IPARTY CORP
Form 10KSB/A
August 12, 2003

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-KSB/A*

(Amendment No. 1)

ý **ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

FOR THE FISCAL YEAR ENDED DECEMBER 28, 2002

OR

o **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

FOR THE TRANSITION PERIOD FROM _____________ TO _____________

COMMISSION FILE NUMBER 0-25507

iPARTY CORP.

(NAME OF SMALL BUSINESS ISSUER IN ITS CHARTER)

DELAWARE	**76-0547750**
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	(I.R.S. EMPLOYER IDENTIFICATION NO.)
1457 VFW PARKWAY WEST ROXBURY, MASSACHUSETTS	**02132**
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)	(ZIP CODE)

(617) 323-0822
(ISSUER'S TELEPHONE NUMBER, INCLUDING AREA CODE)

SECURITIES REGISTERED UNDER SECTION 12(b) OF THE EXCHANGE ACT:

COMMON STOCK, $.001 PAR VALUE	**AMERICAN STOCK EXCHANGE**
(TITLE OF EACH CLASS)	(NAME OF EACH EXCHANGE ON WHICH REGISTERED)

SECURITIES REGISTERED UNDER SECTION 12(g) OF THE EXCHANGE ACT: NONE

Check whether the issuer: (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 ý No o

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this

Form 10-KSB/A or any amendment to this Form 10-KSB/A. o

The Issuer's revenues for its most recent fiscal year ended December 28, 2002 were $52,177,923.

On August 1, 2003, the aggregate market value of the voting common equity of the Registrant (consisting of common stock, $.001 par value (the "Common Stock")) held by non-affiliates of the Registrant was approximately $4,742,002 based on the closing price for such Common Stock on said date as reported by the American Stock Exchange. On August 1, 2003 there were 17,562,972 shares of Common Stock, $.001 par value, issued and outstanding.

*

Amendment to Part II, Item 7, as set forth herein.

Explanatory Note to Form 10-KSB/A

We are filing this Amendment No. 1 to our Annual Report on Form 10-KSB for the fiscal year ended December 28, 2002 to reclassify the Company's Series A-F convertible preferred stock outside of permanent stockholders' equity, as a result of the application of Emerging Issues Task Force ("EITF") Topic No. D-98, *Classification and Measurement of Redeemable Securities*. The effect of this reclassification is to reduce previously reported total stockholders' equity by the carrying values of the respective convertible preferred shares outstanding of $18,584,309, $20,092,667 and $22,965,666 as of December 28, 2002, December 29, 2001 and December 30, 2000, respectively.

In accordance with the rules of the Securities and Exchange Commission, the full text of the affected Item 7 of Part II is included in this amendment and the certifications mandated under the Sarbanes-Oxley Act of 2002 are hereby submitted as of the date hereof.

PART II

ITEM 7. FINANCIAL STATEMENTS

Report of Independent Auditors

Board of Directors and Stockholders
iParty Corp.

We have audited the accompanying consolidated balance sheet of iParty Corp. and subsidiaries as of December 28, 2002, and the related consolidated statements of operations, convertible preferred stock and stockholders' deficit, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. The consolidated financial statements of iParty Corp. as of December 29, 2001, were audited by other auditors who have ceased operations and whose report dated February 22, 2002 expressed an unqualified opinion on those consolidated statements.

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

In our opinion, the 2002 consolidated financial statements referred to above present fairly, in all material respects, the financial position of iParty Corp. and subsidiaries as of December 28, 2002, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States.

As described in Note 1 to the consolidated financial statements, the Company has restated its consolidated balance sheet as of December 28, 2002 and its consolidated statements of convertible preferred stock and stockholders' deficit for the years ended December 28, 2002 and December 29, 2001.

As discussed above, the consolidated financial statements of the Company for the year ended December 29, 2001 were audited by other auditors who have ceased operations. As described in Note 1 to the consolidated financial statements, the Company has restated its consolidated statements of convertible preferred stock and stockholders' deficit for the year ended December 29, 2001 to reclassify the Company's series A F convertible preferred stock outside of permanent stockholders' deficit as a result of the application of EITF Topic No. D-98, *Classification and Measurement of Redeemable Securities.* We have audited the adjustments described in Note 1 that were applied to restate the consolidated statements of convertible preferred stock and stockholders' deficit for the year ended December 29, 2001. With respect to these adjustments, our procedures included (a) agreeing the previously reported series A F convertible preferred stock, additional paid in capital and stockholders' deficit to the previously issued consolidated financial statements, (b) agreeing the adjustments to the underlying records obtained from management and (c) testing the mathematical accuracy of the reconciliation of the restated series A F convertible preferred stock, additional paid in capital and stockholders' deficit. In our opinion, such adjustments are appropriate and have been properly applied. However, we were not engaged to audit, review, or apply any procedures to the 2001 consolidated financial statements of the Company other than with respect to such adjustments and, accordingly, we do not express an opinion or any other form of assurance on the 2001 financial statements taken as a whole.

/s/ Ernst & Young LLP

Boston, Massachusetts
February 21, 2003, except for Note 1 under
the caption Restatement of Financial
Information and Note 10 under the caption
Liquidation Feature of Series A-F
Convertible Preferred Stock,
as to which the date is August 5, 2003

This is a copy of the audit report previously issued by Arthur Andersen LLP in connection with the consolidated financial statements of iParty Corp. as of December 29, 2001 and December 30, 2000, and for the years then included in the Annual Report on Form 10-KSB of iParty Corp. for the fiscal year ended December 29, 2001. This audit report has not been reissued by Arthur Andersen LLP in connection with the filing of this Annual Report on Form 10-KSB/A for the fiscal year ended December 28, 2002. The consolidated balance sheets as of December 29, 2001 and December 30, 2000 and the consolidated statements of operations, stockholders' equity and cash flows for the year ended December 30, 2000 related to this audit report have not been included in the consolidated financial statements in this Annual Report on Form 10-KSB/A for the fiscal year ended December 28, 2002.

Report of Independent Public Accountants

To iParty Corp.:

We have audited the accompanying consolidated balance sheets of iParty Corp. (a Delaware corporation) and subsidiaries as of December 29, 2001 and December 30, 2000, and the related consolidated statements of operations, stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements, based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of iParty Corp. and subsidiaries as of December 29, 2001 and December 30, 2000, 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.

