would establish a new federal standard for protection and use of health information. Any failure by us or by our personnel or partners to comply with any of these legal and other requirements would result in material liability.

Although the company has systems in place for safeguarding patient health information from unauthorized disclosure, these systems may not preclude successful 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.

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 effect 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 greater selectivity in the allocation of capital funds. Such selectivity could have an adverse effect on the Company's ability to sell its systems and related services. The Company cannot predict what impact, if any, such proposals or healthcare reforms might have on its business, results of operations and financial condition.

In the year 2001, the Department of Health and Human Services expects to finalize proposed regulations at the federal level authorized under the Health Insurance Portability and Accountability Act of 1996. 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 accurately predict the impact at this time. 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.

The Company's software may be subject to regulation by the FDA as a medical device. Such regulation could require the registration of the applicable manufacturing facility and software/hardware products, application of

detailed record-keeping and manufacturing standards, and FDA approval or clearance prior to marketing. An approval or clearance 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, results of operations and financial condition.

#### YEAR 2000

The Company is aware of issues associated with the programming code in existing computer systems related to the millennium. In particular, software applications that use only two digits to identify a year in the date field may fail or create errors in the year 2000 ("Year 2000 Issues"). Year 2000 Issues create risk for the Company from unforeseen problems in computer systems that the Company sells to customers on a nationwide basis which are used, among other things, to process their financial transactions and schedule patients ("Company Products"), as well as systems that the Company uses internally to provide certain services to its customers and to process its own financial transactions ("Internal Use Systems"). The potential costs and uncertainties associated with Year 2000 Issues will depend upon a number of factors, including the Company's proprietary and third party developed software, hardware (hardware and third party developed software will hereinafter be referred to collectively as "Third Party Products") and the nature of the industry in which the Company operates.

The nature of the Company's business and its relationships with its customers make it difficult to assess the magnitude of the Company's potential exposure as a result of Year 2000 issues. Company Products and Third Party Products sold by the Company may fail to operate properly or as expected due to Year 2000 Issues. Such failures could result in system failures or miscalculations causing disruptions of customers' operations, including among other things, an inability to process transactions, send invoices, conduct communications, treat patients or engage in similar normal business activities. In addition, Company Products and Third Party Products are often used in conjunction with other vendors' products and services and the Company must rely on these other vendors to complete the material remediation efforts necessary with regards to Year 2000 Issues in connection with such products and services. Should such vendors be unable to complete such remediation efforts in a timely manner, the use of such products and services on the same system as Company Products and Third Party Products may result in system failures. As a result of one or more of the above potential system failures, certain of the Company's customers may assert breach of warranty or other claims against the Company relating to Year 2000 functionality. The assertion of such claims may have a material adverse impact upon the Company's business, results of operations and financial condition. Furthermore, the efforts and resources devoted to Year 2000 Issues of current and potential customers of the Company could result in the deferral, delay or cancellation by customers of current installations of and plans to purchase systems from the Company.

Internal Use Systems, including both information systems and non-information systems, may not operate properly or as expected due to Year 2000 Issues. Year 2000 Issues could result in system failures or miscalculations causing disruption of the Company's operations, including among other things, an inability to process its own and certain of its customers' financial transactions, send invoices, conduct communications, or engage in similar normal business activities.

The failure of one or more Internal Use Systems as a result of Year 2000 Issues may have a material adverse impact upon the Company's business, results of operations and financial condition. The Company cannot be sure that Year 2000 Issues will not affect its business. Thus far, the Company has incurred no materially adverse problems related to Year 2000 Issues associated with the computer systems, software, other property and equipment it uses. However, the Company cannot guarantee that Year 2000 Issues will not adversely affect its business, operating results or financial condition at some point in the future. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Year 2000 Implications."

Item 2. Properties.

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 The Company's principal administrative, data processing, marketing and development operations are located in approximately 19,000 square feet of leased space in Tustin, California under a lease which expires in March 2001. In addition, the Company leases approximately 13,000 square feet of space in Santa Ana, California to house its assembly and warehouse operations, approximately 15,000 square feet of space in Horsham, Pennsylvania, the principal office for Clinitec, approximately 12,000 square feet of space in Atlanta, Georgia, the principal office for MicroMed, and an aggregate of 4,000 square feet of space in Florida, Kansas, Minnesota, Texas, Wisconsin and Washington to house additional sales, training and service operations. These leases, including options, have expiration dates ranging from month-to-month to August 2001. The Company believes that its facilities are adequate for its current needs and that suitable additional or substitute space is available, if needed, at commercially reasonable rates.

Item 3. LEGAL PROCEEDINGS.

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 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.

On January 25, 1999, the court denied plaintiffs' motion to certify the class representative and class legal counsel. Plaintiffs have appealed that decision. 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. Plaintiff will seek new class counsel, however, the named defendants will again have the opportunity to oppose class certification.

The Company and its named officers and directors deny all remaining allegations of wrongdoing made against them in these suits, consider the allegations groundless and without merit, and intend to vigorously defend against these actions.

On May 14, 1997, a second purported class action entitled WENDY WOO v. QUALITY SYSTEMS, INC., ET AL. was filed in the same court. This complaint, which has been consolidated with the Caveny lawsuit, essentially repeats the allegations in the Caveny lawsuit and seeks identical relief. 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 July 1, 1997, a third purported class action entitled WADE CHENEY v. QUALITY SYSTEMS, INC., ET AL. was filed in the United States District Court of the Central District of California, Southern Division. The complaint makes essentially the same factual allegations as in the Caveny and Woo complaints, and purports to state claims under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and under Section 20(a) of said Act. By Court order dated August 13, 1997, this action was stayed temporarily and the Court reserved jurisdiction to lift the stay after all matters are final in the Caveny and Woo actions or if otherwise appropriate, and on August 15, 1997 the case was removed from the Court's active caseload. The Company denies all allegations of wrongdoing made in this suit, considers the allegations groundless and without merit, and if the stay is ever lifted, the Company intends to vigorously defend against this action.

On March 23, 1999, a purported class action and derivative complaint entitled IRVING ROSENZWEIG v. SHELDON RAZIN, ET AL. was filed in the Superior Court of the State of California for the County of Orange, in which Mr. Rosenzweig, on behalf of himself and all non-director shareholders, and derivatively on behalf of the Company, alleges that Sheldon Razin, John Bowers, William Bowers, Patrick Cline, Janet Razin and Gordon Setran (all of the foregoing individuals are directors of the Company) breached their fiduciary duties by allegedly entrenching themselves in their positions of control, failing to ensure that third-party offers involving the Company were fully and fairly considered, and/or failing to conduct a reasonable inquiry to assure the maximization of shareholder value. The complaint seeks declaratory and injunctive relief, an accounting of monetary damages allegedly suffered by plaintiff and the purported class, and attorneys' fees. Defendants demurred to each of the causes of action alleged in the complaint and the court sustained those demurrers with leave to amend in December 1999. Rather than file an amended complaint, plaintiff filed a motion for attorney's fees. Defendants, in turn, filed a motion to dismiss the action for failure to file an amended pleading within the time limit specified by the court. Those motions are currently pending.

The parties agreed to a settlement of action and stipulated to a final judgement and order which was entered by the court on May 15, 2000 at which time the action was dismissed. The final judgement and order provided for a dismissal of the action with prejudice, releases given to each of the defendants, and payment of the nominal sum of \$100,000 (paid by the Company's Directors and Officers Liability Insurance Company) in full settlement of plaintiff's motion for attorney's fees. The settlement further expressly provided that it did not constitute an admission of any liability of defendants, which defendants continue to vigorously deny.

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

No matter was submitted to a vote of security holders during the fourth quarter of fiscal year 2000.

Executive Officers of the Registrant.

The executive officers of the Company as of May 31, 2000 were as follows:

Name	Age	Position
Patrick B. Cline	39	Interim Chief Executive Officer
Greg Flynn	42	General Manager, Executive Vice President
Don L. Jackson	39	Vice President Marketing
Donn Neufeld	43	Vice President Software and Operations
David Razin	36	Vice President Business Development
Paul Holt	34	Interim Chief Financial Officer, Secretary

Executive officers of the Company are elected by, and serve at the discretion of, the Board of Directors. Additional information regarding the Company's executive officers is set forth below.

Patrick B. Cline has served as Interim Chief Executive Officer since April 2000. Mr. Cline has served as Executive Vice President of the Company since May 1996. Mr. Cline is a co-founder of Clinitec and has served as its President since its inception in January 1994 and as its Chief Operating Officer since May 1996 when it was acquired by QSI. Mr. Cline served as Clinitec's Chairman of the Board of Directors and Chief Executive Officer from January 1994 until May 1996. Prior to co-founding Clinitec, Mr. Cline served, from July 1987 to January 1994, as Vice President of Sales and Marketing with Script Systems, a subsidiary of InfoMed, a healthcare information systems company. From January 1994 to May 1994, after the founding of Clinitec, Mr. Cline continued to serve, on a part time basis, as Script Systems' Vice President of Sales and Marketing. Mr. Cline has held senior positions in the healthcare information systems industry since 1981. Mr. Cline has been appointed interim Chief Executive Officer following the resignation of Sheldon Razin on April 3, 2000.

Greg Flynn has served as the Company's General Manager since April 2000 and as Executive Vice President since August 1998 after serving as Vice President of Sales and Marketing from January 1996 to August 1998. Prior to January 1996, Mr. Flynn served as Vice President Administration since June 1992. In these capacities, Mr. Flynn has been responsible for numerous functions related to the ongoing management of the Company and sales. Previously, Mr. Flynn served as the Company's Vice President Corporate Communications. Since joining the Company in January 1982, Mr. Flynn has held a variety of increasingly responsible management positions within the organization. He holds a B.A. degree in English from the University of California, Santa Barbara.

Don L. Jackson joined the Company in June 1998 as its Vice President of Marketing. Prior to joining the Company, Mr. Jackson was the Vice President of Sales and Marketing of Wyndgate Technologies, a developer of information systems for blood banks and transfusion management. From February 1992 to May 1997, Mr. Jackson held several senior management positions with Henry Schein, Inc., Practice Management Technologies Division, a leading provider of computer-based solutions to the dental, medical, and veterinary markets. From 1985 to 1992, Mr. Jackson was Executive Vice President of FoxMeyer's Retail Services Business unit, a developer and distributor of retail pharmacy point of sale computer systems. Mr. Jackson holds an M.B.A. from Southern Methodist University and a B.A. in Computer Science from the University of Texas at Austin.

Donn Neufeld has served as the Company's Vice President Software and Operations since January 1996 and as Vice President Operations from June 1986 until January 1996. From April 1981 until June 1986, Mr. Neufeld held the position of Manager of Customer Support. He joined the Company in December 1980 as part of the System Generation Department. Prior to joining the Company, Mr. Neufeld was a System Analyst/Programmer at Loma Linda University Medical Center.

