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EARTHSHELL CORP
Form 10-K/A
May 03, 2005

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

Form 10-K/A
Amendment No. 2

(Mark One)

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

For The Fiscal Year Ended December 31, 2004
or

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

For The Transition Period From _____ to _____

EARTHSHELL CORPORATION
(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction
of incorporation or organization)

77-0322379
(I.R.S. Employer
Identification No.)

3916 State St., Suite 110
Santa Barbara, CA 93105
(805)563-7590
(Address, including zip code, and telephone number, including area code,
of principal executive offices)

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

Securities registered pursuant to Section 12(g) of the Act:
Common Stock, par value \$0.01 per share
(title of each class)

Indicate by check mark whether the issuer (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 issuer
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 there is no disclosure of delinquent filers in
response to Item 405 of Regulation S-B contained in this form, and no disclosure
will be contained, to the best of the issuer'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.

Indicate by check mark whether the registrant is an accelerated filer (as
defined in Exchange Act Rule 12b-2). Yes No

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The aggregate market value of common stock held by non-affiliates as of June 30, 2004 was \$28,681,801.

The number of shares outstanding of the Registrant's Common Stock as of March 31, 2005 was 18,391,065.

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Documents Incorporated by Reference:

None.

EXPLANATORY NOTE

Earthshell Corporation (the "Company") is filing this Amendment No. 2 on Form 10-K/A (this "Amendment") to the Company's Annual Report on Form 10-K for the year ended December 31, 2004 to make certain corrections to Amendment No.1 on Form 10-K/A filed with the Securities and Exchange Commission on May 2, 2005.

Except for the amendments set forth below, this Amendment does not modify or update the Company's previously reported financial statements and other disclosures in, or exhibits to, the original filing. Unaffected items have not been repeated in this Amendment.

ITEM 7. MANagements' DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

The first full paragraph under the subheading "Critical Accounting Estimates" is amended and restated as follows:

Going Concern Basis. The consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The Company has incurred significant losses since inception, has minimal revenues and has a working capital deficit of \$7,289,431 at December 31, 2004. These factors, along with others, may indicate that the Company will be unable to continue as a going concern for a reasonable period of time. The Company will have to raise additional funds to meet its current obligations and to cover operating expenses through the year ending December 31, 2005. If the Company is not successful in raising additional capital, it may not be able to continue as a going concern for a reasonable period of time. Management plans to address this need by raising cash through either the sale of licenses, the generation of royalty revenues or the issuance of debt or equity securities. In addition, the Company expects cash to be generated in 2005 through royalty payments from licensees. However, the Company cannot assure that additional financing will be available to it, or, if available, that the terms will be satisfactory, that it will receive any royalty payments in 2005. Management will also continue in its efforts to reduce expenses, but cannot assure that it will be able to reduce expenses below current levels. The consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern.

The following text is to appear immediately after Item 7.

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The Management of EarthShell is responsible for establishing and maintaining adequate internal control over financial reporting and for the assessment of the effectiveness of internal control over financial reporting. As defined by the SEC, internal control over financial reporting is a process

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designed by, or supervised by, the Company's principal executive and principal financial officers, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles.

The Company's internal control over financial reporting is supported by written policies and procedures, that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the Company's assets; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of the Company's management and directors; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

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Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a significant deficiency (within the meaning of PCAOB Auditing Standard No. 2), or a combination of significant deficiencies, that results in there being more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis by employees in the normal course of their assigned functions.

In making its assessment of internal control over financial reporting, management used the framework set forth in the report entitled "Internal Control--Integrated Framework" published by the Committee of Sponsoring Organizations ("COSO") of the Treadway Commission to evaluate the effectiveness of the Company's internal control over financial reporting. Because of the material weaknesses described below, management believes that, as of December 31, 2004, the Company did not maintain effective internal control over financial reporting based on those criteria.

The Company's independent auditors have issued an attestation report on management's assessment of the Company's internal control over financial reporting. That report appears on page 6.

During 2004, the Company operated with a significantly reduced number of personnel compared to prior years. The Company's management has implemented and documented internal control over financial reporting which it believed would be considered sufficient, given the resources available to it. However, during the fourth quarter of 2004, the Company's Controller resigned, and has not been replaced to this date, leaving the Company's Chief Financial Officer as the only accounting professional employed by the Company. This resulted in the loss of segregation of responsibilities that are typical to effective financial reporting control methodology. The Company has employed certain mitigating controls designed to offset the inherent control weaknesses that result from a lack of segregation of responsibilities.

Material Weaknesses Identified

The Company's assessment of its internal control over financial reporting

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identified the following material weaknesses:

- o The Company has inadequate segregation of critical duties within each of its accounting processes and a lack of sufficient monitoring controls over these processes to mitigate this risk. The responsibilities assigned to one employee include maintaining the vendor master file, processing payables, creating and voiding checks, reconciling bank accounts, making bank deposits and processing payroll.