/s/ Arthur Andersen LLP

Boston, Massachusetts
February 22, 2002

iPARTY CORP.
CONSOLIDATED BALANCE SHEETS
Restated

		December 28, 2002
ASSETS		
Current assets:		
Cash and cash equivalents	$	2,326,343
Restricted cash		371,952
Accounts receivable		445,988
Inventory, net		8,916,664
Prepaid expenses and other assets		294,370
Total current assets		12,355,317
Property and equipment, net		1,128,897
Other assets		331,669
Total assets	$	13,815,883
LIABILITIES, CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Accounts payable	$	2,752,311
Accrued expenses		1,867,496
Current portion of capital lease obligations		237,080
Borrowings under line of credit		3,476,738
Total current liabilities		8,333,625
Long-term liabilities:		
Capital lease obligations, net of current portion		3,173
Other liabilities		678,932
Total long-term liabilities		682,105
Total liabilities		9,015,730
Commitments and contingencies		
Convertible preferred stock $.001 par value; 10,000,000 shares authorized,		
Series A convertible preferred stock 1,000,000 shares authorized, issued and outstanding in 2002 (aggregate liquidation value of $1,000,000 at December 28, 2002)		1,000,000
Series B convertible preferred stock 1,150,000 shares authorized; 684,799 shares issued and outstanding in 2002 (aggregate liquidation value of $13,695,973 at December 28, 2002) (see Notes 9 and 10)		10,189,809
Series C convertible preferred stock 100,000 shares authorized, issued and outstanding in 2002 (aggregate liquidation value of $2,000,000 at December 28, 2002) (see Notes 9		1,492,000

	December 28, 2002
and 10)	
Series D convertible preferred stock 250,000 shares authorized, issued and outstanding in 2002 (aggregate liquidation value of $5,000,000 at December 28, 2002) (see Notes 9 and 10)	3,652,500
Series E convertible preferred stock 533,333 shares authorized; 466,667 shares issued and outstanding in 2002 (aggregate liquidation value of $1,750,000 at December 28, 2002) (see Notes 9 and 10)	1,750,000
Series F convertible preferred stock 114,286 shares authorized, issued and outstanding in 2002 (aggregate liquidation value of $500,000 at December 28, 2002)	500,000
Total convertible preferred stock	18,584,309
Stockholders' deficit:	
Common stock $.001 par value; 150,000,000 shares authorized; 16,996,570 shares issued and outstanding in 2002	16,997
Additional paid-in capital	46,168,101
Accumulated deficit	(59,969,254)
Total stockholders' deficit	(13,784,156)
Total liabilities, convertible preferred stock and stockholders' deficit	$ 13,815,883

The accompanying notes are an integral part of these Consolidated Financial Statements.

iPARTY CORP.
CONSOLIDATED STATEMENTS OF OPERATIONS

	For the year ended	
	December 28, 2002	December 29, 2001
Revenues	$ 52,177,923	$ 47,983,404
Operating costs:		
Cost of products sold	30,420,475	28,966,573
Marketing and sales	16,195,066	14,961,563
General and administrative	5,578,633	5,906,869
Special charge	396,465	
Stock option compensation expense		320,373
Operating loss	(412,716)	(2,171,974)
Other income (expense):		
Interest income	9,045	117,431
Interest expense	(280,898)	(381,763)
Net loss	$ (684,569)	$ (2,436,306)
Net loss available to common stockholders	$ (774,719)	$ (2,436,306)

	For the year ended	
Loss per share:		
Basic and diluted	$ (0.04)	$ (0.18)
Loss per share available to common stockholders:		
Basic and diluted	$ (0.05)	$ (0.18)
Weighted-average shares outstanding:		
Basic and diluted	16,212,166	13,411,866

The accompanying notes are an integral part of these Consolidated Financial Statements.

iPARTY CORP.
CONSOLIDATED STATEMENTS OF CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS' DEFICIT
Restated

	Preferred Stock		Stockholders' Deficit				
			Common Stock				
	Shares	Amount	Shares	Amount	Additional Paid-in Capital	Accumulated Deficit	Total Stockholders' Deficit
Balance at December 30, 2000	3,569,165	$ 22,965,666	12,174,745	$ 12,175	$ 41,204,890	$ (56,758,229)	$ (15,541,164)
Issuance of common stock upon conversion of Series B convertible preferred stock	(294,793)	(2,872,999)	2,947,930	2,948	2,870,051		2,872,999
Stock option compensation expense					320,373		320,373
Net loss						(2,436,306)	(2,436,306)
Balance at December 29, 2001	3,274,372	20,092,667	15,122,675	15,123	44,395,314	(59,194,535)	(14,784,098)
Issuance of common stock upon conversion of Series B convertible preferred stock	(119,786)	(1,257,886)	1,197,860	1,198	1,256,688		1,257,886
Issuance of common stock upon conversion of Series E preferred stock	(66,666)	(250,000)	666,660	667	249,333		250,000
Series B preferred stock adjustment (Note 9)	(313,974)	(314)			314		314
Series C preferred stock adjustment (Note 9)	(45,198)	(45)			45		45
Series D preferred stock adjustment (Note 9)	(112,996)	(113)			113		113
Equity portion of special charge (Note 9)					171,465		171,465
Exercise of stock options			9,375	9	4,679		4,688
Preferred stock beneficial conversion dividend (Note 9)					90,150	(90,150)	
Net loss						(684,569)	(684,569)
Balance at December 28, 2002	2,615,752	$ 18,584,309	16,996,570	$ 16,997	$ 46,168,101	$ (59,969,254)	$ (13,784,156)

Stockholders' Deficit

The accompanying notes are an integral part of these Consolidated Financial Statements.

iPARTY CORP.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the year ended	
	December 28, 2002	December 29, 2001
Operating activities:		
Net loss	$ (684,569)	$ (2,436,306)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	633,173	616,663
Non-cash portion of special charge	171,465	
Deferred rent	102,518	201,419
Stock option compensation expense		320,373
Changes in operating assets and liabilities:		
Accounts receivable	95,715	406,589
Inventory	366,188	(1,056,292)
Prepaid expenses and other assets	36,541	(35,482)
Accounts payable	116,151	220,481
Accrued severance and restructuring expenses		(775,137)
Accrued expenses	(255,252)	(79,152)
Net cash provided by (used in) operating activities	581,930	(2,616,844)
Investing activities:		
Purchase of property and equipment	(775,147)	(210,738)
Decrease (increase) in restricted cash	296,005	(32,957)
Net cash used in investing activities	(479,142)	(243,695)
Financing activities:		
Net borrowings under line of credit	121,761	554,187
Principal payments on capital lease obligations	(301,978)	(296,818)
Proceeds from exercise of stock options	4,688	
Net cash provided by (used in) financing activities	(175,529)	257,369
Net decrease in cash and cash equivalents	(72,741)	(2,603,170)
Cash and cash equivalents, beginning of year	2,399,084	5,002,254