David Razin has served as Vice President Business Development of the Company since August 1997. Before being named to this position, Mr. Razin served from 1995 to 1997 as Director of Product Development. In that position, Mr. Razin oversaw the development of the Company's Legacy Products, EDI services network and Internet/intranet applications. From 1988 to 1995, Mr. Razin held the position of Manager of Client Managing and Training. Prior to that, Mr. Razin held various positions in software development from 1985 to 1988. David Razin is the son of Sheldon Razin.

Paul Holt was appointed Interim Chief Financial Officer in May 2000. Mr. Holt has served as the Company's Controller since January, 2000. Prior to joining the Company, Mr. Holt was the Controller of Sierra Alloys Co., Inc., a titanium metal manufacturing company from August 1999 to December 1999. From May 1997 to July 1999, he was Controller of Refrigeration Supplies Distributor, a wholesale distributor and manufacturer of refrigeration supplies and heating controls. From March 1995 to April 1997, he was Assistant Controller of Refrigeration Supplies Distributor. Mr. Holt is a Certified Public Accountant and holds an M.B.A. from the University of Southern California and a B.A. in Economics from the University of California, Irvine.

## PART II.

Item 5. MARKET FOR REGISTRANT'S COMMON  
EQUITY AND RELATED STOCKHOLDER MATTERS  
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The Company's Common Stock is traded on the Nasdaq National Market under the symbol "QSII". The following table sets forth for the quarters indicated the high and low sales prices as reported by NASDAQ. The quotations reflect inter-dealer prices, without retail markup, markdown, or commissions, and may not necessarily represent actual transactions.

Quarter Ended	High	Low
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June 30, 1998	11.25	7.25
September 30, 1998	9.28	3.50
December 31, 1998	5.00	3.00
March 31, 1999	4.94	3.50
June 30, 1999	6.56	3.75
September 30, 1999	8.38	5.63
December 31, 1999	7.75	5.88
March 31, 2000	18.75	6.75

At May 31, 2000, there were approximately 153 holders of record of the Company's Common Stock. The Company estimates the number of beneficial holders of its Common Stock to be in excess of 1,200.

Through May 31, 2000, the Company has not paid cash dividends on shares of its Common Stock. The Company anticipates that for the foreseeable future, all earnings, if any, will be retained for use in the Company's business and it does not anticipate paying any cash dividends in the future. Payment of future dividends, if any, will be at the discretion of the Company's Board of Directors after taking into account various factors, including the Company's financial condition, operating results, current and anticipated cash needs and plans for expansion.

## Item 6. SELECTED FINANCIAL DATA.

The following selected financial data with respect to the Company's Consolidated Statements of Operations Data for each of the five years in the period ended March 31, 2000 and the Consolidated Balance Sheet Data as of the end of each such fiscal year are derived from the audited financial statements of the Company. The following information should be read in conjunction with the Consolidated Financial Statements of the Company and the related notes thereto and "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations." included elsewhere herein.

Consolidated Statements of Operations Data  
(In thousands, except for per share data)

	Year Ended March 31,				
	2000	1999	1998	1997	1996
Net Revenues	\$36,373	\$33,816	\$31,216	\$20,127	\$16,732
Cost of Products and Services	16,395	15,834	13,509	10,089	7,929
Gross Profit	19,978	17,982	17,707	10,038	8,803
Selling, General and Administrative	12,645	13,495	12,485	7,736	3,897
Research and Development	3,726	3,603	3,072	1,978	1,567
Purchased In-Process Research and Development(1)	-	-	10,200	8,300	-
Income (Loss) from Operations (3)	3,607	884	(8,050)	(7,976)	3,339
Investment Income	759	413	971	1,285	482
Income (Loss) before Provision for (Benefit from) Income Taxes (3)	4,366	1,297	(7,079)	(6,691)	3,821
Provision for (Benefit from) Income Taxes (2)	1,862	713	(2,463)	784	1,528
Net Income (Loss) (3)	\$ 2,504	\$ 584	\$(4,616)	\$(7,475)	\$ 2,293
Net Income (Loss) per Share:					
Basic (3)	\$ 0.40	\$ 0.09	\$ (0.77)	\$(1.26)	\$ 0.49
Diluted (3)	\$ 0.40	\$ 0.09	\$ (0.77)	\$(1.26)	\$ 0.49
Weighted Average Shares Outstanding:					
Basic	6,208	6,176	5,981	5,937	4,640
Diluted	6,261	6,185	5,981	5,937	4,776

Consolidated Balance Sheet Data  
(in thousands)

	March 31,				
	2000	1999	1998	1997	1996
Cash and Cash Equivalents and Short-Term Investments	\$16,169	\$14,441	\$17,080	\$22,735	\$28,944
Working Capital	21,332	18,166	15,543	25,613	30,196
Total Assets	44,136	40,218	40,916	37,866	37,272
Total Liabilities	12,053	10,554	13,475	5,596	4,571
Shareholders' Equity	\$32,083	\$29,664	\$27,441	\$32,270	\$32,701
	=====	=====	=====	=====	=====

- (1) In May 1996, the Company acquired Clinitec (see "Item 1. Business. Acquisitions.") which was treated as a purchase transaction for accounting purposes. In connection with this treatment, the Company incurred an \$8.3 million charge for purchased in-process research and development during the year ended March 31, 1997.
- In May 1997, the Company acquired MicroMed (see "Item 1. Business. Acquisitions.") which was treated as a purchase transaction for accounting purposes. In connection with this treatment, the Company incurred a \$10.2 million charge for purchased in-process research and development during the year ended March 31, 1998.
- (2) The provision for income taxes for the year ended March 31, 1997 differs from the Company's combined Federal and State statutory rates primarily due to the non-deductible charge for purchased in-process research and development incurred in connection with the acquisition of Clinitec in May 1996.
- (3) Includes a charge of \$10.2 million and \$8.3 million for purchased in-process research and development for the years ended March 31, 1998 and 1997, respectively. Excluding the charge, on a pro forma basis, income from operations and income before provision for (benefit from) income taxes would have been \$2.2 million and \$3.1 million, respectively, for fiscal 1998 and \$324,000 and \$1.6 million, respectively for fiscal 1997. The income tax benefit related to the charge for purchased in-process research and development for the years ended March 31, 1998 and 1997 was \$3.9 million and \$0, respectively. Excluding the charge and related income tax benefit, on a pro forma basis, net income and basic and diluted income per share would have been \$1.7 million, \$0.29 and \$0.28, respectively, for fiscal 1998 and \$825,000, \$0.14 and \$0.14, respectively, for fiscal 1997.

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

Except for the historical information contained herein, the matters discussed in this Annual Report on Form 10-K, 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, 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, and interested persons are urged to review the risks described in "Item 1. Business. Risk Factors," and in "Management's Discussion and Analysis of Financial Condition and Results of Operations," set forth below, as well as in the Company's other public disclosures and filings with the Securities and Exchange Commission.

The following discussion should be read in conjunction with, and is qualified in its entirety by, the Consolidated Financial Statements and related notes thereto included elsewhere herein. Historical results of operations, percentage margin fluctuations and any trends that may be inferred from the discussion below are not necessarily indicative of the operating results for any future period.

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 Operations.

	Year Ended March 31,		
	2000	1999	1998
Net Revenues:			
Sales of computer systems, upgrades and supplies	52.9%	55.8%	64.9%
Maintenance and other services	47.1	44.2	35.1
	100.0	100.0	100.0
Cost of Products and Services	45.1	46.8	43.3
Gross Profit	54.9	53.2	56.7
Selling, General and Administrative Expenses	34.8	39.9	40.0
Research and Development Costs	10.2	10.7	9.8
Purchased In-Process Research and Development	-	-	32.7
Income (Loss) from Operations	9.9	2.6	(25.8)
Investment Income	2.1	1.2	3.1
Income (Loss) before Provision for (Benefit from) Income Taxes	12.0	3.8	(22.7)
Provision for (Benefit from) Income Taxes	5.1	2.1	(7.9)
Net Income (Loss)	6.9%	1.7%	(14.8)%

FOR THE YEARS ENDED MARCH 31, 2000 AND 1999.

For the year ended March 31, 2000, the Company's net income was \$2,504,000 or \$0.40 per share on a basic and diluted basis. In comparison, the company earned \$584,000 or \$0.09 per share on a basic and diluted basis in the year ended March 31, 1999. The increase in net income was achieved through a combination of an increase in revenue from software systems sales, maintenance, and other services along with a reduction in selling, general and administrative expenses. Selling, general and administrative expenses declined due to the integration of the Company's two subsidiaries, Clinitec and Micromed. For the year ended March 31, 2000, revenue increased 7.6% to \$36.4 million compared to \$33.8 million in the year ended March 31, 1999. Selling, general and administrative expenses declined 6.3% to \$12.6 million in the year ended March 31, 2000 compared to \$13.5 million in the year ended March 31, 1999.

Net Revenues. Net revenues for the year ended March 31, 2000 increased 7.6% to \$36.4 million from \$33.8 million for the year ended March 31, 1999. Sales of computer systems, upgrades and supplies increased 2.0% to \$19.2 million from \$18.9 million while net revenues from maintenance and other service grew 14.6% to \$17.1 from \$14.9 million during comparable periods. The increase in net revenues from sales of computer systems, upgrades and supplies was principally due to increased sales of the Company's Clinical Product Suite, NextGen-epm and NextGen-emr products offset by a decrease in sales of Legacy systems. The increase in maintenance and other services net revenue resulted primarily from the Company's increased client base together with an increase in revenues generated from the Company's electronic data interchange services. Revenue from the Company's electronic data interchange services increased 37.6% to \$3.8 million for the year ending March 31, 2000 compared to \$2.8 million in the year ending March 31, 1999.

Cost of Products and Services. Cost of products and services for the year ended March 31, 2000 increased 3.5% to \$16.4 million from \$15.8 million for the year ended March 31, 1999 while the cost of products and services as a percentage of net revenues decreased to 45.1% compared to 46.8% during the comparable periods. The decrease in cost of products and services as a percentage of net revenues resulted from a combination of: the effects of the increase of maintenance and other services revenues, a change in the mix of new systems sales toward systems with lower hardware content, a leveling out of product development, customer service, support and training costs, and an increase in the cost of electronic data interchange services. In the year ended March 31, 2000, the Company was able to leverage its existing infrastructure on to a higher level of computer systems, upgrades and supplies sales. This contributed to the reduction in cost of products and services as a percentage of revenue during the year ended March 31, 2000. Also, new computer systems sales in the year ended March 31, 2000 had a lower level of hardware content compared to the year ended March 31, 1999. System sales without significant hardware components generally yield higher margins than those systems sales with a higher level of hardware content. The mixture of sales with and without significant hardware components fluctuates from period to period. The effect of the mentioned items was slightly offset by an increase in revenue from electronic data interchange services which yield a lower margin than other products and services.

Selling, General and Administrative. Selling, general and administrative expenses for the year ending March 31, 2000 decreased 6.3% to \$12.6 million from \$13.5 million.

