

VASOMEDICAL INC  
Form 10-K/A  
September 28, 2010

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

FORM 10-K/A  
Amendment No. 1

ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended May 31, 2010

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 0-18105

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

Delaware  
(State or other jurisdiction of  
incorporation or organization)

11-2871434  
(IRS Employer  
Identification No.)

180 Linden Avenue, Westbury, New York  
(Address of Principal Executive Offices)

11590  
(Zip Code)

Registrant's telephone number, including area code: (516) 997-4600

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

Securities registered under Section 12(g) of the Act:  
Common Stock, \$.001 par value  
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.  
Yes  No

Indicate by a 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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T

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(§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files)

Yes  No

Indicate by a check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-B 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.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer  Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  
Yes  No

The aggregate market value of common stock held by non-affiliates was approximately \$14,088,479 based on the closing sales price of the common stock as quoted on the OTC-BB on August 23, 2010.

At August 23, 2010, the number of shares outstanding of the issuer's common stock was 110,271,131.

DOCUMENTS INCORPORATED BY REFERENCE

None

EXPLANATORY NOTE

Vasomedical, Inc. (the "Company," "we," "us," or "our") is filing this Amendment No. 1 on Form 10-K/A to our Report on Form 10-K for the fiscal year ended May 31, 2010 (the "Report") for the purpose of including information that was to be incorporated by reference from our definitive proxy statement pursuant to Regulation 14A of the Securities Exchange Act of 1934, as amended, (the "Exchange Act"). We will not file our proxy statement within 120 days of our fiscal year ended May 31, 2010, and are, therefore, amending and restating in their entirety Items 10, 11, 12, 13 and 14 of Part III of the Report.

This amendment also includes audited financial statements that are accompanied by a report signed by our Independent Registered Public Accounting Firm. No changes have been made to the audited financial statements.

Except as described above, no other amendments are being made to this Report. This Form 10-K/A does not reflect events occurring after the August 30, 2010 filing of our Report or modify or update the disclosure contained in the Report in any way other than as required to reflect the amendments discussed above and reflected below.

This amendment should be read in conjunction with our Annual Report for the year ended May 31, 2010 filed on Form 10-K on August 30, 2010.

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PART III

ITEM 10 – DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Directors of the Registrant

As of September 24, 2010, the members of our Board of Directors are:

Name of Director	Age	Principal Occupation	Director Since
Simon Srybnik (3)(4)	94	Chairman of the Board and Director	June, 2007
Derek Enlander (1)(2)	62	Director	July, 2007
Jun Ma	47	President and Chief Executive Officer	June, 2007
Behnam Movaseghi (2)	57	Director	July, 2007
William Dempsey (2)	56	Director	June, 2010
Peter C. Castle (1)	42	Director	August, 2010

(1) Member of the Audit Committee

(2) Member of Compensation Committee

(3) Member of the Corporate Governance Committee

(4) Ex-officio member of all committees

The following is a brief account of the business experience for at least the past five years of our directors:

Simon Srybnik has been a director since June 2007 and Chairman of the Board since June 2010. He is the Chairman of the Board of Kerns Manufacturing Corp. and Living Data Technology Corp. A lifetime entrepreneur and industrialist, Mr. Srybnik has founded and managed many companies in various industries including machinery and process equipment, aerospace and defense, biology and healthcare.

Derek Enlander M.D. has been a director since July 2007. He is an attending physician at the Mount Sinai Medical Center New York, and a clinical instructor at the Mount Sinai Medical School. He is in private practice in Internal Medicine in Manhattan. He is the author of six books on medicine and over twenty research papers. He has invented a new drug to treat immune dysfunction and is the President of Computer Medica Inc., where he invented a Medical History card to store a patient's medical files including X-rays, MRIs, etc. on a credit card size computer readable card.

Jun Ma, PhD has been a director since June 2007 and was appointed President and Chief Executive Officer of the Company on October 16, 2008. Dr. Jun Ma has been an associate professor in engineering at New York Institute of Technology since 1997 and an assistant professor from 1993 to 1997. Previously Dr. Ma provided technology and business consulting services to several companies in aerospace, automotive, biomedical, medical device, and other industries, including Kerns Manufacturing Corp. and Living Data Technology Corp., both of which are stockholders of our Company.

Behnam Movaseghi has been a director since July 2007. Mr. Movaseghi has been treasurer of Kerns Manufacturing Corporation since 2000, and controller from 1990 to 2000. For approximately ten years prior thereto Mr. Movaseghi

was a tax and financial consultant. Mr. Movaseghi is a Certified Public Accountant.

William Dempsey has been a director since June 2010. Mr. Dempsey is the former owner and Managing Director of Cardiac Services Ireland, Ltd., a healthcare and distribution company in Ireland and the United Kingdom. He has over 30 years experience in the healthcare and distribution market in Ireland. Mr. Dempsey successfully built and grew Cardiac Services Ireland Ltd. into one of the country's leading suppliers of cardiology, anesthesia, imaging, fetal and obstetrical patient monitoring and resuscitation products.

Peter Castle has been a director since August 2010. Mr. Castle is currently the President and Chief Operating Officer of NetWolves Corporation, where he has been employed since 1998. Mr. Castle also held the position of Chief Financial Officer from 2001 until October 2009, Vice President of Finance since January 2000, Controller from August 1998 until December 1999 and Treasurer and Secretary from August 1999. NetWolves is a global telecommunications and Internet managed services provider offering single-source network solutions that provides multi-carrier and multi-vendor implementation to over 1,000 customers worldwide.

#### Committees of the Board of Directors

##### Audit Committee and Audit Committee Financial Expert

The Board has a standing Audit Committee. The Board has affirmatively determined that each director who serves on the Audit Committee is independent, as the term is defined by applicable Securities and Exchange Commission ("SEC") rules. During the fiscal year ended May 31, 2010, ("fiscal 2010") the Audit Committee consisted of Photios T. Paulson, who served as the committee chair during fiscal 2010, Derek Enlander and Martin Zeiger until his resignation in April 2010. The members of the Audit Committee have substantial experience in assessing the performance of companies, gained as members of the Company's Board of Directors and Audit Committee, as well as by serving in various capacities in other companies or governmental agencies. As a result, they each have an understanding of financial statements. The Board believes that the addition of Peter Castle in August 2010 fulfills the role of the financial expert on this committee.

The Audit Committee regularly meets with our independent registered public accounting firm outside the presence of management.

The Audit Committee operates under a charter approved by the Board of Directors. The Audit Committee charter is available on our website.

##### Compensation Committee

Our Compensation Committee annually establishes, subject to the approval of the Board of Directors and any applicable employment agreements, the salaries that will be paid to our executive officers during the coming year, as well as administers our stock-based benefit plans. During fiscal 2010, the Compensation Committee consisted of Martin Zeiger, who served as the committee chair, until his resignation in April 2010, Derek Enlander, and Photios T. Paulson. None of these persons were our officers or employees during fiscal 2010 or, except as otherwise disclosed, had any relationship requiring disclosure in this Form 10-K/A.

The Compensation Committee operates under a charter approved by the Board of Directors. The Compensation Committee charter is available on our website.

##### Corporate Governance Committee

The Board of Directors has established a Corporate Governance Committee. During fiscal 2010, the Corporate Governance Committee consisted of John C.K. Hui, who served as committee chair until his resignation in June 2010, Simon Srybnik and Martin Zeiger until his resignation in April 2010. The Corporate Governance Committee monitors developments in corporate governance principles and other corporate governance matters and makes recommendations to the Board of Directors regarding the adoption of additional corporate governance principles.

The Corporate Governance Committee operates under a charter approved by the Board of Directors. The Corporate Governance Committee charter is available on our website.



## MEETINGS OF THE BOARD OF DIRECTORS AND COMMITTEES

During the fiscal year ended May 31, 2010 there were:

- 7 meetings of the Board of Directors
- 4 meetings of the Audit Committee
- 1 meeting of the Compensation Committee

The Corporate Governance Committee did not hold any meetings during the fiscal year ended May 31, 2010.

### Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Exchange Act requires directors, executive officers and persons who beneficially own more than 10% of our common stock (collectively, "Reporting Persons") to file initial reports of ownership and reports of changes in ownership of our common stock with the SEC. Reporting Persons are required by SEC regulations to furnish us with copies of all Section 16(a) reports they file. To our knowledge, based solely on our review of the copies of such reports received or written representations from certain Reporting Persons that no other reports were required, we believe that during fiscal 2010, all Reporting Persons timely complied with all applicable filing requirements.

### Corporate Governance - Code of Ethics

We have adopted a Corporate Code of Business Ethics (the "Code") that applies to all employees, including our principal executive officer, principal financial officer, and directors of the Company. A copy of the Code can be found on our website, [www.vasomedical.com](http://www.vasomedical.com). The Code is broad in scope and is intended to foster honest and ethical conduct, including accurate financial reporting, compliance with laws and the like. If any substantive amendments are made to the Code or if there is any grant of waiver, including any implicit waiver, from a provision of the Code to our Chief Executive Officer or Chief Financial Officer, we will disclose the nature of such amendment or waiver in a Current Report on Form 8-K.

### Executive Officers of the Registrant

As of September 24, 2010 our executive officers are:

Name of Officer	Age	Position held with the Company
Jun Ma, PhD	47	President, Chief Executive Officer and Director
Jonathan Newton	49	Chief Financial Officer
John C.K. Hui, PhD	64	Senior Vice-President and Chief Technology Officer

Jonathan P. Newton was appointed Chief Financial Officer of the Company effective September 1, 2010. From June 2006 to August 2010, Mr. Newton was Director of Budgets and Financial Analysis for Curtiss-Wright Flow Control. His responsibilities included the development of sophisticated financial forecasting models, preparing the annual budget, long-term strategic planning, cost analysis and SOX compliance. From August 2001 to June 2006, Mr. Newton was Vasomedical's Director of Budgets and Analysis. In that capacity, his responsibilities included preparing annual budgets and forecasts, revenue, margin and cost analyses for management and the Company's outside auditors, Board of Directors presentations, and preparation of the Company's quarterly and annual SEC filings. Prior positions included Controller of North American Telecommunications Corp., Accounting Manager for Luitpold Pharmaceuticals, positions of increasing responsibility within the internal audit function of the Northrop Grumman



Corporation and approximately three and one half years as an accountant for Deloitte Haskins & Sells, during which time Mr. Newton became a certified public accountant . Mr. Newton holds a B.S. in Accounting from SUNY at Albany, and a B.S. in Mechanical Engineering from Hofstra University.

John C. K. Hui, Ph.D. has been our Senior Vice President and Chief Technology Officer since October 16, 2008, our President, Chief Executive Officer and Chief Technology Officer from April 1, 2007 through October 15, 2008, as well as a director since February 1995. From February 1995 until April 2007, he was a Senior Vice President. Dr. Hui has been an Assistant Professor in the Department of Surgery and Division of Cardiology at the State University of Stony Brook, New York since 1978. He has also been a scientist in the medical department of Brookhaven National Laboratories. Dr. Hui was CEO and President of and a principal stockholder in Vasogenics, Inc. at the time of its acquisition by us in January 1995.

## ITEM 11 - EXECUTIVE COMPENSATION

The following table sets forth the annual and long-term compensation of our Chief Executive Officer and each of our most highly compensated officers who were serving as executive officers at the end of the last completed fiscal year, and certain former executive officers as required under SEC rules (collectively, the “Named Executive Officers”) for services rendered for fiscal 2010 and the year ended May 31, 2009 (“fiscal 2009”).