	For the year ended	
Cash and cash equivalents, end of year	$ 2,326,343	$ 2,399,084
Cash paid for:		
Interest expense	$ 285,515	$ 392,351
Supplemental disclosure of non-cash financing activities:		
Acquisition of assets under capital lease	$ 7,881	$ 481,118

The accompanying notes are an integral part of these Consolidated Financial Statements.

iPARTY CORP.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 28, 2002

1. THE COMPANY:

The Company's efforts are devoted to the sale of party goods and services through 35 retail stores and the Internet. The Company's retail stores are located throughout New England, with three additional stores located in Florida. The Company was originally an Internet-based merchant of party goods and services. On August 3, 2000, iParty Retail Stores Corp. ("iParty Retail") was incorporated as a wholly-owned subsidiary of iParty Corp. to operate a chain of retail stores selling party goods. On August 15, 2000, iParty Retail acquired certain assets from The Big Party Corporation ("The Big Party"). iParty Retail acquired inventory, fixed assets and the leases of 33 retail stores from The Big Party, in exchange for cash and the assumption of certain liabilities.

The Company believes, based on its current operating plan, that anticipated revenues from operations and borrowings available under the existing line of credit will be sufficient to fund its operations and working capital requirements through the next twelve months. In the event that the Company's operating plan changes or proves inaccurate due to decreased revenues, unanticipated expenses, increased competition, unfavorable economic conditions or other unforeseen circumstances, the Company's liquidity may be negatively impacted. Accordingly, the Company would be required to adjust its expenditures in 2003 to conserve working capital or raise additional capital to fund operations. There can be no assurance, however, that, should the Company require additional financing, such financing will be available on terms and conditions acceptable to the Company.

Restatement of Financial Information

The accompanying consolidated balance sheet as of December 28, 2002 and statements of convertible preferred stock and stockholders' deficit for the years ended December 28, 2002 and December 29, 2001 have been reclassified to present the Company's Series A F convertible preferred stock outside of permanent stockholders' deficit as a result of the application of EITF Topic No. D-98*, Classification and Measurement of Redeemable Securities.* The effect of this reclassification is to reduce previously reported total stockholders' equity by the carrying values of the respective convertible preferred shares outstanding of $18,584,309, $20,092,667 and $22,965,666 as of December 28, 2002, December 29, 2001 and December 30, 2000, respectively. The effect of this reclassification on the conversions of preferred stock in 2002 and 2001 within the statements of convertible preferred stock and stockholders' deficit is to increase the amount of convertible preferred stock transferred to additional paid in capital by $1,507,700 in 2002 and $2,872,704 in 2001. These reclassifications did not impact the Company's results of operations or actual cash flows.

2. SIGNIFICANT ACCOUNTING POLICIES:

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries after elimination of all significant intercompany transactions and balances.

Revenue Recognition

Revenue is recognized at the point of sale for retail sales and upon shipment to customers for Internet sales. Outbound shipping charges billed to Internet customers are included in revenue. In accordance with EITF Issue No. 00-14, *Accounting for Certain Sales Incentives*, the Company classifies discounts as a reduction of revenue. The Company recognizes its revenue with respect to the Internet

operation on a gross basis since the Company is the primary obligor to the customer and the merchant of record under the arrangement.

Concentrations

The Company's Internet operation relies on a single vendor as its sole provider for services including inventory, fulfillment and shipping. While management of the Company believes it could obtain similar services from other vendors for similar terms, a disruption in the services received from this vendor could materially harm the Company's Internet business.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates.

Cash and Cash Equivalents

The Company considers all highly liquid investments with an original maturity date of three months or less to be cash equivalents. Cash equivalents consist primarily of money market accounts and are carried at cost plus accrued interest, which approximates fair value.

Fair Value of Financial Instruments

The carrying values of cash and cash equivalents, accounts receivable and accounts payable approximate fair value because of the short-term nature of these instruments. The fair value of debt approximates carrying value because the debt bears interest at a variable market rate.

Inventories

Inventories consist of party supplies and are valued at the lower of weighted-average cost, which approximates FIFO (first-in, first-out) or market.

Inventory has been reduced by an allowance for obsolete and excess inventory, which is based on management's review of inventories on hand compared to estimated future sales.

Advertising

Advertising costs are expensed as incurred. Advertising costs amounted to $2,751,674 and $2,504,791 for the years ended December 28, 2002 and December 29, 2001, respectively.

Deferred Rent

Certain operating lease agreements contain scheduled rent increases, which are being amortized over the terms of the agreements using the straight-line method, and are included in other liabilities in the accompanying consolidated balance sheet.

Net Loss per Share

Basic net loss per share is computed by dividing net loss by the weighted-average number of common shares outstanding. Diluted loss per share is the same as basic net loss per share for the years ended December 28, 2002 and December 29, 2001, since the Company recognized a net loss in each year.

The following table sets forth the computation of basic and diluted net loss available to common stockholders per share:

	2002	2001
Net loss	$ (684,569)	$ (2,436,306)
Preferred stock beneficial conversion dividend	(90,150)	
Net loss available to common stockholders	$ (774,719)	$ (2,436,306)
Loss per share available to common stockholders, basic and diluted	$ (0.05)	$ (0.18)
Weighted-average shares outstanding, basic and diluted	16,212,166	13,411,866

As of December 28, 2002, there were 42,487,054 potential additional common share equivalents outstanding, including 20,680,658 shares upon the conversion of immediately convertible preferred stock, 13,563,212 shares upon the exercise of warrants with a weighted-average exercise price of $1.43 and 8,243,184 shares upon the exercise of stock options with a weighted-average exercise price of $1.01, but not included in the above calculation as their effect would have been anti-dilutive. The Company has reserved 42,487,054 shares of common stock for issuance in connection with conversion of preferred stock and the exercise of warrants and stock options.

Stock Option Compensation Expense

The Company accounts for its stock option compensation agreements with employees under the provisions of Accounting Principles Board ("APB") Opinion No. 25, *Accounting for Stock Issued to Employees*. The Company has adopted the disclosure-only provisions of Statement of Financial Accounting Standards ("SFAS") No. 123, *Accounting for Stock-Based Compensation*.