The decrease in selling, general and administrative expenses was primarily the result of the integration of Clinitec and Micromed along with a reduction in bad debt expense for the year ended March 31, 2000 compared to the year ended March 31, 1999.

Selling, general and administrative expenses as a percentage of net revenue declined to 34.8% for the year ended March 31, 2000 compared to 39.9% in the year ended March 31, 1999. The decline in selling, general and administrative expenses as a percentage of net revenue was due to the decrease in selling, general and administrative expense along with the increase in revenue described above.

Research and Development Costs. Research and development costs for the year ended March 31, 2000 increased 3.4% to \$3.7 million from \$3.6 million for the year ended March 31, 1999. The increase is the result of increased research and development efforts by Clinitec and Micromed. Research and development costs as a percentage of net revenues decreased to 10.2% as compared to 10.7% for the respective fiscal years as a result of the effect of costs associated with the increased research and development efforts growing at a proportionately lower rate than net revenues during the comparable years.

Investment Income. Investment income for the year ended March 31, 2000 increased 83.8% to \$759,000 from \$413,000 for the year ended March 31, 1999. During the year ended March 31, 1999, the Company liquidated certain investments and incurred a loss of \$241,000. Also contributing to the comparative increase in investment income was an increase in average funds available for investment during the year ended March 31, 2000.

Provision for (Benefit from) Income Taxes. The provision for income taxes for the year ended March 31, 2000 was \$1,862,000 as compared to \$713,000 for the year March 31, 1999. The provision for income taxes for the years ended March 31, 2000 and 1999 respectively, differ from the combined statutory rates primarily due to the effect of varying state tax rates together with the impact of non-deductible amortization of certain intangible assets acquired in the May 1996 acquisition of Clinitec.

FOR THE YEARS ENDED MARCH 31, 1999 AND 1998.

For the year ended March 31, 1999, the Company's net income was \$584,000, or \$0.09 per share on a basic and diluted basis. In comparison, after recognizing a \$10.2 million charge for purchased in-process research and development in connection with the MicroMed acquisition, the Company incurred a net loss of \$(4.6) million, or \$(0.77) per share on a basic and diluted basis, for the year ended March 31, 1998. Excluding the charge, net of the related income tax benefit, net income for the year ended March 31, 1998 would have been \$1.7 million, or \$0.29 per share and \$0.28 per share on a basic and diluted basis, respectively.

Net Revenues. Net revenues for the year ended March 31, 1999 increased 8.3% to \$33.8 million from \$31.2 million for the year ended March 31, 1998. Sales of computer systems, upgrades and supplies decreased 6.9% to \$18.9 million from \$20.3 million while net revenues from maintenance and other services grew 36.5% to \$14.9 million from \$10.9 million during the comparable periods. The decrease in net revenues from sales of computer systems, upgrades and supplies was principally due to the impact of adopting SOP 97-2 as of April 1, 1998 resulting in the deferral of certain revenues from system contracts executed and shipped during the year ended March 31, 1999 combined with the effect of a slight decrease in new system sales during fiscal 1999. The increase in maintenance and other services net revenue resulted principally from an increase in revenues from the Company's increased client base together with 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 year ended March 31, 1999 increased 17.2% to \$15.8 million from \$13.5 million for the year ended March 31, 1998 while cost of products and services as a percentage of net revenues increased to 46.8% from 43.3% during the comparable periods. The increase in cost of products and services in amount during the 1999 fiscal year as compared to the 1998 fiscal year resulted from a combination of the effects of: the increase in maintenance and other service revenues; increased product development, customer service, support, and training personnel at both Clinitec and MicroMed during the 1999 fiscal year; a change in the mix of new systems sales toward systems with higher hardware content in the fiscal 1999 year; and, the impact of the acquisition of MicroMed. The increase in the cost of products and services as a percentage of net revenues for the year ended March 31, 1999 as compared to the year ended March 31, 1998 resulted primarily from a combination of the overall increase in the costs associated with the above-described infrastructure expansion growing at a proportionately greater rate on a year to year basis than the growth in net revenues together with an increase in the percentage of revenues from new systems sales with higher hardware content. Systems sales with significant hardware components generally yield lower margins than those systems sales without significant hardware components. The mixture of sales with and without significant hardware components fluctuates from period to period.

Selling, General and Administrative Expenses. Selling, general and administrative expenses for the year ended March 31, 1999 increased 8.1% to \$13.5 million from \$12.5 million for the year ended March 31, 1998 primarily as a result of: the inclusion of such MicroMed expenses for the entire year ended March 31, 1999 as compared to the inclusion of such MicroMed expenses for only that portion of the corresponding year ended

March 31, 1998 following the May 1997 MicroMed acquisition; an additional \$236,000 provision for doubtful accounts relating to one of MicroMed's customers; an increase in Clinitec's and MicroMed's selling efforts, sales personnel and administrative infrastructure offset in part by a decrease in such infrastructure at QSI. In addition, primarily as a result of the less mature Clinitec and MicroMed infrastructures, selling, general and administrative expenses as a percentage of net revenues remained relatively unchanged at 39.9% and 40.0% for the respective years despite an increase in net revenues.

Research and Development Costs. Research and development costs for the year ended March 31, 1999 increased 17.3% to \$3.6 million from \$3.1 million for the year ended March 31, 1998. The increase is the result of increased research and development efforts by Clinitec and MicroMed as well as consolidation of MicroMed's research and development costs for the entire 1999 fiscal year as compared to consolidating such expenses only for that portion of the corresponding 1998 fiscal year following the May 1997 purchase of the MicroMed business. Research and development costs as a percentage of net revenues increased to 10.7% as compared to 9.8% for the respective fiscal years as a result of the effect of costs associated with the increased research and development efforts growing at a proportionately greater rate than net revenues during the comparable years.

Purchased In-Process Research and Development. In connection with the acquisition of MicroMed in May 1997, the purchase price allocated to in-process research and development for which technological feasibility had not been established was \$10.2 million. In accordance with Statement of Financial Accounting Standards No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed," software development costs must be expensed until technological feasibility has been established. Accordingly, the purchase price allocated to MicroMed's purchased in-process research and development was expensed during the year ended March 31, 1998. There was no similar acquisition transaction during the year ended March 31, 1999.

Investment Income. Investment income for the year ended March 31, 1999 decreased 57.5% to \$413,000 from \$971,000 for the year ended March 31, 1998. The Company had an investment in a fund which traded in special situation securities. During the year ended March 31, 1999, the investment was liquidated and the Company incurred a loss of \$241,000 after recognizing an unrealized gain of \$120,000 during fiscal 1998 relating to this investment. Over the life of this investment, the Company incurred a net gain of \$22,000 in connection therewith. Also contributing to the change in investment income for the fiscal 1999 year as compared to the fiscal 1998 year was a decrease in average funds available for investment during the year ended March 31, 1999. The decrease in available funds is primarily the result of the timing and amounts of the cash payments in May 1997 and June 1998 made to acquire MicroMed, together with amounts used to fund the growth of Clinitec and MicroMed.

Provision for (Benefit from) Income Taxes. The provision for income taxes for the year ended March 31, 1999 was \$713,000 as compared to a benefit of \$2.5 million for the year ended March 31, 1998. The provision for and benefit from income taxes for the years ended March 31, 1999 and 1998, respectively, differ from the combined statutory rates primarily due to the effect of varying state tax rates together with the impact of non-deductible amortization of certain intangible assets acquired in the May 1996 acquisition of Clinitec.

## LIQUIDITY AND CAPITAL RESOURCES.

Cash and cash equivalents increased \$1.7 million in the year ended March 31, 2000 after declining by \$1.9 million and \$5.7 million in the years ended March 31, 1999 and March 31, 1998, respectively. The large decreases in cash and cash equivalents in fiscal 1998 and 1997 were as a result of payments made in connection with the Clinitec and MicroMed acquisitions.

Net cash provided by operating activities was \$3.6 million, \$3.3 million and \$2.2 million for the years ended March 31, 2000, 1999 and 1998, respectively. Net cash provided by operations for the year ended March 31, 2000 consisted principally of net income before depreciation and amortization and increases in deferred service revenue, offset by an increase in accounts receivable and a decrease in accounts payable. Net cash provided by operations for the year ended March 31, 1999 consisted primarily of the Company's net loss adjusted for the principal non-cash operating expenses of depreciation, amortization and the \$10.2 million charge for purchased in-process research and development incurred in connection with the acquisition of MicroMed together with increases in deferred service revenue and other current liabilities offset in part by an increase in accounts receivable and deferred income tax benefits. The increase in accounts receivable during each of the fiscal years resulted primarily from increased sales and the timing of sales in each period.

Net cash used in investing activities was \$1.8 million, \$5.1 million and \$7.8 million for the years ended March 31, 2000, 1999 and 1998, respectively. Net cash used in investing activities for the year ended March 31, 2000 was principally composed of investments in capitalized software and fixed assets. Net cash used in investing activities for the years ended March 31, 1999 and 1998 was principally impacted by the \$3.8 million and \$5.3 million, respectively, paid in connection with the MicroMed acquisition. Net cash used for additions to equipment, improvements and capitalized software for the years ended March 31, 2000, 1999 and 1998 were \$1.7 million, \$1.7 million and \$2.7 million respectively. There were no material short-term investment sales or purchases during the years ended March 31, 2000 and 1998. Net cash used in investing activities for the year ended March 31, 1999 were offset in part by cash provided from net sales of short-term investments of \$467,000.

Net cash used in financing activities for the years ended March 31, 2000 and 1999 was \$85,000 and \$197,000, respectively, which includes \$111,000 and \$247,000 used in each fiscal year to repurchase 17,400 shares and 40,100 shares, respectively, of the Company's Common Stock. Net cash provided by (used in) financing activities for the years ended March 31, 2000, 1999 and 1998 also includes the proceeds from the exercise of employee stock options.

The Company has no significant capital commitments and currently anticipates that additions to equipment and improvements for fiscal 2001 will be comparable to fiscal 2000.

At March 31, 2000, the Company had cash and cash equivalents of \$15.9 million and short-term investments of \$243,000. The Company believes that its cash and cash equivalents and short-term investments on hand at March 31, 2000, together with the cash flows from operations, if any, will be sufficient to meet its working capital and capital expenditure requirements for the next year.

## INTRODUCTION.

The Company is aware of issues associated with the programming code in existing computer systems as the millennium approaches. In particular, software applications that use only two digits to identify a year in the date field may fail or create errors in the year 2000 ("Year 2000 Issues"). Year 2000 Issues create risk for the Company from unforeseen problems in computer systems that the Company sells to customers on a nationwide basis which are used, among other things, to process their financial transactions and schedule patients ("Company Products"), as well as systems that the Company uses internally to provide certain services to its customers and to process its own financial transactions ("Internal Use Systems"). The potential costs and uncertainties associated with Year 2000 Issues will depend upon a number of factors, including the Company's proprietary and third party developed software, hardware (hardware and third party developed software will hereinafter be referred to collectively as "Third Party Products") and the nature of the industry in which the Company operates.