Summary Compensation Table

Name and Principal Position	Year	Salary	Bonus	Stock Awards (\$)	Option Awards (\$)(2)	Non-Equity	Nonqualified	All	Total (\$)
						Incentive Compensation (\$)	Deferred Earnings (\$)	Other Compensation (\$)(1)	
Jun Ma, PhD Chief Executive Officer (3)	2010	\$ 148,471	-	\$ 25,000	\$ 20,000	-	-	\$ 1,195	\$ 194,666
John C. K. Hui Senior Vice President and Chief Technology Officer (Chief Executive Officer) (4)	2009	\$ 97,817	-	\$ 10,000	-	-	-	\$ 583	\$ 108,400
Tarachand Singh (Chief Financial Officer) (5)	2010	\$ 157,151	-	\$ 20,000	-	-	-	\$ 22,286	\$ 199,437
Tricia Efstathiou (Chief Financial Officer) (6)	2009	\$ 178,525	-	-	-	-	-	\$ 19,049	\$ 197,574
	2009	\$ 120,000	-	-	-	-	-	\$ 11,368	\$ 131,368
	2009	\$ 26,630	-	\$ 4,000	-	-	-	\$ 2,858	\$ 33,488
	2009	\$ 78,953	-	-	-	-	-	\$ 8,405	\$ 87,358

- (1) Represents premiums paid on medical, dental, life and disability group benefit plans, as well as amounts matched in the Company’s 401(k) Plan.
- (2) Option awards are valued at the fair market value times the number of shares (which represent the fair market value of the underlying common stock at the time of the respective grants).
- (3) Dr. Ma has served as President and Chief Executive Officer since October 16, 2008; Dr. Ma received common stock valued at \$5,000 for service as a director prior to being named President and Chief Executive Officer.
- (4) Dr. Hui was President and Chief Executive Officer from April 30, 2007 to October 15, 2008.
- (5) Mr. Singh was Chief Financial Officer from March 11, 2009 to August 26, 2010.
- (6) Ms. Efstathiou was Chief Financial Officer from September 20, 2006 to November 5, 2008.

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The following table describes each component of the “All Other Compensation” column in the “Summary Compensation Table” above.

	Fiscal Year	Matching Contribution to 401K Plan	Supplemental Life Insurance	Medical Insurance Benefits	Other Personal Including Personal Use of Auto	Total
Jun Ma	2010	- \$	1,195	-	- \$	1,195
	2009	- \$	583	-	- \$	583
John C. K. Hui	2010	\$ 886	\$ 1,228	\$ 20,172	- \$	22,286
	2009	\$ 1,038	\$ 1,156	\$ 16,855	- \$	19,049
Tarachand Singh	2010	\$ 960	\$ 1,103	\$ 9,305	- \$	11,368
	2009	\$ 475	\$ 216	\$ 2,167	- \$	2,858
Tricia Efstathiou	2009	\$ 474	\$ 514	\$ 7,417	- \$	8,405

## Outstanding Equity Awards at Last Fiscal Year End

The following table provides information concerning outstanding options, unvested stock and equity incentive plan awards for our Named Executive Officers at May 31, 2010:

Name	Option Awards			Option Exercise Price	Option Expiration Date	Stock Awards		Equity Incentive Awards:	
	Number of Securities Underlying Unexercised Options - Exercisable	Number of Securities Underlying Unexercised Options - Unexercisable	Equity Incentive Plan Awards: Number of Underlying Unexercised Options			Number of Shares or Units of Stock That Have Not Vested	Market Value of Shares or Units of Stock That Have Not Vested	Number of Shares, Units or Rights That Have Not Vested	Payout Value of Unearned Shares, Units or Rights That Have Not Vested
Jun Ma, PhD	150,000	-	-	\$0.12	7/25/2017	-	-	-	-
	250,000	-	-	\$0.08	12/17/2014				
John C.K. Hui, PhD	50,000	-	-	\$3.96	7/11/2011	-	-	-	-
	50,000	-	-	\$1.11	7/12/2014	-	-	-	-
	29,558	-	-	\$0.57	6/22/2015	-	-	-	-
	40,000	-	-	\$0.58	9/20/2015	-	-	-	-
	200,000	-	-	\$0.22	4/3/2016	-	-	-	-

## Employment Agreements

As of May 31, 2010, the Company does not have any employment agreements.

## 401(K) Plan

In April 1997, the Company adopted the Vasomedical, Inc. 401(k) Plan to provide retirement benefits for its employees. As allowed under Section 401(k) of the Internal Revenue Code, the plan provides tax-deferred salary deductions for eligible employees. Employees are eligible to participate in the next quarter enrollment period after employment. Participants may make voluntary contributions to the plan up to 15% of their compensation. In fiscal year 2010 and 2009, the Company made discretionary contributions of approximately \$3,000 and \$10,000, respectively, to match a percentage of employee contributions.

Director's Compensation

Non-employee Directors receive a fee of \$1,500 for each Board of Directors and Committee meetings attended and \$2,500 for each Audit Committee meeting attended. They also receive an annual fee of \$15,000. These fees are either paid in cash, or common stock valued at the fair market value of the common stock on the date of grant, which is the meeting date.

## Director Compensation for Fiscal 2010

Name	Fees Earned or Paid in Cash (\$)	Stock Awards (\$)	Option Awards (\$)(1)	Non-equity Incentive Plan Compensation (\$)	Nonqualified Deferred Compensation Earnings (\$)	All Other Compensation (\$)	Total (\$)
Abraham E. Cohen	3,000	22,350	-	-	-	-	25,350
Derek Enlander	4,000	29,850	-	-	-	-	33,850
Joseph Giacalone	-	12,500	-	-	-	-	12,500
Behnam Movaseghi	3,000	22,350	16,000	-	-	-	41,350
Photios T. Paulson	8,000	28,350	-	-	-	-	36,350
Simon Srybnik	3,000	22,350	-	-	-	-	25,350
Martin Zeiger	8,000	24,350	-	-	-	-	32,350

(1) Options valued at \$16,000 remain outstanding as of May 31, 2010.

## Limitation on Liability of Officers and Directors

We have entered into indemnification agreements with each of our current officers and directors pursuant to which we have agreed, among other things, to indemnify these officers and directors to the fullest extent permitted by Delaware law. The Company also provides directors' and officers' liability insurance.

## Compensation Committee Interlocks and Insider Participation

During fiscal 2010, our Compensation Committee consisted of Martin Zeiger, who served as the committee chair, Derek Enlander, and Photios T. Paulson. None of these persons were our officers or employees during fiscal 2010 or, except as otherwise disclosed, had any relationship requiring disclosure in this Form 10-K/A.

## ITEM 12 - SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The following table sets forth the beneficial ownership of shares of our common stock as of May 31, 2010 of (i) each person known by us to beneficially own 5% or more of the shares of outstanding common stock, based solely on filings with the SEC, (ii) each of our executive officers and directors, and (iii) all of our executive officers and directors as a group. Except as otherwise indicated, all shares are beneficially owned, and investment and voting power is held by the persons named as owners.

The percentage of beneficial ownership for the table is based on 110,271,131 shares of our common stock outstanding as of May 31, 2010. To our knowledge, except under community property laws or as otherwise noted, the persons and entities named in the table have sole voting and sole investment power over their shares of our common stock. Unless otherwise indicated, each beneficial owner listed below maintains a mailing address of c/o Vasomedical, Inc., 180 Linden Avenue, Westbury, New York 11590.



Name of Beneficial Owner	Common Stock Beneficially Owned (1)	% of Common Stock (2)	
Abraham Cohen** .....	1,801,379	1.63	%
Derek Enlander ** .....	753,284	*	
John C. K. Hui, PhD (3) ** .....	1,492,214	1.35	%
Jun Ma, PhD ** .....	1,585,834	1.44	%
Benham Movaseghi ** .....	848,125	*	
Photios Paulson** .....	1,168,284	1.06	%
Tarachand Singh** .....	200,000	*	
Simon Srybnik (4) (5) ** .....	44,177,418	40.06	%
Louis Srybnik (4) (5) .....	43,429,293	39.38	%
** Directors and executive officers as a group (8 persons)	52,026,538	47.18	%

\*Less than 1% of the Company's common stock

1. No officer or director owns more than one percent of the issued and outstanding common stock of the Company unless otherwise indicated.

Includes beneficial ownership of the following numbers of shares that may be acquired within 60 days of May 31, 2010 pursuant to a warrant awarded under the Securities Purchase Agreement with Kerns Manufacturing Corp. ("Kerns") and stock options awarded under our stock option plans:



Abraham Cohen	245,000
Derek Enlander	150,000
John C. K. Hui, PhD	369,558
Jun Ma	400,000
Behnam Movaseghi	350,000
Photios Paulson	565,000
Simon Srybnik	4,435,714
Directors and executive officers as a group	5,950,272

2. Applicable percentages are based on 110,271,131 shares of common stock outstanding as of May 31, 2010, adjusted as required by rules promulgated by the SEC.
3. Includes 789,322 shares that are held in a trust for the benefit of Dr. Hui's child. Dr. Hui and his wife are the trustees of this trust.
4. Simon Srybnik and his brother Louis Srybnik are the sole directors and the Chairman of the Board and President, respectively of Kerns, which is the record holder of 25,714,286 shares (of which 4,285,714 shares are not issuable until a restricted warrant is exercised). They are the sole shareholders of Kerns, each holding 50% of the shares. The reporting persons, accordingly, share voting and dispositive powers over the 21,428,572 shares held by Kerns and share dispositive power over the 4,285,714 shares underlying the restricted warrant. As a result, they may be deemed to be the co-beneficial owners of an aggregate of 25,714,286 shares. Mr. Srybnik also holds sole dispositive power over 150,000 shares underlying the option he was granted upon being appointed to the Board of Directors, as well as 498,125 shares of common stock held by him as of May 31, 2010.
5. Simon Srybnik and his brother Louis Srybnik are the sole directors and officers of Living Data Technology Corporation ("Living Data"). They also each own 35% of the outstanding shares of Living Data. The reporting persons, accordingly, share voting and dispositive powers over the 17,815,007 shares of our common stock owned by Living Data and, as a result, may be deemed to be the co-beneficial owners thereof.

#### Equity Compensation Plan Information

We maintain various stock plans under which options vest and shares are awarded at the discretion of our Board of Directors or its Compensation Committee. The purchase price of the shares under the plans and the shares subject to each option granted is not less than the fair market value on the date of the grant. The term of each option is generally five years and is determined at the time of the grant by our board of directors or the compensation committee. The participants in these plans are officers, directors, employees, and consultants of the Company and its subsidiaries and affiliates.

Plan category	(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights	(b) Weighted-average exercise price of outstanding options, warrants and rights	(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity Compensation plans approved by security holders	1,197,306	\$ 0.34	1,285,862
Equity Compensation plans not approved by security holders	8,306,722	\$ 0.42	-
Total	9,504,028		1,285,862

The following information is provided about our current stock option plans not approved by stockholders:

#### 1999 Stock Option Plan

In July 1999, the Company's Board of Directors approved the 1999 Stock Option Plan (the 1999 Plan), for which the Company reserved an aggregate of 2,000,000 shares of common stock. The 1999 Plan provides that a committee of the Board of Directors of the Company will administer it and that the committee will have full authority to determine the identity of the recipients of the options and the number of shares subject to each option. Options granted under the 1999 Plan may be either incentive stock options or non-qualified stock options. The option price shall be 100% of the fair market value of the common stock on the date of the grant (or in the case of incentive stock options granted to any individual principal stockholder who owns stock possessing more than 10% of the total combined voting power of all voting stock of the Company, 110% of such fair market value). The term of any option may be fixed by the committee but in no event shall exceed ten years from the date of grant. Options are exercisable upon payment in full of the exercise price, either in cash or in common stock valued at fair market value on the date of exercise of the option. In July 2000, the Company's Board of Directors increased the number of shares authorized for issuance under the 1999 Plan by 1,000,000 shares to 3,000,000 shares. In December 2001, the Board of Directors of the Company increased the number of shares authorized for issuance under the 1999 Plan by 2,000,000 shares to 5,000,000 shares.

In May 2006, the Board of Directors accelerated the vesting period for all unvested options to May 31, 2006.

The term for which options may be granted under the 1999 Plan expired July 12, 2009. In fiscal 2009, options to purchase 1,411,832 shares of common stock under the 1999 Plan at exercise prices ranging from \$0.22 to \$4.28 were retired or cancelled.

In fiscal 2010, options to purchase 30,000 shares of common stock under the 1999 Plan at an exercise price of \$1.69 were retired or cancelled.