The Company has computed the value of options using the Black-Scholes option pricing model prescribed by SFAS No. 123. The weighted-average fair value of the options granted was $0.29 per share during fiscal 2002 and $0.16 per share during fiscal 2001, using the Black-Scholes option-pricing model with the following assumptions: no dividend yield, volatility of 125% in 2002 and 2001, a risk-free interest rate of 4.86% to 5.95% in 2002 and 5.44% to 6.75% in 2001 and an expected life of five years from date of the grant. Had compensation cost for the Company's stock option plan been determined based upon the fair value at the grant date for awards under the plan consistent with the

methodology prescribed under SFAS 123, the Company's net loss and net loss per share would have been the following pro forma amounts:

	2002	2001
Net loss:		
Reported	$ (684,569)	$ (2,436,306)
Stock option compensation expense	(671,029)	(1,146,653)
Pro forma	$ (1,355,598)	$ (3,582,959)
Net loss per share:		
Reported	$ (0.04)	$ (0.18)
Pro forma	$ (0.08)	$ (0.27)

		2002		2001
Net loss available to common stockholders:				
Reported	$	(774,719)	$	(2,436,306)
Stock option compensation expense		(671,029)		(1,146,653)
Pro forma	$	(1,445,748)	$	(3,582,959)
Net loss per share available to common stockholders:				
Reported	$	(0.05)	$	(0.18)
Pro forma	$	(0.09)	$	(0.27)

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and are depreciated on the straight-line method over the estimated useful lives of the assets. Expenditures for maintenance and repairs are charged to operations as incurred. A listing of the estimated useful life of the various categories of property and equipment is as follows:

Asset Classification	Estimated Useful Life
Computers, equipment, furniture and fixtures	3-5 years
Equipment under capital leases	Lesser of term of lease (3-7 years) or useful life of asset
Leasehold improvements	Lesser of lease term (generally 5 to 10 years) or useful life of asset

Accounting for the Impairment of Long-Lived Assets

The Company adopted SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, in fiscal 2002, which requires that long-lived assets be measured at the lower of carrying amount or fair value less cost to sell. The adoption of SFAS No. 144 did not have a material impact on the Company's consolidated results of operations in fiscal year 2002.

Goodwill and Other Intangible Assets

The Company adopted SFAS No. 142, *Goodwill and Other Intangible Assets*, which revised the accounting for goodwill and other intangible assets in fiscal 2002. Under this pronouncement, goodwill and intangible assets with indefinite lives are no longer subject to amortization, but are monitored

annually for impairment. Any impairment will be measured based upon the fair value of the related asset based upon the provisions of SFAS 142. The adoption of this standard did not have any impact on the Company's consolidated financial statements, since it does not have any goodwill or intangible assets.

New Accounting Pronouncements

In June 2002, the Financial Accounting Standards Board ("FASB") issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. SFAS No. 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and rescinds EITF Issue No. 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)*. This Statement requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. The provisions of SFAS No. 146 are effective for exit and disposal activities that are initiated after December 31,

2002. The Company does not expect the adoption of SFAS No. 146 to have a material impact on its consolidated financial position or consolidated results of operations.

In December 2002, the FASB issued SFAS 148, *Accounting for Stock-Based Compensation Transition and Disclosure, an amendment of FASB Statement No. 123*. SFAS 148 amends FASB Statement No. 123, *Accounting for Stock-Based Compensation*, to provide alternative methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock-based employee compensation. SFAS 148 also amends the disclosure provisions of FASB Statement No. 123 to require prominent disclosure about the effects on reported net income of an entity's accounting policy decisions with respect to stock-based employee compensation, which is disclosed in Note 2.

SFAS 148 also amends APB Opinion No. 28*, Interim Financial Reporting,* to require disclosure about those effects in interim financial statements. The Company currently does not intend to voluntarily change from the intrinsic value method to the fair value method of accounting for stock-based employee compensation. The Company will provide the required disclosure about the effects on reported net income of the Company's accounting policy decisions with respect to stock-based employee compensation commencing with its interim financial statements for the three-month period ending March 29, 2003.

In January 2003, the FASB issued Interpretation No. 46, *Consolidation of Variable Interest Entities*, ("Interpretation No. 46") to clarify the conditions in which assets, liabilities and activities and of another entity should be consolidated into a variable interest entity (including a special purpose entity such as that utilized in an accounts receivable securitization transaction) by a company that bears the majority of the risk of loss from the variable interest entity's activities, is entitled to receive a majority of the variable interest entity's residual returns or both. The provisions of Interpretation No. 46 are required to be adopted by the Company in fiscal year 2003. The Company does not believe the adoption of Interpretation No. 46 will have any impact on its overall financial position or results of operations.

In April 2002, the FASB issued Statement No. 145, *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13 and Technical Corrections*. This statement eliminates extraordinary accounting for a gain or loss reported on the extinguishment of debt, and amends other existing authoritative pronouncements to make technical corrections, clarify meanings or describe their applicability under changed conditions. The provisions of this standard are effective for the Company with the beginning of fiscal 2003; however, the Company does not believe the adoption of this standard will have a material impact on the Company's overall financial position or results of operations.

Reclassifications

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

3. PROPERTY AND EQUIPMENT:

Property and equipment consist of the following:

		Dec. 28, 2002
Computers, equipment, furniture and fixtures	$	1,548,483
Equipment under capital leases		731,795
Leasehold improvements		499,035
		2,779,313
Less accumulated depreciation		(1,650,416)
	$	1,128,897

4. LEASES:

The Company conducts the majority of its operations in leased facilities with certain leased equipment accounted for as operating and capital leases. The original cost of assets under capital leases at December 28, 2002 was $731,795. The accumulated depreciation of assets under capital leases at December 28, 2002 was $448,399. The amortization related to those assets under capital lease is included in depreciation expense.

At December 28, 2002 the minimum rental commitments under all non-cancelable capital and operating leases with initial or remaining terms of more than one year were as follows:

Fiscal Year	Capital	Operating
2003	$ 273,379	$ 5,129,422
2004	3,159	5,130,278
2005	263	4,451,075
2006		3,775,865
2007		2,244,004
Thereafter		4,223,550
	276,801	$ 24,954,194
Less amount representing interest	36,548	
Present value of minimum lease payments	240,253	
Less current portion of obligation under capital leases	237,080	
Long-term obligation under capital leases	$ 3,173	

The Company's rental expense under operating leases for the years ended December 28, 2002 and December 29, 2001 amounted to $4,721,968 and $4,336,976, respectively. Included in these amounts are contingent rentals totaling $19,952 in 2002 and $19,083 in 2001.