Company Products and Third Party Products sold by the Company may fail to operate properly or as expected due to Year 2000 Issues. Such failures could result in system failures or miscalculations causing disruptions of customers' operations, including among other things, an inability to process transactions, send invoices, conduct communications, schedule and treat patients or engage in similar normal business activities. Further, products and services used by the Company's customers, but not supplied by the Company, could fail to operate properly or as expected due to Year 2000 Issues. Customers' efforts to plan for such events could result in the deferral, delay or cancellation by customers of current installations of and plans to purchase systems from the Company. Similarly, Internal Use Systems, including both information systems and non-information systems, may not operate properly or as expected due to Year 2000 Issues. Year 2000 Issues could result in system failures or miscalculations causing disruption of the Company's operations, including among other things, an inability to process its own and certain of its customers financial transactions, send invoices, conduct communications, or engage in similar normal business activities.

The Company cannot be sure that Year 2000 Issues will not affect its business. Thus far, the Company has incurred no materially adverse problems related to Year 2000 Issues associated with the computer systems, software, other property and equipment we use. However, the Company cannot guarantee that Year 2000 Issues will not adversely affect its business, operating results or financial condition at some point in the future.

The Company has undertaken various initiatives intended to address Year 2000 Issues. The Company has identified individuals and/or working groups to (1) develop and implement the Company's definition of Year 2000 readiness; (2) assess Company Products, Third Party Products and Internal Use Systems for possible Year 2000 Issues; (3) monitor development, testing and remediation efforts with respect to Company Products, Third Party Products and Internal Use Systems; (4) monitor and coordinate the Company's deployment plans and results with respect to Year 2000 releases of Company Products, Third Party Products and Internal Use Systems; and, (5) develop contingency plans with respect to Company Products, Third Party Products and Internal Use Systems. Although the Company's efforts to address Year 2000 Issues do not fall precisely into sequential phases, generally these efforts are comprised of an assessment phase, a development phase (only with respect to Company Products and certain proprietary Internal Use Systems), a deployment or remediation phase, and a contingency planning phase.

Company Products. The NextGen Suite of Applications and CPS are designed to be Year 2000 compliant and contain no known Year 2000 Issues when configured and used in accordance with the related documentation, and provided that the underlying operating system of the host machine and any other software used with or in the host machine are also Year 2000 compliant. However, there can be no assurance that such products do not contain undetected errors or defects associated with Year 2000 Issues.

The Company's Legacy Product has required significant development and remediation efforts in connection with Year 2000 Issues with many of these efforts commencing in 1997. The Company completed its development efforts in connection with Year 2000 Issues associated with the Legacy Product and certain associated ancillary products during calendar 1999. Also during calendar 1999, the Company completed deployment of Version 9 of its Legacy Product which has been designed to be Year 2000 compliant.

Third Party Products Sold by the Company. The Company works closely with vendors of significant Third Party Products sold by the Company and has communicated with them to determine the extent to which their products and services are, or will be, Year 2000 compliant. In addition, Company Products have been tested, and the Company plans to continue testing Company Products, with certain Third Party Products. Based upon its current assessments, the Company believes that it has received adequate assurances that significant Third Party Product vendors expect to successfully address their significant identified Year 2000 Issues on a timely basis. Due to uncertainties associated with Third Party Product vendors, the Company is unable to predict whether a material adverse effect on the Company's business, results of operations and financial condition may result from Year 2000 Issues related to Third Party Products despite the Company's current assessment to the contrary.

Internal Use Systems. Based upon the Company's assessment efforts to date, the Company believes that its critical Internal Use Systems are Year 2000 compliant.

Certain of the Internal Use Systems are proprietary and were developed by the Company. Company personnel have used similar techniques to identify Year 2000 issues with its Company Products and proprietary Internal Use Systems.

The proprietary Internal Use Systems have either been modified by Company personnel or replaced with third party developed systems which the Company believes will not fail as a result of Year 2000 Issues. The Company has communicated with developers and/or vendors of certain of its third party developed Internal Use Systems to determine the extent to which those products and services are Year 2000 compliant. Based upon its current assessments, the Company believes that it has received adequate assurances that critical third party developed Internal Use Systems are Year 2000 compliant.

Contingency Plans. The Company is currently engaged in contingency planning to address company-wide personnel, resource, technical and communication matters in connection with foreseeable scenarios that may develop from Year 2000 Issues despite the Company's remediation efforts. The Company expects that its development, remediation, testing, deployment and contingency planning efforts with respect to Company Products, Third Party Products and Internal Use Systems will continue up to and beyond March 31, 2000. The Company's contingency planning includes possible (1) failure by the Company and its vendors to complete efforts to avoid or minimize the impact of Year 2000 Issues on a timely basis; (2) failure of customers to be ready for, or cooperate with, the deployment of Year 2000 compliant Company Products on a timely basis; and, (3) delay, deferral or cancellation by customers of current installations and prospective purchase decisions with respect to Company Products. A reasonably likely "worst case" scenario has not yet been identified, but it is anticipated that such scenario would include the failure of significant communications and computing infrastructures by the Company, its customers and its suppliers together with failures of infrastructures encompassing utilities, transportation, banking and government.

#### COSTS.

The total cost to address the Company's Year 2000 Issues were not material to the Company's financial condition. The Company does not separately track all of its internal personnel costs incurred in connection with identifying and resolving Year 2000 Issues. Excluding internal costs, total expenditures to address Year 2000 Issues were less than \$100,000. All of these expenditures have been funded from operations.

Item 7A. QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK.

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Not Applicable.

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.  
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The Financial Statements of the Company identified in the Index to Financial Statements appearing under "Item 14. Exhibits, Financial Statement Schedules, and Reports on Form 8-K." of this report are incorporated herein by reference to Item 14.

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

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None.

Item 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.  
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Except for information concerning the Company's executive officers which is included under the caption "Executive Officers of the Registrant." following Part I, Item 4 of this report, the information required by Item 10 is incorporated herein by reference from the Company's definitive proxy statement scheduled to be filed with the Securities and Exchange Commission on or before July 29, 2000 for the Company's 2000 annual shareholders' meeting.

Item 11. EXECUTIVE COMPENSATION.

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The information required by Item 11 is incorporated herein by reference from the Company's definitive proxy statement scheduled to be filed with the Securities and Exchange Commission on or before July 29, 2000 for the Company's 2000 annual shareholders' meeting.

Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT.

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The information required by Item 12 is incorporated herein by reference from the Company's definitive proxy statement scheduled to be filed with the Securities and Exchange Commission on or before July 29, 2000 for the Company's 2000 annual shareholders' meeting.

Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.  
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The information required by Item 13 is incorporated herein by reference from the Company's definitive proxy statement scheduled to be filed with the Securities and Exchange Commission on or before July 29, 2000 for the Company's 2000 annual shareholders' meeting.

## PART IV.

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

	Page
(a) Documents filed as part of this report.	
(1) Index to Financial Statements.	
Independent Auditors' Report.	F-1
Consolidated Balance Sheets at March 31, 2000 and 1999	F-2
Consolidated Statements of Operations and Comprehensive Operations for the Years Ended March 31, 2000, 1999 and 1998	F-3
Consolidated Statements of Shareholders' Equity for the Years Ended March 31, 2000, 1999 and 1998	F-4
Consolidated Statements of Cash Flows for the Years Ended March 31, 2000, 1999 and 1998	F-5
Notes to Financial Statements	F-7
(2) Financial Statement Schedule.	
Schedule II - Valuation and Qualifying Accounts	F-21
(3) Exhibits.	

## INDEX TO EXHIBITS

Exhibit	Sequential Page No.
3.1 Articles of Incorporation of the Company, as amended, are hereby incorporated by reference to Exhibit 3.1 to the Registrant's Annual Report on Form 10-K for the year ended March 31, 1984, File No. 2-80056.	
3.2 Bylaws of the Company, as amended, are hereby incorporated by reference to Exhibit 3.3 to the Company's Registration Statement on Form S-1, File No. 2-80056.	
3.2.1 Certificate of Amendment of Bylaws of the Registrant is hereby incorporated by reference to Exhibit 3.2.1 to the Registrant's Registration Statement on Form S-1, File No. 333-00161.	

INDEX TO EXHIBITS  
(continued)

Exhibit -----	Sequential Page No. -----
3.2.2	
Text of Sections 2 and 3 of Article II of the Bylaws of the Registrant is hereby incorporated by reference to Exhibit 3.2.2 to the Registrant's Quarterly report on Form 10-QSB for the period ended December 31, 1996, File No. 0-13801.	
3.2.3	
Certificate of Amendment of Bylaws of the Registrant.	74
10.2*	
1989 Incentive Stock Option Plan is hereby incorporated by reference to Exhibit 4.1 to the Registrant's Registration Statement on Form S-8, File No. 33-31949.	
10.2.1*	
Form of Incentive Stock Option Agreement is hereby incorporated by reference to Exhibit 10.2 to the Registrant's Registration Statement on Form S-1, File No. 333-00161.	
10.2.2*	
Form of Non-Qualified Stock Option Agreement is hereby incorporated by reference to Exhibit 10.3 to the Registrant's Registration Statement on Form S-1, File No. 333-00161.	
10.3*	
Form of Incentive Stock Option Agreement is hereby incorporated by reference to Exhibit 10.2 to the Company's Registration Statement on Form S-1, File No. 2-80056.	
10.4*	
1993 Deferred Compensation Plan, is hereby incorporated by reference to Exhibit 10.5 to the Registrant's Annual Report on Form 10-KSB for the year ended March 31, 1994, File No. 0-13801.	
10.4.2*	
Profit Sharing and Retirement Plan, as amended, is hereby incorporated by reference to Exhibit 10.4.2 to the Registrant's Annual Report on Form 10-KSB for the year ended March 31, 1994, File No. 0-13801.	
10.4.3*	
Profit Sharing and Retirement Plan, as amended, amendments No. 2 and 3, are hereby incorporated by reference to Exhibit 10.4.3 to the Registrant's Annual Report on Form 10-KSB for the year ended March 31, 1996, File No. 0-13801.	