ITEM 13 - CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

On June 21, 2007, we entered into a Securities Purchase Agreement with Kerns Manufacturing Corp. (Kerns). Concurrently with our entry into the Securities Purchase Agreement, we also entered into a Distribution Agreement and a Supplier Agreement with Living Data Technology Corporation, an affiliate of Kerns (Living Data).

We sold to Kerns, pursuant to the Securities Purchase Agreement, 21,428,572 shares of our common stock at \$.07 per share for a total purchase price of \$1,500,000, as well a five-year warrant to purchase 4,285,714 shares of our common stock at an initial exercise price of \$.08 per share (the Warrant). The agreement further provided for the appointment to our Board of Directors of two representatives from Kerns. In furtherance thereof, Dr. Jun Ma and Mr. Simon Srybnik, Chairman of both Kerns and Living Data, have been appointed members of our Board of Directors. On October 15, 2008, Dr. Jun Ma was appointed Chief Executive Officer. Pursuant to the Distribution Agreement, we have become the exclusive distributor in the United States of the AngioNew® ECP systems manufactured by Living Data. As additional consideration for such agreement, we agreed to issue an additional 6,990,840 shares of our common stock to Living Data. Pursuant to the Supplier Agreement, Living Data became the exclusive supplier to us of the ECP therapy systems that we market under the registered trademark EECP®. The Distribution Agreement and the Supplier Agreement each have an initial term extending through May 31, 2012.

On November 20, 2008, the Company entered into an Amendment to the Distribution Agreement with Living Data to expand the territory covered in the Distribution Agreement to provide for exclusive distribution rights of AngioNew® ECP systems worldwide. In consideration for these rights, the Company agreed to issue Living Data 3,000,000 restricted shares of its common stock having a fair market value of \$60,000 at time of issue.

On February 28, 2010, the Company entered into an Amendment to the Supplier Agreement with Living Data to terminate the Supplier Agreement and permit Vasomedical to manufacture or cause to be manufactured EECP® systems at its will. In connection to this termination, Vasomedical purchased Living Data's remaining inventory at cost (\$469,450), which was paid in 7,824,167 shares of common stock valued at the closing price on the contract date.

Pursuant to a Registration Rights Agreement, we granted to Kerns and Living Data, subject to certain restrictions, "piggyback registration rights" covering the shares sold to Kerns as well as the shares issuable upon exercise of the Warrant and the shares issued to Living Data.

On July 10, 2007, the Board of Directors appointed Mr. Behnam Movaseghi, Treasurer and Chief Financial Officer of Kerns Manufacturing Corporation, to our Board of Directors.

As affiliates of Living Data and Kerns, Dr. Ma, Mr. Movaseghi and Mr. Srybnik have each been directly involved in the transactions between Living Data and Kerns, and the Company, with respect to the Securities Purchase Agreement, the Distribution Agreement and the Supplier Agreement, as well as consulting services to the Company with no compensation.

During fiscal 2010, the Company purchased EECP® therapy systems under the Supplier Agreement for \$509,450 from Living Data, including \$469,450 purchased in February 2010, as per an Amendment to the Supplier Agreement dated February 28, 2010. Payment terms on certain purchases leave a balance of \$240,000 in Trade Payable to Related Party on the accompanying consolidated balance sheet as of May 31, 2010.

#### Notes Payable to Related Parties

At May 31, 2010, the Company incurred \$1,250,000 in notes with the proceeds used to finance the start-up costs related to Vaso Healthcare. Beneficial owners issued promissory notes to the Company on various dates during April and May of 2010 and carry an interest rate of 5% per annum and matured on various dates in July 2010. These promissory notes were subsequently cancelled in June 2010 through the issuance of Series E preferred stock.

The following table provides information regarding Notes Payable to Related Parties and interest payable as of May 31, 2010:

Related Party	Principal of Note Payable	Interest Payable on Note as of May 31, 2010
Abraham Cohen	250,000	1,370
William Dempsey	500,000	1,952
Simon Srybnik	500,000	1,952

## Director Independence

We have adopted the NASDAQ Stock Market's standards for determining the independence of directors. Under these standards, the following persons shall not be considered independent:

- a director who is, or at any time during the past three years was, employed by us;
- a director who accepted or who has a family member who accepted any compensation from us in excess of \$120,000 during any period of twelve consecutive months within the three years preceding the determination of independence, other than the following:
  - compensation for service on the Board of Directors or any committee thereof;
  - compensation paid to a family member who is one of our employees (other than an executive officer); or
    - under a tax-qualified retirement plan, or non-discretionary compensation;
- a director who is a family member of an individual who is, or at any time during the past three years was, employed by us as an executive officer;
- a director who is, or has a family member who is, a partner in, or a controlling stockholder or an executive officer of, any organization to which we made, or from which we received, payments for property or services in the current or any of the past three fiscal years that exceed 5% of the recipient's consolidated gross revenues for that year, or \$200,000, whichever is more, other than the following:
  - payments arising solely from investments in our securities; or
  - payments under non-discretionary charitable contribution matching programs;
- a director who is, or has a family member who is, employed as an executive officer of another entity where at any time during the past three years any of our executive officers served on the compensation committee of such other entity; or
- a director who is, or has a family member who is, a current partner of our outside auditor, a current employee of the auditor and personally works on our audit, or was a partner or employee of our outside auditor who worked on our audit at any time during any of the past three years.

For purposes of the NASDAQ independence standards, the term "family member" means a person's spouse, parents, children and siblings, whether by blood, marriage or adoption, or anyone residing in such person's home.

The Board of Directors has assessed the independence of each non-employee director under the independence standards of the NASDAQ Stock Market set forth above, and has affirmatively determined that four of our non-employee directors (Mr. Cohen, Dr. Enlander, Mr. Paulson and Mr. Zeiger) are independent.

We expect each director to attend every meeting of the Board and the committees on which he serves as well as the annual meeting. In 2010, all directors attended at least 75% of the meetings of the Board and the committees on which they served.

## ITEM 14 - PRINCIPAL ACCOUNTING FEES AND SERVICES

Rothstein, Kass & Company, P.C. is our independent registered public accounting firm and performed the audits of our consolidated financial statements for fiscal years 2009 and 2010. The following table sets forth all fees for the fiscal years ended May 31, 2009 and 2010:

	2010	2009 (1)
Audit fees	\$75,000	\$169,382
Tax Fees	\$15,000	\$12,800



The Audit Committee has adopted a policy that requires advance approval of all audit, audit-related, tax services, and other services performed by the Company's independent auditor. Accordingly, the Audit Committee must approve the permitted service before the independent auditor is engaged to perform it. In accordance with such policies, the Audit Committee approved 100% of the services relative to the above "Audit Fees" and "Tax Fees".

Rothstein, Kass & Company, P.C. did not render any other non-audit related services during fiscal year 2010.

- (1) In fiscal year 2009 Rothstein, Kass & Company, P.C. replaced Rosen, Seymour, Shapss, Martin & Company, LLP (formerly Miller Ellin & Company, LLP) as our independent auditors. For fiscal year 2009 the fees for audit and tax services provided by Rosen, Seymour, Shapss, Martin & Company were approximately \$173,142.



SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, we have duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on the 28th day of September, 2010.

VASOMEDICAL,  
INC.  
By: /s/ Jun Ma  
Jun Ma  
President, Chief  
Executive Officer  
and Director  
(Principal  
Executive Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below on September 28, 2010, by the following persons in the capacities indicated:

/s/Jun Ma Jun Ma	President, Chief Executive Officer and Director (Principal Executive Officer)
/s/ Simon Srybnik Simon Srybnik	Chairman of the Board
/s/ Jonathan Newton Jonathan Newton	Chief Financial Officer (Principal Financial Officer)
/s/ Derek Enlander Derek Enlander	Director
/s/ Peter Castle Peter Castle	Director
/s/ William Dempsey William Dempsey	Director
/s/ Behnam Movaseghi Behnam Movaseghi	Director



CONSOLIDATED FINANCIAL STATEMENTS  
For the years ended May 31, 2010 and 2009

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of  
Vasomedical, Inc.

We have audited the accompanying consolidated balance sheets of Vasomedical, Inc. and Subsidiaries (collectively, the "Company") as of May 31, 2010 and 2009, and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Vasomedical, Inc. and Subsidiaries as of May 31, 2010 and 2009, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ Rothstein, Kass & Company, P.C.  
ROTHSTEIN, KASS & COMPANY, P.C.

Roseland, New Jersey  
August 30, 2010

## Vasomedical, Inc. and Subsidiaries

## CONSOLIDATED BALANCE SHEETS

	May 31, 2010	May 31, 2009
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$481,679	\$544,057
Short-term investment, at fair value	68,850	370,523
Accounts receivable, net of an allowance for doubtful accounts of \$146,961 at May 31, 2010 and \$94,973 at May 31, 2009	440,937	659,551
Inventories, net	2,063,769	1,479,724
Other current assets	124,789	175,511
<b>Total current assets</b>	<b>3,180,024</b>	<b>3,229,366</b>
<b>PROPERTY AND EQUIPMENT</b> , net of accumulated depreciation of \$1,612,098 at May 31, 2010 and \$1,562,891 at May 31, 2009	303,038	180,409
<b>DEFERRED DISTRIBUTOR COSTS</b> , net of accumulated amortization of \$338,818 at May 31, 2010, and \$213,234 at May 31, 2009	250,058	375,643
<b>OTHER ASSETS</b>	130,390	178,332
	<b>\$3,863,510</b>	<b>\$3,963,750</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable	\$300,784	\$142,748
Accrued expenses and other liabilities	239,032	362,025
Sales tax payable	141,884	143,693
Deferred revenue - current portion	854,403	957,258
Deferred gain on sale-leaseback of building - current portion	53,245	53,245
Accrued professional fees	86,985	9,750
Trade payable due to related party	240,000	260,000
<b>Total current liabilities</b>	<b>1,916,333</b>	<b>1,928,719</b>
<b>LONG-TERM LIABILITIES</b>		
Notes payable	1,250,000	-
Deferred revenue	172,945	330,449
Accrued rent expense	17,655	16,040
Deferred gain on sale-leaseback of building	62,121	115,365
Other long-term liabilities	11,900	11,900
<b>Total long term liabilities</b>	<b>1,514,621</b>	<b>473,754</b>
<b>COMMITMENTS &amp; CONTINGENCIES (NOTE P)</b>		
<b>STOCKHOLDERS' EQUITY</b>		
Preferred stock, \$.01 par value; 1,000,000 shares authorized; none issued	-	-
Common stock, \$.001 par value; 250,000,000 shares authorized; 110,271,131 shares at May 31, 2010, and 99,843,004 at		

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May 31, 2009, issued and outstanding	110,271	99,843
Additional paid-in capital	48,958,737	48,281,711
Accumulated deficit	(48,636,452)	(46,744,379)
Non-controlling interest	-	(75,898 )
Total stockholders' equity	432,556	1,561,277
	\$3,863,510	\$3,963,750

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

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## Vasomedical, Inc. and Subsidiaries

## CONSOLIDATED STATEMENTS OF OPERATIONS

	Years Ended May 31,	
	2010	2009
Revenues		
Equipment sales	\$ 2,119,270	\$ 2,219,729
Equipment rentals and services	2,086,672	2,251,457
Total revenues	4,205,942	4,471,186
Cost of Sales and Services		
Cost of sales, equipment	1,062,466	1,586,633
Cost of equipment rentals and services	931,964	979,183
Total cost of sales and services	1,994,430	2,565,816
Gross profit	2,211,512	1,905,370
Operating Expenses		
Selling, general and administrative	3,772,569	3,013,276
Research and development	418,803	519,509
Total operating expenses	4,191,372	3,532,785
Loss from operations	(1,979,860 )	(1,627,415 )
Other Income (Expenses)		
Interest and financing costs	(5,383 )	-
Interest and other income, net	79,871	55,334
Amortization of deferred gain on sale-leaseback of building	53,245	53,245
Total other income, net	127,733	108,579
Loss before income taxes	(1,852,127 )	(1,518,836 )
Income tax benefit (expense), net	35,952	(5,875 )
Net loss	(1,816,175 )	(1,524,711 )
Net income attributable to non-controlling interest	75,898	-
Net loss attributable to common stockholders	\$ (1,892,073 )	\$ (1,524,711 )
Net loss per common share		
basic & diluted	\$ (0.02 )	\$ (0.02 )
Weighted average common shares outstanding		
basic & diluted	101,776,390	99,556,191