5. INCOME TAXES:

A reconciliation of the effective rate with the federal statutory rate is as follows:

	2002	2001
Federal statutory rate	(34.0)%	(34.0)%
State income taxes, net of federal benefit	(6.0)	(6.0)
Permanent differences	10.0	
Change in valuation allowance	30.0	40.0
Effective tax rate	%	%

Deferred tax assets consist of the following:

	2002
Net operating loss carryforwards	$ 9,826,000
Inventory reserves	548,000
Deferred rent	171,000
Accrued vacation	81,000
Excess book over tax depreciation and amortization	173,000
Other	99,000
	10,898,000
Less valuation allowance	(10,898,000)

	2002
Net deferred tax asset	$

The Company used approximately $514,000 of net operating loss carryforwards in 2002.

The Company has recorded a valuation allowance against its deferred tax assets because of the uncertainty regarding the realizability of these assets against future taxable income.

As of December 28, 2002, the Company has estimated net operating loss carryforwards of approximately $24.6 million, which expire through fiscal 2021. In accordance with Section 382 of the Internal Revenue Code, the use of these carryforwards will be subject to annual limitations based upon ownership changes of the Company's stock which may have occurred.

6. CONTRACTUAL ARRANGEMENTS:

License agreement

On December 21, 1999, the Company entered into a product license agreement with Margaritaville Holdings. Under the agreement, the Company licensed the "Margaritaville" name for use in a distinct area of the Company's website which was used for the offer and sale of Margaritaville-related products in exchange for 6% royalties on such products and warrants to purchase 550,000 shares of common stock at an exercise price of $2.88, which expire on December 21, 2004. The term of the agreement, which the Company did not renew, expired December 20, 2002. For the years ended December 28, 2002 and December 29, 2001, the Company did not incur any royalty expense associated with the sale of products which bear the "Margaritaville" name.

Fulfillment agreement

On July 8, 1999, the Company entered into a product fulfillment agreement with a direct marketer of party supplies. Under the agreement, the Company utilizes the direct marketer's inventory and fulfillment services to deliver merchandise ordered on the Company's website, or directly through a toll-free telephone number, to consumers. The initial term of the agreement expired on December 31,

2002. Effective as of December 31, 2002, the Company extended its agreement with Taymark through the earlier of (a) May 31, 2003 or (b) the execution of a new agreement with Taymark pursuant to ongoing negotiations. Under the new agreement, the Company would license the iParty.com name to Taymark and Taymark would provide billing, collection and website hosting and maintenance services in addition to the other services currently provided. Additionally, Taymark would pay to the Company a royalty on all sales realized through www.iparty.com. If this agreement were to be executed, the Company would eliminate certain fixed costs related to its Internet operation. There can be no assurance, however, that the Company and Taymark will execute this new agreement. In the event the Company does not execute this new agreement, the Company will seek another strategic partner for the Internet operation.

Earn-out agreement

As discussed in Note 1, the Company purchased from The Big Party, Debtor and Debtor-in-Possession (the "sellers") in 2000 inventory, fixed assets and the leases of 33 retail stores in consideration of cash and assumption of certain liabilities. In addition, the Company agreed to pay the sellers, no later than March 31, 2004, an amount equivalent to the greater of $250,000, or a percentage of the aggregate operating results of the 33 acquired locations. In connection with the Company's purchase accounting in 2000, the Company accrued the guaranteed amount of $250,000. As of December 28, 2002, the Company has $250,000 accrued in other liabilities in the accompanying consolidated balance sheet.

7. RELATED PARTY TRANSACTIONS:

On September 7, 1999, the Company entered into a three-year consulting agreement with one of its outside directors. Compensation under the agreement consisted of options to purchase 100,000 shares of the Company's common stock with an exercise price of $2.00. The options vest ratably over three years, provided that the director is still providing consulting services to the Company on those dates. The fair market value of the Company's stock on the grant date was $3.94. In accordance with EITF Issue No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling Goods or Services,* at the end of each financial reporting period, the value of these shares (as calculated using the Black-Scholes option pricing model) is re-measured using the then-current fair value of the Company's common stock.

On December 28, 2001, the Company terminated this consulting agreement and accelerated the vesting of the remaining options. The fair value of the options was re-measured for the last time upon termination of the agreement. The Company charged $17,754 related to this consulting agreement to stock option compensation expense in fiscal 2001.

On March 9, 2001 and April 5, 2001, the Company granted 100,000 options each to two directors for past consulting services performed on behalf of the Company. In accordance with EITF 96-18, these options were valued using the Black-Scholes options pricing model and fully expensed. The Company charged $28,648 for these consulting services to stock option compensation expense in fiscal 2001.

As described in Mr. Perisano's first employment agreement with the Company, on August 26, 1999 the Company granted Mr. Perisano, options to purchase an aggregate of 434,730 shares of the Company's common stock pursuant to the Company's stock option plan with an exercise price of $2.00, which was below the then-current market price of $3.38. As of December 29, 2001 all such options had vested. These options were fully expensed as of December 29, 2001. The Company charged $273,971 related to this stock option grant to stock option compensation expense in fiscal 2001.

8. LINE OF CREDIT:

The Company has a line of credit with Wells Fargo Retail Finance. On May 23, 2002, the Company amended its existing line of credit (the "line"). The amendment extended the term of the line through July 31, 2004, reduced the minimum interest rate from 8% to 6.5% and eliminated certain financial covenants. The amended line allows for borrowings equal to the lesser of $7,500,000, or the borrowing base, as defined. Its inventory and other assets secure the Company's line of credit. The amended line of credit generally prohibits the payment of any dividends or other distributions to any of the Company's classes of capital stock.

The amount outstanding under the Company's line of credit as of December 28, 2002 was $3,476,738. The outstanding balances under the line of credit are classified as current liabilities in the accompanying consolidated balance sheet, since the Company is required to apply daily lock-box receipts to reduce the amount outstanding. At December 28, 2002, the Company had approximately $1,500,000 of availability under the line of credit.

Interest on the amended line of credit is payable at the greater of the bank's base rate plus 1%, or 6.5%. Borrowings outstanding at December 28, 2002 accrued interest at 6.5%.