INDEX TO EXHIBITS  
(continued)Sequential  
Page  
No.  
-----Exhibit  
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- 10.5 Lease Agreement dated March 11, 1993 between the Registrant and Craig Development Corporation, is hereby incorporated by reference to Exhibit 10.35 to the Registrant's Annual Report on Form 10-K for the year ended March 31, 1993, File No. 0-13801.
- 10.6 Lease agreement dated September 12, 1994 between the Registrant and Koll/Realty Orangewood Business Center General Partnership, is hereby incorporated by reference to Exhibit 10.8 to the Registrant's Annual Report on Form 10-KSB for the year ended March 31, 1995, File No. 0-13801.
- 10.7 Series "A" Convertible Preferred Stock Purchase Agreement, as amended, dated April 21, 1995 between the Registrant and Clinitec International, Inc., is hereby incorporated by reference to Exhibit 10.11 to the Registrant's Annual Report on Form 10-KSB for the year ended March 31, 1995, File No. 0-13801.
- 10.8 Form of Indemnification Agreement is hereby incorporated by reference to Exhibit 10.10 to the Registrant's Registration Statement on Form S-1, File No. 333-00161.
- 10.9 Marketing agreement, as amended, dated April 1, 1995 between the Registrant and Clinitec International, Inc., is hereby incorporated by reference to Exhibit 10.12 to the Registrant's Annual Report on Form 10-KSB for the year ended March 31, 1995, File No. 0-13801.
- 10.10 Agreement and Plan of Merger, dated May 16, 1996, by and among Quality Systems, Inc., CII Acquisition Corporation, Clinitec International, Inc. and certain shareholders of Clinitec International, Inc. and certain exhibits is hereby incorporated by reference to Exhibit 2 to the Registrant's Current Report on Form 8-K, dated May 17, 1996 and filed May 30, 1996.
- 10.11\* Employment agreement dated May 16, 1996 by and between CII Acquisition Corporation and Patrick Cline is hereby incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K/A dated May 17, 1996 and filed June 21, 1996.

INDEX TO EXHIBITS  
(continued)

Exhibit -----	Sequential Page No. -----
10.12 Shareholder Rights Agreement, dated as of November 25, 1996, by and between Quality Systems, Inc. and U.S. Stock Transfer Corp. is hereby incorporated by reference to the Exhibit to the Registrant's Registration Statement on Form 8-A, File No. 001-12537.	
10.13 Asset Purchase Agreement, dated May 15, 1997, by and among MicroMed Healthcare Information Systems, Inc., MHIS Acquisition Corp., Quality Systems, Inc., and certain shareholders of MicroMed Healthcare Information Systems, Inc. is hereby incorporated by reference to Exhibit 2 of Registrant's Current Report on Form 8-K, dated May 15, 1997 and filed May 29, 1997, File No. 0-13801.	
10.14* 1998 Employee Stock Contribution Plan is hereby incorporated by reference to Exhibit 4.1 to the Registrant's Registration Statement on Form S-8, File No. 333-63131.	
10.15* 1998 Stock Option Plan is hereby incorporated by reference to Exhibit 4.1 to the Registrant's Registration Statement on Form S-8, File No. 333-67115.	
10.16* Memorandum of Understanding regarding the April 3, 2000 resignation of Sheldon Razin between Sheldon Razin and Quality Systems, Inc.	
10.17* Memorandum of Understanding Relating to Director Nominees is hereby incorporated by reference to Registrant's Definitive Proxy Statement for the Company's 1999 Shareholder's Meeting, File No. 001-12537.	
21 List of Subsidiaries.	78
23.1 Independent Auditor's Consent - Deloitte & Touche LLP.	80
27.1 Financial Data Schedule, is filed herewith.	82

\* This exhibit is a management contract or a compensatory plan or arrangement.

INDEX TO EXHIBITS  
(continued)

(b) Reports on Form 8-K: None

## SIGNATURES.

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

## QUALITY SYSTEMS, INC.

By: /s/PATRICK CLINE Date: June 26, 2000

-----  
 PATRICK CLINE  
 Interim Chief Executive Officer

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

Signature	Title	Date
-----	-----	-----
/s/ SHELDON RAZIN ----- SHELDON RAZIN	Chairman of the Board of Directors	June 26, 2000
/s/ AHMED HUSSEIN ----- AHMED HUSSEIN	Co-Chairman of the Board of Directors	June 26, 2000
/s/ PATRICK CLINE ----- PATRICK CLINE	Interim Chief Executive Officer	June 26, 2000
/s/ PAUL HOLT ----- PAUL HOLT	Interim Chief Financial Officer, Secretary (Principal Financial and Accounting Officer)	June 26, 2000
/s/ MOHAMMED TAWFICK EL-BARDAI ----- MOHAMMED TAWFICK EL-BARDAI	Director	June 26, 2000
/s/ DALE HANSON ----- DALE HANSON	Director	June 26, 2000
/s/ FRANK MEYER ----- FRANK MEYER	Director	June 26, 2000
/s/ WILLIAM SMALL ----- WILLIAM SMALL	Director	June 26, 2000
/s/ EMAD ZIKRY ----- EMAD ZIKRY	Director	June 26, 2000

INDEPENDENT AUDITORS' REPORT  
-----

Board of Directors and Shareholders  
Quality Systems, Inc.

We have audited the accompanying consolidated balance sheets of Quality Systems, Inc. and subsidiaries as of March 31, 2000 and 1999, and the related consolidated statements of operations and comprehensive operations, shareholders' equity and cash flows for each of the three years in the period ended March 31, 2000. Our audits also included the financial statement schedule listed in the Index of Item 14. (a) (2). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Quality Systems, Inc. and subsidiaries as of March 31, 2000 and 1999, and the results of their operations and their cash flows for each of the three years in the period ended March 31, 2000 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, presents fairly in all material respects the information set forth therein.

DELOITTE & TOUCHE LLP  
Costa Mesa, California  
May 19, 2000

QUALITY SYSTEMS, INC.  
CONSOLIDATED BALANCE SHEETS  
(in thousands)

ASSETS	March 31,			
	2000	1999		
<b>Current Assets:</b>				
Cash and cash equivalents	\$15,926	\$14,196		
Short-term investments	243	245		
Accounts receivable, less allowance for doubtful accounts of \$1,121 and \$754, respectively	13,710	12,488		
Inventories	1,010	772		
Deferred Tax Asset			2,066	765
Other current assets	430	254		
			-----	
Total current assets	33,385	28,720		
Equipment and Improvements, net	1,797	1,783		
Capitalized Software Costs, net	1,984	2,144		
Deferred Tax Asset	3,042	3,254		
Excess of Cost Over Net Assets of Acquired Business, net of accumulated amortization of \$1,294 and \$954, respectively	2,112	2,452		
Other Assets	1,816	1,865		
			-----	
Total assets	\$44,136	\$40,218		
	=====	=====		
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>				
<b>Current Liabilities:</b>				
Accounts payable	\$ 1,246	\$ 1,813		
Deferred service revenue	5,691	4,484		
Other current liabilities	5,116	4,257		
			-----	
Total liabilities	12,053	10,554		
			-----	
<b>Commitments and Contingencies</b>				
<b>Shareholders' Equity:</b>				
Common stock, \$0.01 par value, 20,000 shares authorized, 6,201 and 6,214 shares issued and outstanding, respectively	62	62		
Additional paid-in capital	35,483	35,568		
Accumulated deficit	(3,462)	(5,966)		
			-----	
Total shareholders' equity	32,083	29,664		
			-----	
Total liabilities and shareholders' equity	\$44,136	\$40,218		
	=====	=====		

See notes to consolidated financial statements.

QUALITY SYSTEMS, INC.  
 CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE OPERATIONS  
 (in thousands, except per share amounts)

	Years Ended March 31,		
	2000	1999	1998
	-----	-----	-----
Net Revenues:			
Sales of computer systems, upgrades and supplies	\$19,247	\$18,875	\$20,273
Maintenance and other services	17,126	14,941	10,943
	-----	-----	-----
	36,373	33,816	31,216
Cost of Products and Services	16,395	15,834	13,509
	-----	-----	-----
Gross Profit	19,978	17,982	17,707
Selling, General and Administrative Expenses	12,645	13,495	12,485
Research and Development Costs	3,726	3,603	3,072
Purchased In-Process Research and Development	-	-	10,200
	-----	-----	-----
Income (Loss) from Operations	3,607	884	(8,050)
Investment Income	759	413	971
	-----	-----	-----
Income (Loss) before Provision for (Benefit from) Income Taxes	4,366	1,297	(7,079)
Provision for (Benefit from) Income Taxes	1,862	713	(2,463)
	-----	-----	-----
Net Income (Loss) and Comprehensive Income (Loss)	\$ 2,504	\$ 584	\$(4,616)
	=====	=====	=====
Net Income (Loss) per Share, basic and diluted	\$ 0.40	\$ 0.09	\$ (0.77)
	=====	=====	=====

See notes to consolidated financial statements.

QUALITY SYSTEMS, INC.  
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY  
(in thousands)

	Common		Additional Paid-in Capital	Accumulated Deficit
	Shares Number	Issued Amount		
Balance at April 1, 1997	5,997	60	34,144	(1,934)
Exercise of Stock Options	31	-	48	-
Tax Benefit Resulting from Stock Options	-	-	10	-
Purchases of Common Stock	(40)	-	(271)	-
Net Loss	-	-	-	(4,616)
Balance at March 31, 1998	5,988	60	33,931	(6,550)
Shares Issued in Acquisition of MicroMed Healthcare Information Systems, Inc.	245	3	1,833	-
Exercise of Stock Options	33	-	50	-
Purchases of Common Stock	(52)	(1)	(246)	-
Net Income	-	-	-	584
Balance at March 31, 1999	6,214	\$ 62	\$ 35,568	\$ (5,966)
Exercise of Stock Options	4	-	25	-
Tax Benefit Resulting From Stock Options	-	-	1	-
Purchases of Common Stock	(17)	-	(111)	-
Net Income	-	-	-	2,504
Balance at March 31, 2000	6,201	\$ 62	\$ 35,483	\$ (3,462)

See notes to consolidated financial statements.

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

	Years Ended March 31,		
	2000	1999	1998
Cash Flows from Operating Activities:			
Net income (loss)	\$ 2,504	\$ 584	\$ (4,616)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Purchased in-process research and development			\$ 10,200
Depreciation and amortization	2,204	2,465	1,895
Provision for bad debts	529	954	339
(Loss) gain on short-term investments and other	132	261	(90)
Deferred income taxes	(1,088)	(592)	(3,336)
Changes, net of amounts acquired, in:			
Accounts receivable	(1,751)	(3,496)	(3,514)
Inventories	(238)	556	(257)
Other current assets	(176)	(2)	116
Accounts payable	(567)	486	(72)
Deferred service revenue	1,207	2,240	590
Income taxes payable and taxes related to equity accounts	723	344	397
Other current liabilities	136	(453)	590
Net Cash Provided By Operating Activities	3,615	3,347	2,242
Cash Flows from Investing Activities:			
Proceeds from sales of short-term investments	29	542	-
Purchases of short-term investments	(50)	(75)	-
Additions to equipment and improvements	(588)	(521)	(810)
Additions to capitalized software costs	(1,130)	(1,204)	(1,861)
Purchase of net assets of MicroMed Healthcare Information Systems, Inc.	-	(3,840)	(5,327)
Change in other assets	(60)	37	234
Net Cash Used In Investing Activities	(1,799)	(5,061)	(7,764)

See notes to consolidated financial statements.