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

## Vasomedical, Inc. and Subsidiaries

## CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

	Common Shares	Stock Amount	Additional Paid in- Capital	Accumulated Deficit	Non- controlling interest	Total Stockholders' Equity
Balance at May 31, 2008	93,768,004	\$ 93,768	\$ 48,068,432	\$ (45,219,668)	\$ (75,898 )	\$ 2,866,634
Common stock issued pursuant to Distribution and Supply agreement	3,000,000	3,000	57,000			60,000
Common stock issued to Directors for fiscal year 2008 compensation	2,075,000	2,075	122,424			124,499
Stock-based compensation	1,000,000	1,000	33,855			34,855
Net loss				(1,524,711 )		(1,524,711)
Balance at May 31, 2009	99,843,004	\$ 99,843	\$ 48,281,711	\$ (46,744,379)	\$ (75,898 )	\$ 1,561,277
Inventory purchased from related party paid in common stock	7,824,167	7,824	461,626			469,450
Common stock issued to Directors for fiscal year 2009 compensation and meeting fees	1,937,292	1,937	148,663			150,600
Stock-based compensation	666,668	667	66,737			67,404
Net income (loss)				(1,892,073 )	75,898	(1,816,175)
Balance at May 31, 2010	110,271,131	\$ 110,271	\$ 48,958,737	\$ (48,636,452)	\$ -	\$ 432,556

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





## Vasomedical, Inc. and Subsidiaries

## CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended May 31,	
	2010	2009
Cash flows from operating activities		
Net loss	\$(1,816,175)	\$(1,524,711)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization of property and equipment	123,704	102,245
Amortization of deferred gain on sale-leaseback of building	(53,246 )	(53,245 )
Provision for doubtful accounts	51,988	(175,210 )
Amortization of deferred distributor costs	125,585	111,458
Expenses paid for distributor agreement	-	(20,000 )
Stock-based compensation	218,004	159,354
Changes in operating assets and liabilities:		
Accounts receivable	166,626	233,510
Inventories, net	(287,320 )	19,629
Other current assets	50,722	(119,278 )
Accounts payable	158,036	(406,145 )
Accrued expenses and other liabilities	(122,993 )	88,854
Sales tax payable	(1,809 )	(5,609 )
Deferred revenue	(260,359 )	(330,346 )
Accrued rent expense	1,615	7,384
Accrued professional fees	77,235	(64,750 )
Trade payable due to related party	(20,000 )	260,000
Net cash used in operating activities	(1,588,387)	(1,716,860)
Cash flows from investing activities		
Purchases of property and equipment	(25,664 )	(22,559 )
Purchases of short-term investments	(68,850 )	(370,523 )
Redemption of short-term investments	370,523	-
Net cash provided by (used in) investing activities	276,009	(393,082 )
Cash flows from financing activities		
Proceeds from notes payable	1,250,000	-
Net cash provided by financing activities	1,250,000	-
<b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(62,378 )</b>	<b>(2,109,942)</b>
Cash and cash equivalents - beginning of year	544,057	2,653,999
Cash and cash equivalents - end of year	\$481,679	\$544,057
<b>SUPPLEMENTAL DISCLOSURE OF CASH INFORMATION</b>		
Interest paid	\$109	\$-
Income taxes paid	\$6,349	\$-
<b>SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES</b>		
Inventories transferred to property and equipment, attributable to operating leases, net	\$172,726	\$153,325
Common stock issued for distribution agreement	\$-	\$60,000

Inventory purchased from related party paid in common stock	\$469,450	\$-
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The accompanying notes are an integral part of these consolidated financial statements.

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Vasomedical, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

May 31, 2010 and 2009

Vasomedical, Inc. was incorporated in Delaware in July 1987. Unless the context requires otherwise, all references to “we”, “our”, “us”, “Company”, “registrant”, “Vasomedical” or “management” refer to Vasomedical, Inc. and its subsidiaries. Since 1995, we have been primarily engaged in designing, manufacturing, marketing and supporting EECP® enhanced external counterpulsation systems based on our unique proprietary technology currently indicated for use in cases of stable or unstable angina (i.e., chest pain), congestive heart failure (CHF), acute myocardial infarction (i.e., heart attack, (MI)) and cardiogenic shock. The EECP® therapy system is a non-invasive, outpatient therapy for the treatment of diseases of the cardiovascular system. The therapy serves to increase circulation in areas of the heart with less than adequate blood supply and helps to restore systemic vascular function. The therapy also increases blood flow and oxygen supply to the heart muscle and other organs and decreases the heart’s workload and need for oxygen, while also improving function of the endothelium, the lining of blood vessels throughout the body, lessening resistance to blood flow. We provide hospitals, clinics and physician private practices with EECP® equipment, treatment guidance, and a staff training and equipment maintenance program designed to provide optimal patient outcomes. EECP® is a registered trademark for our enhanced external counterpulsation systems.

We have Food and Drug Administration (FDA) clearance to market our EECP® therapy for use in the treatment of stable and unstable angina, congestive heart failure, acute myocardial infarction, and cardiogenic shock, however, our current marketing efforts are limited to the treatment of chronic stable angina and congestive heart failure. Medicare and other third-party payers currently reimburse for the treatment of angina symptoms in patients with moderate to severe symptoms who are refractory to medications and not candidates for invasive procedures, including patients with serious comorbidities, such as heart failure, diabetes, and peripheral vascular disease. Patients with primary diagnoses of heart failure, diabetes, and peripheral vascular disease are also reimbursed under the same criteria, provided the primary indication for treatment with EECP® therapy is angina symptoms.

During the last several years, we incurred operating losses. We have attempted to achieve profitability by reducing operating costs and halting the trend of declining revenue, and to reduce cash usage through bringing our cost structure more into alignment with current revenues. Excluding the start-up costs related to Vaso Healthcare (see below), the Company has reduced personnel costs through reorganization. The Company has negotiated new terms on professional fees, facility expenses, and shipping and supply costs. The Company is also looking to obtain other sources of funding to help stabilize cash flow and to respond to customers requests for flexible payment terms on our EECP® therapy systems.

In the last couple of years, the Company has been looking to diversify its business, including offering additional medical devices in its product portfolio, and has since introduced patient monitoring devices (the BIOX series Holter and ABP recorders and analysis software) and patient management devices (the EZ ECG and EZ O2 products) into the US market. In April 2010, the Company, through a wholly-owned subsidiary Vaso Diagnostics d/b/a Vaso Healthcare, organized a group of medical device sales professionals in the hope of entering into the sales and representation business for other equipment manufacturers. On May 19, 2010, Vaso Healthcare signed a sales representative agreement with GE Healthcare (the “GEHC Agreement), the healthcare business unit of GE (NYSE: GE), for the sale of select GE Healthcare Diagnostic Imaging products. Under the GEHC Agreement, Vaso Healthcare has been appointed the exclusive representative for these products to specific market segments in the 48 contiguous states of the United States and the District of Columbia. The GEHC agreement is for an initial term of three years commencing July 1, 2010, subject to extension and also subject to earlier termination under certain

circumstances. These circumstances include failure to materially achieve sales goals, failure to maintain a minimum number of sales representatives, and various legal and GEHC policy requirements. The Company has received financial commitments for up to \$5,000,000 for the purpose of funding this project, of which, \$1,250,000 was received as of May 31, 2010 in the form of promissory notes. Promissory notes were subsequently cancelled in June 2010 through the issuance of the Company's Series E convertible preferred stock. As of August 29, 2010, the Company had issued an aggregate of \$3,300,000 principal amount of its Series E convertible preferred stock.

Based on our current operations, including anticipated internally generated funds from Vaso Healthcare and the receipt of funds through the issuance of our Series E convertible preferred stock, we believe that we have sufficient working capital to continue our operations through at least June 1, 2011.

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Vasomedical, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

May 31, 2010 and 2009

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A summary of the significant accounting policies consistently applied in the preparation of the consolidated financial statements follows:

Principles of Consolidation

The consolidated financial statements include the accounts of the Company, its wholly-owned subsidiary and its inactive majority-owned subsidiary. Significant intercompany accounts and transactions have been eliminated.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP") requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Significant estimates and assumptions relate to estimates of collectibility of accounts receivable, the realizability of deferred tax assets, and the adequacy of inventory and warranty reserves. Actual results could differ from those estimates.

Revenue Recognition

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred or service has been rendered, the price is fixed or determinable and collectibility is reasonably assured. In the United States, we recognize revenue from the sale of our EECP® systems in the period in which we deliver the system to the customer. Revenue from the sale of our EECP® systems to international markets is recognized upon shipment, during the period in which we deliver the product to a common carrier, as are supplies, accessories and spare parts delivered to both domestic and international customers. Returns are accepted prior to the in-service and training subject to a 10% restocking charge or for normal warranty matters, and we are not obligated for post-sale upgrades to these systems. In addition, we use the installment method to record revenue based on cash receipts in situations where the account receivable is collected over an extended period of time and in our judgment the degree of collectibility is uncertain.

In most cases, revenue from domestic EECP® system sales is generated from multiple-element arrangements that require judgment in the areas of customer acceptance, collectability, the separability of units of accounting, and the fair value of individual elements. We follow the FASB Accounting Standards Codification ("ASC") Topic 605 "Revenue Recognized" ("ASC 605") which outlines a framework for recognizing revenue from multi-deliverable arrangements. The principles and guidance outlined in ASC 605 determine (a) how the arrangement consideration should be measured (b) whether the arrangement should be divided into separate units of accounting, and (c) how the arrangement consideration should be allocated among the separate units of accounting. We determined that the domestic sale of our EECP® systems includes a combination of three elements that qualify as separate units of accounting:

- EECP® equipment sale;

- provision of in-service and training support consisting of equipment set-up and training provided at the customer's facilities; and
- a service arrangement (usually one year), consisting of: service by factory-trained service representatives, material and labor costs, emergency and remedial service visits, software upgrades, technical phone support and preferred response times.

Each of these elements represent individual units of accounting as the delivered item has value to a customer on a stand-alone basis, objective and reliable evidence of fair value exists for undelivered items, and arrangements normally do not contain a general right of return relative to the delivered item. We determine fair value based on the price of the deliverable when it is sold separately or based on third-party evidence. In accordance with the guidance in ASC 605, we use the residual method to allocate the arrangement consideration when it does not have fair value of the EECP® system sale. Under the residual method, the amount of consideration allocated to the delivered item equals the total arrangement consideration less the aggregate fair value of the undelivered items. Assuming all other criteria for revenue recognition have been met, we recognize revenue for:

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Vasomedical, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

May 31, 2010 and 2009

- EECPC® equipment sales, when delivery and acceptance occurs based on delivery and acceptance documentation received from independent shipping companies or customers;
  - in-service and training, following documented completion of the training; and
  - the service arrangement, ratably over the service period, which is generally one year.

In-service and training generally occurs within a few weeks of shipment and our return policy states that no returns will be accepted after in-service and training has been completed. The amount related to in-service and training is recognized as service revenue at the time the in-service and training is completed and the amount related to service arrangements is recognized ratably as service revenue over the related service period, which is generally one year. Costs associated with the provision of in-service and training and the service arrangement, including salaries, benefits, travel, spare parts and equipment, are recognized in cost of equipment sales as incurred.

The Company also recognizes revenue generated from servicing EECPC® systems that are no longer covered by the service arrangement, or by providing sites with additional training, in the period that these services are provided. Revenue related to future commitments under separately priced extended service agreements on our EECPC® system are deferred and recognized ratably over the service period, generally ranging from one year to four years. Costs associated with the provision of service and maintenance, including salaries, benefits, travel, spare parts and equipment, are recognized in cost of sales as incurred. Amounts billed in excess of revenue recognized are included as deferred revenue in the consolidated balance sheets.