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- o The departure of the Company's Controller in November 2004 resulted in the accounting and reporting functions being centralized under the Chief Financial Officer, with no additional personnel in the Company having an adequate knowledge of accounting principles and practices. As a result, certain transactions had not been recorded in a timely manner and several adjustments to the financial statements that were considered material to the financial position at December 31, 2004 and results of operations for the year then ended were recorded.
- o There are weaknesses in the Company's information technology controls which makes the Company's financial data vulnerable to error or fraud. Specifically, there is a lack of documentation regarding the roles and responsibilities of the IT function, lack of security management and monitoring and inadequate segregation of duties involving IT functions.

Additionally, at the conclusion of our independent auditor's examination of the Company's internal control over financial reporting, our independent auditor noted several other areas of operations which could be improved. Our auditors did not believe these items constituted material weaknesses.

Remediation Steps to Address the Material Weaknesses

In consultation with its independent auditors, as of the date of this report, the Company has begun taking the following remediation steps, among others, to enhance its internal control over financial reporting and reduce control deficiencies in general, including the material weaknesses enumerated above:

- o management is actively seeking qualified candidates to perform the Controller responsibilities;
- o management has engaged an outside firm to perform the Internal Audit functions. This outside firm will report to the Audit Committee of the Board of Directors; and
- o management employs an outside firm to monitor and maintain the Company's information systems. This group will be directed to develop and implement Company-wide information management control procedures.

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ITEM 9A. CONTROLS AND PROCEDURES

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(a) Evaluation of Disclosure Controls and Procedures.

The Company's Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this Report (the "Evaluation Date"). Based on such evaluation, such officers concluded that, as of the Evaluation Date, the Company's disclosure controls and procedures were effective in ensuring that (i) information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms and (ii) information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the Company's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

(b) Changes in Internal Control Over Financial Reporting.

During the Company's last fiscal quarter, other than the departure of the Company's former Controller (described in Management's Report on Internal Control Over Financial Reporting on page 2) no changes in the Company's internal control over financial reporting came to management's attention that materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting. However, as permitted under Release No. 50754 dated November 30, 2004, the Company has included management's annual report on internal control over financial reporting and the related attestation report of the Company's registered public accounting firm in this Amendment to the Company's annual report on Form 10-K/A. See "Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting" and Management's Report on Internal Control Over Financial Reporting on pages 2 and 6, respectively.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Earthshell Corporation:

We have audited management's assessment, included in the accompanying "Management's Annual Report on Internal Controls over Financial Reporting," that Earthshell Corporation (the "Company") did not maintain effective internal control over financial reporting as of December 31, 2004, because of the effect of pervasive material weaknesses in the design and operation of the Company's system of internal controls, based on criteria established in Internal Control--Integrated Framework issued by the Committee of Sponsoring Organization of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and

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performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

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A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The Company has pervasive material weaknesses in the design and operation of its system of internal controls over financial reporting. The following material weaknesses have been identified and included in management's assessment:

(1) Inadequate segregation of duties involving the authorization, recording, custody, and periodic reconciliation of accounting transactions.

(2) Insufficient staffing of accounting personnel with adequate knowledge of accounting principles generally accepted in the United States. This inadequate staffing in the accounting department resulted in transactions not being recorded in a timely manner. In addition, there was inadequate application of accounting principles generally accepted in the United States in relation to the valuation of the gain on settlements of debt obligations in 2004, the classification of certain debts in the financial statements and the proper recording of liabilities as of December 31, 2004. This weakness resulted in the recording of several adjustments to the financial statements that were considered material to the financial position at December 31, 2004 and results of operations for the year then ended.

(3) A pervasive lack of general controls over the information technology system which could have a material effect on the financial statements.

These material weaknesses were considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2004 financial statements, and this report does not affect our report dated March 4, 2005 on those financial statements.

In our opinion, management's assessment that Earthshell Corporation did not maintain effective internal control over financial reporting as of December

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31, 2004, is fairly stated, in all material respects, based on criteria established in Internal Control--Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, in our opinion, because of the effect of the material weakness described above on the achievement of the objectives of the control criteria, Earthshell Corporation has not maintained effective internal control over financial reporting as of December 31, 2004 based on criteria established in Internal Control--Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We do not express an opinion or any other form of assurance on management's statements referring to the corrective actions taken by the Company after the date of management's assessment.

/s/ Farber & Hass LLP
April 26, 2005
Camarillo, California

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this Amendment No. 2 to its report to be signed on its behalf by the undersigned, thereunto duly authorized.