QUALITY SYSTEMS, INC.  
 CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)  
 (in thousands)

	Years Ended March 31,		
	2000	1999	1998
Cash Flows from Financing Activities:			
Purchases of Common Stock	\$ (111)	\$ (247)	\$ (271)
Proceeds from exercise of stock options	25	50	48
Net Cash Used In Financing Activities	(86)	(197)	(223)
Net Increase (Decrease) in Cash and Cash Equivalents	1,730	(1,911)	(5,745)
Cash and Cash Equivalents, beginning of year	14,196	16,107	21,852
Cash and Cash Equivalents, end of year	\$ 15,926	\$ 14,196	\$ 16,107

Supplemental Information - During fiscal 2000, 1999 and 1998 the Company made income tax payments of \$2,421, \$951 and \$485, respectively.

	Years Ended March 31,		
	2000	1999	1998
Detail of businesses acquired in purchase transactions:			
Purchased In-Process			
Research and Development	\$ -	\$ -	\$ 10,200
Fair Value of Assets Acquired	-	-	1,480
Liabilities Assumed	-	-	(677)
Common Stock Issued in Acquisition	-	(1,836)	-
Acquisition Obligation	-	5,676	(5,676)
Cash Paid for the Acquisition, net of cash acquired	\$ -	\$ 3,840	\$ 5,327

See notes to consolidated financial statements.

QUALITY SYSTEMS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 1 - DESCRIPTION OF BUSINESS

Quality Systems, Inc. ("QSI") and its wholly-owned subsidiaries, Clinitec International, Inc. ("Clinitec") and MicroMed Healthcare Information Systems, Inc. ("MicroMed"), (collectively the "Company") develop and market proprietary computer information systems for medical and dental group practices, community health centers, physician hospital organizations, management service organizations, and dental schools. The Company's proprietary software systems include general patient information, appointment scheduling, billing, insurance claims submission and processing, managed care plan implementation and referral management, treatment outcome studies, treatment planning, drug formularies, electronic medical records, dental charting and letter generation. In addition to providing fully integrated solutions, the Company provides its clients with comprehensive hardware and software maintenance and support services, system training services and electronic claims submission services.

## NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation - The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant inter-company amounts have been eliminated.

Basis of Presentation - The accompanying consolidated financial statements have been prepared in accordance with accounting principals generally accepted in the United States of America.

Revenue Recognition - In October 1997, the American Institute of Certified Public Accounts issued Statement of Position ("SOP") 97-2, "Software Revenue Recognition" ("SOP 97-2"), which was later amended in part by SOP 98-4, "Deferral of the Effective Date of a Provision of SOP 97-2, Software Revenue Recognition" ("SOP 98-4"). As of April 1, 1998, the Company has adopted SOP 97-2, as amended by SOP 98-4. SOP 97-2 provides guidance on applying generally accepted accounting principles in recognizing revenue on software transactions and supersedes the guidance contained in SOP 91-1 which the Company has heretofore been following. The Company generates revenues from licensing rights to use its software products directly to end-users. The Company also generates revenues from sales of hardware and third party software, and implementation, training, software customization and post-contract support ("maintenance") services performed for customers who license the Company's products. A typical system contract contains multiple elements of two or more of the above items. In accordance with SOP 97-2, revenue is allocated to each element of the contract based on vendor specific evidence of each element's fair market value. Provided the fees are fixed and determinable and collection is considered probable, revenue from licensing rights and sales of hardware and third party software are recognized upon shipment. Revenue from implementation, training and software customization services is recognized as the corresponding services are performed. Maintenance revenue is recognized ratably over the contractual maintenance period.

QUALITY SYSTEMS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Cash Equivalents - The Company considers all highly liquid interest earning deposits purchased with an original maturity of three months or less to be cash equivalents.

Short-Term Investments - The Company classifies its short-term investments into one of the following categories:

Held to maturity - Debt securities for which the Company has the intent and the ability to hold to maturity.

Trading - Debt securities that do not meet the "intent-to-hold" criteria and equity securities, both of which are bought and held principally for the purpose of being sold in the near term.

Available-for-sale - Debt securities that do not meet the "intent-to-hold" criteria and which are not classified as trading securities, as well as all equity securities not otherwise classified as trading securities.

Held to maturity securities are carried in the balance sheet at cost (unless there are declines in the values of individual securities that are not due to temporary declines), and realized gains and losses are recorded in the statement of operations in the period that they are earned or incurred. Trading securities are carried in the balance sheet at fair market value and unrealized gains and losses are recorded in the statement of operations. Available-for-sale securities are carried in the balance sheet at fair market value; realized gains and losses are recorded in the statement of operations when they are earned or incurred, and unrealized gains and losses, net of tax effect, are recognized as a component of shareholders' equity. Realized gains and losses from investment transactions are determined on a first-in, first-out basis.

Accounts Receivable -The Company provides credit terms ranging from 30 days to 12 months for most system and maintenance contract sales and generally does not require collateral. The Company performs ongoing credit evaluations of its customers and maintains reserves for potential credit losses.

Inventories - Inventories are valued at lower of cost (first-in, first-out) or market. Certain inventories are maintained for customer support pursuant to service agreements and are amortized over a five-year period using the straight-line method.

Equipment and Improvements - Equipment and improvements are stated at cost less accumulated depreciation and amortization. Depreciation and amortization of equipment and improvements are provided over the estimated useful lives of the assets, or the related lease terms if shorter, by the straight-line method. Useful lives range from five to seven years.

Software Development Costs - Development costs incurred in the research and development of new software products and enhancements to existing software products are expensed as incurred until technological feasibility has been established. After technological feasibility is established, any additional development costs are capitalized in accordance with Statement of Financial Accounting Standards ("SFAS") No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed." Such costs are

QUALITY SYSTEMS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

generally amortized on a straight line basis over the lesser of three years or the economic life of the related product. The Company performs a periodic review of the recoverability of such capitalized software costs. At the time a determination is made that capitalized amounts are not recoverable based on the estimated cash flows to be generated from the applicable software, any remaining capitalized amounts are written off.

Excess of Cost Over Net Assets of Acquired Business and Intangible Assets - Excess of costs over net assets of acquired business and intangible assets are being amortized using the straight-line method over ten years and five years, respectively. The Company performs a periodic review of the recoverability of such unamortized amounts. At the time a determination is made that any portion of such unamortized amounts are not recoverable based on the estimated cash flows to be generated, the excess amount is written off.

Long Lived Assets - The Company accounts for the impairment and disposition of long-lived assets in accordance with Statement of Financial Accounting Standards (SFAS) No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of. In accordance with SFAS No. 121, long-lived assets to be held are reviewed for events or changes in circumstances which indicate that their carrying value may not be recoverable. The Company periodically reviews the carrying value of long-lived assets to determine whether or not an impairment to such value has occurred and has determined that there was no impairment at March 31, 2000.

Income Taxes - Income taxes are provided for the tax effects of transactions reported in the financial statements and consist of taxes currently due plus deferred taxes related primarily to differences between the basis of assets and liabilities for financial and tax reporting. The deferred tax assets and liabilities represent the future tax return consequences of those differences, which will either be taxable or deductible when the assets and liabilities are recovered or settled. Deferred taxes also are recognized for operating losses that are available to offset future taxable income and tax credits that are available to offset future income taxes. Valuation allowances are established as a reduction of net deferred tax assets when management cannot determine that it is now more likely than not that the deferred assets will be realized.

Earnings per Share - Pursuant to SFAS No 128, "Earnings Per Share," ("SFAS No. 128"), the Company provides dual presentation of "basic" and "diluted" earnings per share ("EPS"). SFAS No. 128 replaced "primary" and "fully diluted" EPS under Accounting Principles Board ("APB") Opinion No. 15.

Basic EPS excludes dilution from common stock equivalents and is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution from common stock equivalents, similar to fully diluted EPS, but uses only the average stock price during the period as part of the computation.

QUALITY SYSTEMS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The following table reconciles the weighted average shares outstanding for basic and diluted net income (loss) per share for the periods presented.

	Years Ended March 31,		
	2000	1999	1998
(in thousands except per share amounts)			
Net income (loss)	\$ 2,504	\$ 584	\$(4,616)
Basic net income (loss) per common share:			
Weighted average of common shares outstanding	6,208	6,176	5,981
Basic net income(loss) per common share	\$ 0.40	\$ 0.09	\$ (0.77)
Diluted net income (loss) per share:			
Weighted average of common shares outstanding	6,208	6,176	5,981
Weighted average of common shares equivalents- Weighted average options outstanding	53	9	-
Weighted average number of common and common equivalent shares	6,261	6,185	5,981
Diluted net income(loss) per common share	\$ 0.40	\$ 0.09	\$ (0.77)

Stock-Based Compensation - The Company accounts for stock-based awards to employees using the intrinsic value method in accordance with APB Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB No. 25").

Comprehensive Income (Loss) - In fiscal 1999, the Company adopted SFAS No. 130, "Reporting Comprehensive Income" ("SFAS No. 130"). This statement establishes standards for the reporting of comprehensive income and its components. Comprehensive income, as defined, includes all changes in equity (net assets) during a period, from non-owner sources. For the years ended, March 31, 2000, 1999, and 1998, there were no significant differences between net income (loss) and comprehensive income (loss).

Segment Disclosures - In fiscal 1999, the Company adopted SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information" ("SFAS No. 131"). The Company adopted SFAS No. 131 effective with the fiscal year ended March 31, 1999. SFAS No. 131 establishes standards for reporting information regarding operating segments in annual financial statements and requires selected information for those segments to be presented in interim financial reports issued to shareholders. SFAS No. 131 also establishes standards for related disclosures about major customers, products and services, and geographic areas. Operating segments are identified as components of an enterprise about which separate discrete financial information is available for evaluation by the chief operating decision maker, or decision making group, in making decisions on how to allocate resources and assess performance.

The Company views its operations and manages its business as one segment, healthcare information solutions, which includes software, hardware and related services. Substantially all of the Company's operations are in the United States.

QUALITY SYSTEMS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

No one customer accounted for 10% or more of the Company's revenues in fiscal 2000, 1999, or 1998. As a result, the financial information disclosed herein represents all of the material financial information related to the Company's principal operating segment.

Use of Estimates - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and could differ from those estimates made in the current year.

Reclassifications - Certain amounts in the accompanying financial statements have been reclassified to conform with the March 31, 2000 presentation.

New Accounting Pronouncements - In June 1998, the FASB issued SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities ("SFAS No. 133"), which the Company is required to adopt in fiscal 2002. This statement establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts for hedging activities. As of March 31, 2000, the Company had no derivative instruments nor had it engaged in hedging activities, but it will continue to evaluate the effects of adopting SFAS No. 133.

NOTE 3 - CASH EQUIVALENTS AND SHORT-TERM INVESTMENTS

At March 31, 2000 and 1999, the Company had cash equivalents of \$15.1 million and \$12.9 million, respectively, invested in a major national brokerage firm's institutional fund that specializes in U.S. government securities and commercial paper with high credit ratings.

At March 31, 2000 and 1999, all short-term investments consist of trading securities. The Company bears no off-balance sheet risk on its investments.