Revenues from the sale of EECPC® systems through our international distributor network are generally covered by a one-year warranty period. For these customers we accrue a warranty reserve for estimated costs to provide warranty parts when the equipment sale is recognized.

The Company has also entered into lease agreements for our EECPC® systems, generally for terms of one year or less, that are classified as operating leases. Revenues from operating leases are generally recognized, in accordance with the terms of the lease agreements, on a straight-line basis over the life of the respective leases. For certain operating leases in which payment terms are determined on a “fee-per-use” basis, revenues are recognized as incurred (i.e., as actual usage occurs). The cost of the EECPC® system utilized under operating leases is recorded as a component of property and equipment and is amortized to cost of sales over the estimated useful life of the equipment, not to exceed five years. There were no significant minimum rental commitments on these operating leases at May 31, 2010.

#### Shipping and Handling Costs

All shipping and handling expenses are charged to cost of sales. Amounts billed to customers related to shipping and handling costs are included as a component of sales.

#### Research and Development

Research and development costs attributable to development are expensed as incurred. Included in research and development costs is amortization expense related to the capitalized cost of EECPC® systems under loan for clinical trials.

#### Stock-Based Employee Compensation



The Company complies with ASC Topic 718 “Compensation – Stock Compensation” (“ASC 718”), which requires all companies to recognize the cost of services received in exchange for equity instruments, to be recognized in the financial statements based on their fair values.

During the fiscal year ended May 31, 2010, the Company’s Board of Directors granted 666,668 shares of common stock to two officers of the Company in lieu of a portion of their calendar year 2010 salaries, which will be amortized over the remainder of calendar year 2010. During the fiscal year ended May 31, 2009, the Company’s Board of Directors granted 100,000 shares of common stock having a fair market value of \$0.08 per share at the time of the respective grant to one employee of the Company, 700,000 shares having a fair market value of \$0.02 per share at the time of the respective grant to two officers of the Company, and 200,000 shares having a fair market value of \$0.02 per share at the time of the respective grant to one employee of the Company.

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Vasomedical, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

May 31, 2010 and 2009

Stock-based compensation expense recognized for the fiscal years ended May 31, 2010 and 2009 was \$218,004 and \$159,354, respectively.

Vasomedical accounts for stock-based compensation in accordance with fair value recognition provisions, under which the Company uses the Black-Scholes option pricing model which requires the input of subjective assumptions. These assumptions include estimating the length of time employees will retain their stock options before exercising them (“expected term”), the estimated volatility of the Company’s common stock price over the expected term and the number of options that will ultimately not complete their vesting requirements. The Company estimates the expected term and forfeitures based on the terms set forth in the option agreements and no assumption that any options will not complete their vesting period, which approximates actual historical behavior, and it estimates volatility of the Company’s stock based on the Company’s historical stock price performance over the past five years. Changes in the subjective assumptions could materially affect the estimate of fair value of stock-based compensation; however management believes changes in certain assumptions that could be reasonably possible in the near term, would not have a material effect on the expense recognized for fiscal 2010.

The fair value of the Company’s stock options was estimated using the following weighted-average assumptions for options granted during the year ended May 31, 2010:

Expected dividend yield	0.00%
Average risk free interest rate	2.24%
Expected life	5 years
Expected volatility	102.31%

During fiscal year 2010 the Company’s Board of Directors granted options for 250,000 shares of common stock to one officer and options for 200,000 shares to one director of the company, pursuant to the 2004 Stock Option Plan. These options have an exercise price of \$0.08 per share and expire five years from date of grant.

No stock options were issued during the year ended May 31, 2009.

Cash and Cash Equivalents

Cash and cash equivalents represent cash and short-term, highly liquid investments either in certificates of deposit, treasury bills, money market funds, or investment grade commercial paper issued by major corporations and financial institutions that generally have maturities of three months or less from the date of acquisition. Dividend and interest income are recognized when earned. The cost of securities sold is calculated using the specific identification method.

Short-Term Investments

The Company's short-term investments consist of certificates of deposit with original maturities less than 3 months. They are bought and held principally for the purpose of selling them in the near-term and are classified as trading securities. Trading securities are recorded at fair value on the balance sheets in current assets, with the change in fair value during the years included in earnings.

#### Accounts Receivable, net

The Company's accounts receivable are due from customers engaged in the provision of medical services. Credit is extended based on evaluation of a customer's financial condition and, generally, collateral is not required. Accounts receivable are generally due 30 to 90 days from shipment and are stated at amounts due from customers net of allowances for doubtful accounts, returns, term discounts and other allowances. Accounts that remain outstanding longer than the contractual payment terms are considered past due. Estimates are used in determining the allowance for doubtful accounts based on the Company's historical collections experience, current trends, credit policy and a percentage of its accounts receivable by aging category. In determining these percentages, the Company reviews historical write-offs of their receivables. The Company also looks at the credit quality of their customer base as well as changes in their credit policies. The Company continuously monitors collections and payments from our customers, and writes off receivables when all efforts at collection have been exhausted. While credit losses have historically been within expectations and the provisions established, the Company cannot guarantee that it will continue to experience the same credit loss rates that they have in the past.

## Vasomedical, Inc. and Subsidiaries

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

May 31, 2010 and 2009

The changes in the Company's allowance for doubtful accounts are as follows:

	May 31, 2010	May 31, 2009
Beginning Balance	\$ 94,973	\$ 270,183
Provision on losses on account receivable	71,194	-
Direct write-offs, net of recoveries	(19,206 )	(175,210 )
Ending Balance	\$ 146,961	\$ 94,973

## Concentrations of Credit Risk

We market the EECPC® system principally to hospitals and physician private practices. We perform credit evaluations of our customers' financial condition and, as a consequence, believe that our receivable credit risk exposure is limited. For the years ended May 31, 2010 and 2009, no customer accounted for 10% or more of revenues or accounts receivable.

The Company maintains cash balances in certain financial institutions, which, at time, may exceed federally insured limits. The Company has not experienced any losses on these accounts and believes it is not subject to any significant credit risk on these accounts.

Our revenues were derived from the following geographic areas:

	May 31, 2010	May 31, 2009
Domestic (United States)	\$ 2,953,672	\$ 3,078,785
Non-domestic (foreign)	1,252,270	1,392,401
	\$ 4,205,942	\$ 4,471,186

## Inventories, net

The Company values inventory at the lower of cost or estimated market, with cost being determined on a first-in, first-out basis. The Company often places EECPC® systems at various field locations for demonstration, training, evaluation, and other similar purposes at no charge. The cost of these EECPC® systems is transferred to property and equipment and is amortized over two to five years. The Company records the cost of refurbished components of EECPC® systems and critical components at cost plus the cost of refurbishment. The Company regularly reviews inventory quantities on hand, particularly raw materials and components, and records a provision for excess and obsolete inventory based primarily on existing and anticipated design and engineering changes to its products as well as forecasts of future product demand.

We comply with the provisions of ASC Topic 330 "Inventory". The statement clarifies that abnormal amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage) should be recognized as current-period charges and requires the allocation of fixed production overhead to inventory based on the normal capacity of the production facilities.

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Vasomedical, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

May 31, 2010 and 2009

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and amortization. Major improvements are capitalized and minor replacements, maintenance and repairs are charged to expense as incurred. Upon retirement or disposal of assets, the cost and related accumulated depreciation are removed from the consolidated balance sheet. Depreciation is provided over the estimated useful lives of the assets, which range from two to twenty years, on a straight-line basis. Accelerated methods of depreciation are used for tax purposes. We amortize leasehold improvements over the useful life of the related leasehold improvement or the life of the related lease, whichever is less. (See Note E.)

Deferred Revenue

We record revenue on extended service contracts ratably over the term of the related service contracts. Under the provisions of ASC 605, we began to defer revenue related to EECP® system sales for the fair value of installation and in-service training to the period when the services are rendered and for service obligations ratably over the service period, which is generally one year. (See Note G.)

Warranty Costs

Equipment sold is generally covered by a warranty period of one year. In accordance with ASC Topic 450 "Loss Contingencies", we accrue a warranty reserve for estimated costs of providing a parts only warranty when the equipment sale is recognized.

The factors affecting our warranty liability include the number of units sold and the historical and anticipated rates of claims and costs per claim. (See Note J.)

Income Taxes

Deferred income taxes are recognized for temporary differences between financial statement and income tax bases of assets and liabilities and loss carryforwards for which income tax benefits are expected to be realized in future years. A valuation allowance is established, when necessary, to reduce deferred tax assets to the amount expected to be realized. In estimating future tax consequences, we generally consider all expected future events other than an enactment of changes in the tax laws or rates. Deferred tax assets are continually evaluated for realizability. To the extent our judgment regarding the realization of the deferred tax assets changes, an adjustment to the allowance is recorded, with an offsetting increase or decrease, as appropriate, in income tax expense. Such adjustments are recorded in the period in which our estimate as to the realizability of the assets changed that it is "more likely than not" that all of the deferred tax assets will be realized. The "realizability" standard is subjective and is based upon our estimate of a greater than 50% probability that the deferred tax asset can be realized.

Deferred tax assets and liabilities are classified as current or non-current based on the classification of the related asset or liability for financial reporting. A deferred tax asset or liability that is not related to an asset or liability for financial reporting, including deferred tax assets related to carryforwards, are classified according to the expected reversal date of the temporary difference.

The Company also complies with the provisions of the ASC Topic 740 "Income Taxes", which prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of tax positions taken

or expected to be taken in a tax return. For those benefits to be recognized, a tax position must be more-likely-than-not to be sustained upon examination by the relevant taxing authority based on the technical merits. The Company recognizes accrued interest and penalties related to unrecognized tax benefits as income tax expense. No amounts were accrued for the payment of interest and penalties at May 31, 2010 and 2009. Generally the Company is no longer subject to income tax examinations by major taxing authorities for years before 2006. Management is currently unaware of any issues under review that could result in significant payments, accruals or material deviations from its position.

Vasomedical, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

May 31, 2010 and 2009

Fair Value of Financial Instruments

The Company complies with the provisions of ASC 820 “Fair Value Measurements and Disclosures” (“ASC 820”). Under ASC 820, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (i.e., the “exit price”) in an orderly transaction between market participants at the measurement date.

In determining fair value, the Company uses various valuation approaches. ASC 820 establishes a fair value hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are those that market participants would use in pricing the asset or liability based on market data obtained from sources independent of the Company. Unobservable inputs reflect the Company’s assumptions about the inputs market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The fair value hierarchy is categorized into three levels based on the inputs as follows:

Level 1 - Valuations based on unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access. Valuation adjustments and block discounts are not applied to Level 1 securities. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these securities does not entail a significant degree of judgment.

Level 2 - Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.

Level 3 - Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

Valuation Techniques

The Company values investments in securities and securities sold short that are freely tradable and are listed on a national securities exchange or reported on the NASDAQ national market at their last sales price as of the last business day of the fiscal year.

The carrying amounts of cash and cash equivalents, accounts receivable and accounts payable approximate fair value due to the short-term maturities of the instruments.

Net Loss Per Common Share

Basic loss per common share is based on the weighted average number of common shares outstanding without consideration of potential common stock. Diluted loss per common share is based on the weighted number of common and potential dilutive common shares outstanding. The diluted calculation takes into account the shares that may be issued upon the exercise of stock options and warrants, reduced by the shares that may be repurchased with the funds received from the exercise, based on the average price during the period.

Options and warrants to purchase 9,504,028 and 10,275,183 shares of common stock were excluded from the computation of diluted earnings per share for the years ended May 31, 2010 and 2009, respectively, because the effect of their inclusion would be anti-dilutive.

Reclassifications



Certain reclassifications have been made to prior year amounts to conform with the current year presentation.