EARTHSHELL CORPORATION

By: /s/ Simon K. Hodson

Name: Simon K. Hodson
Title: Vice Chairman of the Board and
Chief Executive Officer

Date: May 3, 2005

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

Signature	Title	
----- /s/ Essam Khashoggi ----- Essam Khashoggi	Chairman of the Board	May
----- /s/ Simon K. Hodson ----- Simon K. Hodson	Vice Chairman of the Board and Chief Executive Officer (Principal Executive Officer)	May
----- /s/ D. Scott Houston ----- D. Scott Houston	Chief Financial Officer and Secretary (Principal Financial Officer)	May
----- /s/ Layla Khashoggi -----	Director	May

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Corporation 1995 Stock Incentive Plan.(1)

- 10.7 Warrant to Purchase Stock issued July 2, 1996 by the Company to Imperial Bank.(1)
 - 10.8 Amended and Restated Technical Services and Sublease Agreement dated October 1, 1997 by and between the Company and EKI.(1)
 - 10.9 Amended and Restated Agreement for Allocation of Patent Costs dated October 1, 1997 by and between the Company and EKI.(1)
 - 10.10 Warrant to Purchase Stock issued October 6, 1997 by the Company to Imperial Bank.(1)
 - 10.11 Warrant to Purchase Stock dated December 31, 1997 by the Company to Imperial Bank.(1)
 - 10.12 Letter Agreement re Haas/BIOPAC Technology dated February 17, 1998 by and between the Company and EKI.(1)
 - 10.13 Second Amendment to 1995 Stock Incentive Plan of the Company.(1)
 - 10.14 Amendment No. 2 to Registration Rights Agreement dated as of September 16, 1993.(1)
 - 10.15 Amendment No. 2 to Registration Rights Agreement dated February 28, 1995.(1)
 - 10.16 Employment Agreement dated April 15, 1998 by and between the Company and Vincent J. Truant.(3)
 - 10.17 First Amendment dated June 2, 1998 to the Amended and Restated License Agreement by and between the Company and E. Khashoggi Industries("EKI").(4)
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- 10.18 First Amendment to 1995 Stock Incentive Plan of the Company.(5)
 - 10.19 Third Amendment to 1995 Stock Incentive Plan of the Company.(6)
 - 10.20 Fourth Amendment to 1995 Stock Incentive Plan of the Company.(6)
 - 10.21 Lease Agreement dated August 23, 2000 by and between the Company and Heaver Properties, LLC.(7)
 - 10.22 Settlement Agreement with Novamont dated August 3, 2001.(8)
 - 10.23 Amendment to Common Stock Purchase Agreement dated March 28, 2001.(8)
 - 10.24 Securities Purchase Agreement dated as of August 12, 2002 between the Company and the investors signatory thereto.(9)
 - 10.25 Amendment #1 to Employment Agreement dated as of May 15, 2002 by and between the Company and Vince Truant.(10)
 - 10.26 Loan Agreement dated as of September 9, 2002 between the Company and E. Khashoggi Industries, LLC.(11)

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- 10.27 Second Amendment dated 29 July, 2002 to Amended and Restated License Agreement between E. Khashoggi Industries, LLC and the Company.(12)
- 10.28 License and Information Transfer Agreement dated 29 July, 2002 between the Biotec Group and the Company.(12)
- 10.29 Loan and Securities Purchase Agreement dated as of March 5, 2003 between the Company and the investors signatory thereto.(13)
- 10.30 Sublicense Agreement dated February 20, 2004 by and between the Company and Hood Packaging Corporation. (15)
- 10.31 Operating and Sublicense Agreement dated October 3, 2002 by and between the Company and Sweetheart Cup Company, Inc. (15)
- 10.32 First Amendment to Operating and Sublicense Agreement dated July 2003 by and between the Company and Sweetheart Cup Company, Inc. (15)
- 10.34 Lease Agreement dated July 2003 between the Company and Sweetheart Cup Company, Inc. (15)
- 10.35 First Amendment to Lease Agreement dated December 16, 2003 between the Company and Sweetheart Cup Company, Inc. (15)
- 10.37 Sublicense Agreement dated November 11, 2004 by and between the Company and EarthShell Hidalgo S.A. de C.V.(18)