Investment income for each of the three years ended March 31, 2000 consists of the following:

	Years Ended March 31,		
	2000	1999	1998
	-----		
	(in thousands)		
Interest Income	\$ 783	\$ 674	\$ 884
Net Gains (Losses) on			
Short-Term Investments --			
Realized	0	(220)	146
Unrealized	(24)	(38)	(58)
Other	0	(3)	(1)
	-----		
	\$ 759	\$ 413	\$ 971
	=====	=====	=====

QUALITY SYSTEMS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

## NOTE 4 - CAPITALIZED SOFTWARE COSTS

Capitalized software costs at March 31, 2000 and 1999 were net of accumulated amortization of \$3.3 million and \$2.0 million, respectively.

Information related to net capitalized software costs is as follows:

	Years Ended March 31,		
	2000	1999	1998
	-----		
	2000	1999	1998
	-----		
	(in thousands)		
Beginning of year	\$ 2,144	\$ 2,183	\$ 1,041
Capitalized	1,130	1,204	1,861
Amortization	(1,290)	(1,243)	(719)
	-----	-----	-----
End of year	\$ 1,984	\$ 2,144	\$ 2,183
	=====	=====	=====

QUALITY SYSTEMS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

## NOTE 5 - COMPOSITION OF CERTAIN FINANCIAL STATEMENT CAPTIONS

	March 31,	
	2000	1999
	(in thousands)	
<b>INVENTORIES:</b>		
Computer systems and components	\$ 785	\$ 529
Replacement parts for certain client systems, net of accumulated amortization of \$594 and \$652, respectively	188	194
Miscellaneous parts and supplies	37	49
	-----	-----
	\$ 1,010	\$ 772
	=====	=====
 <b>EQUIPMENT AND IMPROVEMENTS:</b>		
Computers and electronic test equipment	\$ 3,175	\$ 2,870
Furniture and fixtures	964	899
Vehicles	72	72
Leasehold improvements	133	198
	-----	-----
	4,344	4,039
Accumulated depreciation and amortization	(2,547)	(2,256)
	-----	-----
	\$ 1,797	\$ 1,783
	=====	=====
 <b>OTHER ASSETS:</b>		
Intangible assets, net of accumulated amortization of \$1,196 and \$841, respectively	\$ 574	\$ 929
Other	1,242	936
	-----	-----
	\$ 1,816	\$ 1,865
	=====	=====
 <b>OTHER CURRENT LIABILITIES:</b>		
Accrued payroll and related expenses	\$ 1,322	\$ 1,369
Deferred compensation	1,021	821
Income taxes payable	1,445	897
Other accrued expenses	1,328	1,170
	-----	-----
	\$ 5,116	\$ 4,257
	=====	=====

QUALITY SYSTEMS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

## NOTE 6 - INCOME TAXES

The income tax provision (benefit) consists of the following components:

	Years Ended March 31,		
	2000	1999	1998
	-----		
	(in thousands)		
Federal-			
Current taxes	\$ 2,308	\$ 1,095	\$ 672
Deferred taxes	(808)	(473)	(2,832)
	-----	-----	-----
	1,500	622	(2,160)
State-			
Current taxes	642	210	201
Deferred taxes	(280)	(119)	(504)
	-----	-----	-----
	362	91	(303)
	-----	-----	-----
	\$ 1,862	\$ 713	\$ (2,463)
	=====	=====	=====

The income tax provision (benefit) differs from an amount computed at the Federal statutory rate as follows:

	Years Ended March 31,		
	2000	1999	1998
	-----		
	(in thousands)		
Federal income tax provision (benefit) at statutory rate (34%)	\$ 1,485	\$ 441	\$ (2,407)
Increases (decreases) resulting from:			
Non-deductible amortization of purchased intangible assets	160	161	144
State income taxes	222	96	(201)
Other	(5)	15	1
	-----	-----	-----
	\$ 1,862	\$ 713	\$ (2,463)
	=====	=====	=====

QUALITY SYSTEMS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The net deferred tax benefits in the accompanying consolidated balance sheets include the following components:

	March 31,	
	----- 2000	1999 -----
	(in thousands)	
Deferred tax assets -		
Short-term investments	\$ 14	\$ 10
Accounts receivable	1,459	298
Inventories	70	56
Purchased in-process research and development	3,130	3,388
Intangible assets	128	83
Accrued compensation	291	280
Accrued liability for deferred compensation	348	277
Other Accrued Liabilities		12
Deferred revenue	109	297
State income taxes	139	54
Net operating loss carryforward	-	84
	----- 5,700	4,827 -----
Deferred tax liabilities -		
Inventories	(18)	(21)
Equipment and improvements	(12)	(12)
Accumulated depreciation	(57)	(76)
Capitalized software	(495)	(490)
Deferred revenue	(10)	(209)
	----- (592)	(808) -----
	\$ 5,108	\$ 4,019
	=====	=====

The deferred tax assets and liabilities have been shown net in the accompanying balance sheets based on the long-term or short-term nature of the items which give rise to the deferred amount.

NOTE 7 - EMPLOYEE BENEFIT PLANS

QSI, Clinitec and MicroMed each have a profit sharing and retirement plan (collectively, the "Retirement Plans") for the benefit of substantially all of their employees. Participating employees may defer up to 15% of their compensation per year. The Company's annual contribution is determined by the Company's Board of Directors and the Retirement Plans may be amended or discontinued at the discretion of the Board of Directors. Contributions of \$73,000, \$53,000 and \$43,000 were made to the Retirement Plans for the fiscal years ended March 31, 2000, 1999 and 1998, respectively.

During the fiscal year ended March 31, 1994, QSI initiated a deferred compensation plan (the "Deferral Plan") for the benefit of officers and key employees. Participating employees may defer all or a portion of their compensation for a Deferral Plan year. In addition, the Company may, but is not required to, make contributions into the Deferral Plan on behalf of participating employees. Each participating employee's deferred compensation and share of Company contributions has been invested in a life

QUALITY SYSTEMS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

insurance policy which has death benefit and mutual fund features. Investment decisions are made by each participating employee from a family of mutual funds. The Company is the owner and beneficiary of the life insurance policies and has an obligation to pay the greater of the death benefit or the net cash surrender value upon each employee's death or termination. The net cash surrender value of the life insurance policies and the related Company obligation for deferred compensation was \$1,021,000 and \$821,000 at March 31, 2000 and 1999, respectively. The Company made contributions of \$10,000, \$8,000 and \$8,000 to the Deferral Plan for the fiscal years ended March 31, 2000, 1999 and 1998, respectively.

## NOTE 8 - EMPLOYEE STOCK OPTION PLANS

During fiscal 1990, the Company's shareholders approved a stock option plan (the "1989 Plan") under which 1,000,000 shares of Common Stock have been reserved for the issuance of options. The 1989 Plan provides that salaried officers, key employees and non-employee directors of the Company may, at the discretion of the Board of Directors, be granted options to purchase shares of Common Stock at an exercise price not less than 85% of their fair market value on the option grant date. Upon an acquisition of the Company by merger or asset sale, each outstanding option will be subject to accelerated vesting under certain circumstances. The 1989 Plan terminated on June 30, 1999, however there remain 274,359 outstanding options under the 1989 plan which remain eligible for exercise until the expiration of their respective terms.

In September 1998, the Company's shareholders approved a stock option plan (the "1998 Plan") under which 1,000,000 shares of Common Stock have been reserved for the issuance of options. The 1998 Plan provides that employees, directors and consultants of the Company, at the discretion of the Board of Directors, be granted options to purchase shares of Common Stock. The exercise price of each option granted shall be determined by the Company's Board of Directors at the date of grant. Upon an acquisition of the Company by merger or asset sale, each outstanding option will be subject to accelerated vesting under certain circumstances. The 1998 Plan terminates on December 31, 2007, unless sooner terminated by the Board. At March 31, 2000, 899,000 shares were available for future grant under the 1998 Plan.

QUALITY SYSTEMS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

A summary of option transactions under the 1989 & 1998 Plans for the three years ended March 31, 2000 is as follows:

	Number of Shares	Weighted Average Exercise Price			
<hr/>					
Outstanding, April 1, 1997 (43,000 exercisable at a weighted average price of \$2.98)	267,500	15.20			
Granted (weighted average fair value of \$662,000)	164,831	7.37			
Exercised	(30,250)	1.60			
Cancelled	(182,549)	21.08			
<hr/>					
Outstanding, March 31, 1998 (50,500 exercisable at a weighted average price of \$3.45)	219,532	6.31			
Granted (weighted average fair value of \$123,000)	60,000	7.26			
Exercised	(33,000)	1.50			
Cancelled	(66,250)	7.56			
<hr/>					
Outstanding, March 31, 1999 (53,821 exercisable at a weighted average price of \$7.09)	180,282	\$ 7.04			
Granted (weighted average fair value of \$775,000)		220,250	6.58		
Exercised				(4,625)	5.52
Cancelled				(23,048)	6.86
<hr/>					
Outstanding, March 31, 2000 (107,867 exercisable at a weighted average price of \$7.11)	=====	=====	372,859	6.80	

The outstanding stock options vest ratably over a four-year period commencing from the respective option grant dates. Stock options outstanding at March 31, 2000 are summarized as follows:

Options Outstanding -			
Range of Exercise Prices	Number Outstanding at March 31, 2000	Weighted Average Remaining Contractual Life (Yrs.)	Weighted Average Exercise Price
<hr/>			
\$ 3.69 - \$ 6.25	127,625	3.8	\$ 6.04
6.38 - 8.13	226,734	3.6	6.91
9.38 - 23.50	18,500	3.6	10.71
<hr/>			
\$ 3.69 - \$23.50	372,859	3.7	\$ 6.80
<hr/>			

Options Exercisable -			
Range of Exercise Prices	Number Exercisable at March 31, 2000	Weighted Average Exercise Price	
<hr/>			
\$ 3.69 - \$ 6.25	2,500	\$ 4.31	
6.38 - 8.13	100,492	6.90	
9.38 - 23.50	4,875	12.82	
<hr/>			
\$ 3.69 - \$23.50	107,867	\$ 7.11	
<hr/>			

QUALITY SYSTEMS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The Company continues to account for its stock-based awards using the intrinsic value method in accordance with APB No. 25. Accordingly, no compensation expense has been recognized in the financial statements for employee stock option grants which had market value exercise prices. SFAS No. 123, "Accounting for Stock-Based Compensation," ("SFAS No. 123") requires the disclosure of pro forma net income (loss) and pro forma net income (loss) per share had the Company adopted the fair value method as of the beginning of fiscal 1996. Under SFAS No. 123, the fair value of stock-based awards to employees is calculated through the use of option pricing models, even though such models were developed to estimate the fair value of freely tradable, fully transferable options without vesting restrictions, which significantly differ from the Company's stock option awards. These models also require subjective assumptions, including future stock price volatility and expected time to exercise, which greatly affect the calculated values.