#### Recently Issued Accounting Pronouncements

The Company continually assesses any new accounting pronouncements to determine their applicability to the Company. Where it is determined that a new accounting pronouncement affects the Company's financial reporting, the Company undertakes a study to determine the consequence of the change to its financial statements and assures that there are proper controls in place to ascertain that the Company's financials properly reflect the change. New pronouncements assessed by the Company recently are discussed below:

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Vasomedical, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

May 31, 2010 and 2009

In June 2009, Financial Accounting Standards Board's ("FASB") Accounting Standards Codification (the "Codification") became the single official source of authoritative U.S. GAAP (other than guidance issued by the SEC), superseding existing FASB, American Institute of Certified Public Accountants, Emerging Issues Task Force ("EITF"), and related literature. Since that date, only one level of authoritative U.S. GAAP exists. All other literature is considered non-authoritative. The Codification did not change U.S. GAAP; instead, it introduced a new structure that is organized in an easily accessible, user-friendly online research system. The Codification, which changed the referencing of financial standards, was effective for interim and annual periods ending on or after September 15, 2009.

In January 2010, the FASB issued an update to ASC Topic 820, "Fair Value Measurements and Disclosures", amending the disclosure requirements under Topic 820. The update requires additional disclosures for transfers in and out of Levels 1 and 2 fair value measurements, as well as enhanced disclosures for activity in Level 3 fair value measurements. In addition, the update also clarifies existing requirements regarding the level of disaggregation for assets and liabilities and disclosure of inputs and valuation techniques used to measure fair value. The additional disclosure requirements under ASC Topic 820 were effective for the Company beginning January 1, 2010 and did not have an impact on the Company's consolidated financial statements.

In August 2009, the FASB issued an update to ASC Topic 820 that provides additional guidance on the fair value measurement of liabilities. Specifically, this update provides clarification in circumstances in which a quoted price in an active market is not available. The update to ASC Topic 820 was effective for the Company beginning July 1, 2009 and did not have an impact on the Company's consolidated financial statements.

In June 2008, the FASB issued an update to ASC Topic 260, "Earnings Per Share", that addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share under the two-class method. The update to ASC Topic 260 requires unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) to be treated as participating securities and to be included in the computation of earnings per share pursuant to the two-class method. The revisions to ASC Topic 260 were effective for the Company beginning July 1, 2009 and did not have an impact on the Company's consolidated financial statements.

In December 2007, the FASB issued an update to ASC Topic 805, "Business Combinations", which significantly changed the accounting for business combinations in a number of areas, including the treatment of contingent consideration, pre-acquisition contingencies, transaction costs, restructuring costs and income taxes. The revisions to ASC Topic 805 were effective for acquisitions that occur after July 1, 2009 and did not have an impact on the Company's consolidated financial statements.

In April 2008, the FASB issued an update to ASC Topic 350, "Intangibles — Goodwill and Other", which amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset. This amendment is effective on a prospective basis to all intangible assets acquired and for disclosures on all intangible assets recognized on or after the beginning of the first annual period subsequent to December 15, 2008. The amendment to ASC Topic 350 was effective for the Company beginning July 1, 2009 and did not have a material impact on the Company's consolidated financial statements.

In October 2009, the FASB issued an update to ASC Topic 605, "Revenue Recognition", revised the authoritative guidance for revenue arrangements with multiple deliverables. This revised authoritative guidance requires companies to allocate revenue in arrangements involving multiple deliverables based on the estimated selling price of

each deliverable, even though such deliverables are not sold separately either by a company itself or other vendors. This revised authoritative guidance eliminates the requirement that all undelivered elements must have objective and reliable evidence of fair value before a company can recognize the portion of the overall arrangement fee that is attributable to items that already have been delivered. As a result, the new guidance may allow some companies to recognize revenue on transactions that involve multiple deliverables earlier than under current requirements. This revised authoritative guidance is effective for revenue arrangements entered into or materially modified in fiscal years beginning on or after December 15, 2009. Early adoption is permitted at the beginning of a company's fiscal year. We adopted this guidance on June 1, 2010, and are evaluating the effect of the adoption on our consolidated financial statements.

No other recently issued, but not yet effective, pronouncement is expected to have a material impact on the Company's consolidated financial statements.

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## Vasomedical, Inc. and Subsidiaries

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

May 31, 2010 and 2009

## NOTE C – FAIR VALUE MEASUREMENTS

The Company's assets recorded at fair value have been categorized based upon a fair value hierarchy in accordance with ASC 820.

The following table presents information about the Company's assets and liabilities measured at fair value as of May 31, 2010:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of May 31, 2010
Assets				
Cash equivalents invested in money market fund (included in cash and cash equivalents)	\$ 21,516	\$ -	\$ -	\$ 21,516
Investment in certificates of deposit (included in short-term investments)	68,850	-	-	68,850
	\$ 90,366	\$ -	\$ -	\$ 90,366

The following table presents information about the Company's assets and liabilities measured at fair value as of May 31, 2009:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of May 31, 2009
Assets				
Cash equivalents invested in money market fund (included in cash and cash equivalents)	\$ 315,002	\$ -	\$ -	\$ 315,002
Investment in certificates		-	-	370,523

of deposit  
(included in short-  
term investments)

370,523

\$685,525      \$      -      \$      - \$      685,525

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## Vasomedical, Inc. and Subsidiaries

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

May 31, 2010 and 2009

The fair values of the Company's cash equivalents invested in money market fund are determined through market, observable and corroborated sources.

## NOTE D – INVENTORIES, NET

Inventories, net of reserves consisted of the following:

	May 31, 2010	May 31, 2009
Raw materials	\$ 585,991	\$ 646,775
Work in process	608,658	522,823
Finished goods	869,120	310,126
	\$ 2,063,769	\$ 1,479,724

At May 31, 2010 and 2009, the Company maintained reserves for excess and obsolete inventories of \$358,972 and \$393,972, respectively.

## NOTE E – PROPERTY AND EQUIPMENT

Property and equipment is summarized as follows:

	May 31, 2010	May 31, 2009
Office, laboratory and other equipment	\$ 942,476	\$ 919,435
EECP® systems under operating leases or under loan for clinical trials	823,195	674,400
Furniture and fixtures	149,465	149,465
	1,915,136	1,743,300
Less: accumulated depreciation	1,612,098	1,562,891
Property and equipment - net	\$ 303,038	\$ 180,409

Depreciation expense amounted to \$76,802 and \$52,232 for the years ended May 31, 2010 and 2009, respectively.

## NOTE F – INTANGIBLE ASSETS

The Company owns thirteen US patents including eight utility and three design patents that expire at various times between 2010 and 2023. In addition, more than 20 foreign patents have been issued that expire at various times from 2010 to 2023. Cost incurred for submitting the applications to the United States Patent and Trademark Office and other foreign authorities for these patents have been capitalized. Patent costs are being amortized using the straight-line method over the related 10-year lives. The Company begins amortizing patent costs once a filing receipt is received stating the patent serial number and filing date from the Patent Office or other foreign authority.

The changes in the Company's intangible assets are as follows:

	May 31, 2010	May 31, 2009
<b>Patent Costs</b>		
Costs	\$ 469,043	\$ 469,043
Accumulated amortization	(350,553)	(303,649)
	\$ 118,490	\$ 165,394

Intangible assets are included in other assets on the Company's consolidated balance sheets.

## Vasomedical, Inc. and Subsidiaries

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

May 31, 2010 and 2009

Amortization expense amounted to \$46,904 for the years ended May 31, 2010 and 2009.

## NOTE G – DEFERRED REVENUE

The changes in the Company's deferred revenues are as follows:

	Years Ended 2010	May 31, 2009
Deferred revenue at the beginning of the period	\$ 1,287,707	\$ 1,618,053
<b>Additions:</b>		
Deferred extended service contracts	1,047,290	1,086,968
Deferred in-service and training	22,500	37,500
Deferred service arrangement obligations	70,500	133,500
Deferred service arrangement promotion	-	600
<b>Recognized as revenue:</b>		
Deferred extended service contracts	(1,253,532 )	(1,366,062 )
Deferred in-service and training	(30,000 )	(35,000 )
Deferred service arrangement obligations	(117,117 )	(185,452 )
Deferred service arrangement promotion	-	(2,400 )
Deferred revenue at end of period	1,027,348	1,287,707
Less: current portion	854,403	957,258
Long-term deferred revenue at end of period	\$ 172,945	\$ 330,449

## NOTE H – SALE-LEASEBACK

In August 2007, the Company sold its warehouse and corporate facility for \$1,400,000. Under the agreement, the Company is leasing back the property from the purchaser over a period of five years. The Company is accounting for the leaseback as an operating lease. The gain of \$266,226 realized in this transaction was deferred and is being amortized to income ratably over the term of the lease. The unamortized deferred gain of \$115,366 and \$168,610 as of May 31, 2010 and 2009, respectively, is shown as deferred gain on sale-leaseback of building in the Company's consolidated balance sheets. The short-term portion of \$53,245 is shown in current liabilities and the long-term portion is in other long-term liabilities. The amount amortized in fiscal 2010 and 2009 was \$53,246.

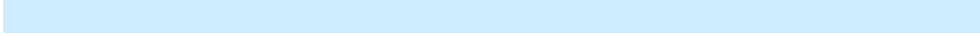
## NOTE I – ACCOUNTS PAYABLE AND ACCRUED EXPENSES

At May 31, 2010 and 2009, accounts payable and accrued expenses consisted of the following:

	May 31, 2010	May 31, 2009
Accounts payable	\$ 300,784	\$ 142,748
Accrued expenses	205,032	328,525
Other	34,000	33,500



\$ 539,816 \$ 504,773



## Vasomedical, Inc. and Subsidiaries

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

May 31, 2010 and 2009

## NOTE J – WARRANTY LIABILITY

The changes in the Company's product warranty liability are as follows:

	Years ended May31,	
	2010	2009
Warranty liability at the beginning of the period	\$ 23,250	\$ 17,250
Expense for new warranties issued	47,500	81,800
Warranty claims	(44,250 )	(75,800 )
Warranty liability at the end of the period	26,500	23,250
Long-term warranty liability at the end of the period	\$ -	\$ -

Warranty liability is included in accrued expenses and other liabilities on the Company's consolidated balance sheets.

## NOTE K – NOTES PAYABLE

At May 31, 2010, the Company had \$1,250,000 in notes payable to finance the start-up costs related to Vaso Healthcare. Beneficial owners issued promissory notes to the Company on various dates during April and May of 2010 and carry an interest rate of 5% per annum and matured on various dates in July 2010. These promissory notes were subsequently settled in June 2010 through the issuance of Series E preferred stock (see Note R).

## NOTE L – RELATED-PARTY TRANSACTIONS

On June 21, 2007, we entered into a Securities Purchase Agreement with Kerns Manufacturing Corp. (Kerns). Concurrently with our entry into the Securities Purchase Agreement, we also entered into a Distribution Agreement and a Supplier Agreement with Living Data Technology Corporation, an affiliate of Kerns (Living Data).

We sold to Kerns, pursuant to the Securities Purchase Agreement, 21,428,572 shares of our common stock at \$.07 per share for a total purchase price of \$1,500,000, as well a five-year warrant to purchase 4,285,714 shares of our common stock at an initial exercise price of \$.08 per share (the Warrant). The agreement further provided for the appointment to our Board of Directors of two representatives from Kerns. In furtherance thereof, Dr. Jun Ma and Mr. Simon Srybnik, Chairman of both Kerns and Living Data, have been appointed members of our Board of Directors. On October 15, 2008, Dr. Jun Ma was appointed Chief Executive Officer. Pursuant to the Distribution Agreement, we have become the exclusive distributor in the United States of the AngioNew® ECP systems manufactured by Living Data. As additional consideration for such agreement, we agreed to issue an additional 6,990,840 shares of our common stock to Living Data. Pursuant to the Supplier Agreement, Living Data became the exclusive supplier to us of the ECP therapy systems that we market under the registered trademark EECp®. The Distribution Agreement and the Supplier Agreement each have an initial term extending through May 31, 2012.

On November 20, 2008, the Company entered into an Amendment to the Distribution Agreement with Living Data to expand the territory covered in the Distribution Agreement to provide for exclusive distribution rights of AngioNew®

ECP systems worldwide. In consideration for these rights, the Company agreed to issue Living Data 3,000,000 restricted shares of its common stock having a fair market value of \$60,000 at time of issue.