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- 10.38 Standby Equity Distribution Agreement dated as of March 23, 2005 between the Company and Cornell Capital Partners, LP. (16)
- 10.39 Registration Rights Agreement dated as of March 23, 2005 between the Company and Cornell Capital Partners, LP. (16)
- 10.40 Placement Agent Agreement dated as of March 23, 2005 by and among the Company, Cornell Capital Partners, LP and Sloan Securities Corporation. (16)
- 10.41 Security Agreement dated as of March 23, 2005 between the Company and Cornell Capital Partners, LP. (16)
- 10.42 Promissory Note dated as of March 23, 2005 issued to Cornell Capital Partners, LP. (16)
- 10.43 Meridian Business Solutions Sublicense Agreement dated May 13, 2004. (17)
- 10.44 Amended and Restated Debenture Purchase Agreement by and among the Company, EKI and SF Capital Partners, Ltd. dated September 30, 2004. (17)
- 10.45 Amended and Restated Debenture Purchase Agreement by and among the Company, EKI and Omicron Master Trust dated September 29, 2004. (17)
- 10.46 Amended and Restated Debenture Purchase Agreement by and among the Company, EKI and Islandia, Ltd. dated September 29, 2004. (17)
- 10.47 Amended and Restated Debenture Purchase Agreement by and among the

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Company, EKI and Midsummer Investment, Ltd. dated September 29, 2004. (17)

- 10.48 Conversion Agreement by and among the Company, EKI and RHP Master Fund, Ltd. dated July 20, 2004. (17)
- 10.49 Amended and Restated Debenture Purchase Agreement by and among the Company, EKI and Straus-GEPT L.P. dated September 29, 2004. (17)
- 10.50 Amended and Restated Debenture Purchase Agreement by and among the Company, EKI and Straus Partners L.P. dated September 29, 2004. (17)
- 10.51 Amended and Restated Debenture Purchase Agreement by and among the Company and EKI dated September 30, 2004. (17)
- 10.52 Agreement with EKI dated July 16, 2004 to convert debt to equity. (17)
- 10.53 Agreement dated September 1, 2004 for conversion of Biotech indebtedness. (17)
- 10.54 Stock Purchase Agreement between the Company and Meridian Business Solutions, LLC dated August 5, 2004. (17)
- 14.1 EarthShell Corporation Code of Ethics for Directors, Officers and Employees (15)
- 16.1 Letter from Deloitte & Touche LLP to the Securities and Exchange Commission dated July 9, 2003, regarding change in certifying accountant. (14)

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- 31.1 Certification of the CEO pursuant to Rules 13a-14 and 15d-14 under the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of the CFO pursuant to Rules 13a-14 and 15d-14 under the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

- (1) Previously filed, as an exhibit to the Company's Registration Statement on Form S-1 and amendments thereto, File no. 333-13287, and incorporated herein by reference.
- (2) Previously filed as an exhibit to the Company's quarterly report on Form 10-Q, for the quarter ended March 31, 1998, and incorporated herein by reference.
- (3) Previously filed as an exhibit to the Company's quarterly report on Form 10-Q, for the quarter ended June 30, 1998, and incorporated herein by reference.
- (4) Previously filed as an exhibit to the Company's quarterly report on Form 10-Q, for the quarter ended September 30, 1998, and incorporated herein by reference.
- (5) Previously filed as an exhibit to the Company's annual report on Form

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10-K, for the fiscal year ended December 31, 1998, and incorporated herein by reference.

- (6) Previously filed as part of the Company's definitive proxy statement on Schedule 14A, file no. 000-23567, for its 1999 annual meeting of stockholders, and incorporated herein by reference.
- (7) Previously filed as an exhibit to the Company's annual report on Form 10-K, for the fiscal year ended December 31, 2000, and incorporated herein by reference.
- (8) Previously filed as an exhibit to the Company's quarterly report on Form 10-Q, for the quarter ended June 30, 2001, and incorporated herein.
- (9) Previously filed as an exhibit to the Company's current report on Form 8-K dated August 12, 2002, and incorporated herein by reference.
- (10) Previously filed as an exhibit to the Company's quarterly report on Form 10-Q for the quarter ended June 30, 2002, and incorporated herein by reference.
- (11) Previously filed as an exhibit to the Company's current report on Form 8-K dated September 17, 2002, and incorporated herein by reference.
- (12) Previously filed as an exhibit to the Company's quarterly report on Form 10-Q for the quarter ended September 30, 2002, and incorporated herein by reference.
- (13) Previously filed as an exhibit to the Company's current report on Form 8-K dated March 5, 2003, and incorporated herein by reference.
- (14) Previously filed as an exhibit to the Company's current report on Form 8-K dated July 11, 2003, and incorporated herein by reference.
- (15) Previously filed as an exhibit to the Company's annual report on Form 10-K, for the fiscal year ended December 31, 2003, and incorporated herein by reference.
- (16) Previously filed as an exhibit to the Company's current report on Form 8-K dated March 29, 2005, and incorporated herein by reference.
- (17) Previously filed as part of the Company's quarterly report on Form 10-Q for the quarter ended September 30, 2004, and incorporated herein by reference.
- (18) Previously filed as an exhibit to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2004, and incorporated herein by reference.