The Company's calculations were made using the Black-Scholes option pricing model with the following assumptions: expected life -- twelve months following full vesting or approximately 42 months from the date of the grant; stock volatility -- ranging from 50% to 60% in fiscal 2000, ranging from 44% to 81% in fiscal 1999, and ranging from 47% to 59% in fiscal 1998; risk free interest rates -- 6.0% in fiscal 2000, 5.5% in fiscal 1999, and 5.9% in fiscal 1998; and, no dividends during the expected term. The Company's calculations are based on a single option valuation approach and forfeitures are recognized as they occur. If the computed fair values of the fiscal 2000, 1999 and 1998 awards had been amortized to expense over the vesting period of the awards, pro forma net income would have been \$2,111,000 or \$0.34 per share, in fiscal 2000; the pro forma net income would have been \$410,000, or \$0.06 per share, in fiscal 1999; and the pro forma net loss would have been \$(4,801,000), or \$(0.80) per share, in fiscal 1998. These amounts are based on calculated values for option awards in fiscal 2000, 1999 and 1998 of \$775,000, \$123,000 and \$662,000, respectively.

## NOTE 9 - COMMITMENTS AND CONTINGENCIES

Litigation - On April 22, 1997, a purported class action was filed in California Superior Court on behalf of all persons who purchased the Company's Common Stock between June 26, 1995 and July 3, 1996. The complaint alleges that the Company and certain of its officers and directors, as well as other defendants not affiliated with the Company, violated sections of the California Corporations Code by issuing positive statements about the Company that allegedly were knowingly false, in part, in order to assist the Company and certain of its officers and directors in selling Common Stock at an inflated price in the Company's March 5, 1996 public offering and at other points during the period specified. On January 25, 1999 the court denied plaintiffs' motion to certify the class representative and class legal counsel. On May 9, 2000, the Court of Appeals affirmed the order disqualifying the class legal counsel as final. The Plaintiff will seek new class counsel however, the Company and its named officers and directors will have the opportunity to oppose class certification. On May 14, 1997, a second purported class action was filed in the same court essentially repeating the allegations of the April 22, 1997 suit.

QUALITY SYSTEMS, INC  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

On July 1, 1997, a third purported class action was filed in the United States District Court repeating essentially the same factual allegations as the April 22, 1997 suit and purports to state claims under the Federal securities laws. By court order dated August 13, 1997, this action was stayed temporarily and the Court reserved jurisdiction to list the stay after all matters are final in the class action filed on April 22, 1997. The Company and its named officers and directors deny all allegations of wrongdoing made against them in these suits, consider the allegations groundless and without merit, and intend to vigorously defend against these actions.

On March 23, 1999, a purported class action and derivative complaint was filed in California Superior Court on behalf of the Company's non-director shareholders alleging that certain of the Company's directors breached their fiduciary duties principally by failing to assure the maximization of shareholder value. The parties in this action have agreed to a settlement which calls for a dismissal of the action with prejudice, release given to each of the defendants, and payment of the nominal sum of \$100,000 (paid by the Company's Directors and Officers Liability Insurance Company) in full settlement of plaintiff's motion for attorney's fees. The settlement further expressly provides that it does not constitute an admission of any liability of defendants, which defendants continue to vigorously deny.

The Company is a party to various other claims, legal actions and complaints arising in the ordinary course of business. The Company believes such matters are without merit, or involve such amounts that unfavorable disposition would not have a material adverse effect on the Company's financial statements.

Rental Commitments - The Company leases its facilities and offices under non-cancelable operating lease agreements expiring at various dates through July 2002. The Company has rental commitments under these agreements in fiscal 2001, 2002 and 2003 of \$827,000, \$216,000, and \$72,000, respectively. Total rental expense for all operating leases was \$901,000, \$807,000 and \$672,000 for the years ended March 31, 2000, 1999 and 1998, respectively.

## NOTE 10 - ACQUISITIONS

MicroMed - On May 15, 1997, the Company acquired substantially all of the assets of MicroMed, a developer and marketer of proprietary information systems utilizing a graphical user interface client/server platform for medical group practices. The purchase price consisted of an initial cash payment of \$4.8 million paid at the closing of the transaction and an additional payment of \$5.7 million due no later than June 29, 1998. The additional payment, paid on June 29, 1998, consisted of \$3.8 million in cash and 245,454 shares of QSI Common Stock valued at \$1.8 million, or \$7.48 per share.

The acquisition was recorded as a purchase transaction. In connection with this treatment, the \$10.6 million paid, by the Company, including related acquisition costs, together with a \$550,000 loan payable by MicroMed to the Company as of the acquisition date and \$677,000 of assumed MicroMed liabilities was allocated to \$1.3 million of acquired identified assets, \$10.2 million of acquired in-process research and development, and \$264,000 of purchase price in excess of assets acquired.

QUALITY SYSTEMS, INC  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The technological feasibility of the acquired in-process research and development had not been established at the dates the purchase price was allocated and, accordingly, the allocated value was charged to operations during the year ended March 31, 1998. If the MicroMed acquisition had been consummated as of the beginning of the year ended March 31, 1998, the impact on pro forma revenues, net loss and net loss per share would not have been material for the year ended March 31, 1998.

NOTE 11 - SHAREHOLDER RIGHTS PLAN

Each share of the Company's Common Stock included a Right to purchase from the Company one share of Common Stock for \$40, subject to adjustment. These Rights were be exercisable only if a person or group without prior consent of the Company's board became the beneficial owner of 15% or more of the Common Stock. The terms of the Rights served to deter potential attempts to acquire control of the Company without the approval of the Company's Board of Directors. In August 1999, the Company's Board of Directors terminated the shareholder rights plan and authorized the redemption of all outstanding Rights issued under the Rights agreement.

NOTE 12 - STOCK REPURCHASE PLAN

In February 1997, the Company's Board of Directors authorized the repurchase on the open market of up to 10% of the shares of the Company's outstanding Common, subject to compliance with applicable laws and regulations. This authorization has been renewed annually and currently expires on June 7, 2001. As of March 31, 2000, the Company has repurchased 109,900 shares at a cash cost of \$629,000. The Company's management could, in the exercise of its judgment, decide not to effect any additional repurchases, or to repurchase fewer shares than authorized.

QUALITY SYSTEMS, INC.  
SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS

ALLOWANCE FOR DOUBTFUL ACCOUNTS  
(in thousands)

Column A Description	Column B Balance at beginning of period	Column C - Additions		Column D Deductions	Column E Balance at end of Period
		(1) Charged to costs and expenses	(2) Charged to other accounts		
Fiscal Year Ended:					
March 31, 2000	\$ 754	\$ 529	\$ -	\$ 162	\$1,121
March 31, 1999	521	954	-	721	754
March 31, 1998	\$ 297	\$ 339	\$ -	\$ 115	\$ 521
	=====	=====	=====	=====	=====



## CERTIFICATE OF AMENDMENT OF BYLAWS.

The undersigned hereby certifies that she is the duly elected and acting Secretary of Quality Systems, Inc., a California corporation ("QSI"), and that the following amendment was duly adopted by the Board of Directors of QSI at a duly called and noticed meeting thereof, held on the ninth of September, 1998:

WHEREAS, Article III, Section 2 of the Bylaws of the Corporation currently provides that the authorized number of directors of the Corporation shall be not less than five (5) and not more than nine (9), with the exact number of directors having been fixed within those limits at six (6); and

WHEREAS, the exact number of directors, within the limits specified, may be altered from time to time by an amendment of the last sentence of Article III, Section 2 of the Bylaws duly adopted by the Board of Directors or the shareholders; and

WHEREAS, it is deemed to be advisable and in the best interests of this Corporation and its shareholders that this Board of Directors adopt an amendment to the last sentence of Article III, Section 2 of the Bylaws so as to increase the actual number of directors to seven (7) from six (6);

NOW, THEREFORE, BE IT RESOLVED, that the last sentence of Article III, Section 2 of the Bylaws of the Corporation be, and hereby is, amended to read in its entirety as follows:

"The exact number of directors shall be seven (7) until changed as provided in this Section 2."

and that the foregoing amendment has not been rescinded, modified or revoked and is in full force and effect.

Executed in Tustin, California this ninth day of September, 1998.

/s/

-----  
TBD

Exhibit 10.16

## MEMORANDUM OF UNDERSTANDING

1. Sheldon Razin ("Razin") will go on vacation, effective March 31, 2000, and return April 3, 2000. He will resign as CEO on April 3, 2000. The press announcement will not contain negative remarks and will indicate his continued Chairmanship pursuant to the 8/99 MOU.

2. Razin's existing options to purchase QSII shares (approx. 30,000 shares) shall vest in equal installments over the next four years, as if he had remained as CEO.

3. Razin will receive as a severance his current salary through September 30, 2000.

4. Razin will remain on the Company's insurance plans until age 65, at the Company's expense.

5. Razin will take over his Center Club membership, health club membership, and be permitted to buy his company car at FMV (blue book). He will transfer his cellphone into his name, and may purchase certain personal items, such as his desk, which will be identified later.

6. Razin will be designated an employee if necessary to accomplish items 2 and 4 above.

7. Razin will vacate his office no later than April 7, 2000.

QUALITY SYSTEMS, INC.

By: \_\_\_\_\_

-----  
Sheldon Razin

Exhibit 21

## QUALITY SYSTEMS, INC.

## List of Subsidiaries

1. Clinitec International, Inc., a California Corporation, is a wholly-owned subsidiary of Quality Systems, Inc.
  
2. MicroMed Healthcare Information Systems, Inc., a California Corporation, is a wholly-owned subsidiary of Quality Systems, Inc.

Exhibit 23.1

## INDEPENDENT AUDITORS' CONSENT

We consent to the incorporation by reference in Registration Statements Number 2-82773, 33-31949, 333-63131 and 333-67115 on Form S-8 of our report dated May 19, 2000, appearing in this Annual Report on Form 10-K for Quality Systems, Inc. for the year ended March 31, 2000.

DELOITTE & TOUCHE LLP  
Costa Mesa, California  
June 21, 2000

Exhibit 27.1

YEAR	MAR-31-2000	YEAR	MAR-31-1999
	MAR-31-2000		MAR-31-1999
	15,926,000		14,196,000
	243,000		245,000
	13,710,000		12,488,000
	0		0
	1,010,000		772,000
	33,385,000		28,720,000
	1,797,000		1,783,000
	0		0
	44,136,000		40,218,000
12,053,000		10,554,000	
0		0	0
	0		0
	62,000		62,000
44,136,000	32,021,000		29,602,000
	40,218,000		
	19,247,000		18,875,000
36,373,000		33,816,000	
	0		0
	16,395,000		15,834,000
16,371,000		17,098,000	
0		0	
	0		0
	4,366,000		1,297,000
	1,862,000		713,000
2,504,000		584,000	
0		0	
0		0	
	0		0
	2,504,000		584,000
	0.40		0.09
	0.40		0.09