On February 28, 2010, the Company entered into an Amendment to the Supplier Agreement with Living Data to terminate the Supplier Agreement and permit Vasomedical to manufacture or cause to be manufactured EECF® systems at its will. In connection to this termination, Vasomedical purchased Living Data's remaining inventory at cost (\$469,450), which was paid in 7,824,167 shares of common stock valued at the closing price on the contract date.

Pursuant to a Registration Rights Agreement, we granted to Kerns and Living Data, subject to certain restrictions, "piggyback registration rights" covering the shares sold to Kerns as well as the shares issuable upon exercise of the Warrant and the shares issued to Living Data.

Vasomedical, Inc. and Subsidiaries  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
May 31, 2010 and 2009

On July 10, 2007, the Board of Directors appointed Mr. Behnam Movaseghi, Treasurer and Chief Financial Officer of Kerns Manufacturing Corporation, to our Board of Directors.

As affiliates of Living Data and Kerns, Dr. Ma, Mr. Movaseghi and Mr. Srybnik have each been directly involved in the transactions between Living Data and Kerns, and the Company, with respect to the Securities Purchase Agreement, the Distribution Agreement and the Supplier Agreement, as well as consulting services to the Company with no compensation.

During fiscal 2009, the Company purchased EECP® therapy systems under the Supplier Agreement for \$595,000 from Living Data. During fiscal 2010, the Company purchased additional EECP® therapy systems under the Supplier Agreement for \$509,450 from Living Data, including \$469,450 purchased in February 2010, as per an Amendment to the Supplier Agreement dated February 28, 2010. Payment terms on certain purchases leave a balance of \$240,000 and \$260,000 in Trade Payable to Related Party on the accompanying consolidated balance sheet as of May 31, 2010 and 2009, respectively. In addition, during fiscal 2009, Living Data purchased \$3,118, worth of EECP® therapy system components from the Company.

During fiscal 2009 Living Data assigned to Vasomedical, Inc. all of its rights and interests under its Distributorship Agreement with a corporation organized and existing under the laws of the People's Republic of China, that manufactures Ambulatory Blood Pressure Monitors, Ambulatory ECG Recorders and Holter & ABPM Combiner Recorders, for \$20,000 payable to Living Data based on certain terms and conditions. Vasomedical also must pay to Living Data 5% of the selling price or 5% of the cost of all goods sold (whichever is higher), and 5% of the cost of all goods transferred but not sold under the Assignment Agreement to Living Data based on sales of this equipment. The Company now sells these systems in the United States and some other countries now that regulatory clearance had been obtained.

During fiscal 2009 Living Data assigned to Vasomedical, Inc. all of its rights and interests under its Distributorship Agreement with a corporation organized and existing under the laws of the People's Republic of China that manufactures Ultrasound Scanners, for \$20,000 payable to Living Data based on certain terms and conditions. Vasomedical also must pay to Living Data 5% of the selling price or 5% of the cost of all goods sold (whichever is higher), and 5% of the cost of all goods transferred but not sold under the Assignment Agreement to Living Data based on sales of this equipment. The Company has elected not to sell these systems in the United States and other countries.

Further, Kerns provides the Company, free of charge, part-time use of one of its Information Technology (IT) employees as well one of their IT consultants to provide the Company with IT and database support services. In addition, a clinical applications support specialist and a service engineer from Living Data were used by the Company during fiscal 2009 to provide customers with clinical training and technical service. The Company was charged \$3,900 for the services of the clinical applications support specialist and \$2,700 for the services of the service engineer during fiscal 2009.

#### NOTE M – STOCKHOLDERS' EQUITY AND WARRANTS

##### Common stock

See Note L for discussion of common stock issued in fiscal 2010 and 2009 in connection with related party agreements. Additionally during fiscal year 2010 and 2009, the Company issued 2,603,960, and 3,075,000 shares of common stock, respectively, to directors, officers, employees, and/or consultants.

On June 21, 2007, a five-year warrant to purchase 4,285,714 shares of our common stock at an initial exercise price of \$.08 per share was issued to Kerns under the Securities Purchase Agreement.

On July 19, 2005, we granted warrants for the purchase of 2,254,538 shares of common stock to investors and consultants. The warrants, with an exercise price of \$0.69 per share for a term of five years, expired unexercised on July 19, 2010.

## Vasomedical, Inc. and Subsidiaries

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

May 31, 2010 and 2009

## Preferred stock

At May 31, 2010 and 2009, the Company had 1,000,000 shares of preferred stock authorized, with no shares issued and outstanding. There are 850,000 shares that have been designated to a series as shown in the table below, 150,000 shares are available to be designated.

The following table illustrates the various series of preferred stock and their stated value:

	Authorized shares	Stated par value
Series A	500,000	NONE
Series B	150,000	\$ 20.00
Series C	175,000	\$ 20.00
Series D	25,000	\$ 100.00

Series A preferred stock shares are convertible into two shares of common stock to the extent the Company has, at the time of conversion, sufficient authorized but unissued shares of common stock.

Series B preferred stock shares are convertible into shares of common stock at a conversion ratio of the stated value plus accrued but unpaid dividends, over the conversion price, which is equal to the lesser of \$2.18 or 85% of the average per share market value for the five (5) trading days immediately preceding the conversion date.

Series C preferred stock shares are convertible into shares of common stock at a conversion ratio of the stated value plus accrued but unpaid dividends, over the conversion price which, is equal to the lesser of \$2.08 or 85% of the average per share market value for the five (5) trading days immediately preceding the conversion date.

Series D preferred stock shares are convertible into shares of common stock at a conversion ratio equal to the stated value over the conversion price. The conversion price is equal to 85% of the market value, defined as the weighted average price of the common stock during the five (5) trading days immediately preceding the conversion date. In no event shall the conversion price be less than \$0.40 per share or exceed \$0.6606 per share.

The Series A preferred stock has voting rights equal to two (2) votes per share. The holders of Series B, Series C, and Series D have no voting rights.

Series A, preferred stock shareholders are not entitled to dividends.

Series B and Series C preferred stock shareholders are entitled to cumulative dividends of 5% per share per annum (as a percentage of stated value per share) payable in cash or shares of common stock, quarterly in arrears, but in no event later than the conversion date. Dividends on the Series B preferred stock shall accrue daily commencing on the original issue date, and shall be deemed to accrue on such date whether or not earned or declared and whether or not there are profits, surplus, or other funds of the Company legally available for payment of dividends.

Series D preferred stock shareholders are entitled to a per share dividend of the stated value of the shares times the higher of (i) the prime rate as reported by The Wall Street Journal on the first day of the month plus three (3) percent, or (ii) 8.5%. The dividend shall be paid monthly in arrears on the last day of each month in cash, and prorated for any partial month periods. The dividend shall be calculated on the basis of a 360-day year.

Series D has a preference in liquidation to the Series C, Series B, and Series A, common stock and any other capital stock of the Company. Series C, Series B and Series A have preference in liquidation to the common stock and any other capital stock of the Company. Upon liquidation or dissolution, the amount to be paid to Series D, Series C, Series B and Series A are the Series D Stated Value, Series C Stated Value, Series B Stated Value, as indicated above, and Series A at \$0.80 per share.

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## Vasomedical, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
May 31, 2010 and 2009

## Warrants

Warrant activity for the years ended May 31, 2009 and 2010 is summarized as follows:

	Employees	Consultants	Total	Weighted Average Price
Balance at May 31, 2008	-	6,540,252	6,540,252	\$0.29
Warrants Expired	-	-	-	
Warrants Issued	-	-	-	
Balance at May 31, 2009	-	6,540,252	6,540,252	\$0.29
Warrants Expired	-	-	-	
Warrants Issued	-	-	-	
Number of shares exercisable at May 31, 2010	-	6,540,252	6,540,252	\$0.29

## NOTE N - OPTION PLANS

## 1995 Stock Option Plan

In May 1995, the Company's stockholders approved the 1995 Stock Option Plan for officers and employees of the Company for which the Company reserved an aggregate of 1,500,000 shares of common stock. In December 1997, the Company's Board of Directors terminated the 1995 Stock Option Plan with respect to new option grants.

In fiscal 2010 and 2009, there was no activity under the 1995 Stock Option Plan.

## Outside Director Stock Option Plan

In May 1995, the Company's stockholders approved an Outside Director Stock Option Plan (the OD Plan) for non-employee directors of the Company, for which the Company reserved an aggregate of 300,000 shares of common stock. In December 1997, the Company's Board of Directors terminated the OD Plan with respect to new option grants.

In fiscal 2010 and 2009, there was no activity under the OD Plan.

## 1997 Stock Option Plan

In December 1997, the Company's stockholders approved the 1997 Stock Option Plan (the 1997 Plan) for officers, directors, employees and consultants of the Company for which the Company has reserved an aggregate of 1,800,000 shares of common stock. The 1997 Plan provides that a committee of the Board of Directors of the Company will administer it and that the committee will have full authority to determine the identity of the recipients of the options and the number of shares subject to each option. Options granted under the 1997 Plan may be either incentive stock options or non-qualified stock options. The option price shall be 100% of the fair market value of the common stock on the date of the grant (or in the case of incentive stock options granted to any individual principal stockholder who



owns stock possessing more than 10% of the total combined voting power of all voting stock of the Company, 110% of such fair market value). The term of any option may be fixed by the committee but in no event shall exceed ten years from the date of grant. Options are exercisable upon payment in full of the exercise price, either in cash or in common stock valued at fair market value on the date of exercise of the option.

In January 1999, the Company's Board of Directors increased the number of shares authorized for issuance under the 1997 Plan by 1,000,000 shares to 2,800,000 shares.

In May 2006, the Board of Directors accelerated the vesting period for all unvested options to May 31, 2006.

The term for which options may be granted under the 1997 Plan expired on August 6, 2007. In fiscal 2009, options to purchase 357,668 shares of common stock under the 1997 Plan at exercise prices ranging \$0.88 to \$1.09 were retired or cancelled.

Vasomedical, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

May 31, 2010 and 2009

In fiscal 2010, there was no activity under the 1997 plan.

1999 Stock Option Plan

In July 1999, the Company's Board of Directors approved the 1999 Stock Option Plan (the 1999 Plan), for which the Company reserved an aggregate of 2,000,000 shares of common stock. The 1999 Plan provides that a committee of the Board of Directors of the Company will administer it and that the committee will have full authority to determine the identity of the recipients of the options and the number of shares subject to each option. Options granted under the 1999 Plan may be either incentive stock options or non-qualified stock options. The option price shall be 100% of the fair market value of the common stock on the date of the grant (or in the case of incentive stock options granted to any individual principal stockholder who owns stock possessing more than 10% of the total combined voting power of all voting stock of the Company, 110% of such fair market value). The term of any option may be fixed by the committee but in no event shall exceed ten years from the date of grant. Options are exercisable upon payment in full of the exercise price, either in cash or in common stock valued at fair market value on the date of exercise of the option. In July 2000, the Company's Board of Directors increased the number of shares authorized for issuance under the 1999 Plan by 1,000,000 shares to 3,000,000 shares. In December 2001, the Board of Directors of the Company increased the number of shares authorized for issuance under the 1999 Plan by 2,000,000 shares to 5,000,000 shares.

In May 2006, the Board of Directors accelerated the vesting period for all unvested options to May 31, 2006.

The term for which options may be granted under the 1999 Plan expired July 12, 2009. In fiscal 2009, options to purchase 1,411,832 shares of common stock under the 1999 Plan at exercise prices ranging from \$0.22 to \$4.28 were retired or cancelled.

In fiscal 2010, options to purchase 30,000 shares of common stock under the 1999 Plan at an exercise price of \$1.69 were retired or cancelled.

2004 Stock Option and Stock Issuance Plan

In October 2004, the Company's stockholders approved the 2004 Stock Option and Stock Issuance Plan (the 2004 Plan), for which the Company reserved an aggregate of 2,500,000 shares of common stock. The 2004 Plan is divided into two separate equity programs: (i) the Option Grant Program under which eligible persons ("Optionees") may, at the discretion of the board of directors, be granted options to purchase shares of common stock; and (ii) the Stock Issuance Program under which eligible persons ("Participants") may, at the discretion of the board or directors, be issued shares of common stock directly, either through the immediate purchase of such shares or as a bonus for services rendered to the Corporation.