The amended agreement includes one financial covenant, which requires the Company to maintain a minimum availability under the line of credit in the amount of $300,000 at the end of each month. At December 28, 2002, the Company was in compliance with this financial covenant.

9. SPECIAL CHARGE:

On October 31, 2002, the Company issued a press release and filed a Current Report on Form 8-K to notify stockholders that the Company had incorrectly applied the anti-dilution provisions of its Series B, C and D convertible preferred stock (the "Affected Preferred Stock") in conjunction with dilutive financings in August and September 2000.

The Company determined that it inadvertently issued additional shares of Affected Preferred Stock, instead of adjusting the Affected Preferred Stock's conversion ratios. The Company also miscalculated the number of common shares issuable upon conversion of the Affected Preferred Stock.

The Company also reviewed the anti-dilution provisions of certain of its warrants to purchase common stock that were issued in conjunction with the Affected Preferred Stock (the "Affected Warrants"), and has determined that it mistakenly issued additional warrant certificates, instead of adjusting the Affected Warrants' conversion ratios. The warrant calculations also mistakenly omitted the dilutive effect of a warrant issued by the Company in December 1999.

The Company has performed the calculations to compute the correct number of shares of Affected Preferred Stock and Affected Warrants that should be issued and outstanding as of December 28, 2002, along with the appropriate conversion ratios in effect at December 28, 2002. The Company has notified each holder of Affected Preferred Stock as of December 2, 2002. The Company has also instructed its transfer agent to apply any Affected Stock conversions using the corrected ratios and prices. The Company has presented its balance sheet, earnings per share and all footnotes information for 2002, in accordance with the corrected information. The accounting implications of this situation are as follows:

Beginning in September 2000, the Company believed and treated holders of Affected Preferred Stock as if they were entitled to approximately 2.3 million more common shares upon conversion of their Affected Preferred Stock than they were in fact entitled to. Of this overstated amount, since October 2000, 590,327 common shares have been issued upon conversions of shares of Affected Preferred Stock and sold in the public market (the "Overissued Shares"). On October 31, 2002, the Company's Board of Directors ratified the issuance of the Overissued Shares.

Beginning in September 2000, the Company believed and treated holders of Affected Warrants as if they were entitled to 116,291 fewer common shares upon exercise of their Affected Warrants than they were in fact entitled to. None of the Affected Warrants have been exercised to date.

The impact of these matters has not required the Company to make any changes to its previously reported earnings per share. The impact of the common stock equivalents did not affect quarterly or annual diluted loss per share, since such the inclusion of such shares would have been anti-dilutive. The impact of common stock equivalents did not impact quarterly diluted net income per share in such periods of profit, given the minimal amount of net income in comparison to the weighted-average shares outstanding.

The Company has recorded a special charge for the year ended December 28, 2002 in the amount of $396,465, which includes a non-cash charge of $171,465 for the recognition of the Overissued Shares, and $225,000 of professional fees incurred through December 28, 2002.

The Company also recorded a beneficial conversion dividend in the amount of $90,150 in the fourth quarter, which reflects the impact of anti-dilution adjustments to the conversion ratios of the Series E and F convertible preferred stock.

The following table summarizes the changes in the number of shares of convertible preferred stock during the past fiscal year.

	Shares Historically Reported as Issued and Outstanding as of 12/29/01	**Conversions to Common Stock**	**Adjustments**	**Shares Issued and Outstanding as of 12/28/02**
Series A Convertible Preferred Stock	1,000,000			1,000,000
Series B Convertible Preferred Stock	1,118,559	(119,786)	(313,974)	684,799
Series C Convertible Preferred Stock	145,198		(45,198)	100,000
Series D Convertible Preferred Stock	362,996		(112,996)	250,000
Series E Convertible Preferred Stock	533,333	(66,666)		466,667
Series F Convertible Preferred Stock	114,286			114,286
Total	3,274,372	(186,452)	(472,168)	2,615,752

10. PREFERRED STOCK:

Series A Convertible Preferred Stock

The shares of Series A convertible preferred stock are immediately convertible into 1,000,000 shares of common stock on a 1.00 to 1.00 ratio at December 28, 2002, and carry an aggregate liquidation value of $1,000,000 ($1.00 per share) at December 28, 2002. Holders of Series A convertible preferred stock have a liquidation preference senior to the Company's common stockholders, and are *pari passu* with the Company's Series B, C, D, E and F convertible preferred stock. Holders of Series A convertible preferred stock are not entitled to any dividends.

Holders of Series A convertible preferred stock vote on an as-if-converted basis on all matters submitted to a vote of the Company's stockholders.

Series B Convertible Preferred Stock

The shares of Series B convertible preferred stock are immediately convertible into 8,813,368 shares of common stock on a 1.000 to 12.870 ratio at December 28, 2002, and carry an aggregate liquidation value of $13,695,973 ($1.55 per share) at December 28, 2002. With certain exceptions, the

conversion price will be adjusted on a weighted-average basis in the event the Company issues common stock or certain rights to purchase or convert into common stock as defined in the Company's Certificate of Incorporation as amended at a price below the conversion price. The Series B convertible preferred stock will automatically convert into common stock at the conversion price then in effect in the event the Company consummates a secondary public offering resulting in gross proceeds to the Company of at least $10,000,000.

In the event of liquidation, the holders of Series B convertible preferred stock have preference to holders of the Company's common stock, and are pari passu with the Company's Series A, C, D, E and F convertible preferred stock.

Holders of Series B convertible preferred stock vote on an as-if-converted basis on all matters submitted to a vote of the Company's stockholders.

Series C Convertible Preferred Stock

The shares of Series C convertible preferred stock are immediately convertible into 1,310,600 shares of common stock on a 1.000 to 13.106 ratio at December 28, 2002, and carry an aggregate liquidation value of $2,000,000 ($1.53 per share) at December 28, 2002. With certain exceptions, the conversion price will be adjusted on a weighted-average basis in the event the Company issues common stock or certain rights to purchase or convert into common stock as defined in the Company's Preferred Stock Charter at a price below the conversion price. The Series C convertible preferred stock will automatically convert into common stock at the conversion price then in effect in the event the Company consummates a secondary public offering resulting in gross proceeds to the Company of at least $10,000,000.

In the event of liquidation, the holders of Series C convertible preferred stock have preference to holders of the Company's common stock, and are pari passu with the Company's Series A, B, D, E and F convertible preferred stock.