Options granted under the 2004 Stock Plan shall be non-qualified or incentive stock options and the exercise price is the fair market value of the common stock on the date of grant except that for incentive stock options it shall be 110% of the fair market value if the Optionee owns 10% or more of our common stock. The term of any option may be fixed by the board of directors or committee but in no event shall exceed ten years from the date of grant. Stock options granted under the 2004 Plan may become exercisable in one or more installments in the manner and at the time or times specified by the committee. Options are exercisable upon payment in full of the exercise price, either in cash or in common stock valued at fair market value on the date of exercise of the option. The term for which options may be granted under the 2004 Plan expires July 12, 2014.

Under the stock issuance program, the purchase price per share shall be fixed by the board of directors or committee but cannot be less than the fair market value of the common stock on the issuance date. Payment for the shares may be made in cash or check payable to us, or for past services rendered to us and all shares of common stock issued thereunder shall vest upon issuance unless otherwise directed by the committee. The number of shares issuable is also subject to adjustments upon the occurrence of certain events, including stock dividends, stock splits, mergers, consolidations, reorganizations, recapitalizations, or other capital adjustments. The term for which shares may be issued under the 2004 Plan expires July 12, 2014.

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## Vasomedical, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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The 2004 Plan provides that a committee of the Board of Directors of the Company will administer it and that the committee will have full authority to determine and designate the individuals who are to be granted stock options or qualify to purchase shares of common stock under the 2004 Stock Plan, the number of shares to be subject to options or to be purchased and the nature and terms of the options to be granted. The committee also has authority to interpret the 2004 Plan and to prescribe, amend and rescind the rules and regulations relating to the 2004 Plan.

In May 2006, the Board of Directors accelerated the vesting period for all unvested options to May 31, 2006.

In fiscal 2009, the Board of Directors did not grant any non-qualified stock options under the 2004 Plan. In fiscal 2009, there were no options to purchase shares of common stock under the 2004 Plan. In fiscal 2009, options to purchase 692,471 shares of common stock under the 2004 Plan at exercise prices ranging from \$0.09 to \$0.58 were retired or cancelled.

In fiscal 2010, the Company's Board of Directors granted non-qualified stock options under the 2004 Plan to one director to purchase an aggregate of 200,000 shares of common stock, at an exercise price of \$0.08 per share (which represented the fair market value of the underlying common stock at the time of the respective grants) and the Company's Board of Directors granted non-qualified stock options under the 2004 Plan to one officer to purchase an aggregate of 250,000 shares of common stock, at an exercise price of \$0.08 per share (which represented the fair market value of the underlying common stock at the time of the respective grants). These options expire five years from the date of grant. In fiscal 2010, options to purchase 449,463 shares of common stock under the 2004 Plan at exercise prices ranging from \$0.57 to \$3.96 were retired or cancelled.

At May 31, 2010, there were 1,285,862 shares available for future grants under the 2004 Plan.

Stock option activity under all the plans for the years ended May 31, 2009 and 2010 is summarized as follows:

	Outstanding Options			Weighted Average Exercise Price
	Shares Available for Grant	Number of Shares	Range of Exercise Price per Share	
Balance at May 31, 2008	1,662,460	5,455,210	0.09 - \$ 4.28	\$ 0.86
Options canceled	2,104,303	(2,461,971)	0.09 - \$ 4.28	\$ 0.99
Balance at May 31, 2009	3,766,763	2,993,239	0.09 - \$ 3.96	\$ 0.74
Options Granted	(450,000 )	450,000	\$ 0.08	\$ 0.08
Options canceled	479,463	(479,463 )	0.57 - \$ 3.96	\$ 1.24
Expiration of 1999 Stock option plan	(2,510,364)			
Balance at May 31, 2010	1,285,862	2,963,776	0.08 - \$ 3.96	\$ 0.57

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Vasomedical, Inc. and Subsidiaries  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
May 31, 2010 and 2009

The following table summarizes information about stock options outstanding and exercisable at May 31, 2010:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding at May 31, 2010	Weighted Average Remaining Contractual Life (yrs.)	Weighted Average Exercise Price	Number Exercisable at May 31, 2010	Weighted Average Exercise Price
0.08 - \$0.58	2,139,776	6.0	\$0.16	2,139,776	\$0.16
0.71 - \$0.95	320,000	3.1	\$0.88	320,000	\$0.88
1.00 - \$1.31	295,000	3.8	\$1.15	295,000	\$1.15
2.91 - \$3.96	209,000	1.2	\$3.43	209,000	\$3.43
	2,963,776	5.1	\$0.57	2,963,776	\$0.57

The weighted-average fair value exercise price of options and warrants granted during fiscal years 2010 was \$0.08. At May 31, 2010, there were 88,938,979 remaining authorized shares of common stock after reserves for all stock option plans and stock warrants.

#### NOTE O - INCOME TAXES

As of May 31, 2010, the recorded deferred tax assets were \$20,966,375, reflecting an increase of \$629,723 during the fiscal year ended May 31, 2010, which was offset by a valuation allowance of the same amount.

The Company's deferred tax assets (liabilities) are summarized as follows:

	2010	2009
Net operating loss carryforwards	\$ 20,783,805	\$ 20,123,742
Depreciation and amortization	(34,670 )	(16,110 )
Deferred rent	6,000	5,450
Deferred gain on sale of building	39,220	57,330
Allowance for doubtful accounts	49,970	32,290
Reserve for obsolete inventory	122,050	133,950
Total gross deferred taxes	20,966,375	20,336,652
Valuation allowance	(20,966,375 )	(20,336,652 )
Net deferred tax assets	\$ -	\$ -

At May 31, 2010, the Company had net operating loss carryforwards for Federal and state income tax purposes of approximately \$53.6 million expiring at various dates from 2011 through 2030. In fiscal 2010 and 2009,

approximately \$2.5 million and \$0.5 million respectively, of net operating loss carryforwards expired. Future expirations of net operating loss carryforwards are approximately as follows:

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Vasomedical, Inc. and Subsidiaries  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 May 31, 2010 and 2009

Fiscal Year	Amount
2011	\$ 5,400,000
2012	6,100,000
2013	4,400,000
2014	-
2015	-
Thereafter	37,700,000
Total	\$ 53,600,000

The components of income tax benefit for the year ended May 31, 2010 include federal research and development credits of approximately \$17,400. The remaining income tax benefit for the years ended May 31, 2009 and 2010 consist primarily of federal and state refunds and adjustments for amounts paid or accrued in excess of actual income tax liabilities.

Under current tax law, the utilization of tax attributes will be restricted if an ownership change, as defined, were to occur. Section 382 of the Internal Revenue Code provides, in general, that if an “ownership change” occurs with respect to a corporation with net operating and other loss carryforwards, such carryforwards will be available to offset taxable income in each taxable year after the ownership change only up to the “Section 382 Limitation” for each year (generally, the product of the fair market value of the corporation’s stock at the time of the ownership change, with certain adjustments, and a specified long-term tax-exempt bond rate at such time). The Company’s ability to use its loss carryforwards will be limited in the event of an ownership change.

The following is a reconciliation of the effective income tax rate to the federal statutory rate:

	2010	2009
	%	%
Federal statutory rate	(34.00 )	(34.00 )
Change in valuation allowance		
relating to operations	34.00	34.00
Other	(1.90 )	-
	(1.90 )	-

#### NOTE P - COMMITMENTS AND CONTINGENCIES

##### Sales representation agreement

The Company’s agreement with GE Healthcare may be terminated by GE Healthcare effective 30 days following notice, if the Company materially fails to achieve sales targets set by GE Healthcare annually. These targets may be modified by mutual agreement.

##### Leases



On August 15, 2007, we sold our facility under a five-year leaseback agreement. Vaso Healthcare rents an office in Greensboro, North Carolina pursuant to a lease which expires in May 2013. Future rental payments under the operating lease are approximately as follows:

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## Vasomedical, Inc. and Subsidiaries

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

May 31, 2010 and 2009

For the years ended May 31,

2011	\$201,000
2012	210,000
2013	88,000
Total	\$499,000

Rent expense related to these leases for the years ended May 31, 2010 and 2009 was approximately \$150,000.

## Litigation

The Company is currently, and has been in the past, a party to various routine legal proceedings incident to the ordinary course of business. The Company believes that the outcome of all such pending legal proceedings in the aggregate is unlikely to have a material adverse effect on the business or consolidated financial condition of the Company.

## NOTE Q - 401(K) PLAN

In April 1997, the Company adopted the Vasomedical, Inc. 401(k) Plan to provide retirement benefits for its employees. As allowed under Section 401(k) of the Internal Revenue Code, the plan provides tax-deferred salary deductions for eligible employees. Employees are eligible to participate in the next quarter enrollment period after employment. Participants may make voluntary contributions to the plan up to 15% of their compensation. In fiscal year 2010 and 2009, the Company made discretionary contributions of approximately \$3,000 and \$10,000, respectively, to match a percentage of employee contributions.

## NOTE R – SUBSEQUENT EVENTS

On various dates during June, July, and August 2010, the Company had issued an aggregate of \$3,300,000 principal amount of its Series E convertible preferred stock (described below) as part of its \$5,000,000 financial commitment.

On June 24, 2010, the Company filed a Certificate of Designations of Preferences and Rights of Series E Convertible Preferred Stock (“Certificate of Designations”), as authorized by the Board of Directors, designating 350,000 shares of its 1,000,000 shares of preferred stock as Series E Convertible Preferred Stock (“Series E Preferred”). The following is a summary of the powers, designations, preferences and other rights of the Series E Preferred.

- i. Face Amount. The face amount per share of the Series E Preferred Stock is \$16.00.
- ii. Dividends. Cumulative dividends will accrue at a rate of 5% per annum, payable semi-annually in additional shares of the Series E Preferred. Dividends on the Series E Preferred will be paid in preference to any dividends paid to the holders of the Company’s Common Stock or any other series of the Company’s preferred stock made junior to the Series E Preferred.
- iii. Liquidation Preference. On any liquidation, dissolution or winding-up of the Corporation, the holders of the Series E Preferred will receive payment of twice the aggregate face amount thereof, plus all accrued and unpaid dividends, before any payments or distributions are paid or provided for the Company’s Common Stock or any other series of the Company’s preferred stock made junior to the Series E Preferred. In the event of a sale of all or substantially all the Company’s stock or assets, the holders of the Series E Preferred will receive payment of 1.2 times the aggregate face amount thereof, plus all accrued and unpaid dividends, before any payments or

distributions are paid or provided for the Company's Common Stock or any other series of the Company's preferred stock made junior to the Series E Preferred.

- iv. **Conversion Rights.** Each share of the Series E Preferred will be convertible at any time or from time to time at the holder's option commencing six months from the issuance date into 100 shares of Common Stock (an exercise price of \$.16 per share of Common Stock, the "Conversion Price"), subject to anti-dilution adjustment as set forth below. Commencing at any time one year from the issuance date, one-half 50% of the Series E Preferred will be automatically converted into 100 shares of Common Stock for each share of Series E Preferred if the closing market price of the Common Stock is 3 times the Conversion Price for 30 consecutive trading days and the average daily trading volume during those 30 days is 250,000 shares or greater. Notwithstanding the foregoing, the Series E Preferred shall be automatically converted into Common Stock on June 1, 2015.
- v. **Voting Rights.** Investors in the Series E Preferred will have voting rights in the ratio of 100 votes for each share of Series E Preferred and shall vote together with the Common Stock as a single class.
- vi. **Anti-Dilution Adjustments.** The 100-to-1 conversion ratio of the Series E Preferred will be subject to proportional adjustment for stock dividends, stock splits and other similar changes in capitalization. If the Company issues or sells shares of its capital stock for consideration of a price of less than the lesser of its then current market price or the applicable Conversion Price, the Conversion Price shall be adjusted to be such lower price at which the Company issued or sold shares of its capital stock; provided, however, that the Company shall have the right to issue shares and options under its option plans.