Holders of Series C convertible preferred stock vote on an as-if-converted basis on all matters submitted to a vote of the Company's stockholders.

Series D Convertible Preferred Stock

The shares of Series D convertible preferred stock are immediately convertible into 3,513,750 shares of common stock on a 1.000 to 14.055 ratio at December 28, 2002, and carry an aggregate liquidation value of $5,000,000 ($1.42 per share) at December 28, 2002. With certain exceptions, the conversion price will be adjusted on a weighted-average basis in the event the Company issues common stock or certain rights to purchase or convert into common stock as defined in the Company's Preferred Stock Charter at a price below the conversion price. The Series D convertible preferred stock will automatically convert into common stock at the conversion price then in effect in the event the Company consummates a secondary public offering resulting in gross proceeds to the Company of at least $10,000,000.

In the event of liquidation, the holders of Series D convertible preferred stock have preference to holders of the Company's common stock, and are pari passu with the Company's Series A, B, C, E and F convertible preferred stock.

Holders of Series D convertible preferred stock vote on an as-if-converted basis on all matters submitted to a vote of the Company's stockholders.

Series E Convertible Preferred Stock

The shares of Series E convertible preferred stock are immediately convertible into 4,858,137 shares of common stock on a 1.000 to 10.359 ratio at December 28, 2002, and carry an aggregate liquidation value of $1,750,000 ($0.36 per share) at December 28, 2002. With certain exceptions, the conversion price will be adjusted on a weighted-average basis in the event the Company issues common stock or certain rights to purchase or convert into common stock as defined in the Company's Preferred Stock Charter at a price below the conversion price. The Series E convertible preferred stock will automatically convert into common stock at the conversion price then in effect in the event the average closing bid price of the common stock equals or exceeds $10.00 per share for 20 consecutive trading days within a period of 30 consecutive trading days.

In the event of liquidation, the holders of Series E convertible preferred stock have preference to holders of the Company's common stock, and are pari passu with the Company's Series A, B, C, D and F convertible preferred stock.

Holders of Series E convertible preferred stock vote on an as-if-converted basis on all matters submitted to a vote of the Company's stockholders.

Series F Convertible Preferred Stock

The shares of Series F convertible preferred stock are immediately convertible into 1,184,803 shares of common stock on a 1.000 to 10.367 ratio at December 28, 2002, and carry an aggregate liquidation value of $500,000 ($0.42 per share) at December 28, 2002. With certain exceptions, the conversion price will be adjusted on a weighted-average basis in the event the Company issues common stock or certain rights to purchase or convert into common stock as defined in the Company's Preferred Stock Charter at a price below the conversion price. The Series F convertible preferred stock will automatically convert into common stock at the conversion price then in effect in the event the average closing bid price of the common stock equals or exceeds $10.00 per share for 20 consecutive trading days within a period of 30 consecutive trading days.

In the event of liquidation, the holders of Series F convertible preferred stock have preference to holders of the Company's common stock, and are pari passu with the Company's Series A, B, C, D and E convertible preferred stock.

Holders of Series F preferred stock vote on an as-if-converted basis on all matters submitted to a vote of the Company's stockholders.

Liquidation Feature of Series A-F Convertible Preferred Stock

The holders of Series A-F convertible preferred stock have the right to a liquidation preference, which may be exercised by the preferred stockholders under certain events outside of the Company's control. In accordance with EITF Topic D-98, the Company has included the respective equity securities outside of permanent stockholders' deficit in the accompanying balance sheet as of December 28, 2002 at their respective carrying values. The carrying values have been determined based on their fair market values at the original dates of issuance. In certain cases, warrants were issued, which the Company allocated value to and included in additional paid in capital. In the event such a liquidation event occurs, the difference between the carrying value of the convertible preferred stock and their liquidation value will be accreted. This amount was $5.4 million on December 28, 2002.

11. WARRANTS:

At December 28, 2002, there were several warrants outstanding for shares of the Company's common stock. These warrants were issued in connection with certain Preferred Stock financings and certain licensing and marketing arrangements. Substantially all of the warrant agreements contain

certain anti-dilution provisions, which protect the warrant holders against dilution upon the occurrence of certain events, including the sale of common stock or certain rights to purchase or convert into common stock, as defined in the warrant agreement for less than fair market value or less than the exercise price of the previously issued warrants. If such event occurs, this can result in additional shares being available to the warrant holder and a reduction in the exercise price for each share.

The following table summarizes the Company's outstanding warrants, including the impact of anti-dilution events which occurred in previous years, at December 28, 2002:

	Exercise Price	Expiration Date

Warrant Shares	Exercisable into Common Shares		
528,210	528,210	$2.63 - $5.13	04/16/09-08/15/09
5,244,760	8,359,616	$1.25	8/26/05
500,000	800,000	$1.25	8/26/05
929,929	1,487,886	$1.25	8/26/05
1,250,000	1,837,500	$1.36	8/26/05
550,000	550,000	$2.88	12/21/04
9,002,899	13,563,212	$1.43	

Commencing one year from the issue date, the Company may, on a 30-day notice, redeem certain common stock warrants at a price of $0.05 per warrant if the average close bid price of the common stock equals or exceeds $8.00 per share for 20 consecutive trading days within a period of 30 consecutive trading days.

12. STOCK OPTION PLAN:

Under the Company's Amended and Restated 1998 Incentive and Nonqualified Stock Option Plan (the "1998 Plan") options to acquire 11,000,000 shares of common stock may be granted to officers, directors, key employees and consultants. The exercise price for qualified incentive options cannot be less than the fair market value of the stock on the grant date and the exercise price of nonqualified options can be fixed by the Board. Qualified incentive options to purchase the Company's common stock under the 1998 Plan have been granted to employees, directors and consultants of the Company at fair market value at the date of grant. Generally, the options become exercisable over periods up to four years, and expire ten years from the date of grant.

A summary of the Company's stock options is as follows:

	Shares	Weighted-Average Exercise Price	Price Range
Outstanding December 30, 2000	4,646,177	$ 1.99	$0.10 - $5.38
Granted	4,076,597	$ 0.25	$0.10 - $0.48
Canceled	(1,199,810)	$ 1.84	$0.10 - $5.25
Outstanding December 29, 2001	7,522,964	$ 1.07	$0.10 - $5.38
Granted	863,457	$ 0.33	$0.21 - $0.67
Exercised	(9,375)	$ 0.50	$0.50 - $0.50
Canceled	(133,862)	$ 0.31	$0.10 - $0.50
Outstanding December 28, 2002	8,243,184	$ 1.01	$0.11 - $5.38
Available for grant December 28,2002	2,412,441		
Exercisable December 28, 2002	5,181,612	$ 1.37	$0.11 - $5.38

The following table summarizes information for options outstanding and exercisable at December 28, 2002:

	Options Outstanding	Options Exercisable
Price Range	Shares	Shares

	Options Outstanding			Options Exercisable	
		Average Remaining Life	Weighted-Average Exercise Price		Weighted-Average Exercise Price
$0.10 - $0.20	228,540	8.2	$ 0.18	114,288	$ 0.17
$0.21 - $0.30	3,782,427	8.6	$ 0.25	2,024,984	$ 0.25
$0.31 - $0.45	1,016,570	9.1	$ 0.33	284,888	$ 0.33
$0.46 - $0.68	95,390	7.8	$ 0.51	49,925	$ 0.50
$0.69 - $0.99	1,006,527	7.4	$ 0.69	650,049	$ 0.69
$1.00 - $1.53	125,000	3.5	$ 1.09	125,000	$ 1.09
$1.54 - $2.30	659,730	5.9	$ 1.99	659,730	$ 1.99
$2.31 - $3.45	305,000	4.6	$ 2.85	305,000	$ 2.85
$3.46 - $5.38	1,024,000	3.9	$ 3.81	967,748	$ 3.81
Total	8,243,184		$ 1.01	5,181,612	$ 1.37

13. STOCKHOLDER RIGHTS PLAN:

The Company has a Stockholder Rights Plan (the "Plan") effective November 9, 2001. Under the Plan each share of the Company's capital stock outstanding at the close of business on November 9, 2001 and each share of the Company's capital stock issued subsequent to that date has a right associated with it, such that each share of its common stock is entitled to one right and each share of its preferred stock is entitled to such number of rights equal to the number of common shares into which it is convertible.

The rights are exercisable only in the event, with certain exceptions, an acquiring party accumulates ten percent or more of the Company's voting stock, or if a party announces an offer to acquire 15 percent or more of the Company's voting stock and the rights expire on November 9, 2011.

When exercisable, each right entitles the holder to purchase from the Company, one one-hundredth of a share of a new series of Series G Junior Preferred Stock at an initial purchase price of $2.00. In addition, upon the occurrence of certain events, holders of the rights will be entitled

to purchase either iParty Corp. stock or shares in an "acquiring entity" at half of market value. The Company generally will be entitled to redeem the rights at $0.001 per right at any time until the date on which a ten percent position in its voting stock is acquired by any person or group. Until a right is exercised, the holder thereof, as such, will have no rights as a shareholder of the Company, including, without limitation, the right to vote or receive dividends.

14. PROFIT SHARING 401(k) PLAN:

The iParty 401(k) Plan is a qualified profit sharing plan covering substantially all of its employees. Contributions to this plan are at the discretion of the Board of Directors. The Company's expense, including matching contributions and any discretionary amounts for the years ended December 28, 2002 and December 29, 2001, was $88,532 and $43,893, respectively.

15. SEGMENT REPORTING:

SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*, establishes standards for the way business enterprises report information about operating segments in annual financial statements and requires that those enterprises report selected information about operating segments in interim financial reports issued to stockholders.

Operating segments represent components of the Company's business that are evaluated regularly by management in assessing the performance and resource allocation. The Company has determined that its reportable segments consist of a retail stores operation and an Internet operation.

The reporting segments follow the same accounting policies used for the Company's consolidated financial statements and are described in the summary of significant accounting policies. Management evaluates a segment's performance based upon net revenue, operating income (loss) and net income (loss). Inter-segment transactions are uncommon and not material. Therefore, they have not been separately reflected in the financial table below. The totals of the reportable segments' revenues, net profits and assets agree with the Company's comparable amount contained in the audited financial statements. Revenues from customers outside of the United States are not material. No one customer accounts for more than ten percent of the Company's consolidated revenues.

Segment data is as follows:

	For the year ended December 28, 2002		
	Internet	Retail Stores	Total
Net revenue	$ 630,602	$ 51,547,321	$ 52,177,923
Operating income (loss)	$ (660,652)	$ 247,936	$ (412,716)
Net loss	$ (664,200)	$ (20,369)	$ (684,569)
Total assets	$ 98,642	$ 13,717,241	$ 13,815,883
Depreciation and amortization	$ 238,813	$ 394,360	$ 633,173
Capital expenditures	$	$ 775,147	$ 775,147

	For the year ended December 29, 2001		
	Internet	Retail Stores	Total
Net revenue	$ 914,469	$ 47,068,935	$ 47,983,404
Operating income (loss)	$ (1,172,367)	$ (999,607)	$ (2,171,974)
Net loss	$ (1,075,900)	$ (1,360,406)	$ (2,436,306)
Total assets	$ 2,721,046	$ 11,812,172	$ 14,533,218
Depreciation and amortization	$ 433,978	$ 182,685	$ 616,663
Capital expenditures	$ 2,025	$ 208,713	$ 210,738

SIGNATURES

IN ACCORDANCE WITH SECTION 13 OR 15(D) OF THE EXCHANGE ACT, THE REGISTRANT CAUSED THIS REPORT TO BE SIGNED ON ITS BEHALF BY THE UNDERSIGNED, THEREUNTO DULY AUTHORIZED.

iPARTY CORP.

By: /s/ SAL PERISANO

Sal Perisano
Chief Executive Officer and Principal Executive Officer

Dated: August 11, 2003

IN ACCORDANCE WITH THE EXCHANGE ACT, THIS REPORT HAS BEEN SIGNED BELOW BY THE FOLLOWING PERSONS ON BEHALF OF THE REGISTRANT AND IN THE CAPACITIES AND ON THE DATES INDICATED.

SIGNATURE	TITLE	DATE
/s/ SAL PERISANO Sal Perisano	Chief Executive Officer, Principal Executive Officer and Director	August 11, 2003
/s/ ROBERT LESSIN Robert Lessin	Director	August 11, 2003
Lorenzo Roccia	Director	
/s/ CHRISTINA WEAVER Christina Weaver	Director	August 11, 2003
/s/ PATRICK FARRELL Patrick Farrell	President, Chief Financial Officer and Principal Financial Officer	August 11, 2003

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