
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

AMENDMENT NO. 1 TO

FORM 10-Q/A

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

For the quarterly period ended June 30, 2003

Commission File Number 000-30229

SONUS NETWORKS, INC.

(Exact name of Registrant as specified in its charter)

DELAWARE

(State or other jurisdiction of
incorporation or organization)

04-3387074

(I.R.S. employer identification no.)

250 Apollo Drive, Chelmsford, Massachusetts 01824
(Address of principal executive offices, including zip code)

(978) 614-8100

(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

As of July 31, 2003, there were 225,991,433 shares of \$0.001 par value per share, common stock outstanding.

EXPLANATORY NOTE

As reported in our 2003 Annual Report on Form 10-K/A filed with the Securities and Exchange Commission (SEC) on July 28, 2004, we have restated our consolidated financial statements for the years ended December 31, 2002 and 2001 and the nine months ended September 30, 2003. We also reported in our 2003 Annual Report on Form 10-K/A that we anticipated amending our previously filed quarterly reports for each of the first three quarters of 2003. This Amendment No. 1 on Form 10-Q/A to our Quarterly Report on Form 10-Q for the quarter ended June 30, 2003, filed with the SEC on August 14, 2003, is being filed for the purpose of restating our condensed consolidated financial statements and related disclosures for the three and six months ended June 30, 2003 and 2002 under Item 1 of Part I; and restating Items 2 and 4 of Part I as well as Item 6 of Part II, consistent with the restatement-related adjustments described in our 2003 Annual Report filed on Form 10-K/A with the SEC on July 28, 2004.

This Amendment No. 1 on Form 10-Q/A does not reflect events occurring after the filing of the original Quarterly Report on Form 10-Q on August 14, 2003, or modify or update the disclosure presented in the original Quarterly Report on Form 10-Q, except to reflect the revisions as described above.

**SONUS NETWORKS, INC.
AMENDMENT NO. 1 ON FORM 10-Q/A
QUARTER ENDED JUNE 30, 2003**

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PART I—FINANCIAL INFORMATION

Item 1: Financial Statements

SONUS NETWORKS, INC.
Condensed Consolidated Balance Sheets
(In thousands, except share data)

	<u>June 30, 2003</u> (As Restated) (Unaudited)	<u>December 31, 2002</u>
Assets		
Current assets:		
Cash and cash equivalents	\$ 116,773	\$ 57,278
Marketable securities	45,875	60,860
Accounts receivable, net	11,004	4,622
Inventory, net	15,406	10,449
Other current assets	7,152	3,516
	<u>196,210</u>	<u>136,725</u>
Property and equipment, net	7,740	11,546
Purchased intangible assets, net	3,606	4,810
Other assets	300	436
	<u>\$ 207,856</u>	<u>\$ 153,517</u>
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 3,927	\$ 3,625
Accrued expenses	15,273	16,489
Accrued restructuring expenses	1,204	2,331
Current portion of deferred revenue	66,741	51,728
Current portion of long-term liabilities	1,431	1,606
	<u>88,576</u>	<u>75,779</u>
Long-term deferred revenue, less current portion	8,423	8,024
Long-term liabilities, less current portion	2,200	3,293
Convertible subordinated note	10,000	10,000
Commitments and contingencies (Note 9)		
Stockholders' equity:		
Preferred stock, \$0.01 par value; 5,000,000 shares authorized, none issued and outstanding	—	—
Common stock, \$0.001 par value; 600,000,000 shares authorized, 227,741,148 and 206,866,358 shares issued and 225,454,238 and 204,599,548 shares outstanding at June 30, 2003 and December 31, 2002	228	207
Capital in excess of par value	911,005	853,560
Accumulated deficit	(810,434)	(793,426)
Deferred compensation	(1,876)	(3,659)
Treasury stock, at cost; 2,286,910 and 2,266,810 common shares at June 30, 2003 and December 31, 2002	(266)	(261)
	<u>98,657</u>	<u>56,421</u>
	<u>\$ 207,856</u>	<u>\$ 153,517</u>

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

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(In thousands, except per share data)
(Unaudited and As Restated)

	<u>Three Months ended June 30,</u>		<u>Six Months ended June 30,</u>	
	2003	2002	2003	2002
Revenues:				
Product	\$ 8,255	\$ 46,110	\$ 11,772	\$ 59,229
Service	7,111	5,665	12,803	13,054
Total revenues	<u>15,366</u>	<u>51,775</u>	<u>24,575</u>	<u>72,283</u>
Cost of revenues (1):				
Product	3,896	16,638	5,434	23,576
Service	3,369	3,022	5,924	6,007
Write-off of inventory and purchase commitments	—	—	—	6,865
Total cost of revenues	<u>7,265</u>	<u>19,660</u>	<u>11,358</u>	<u>36,448</u>
Gross profit	<u>8,101</u>	<u>32,115</u>	<u>13,217</u>	<u>35,835</u>
Operating expenses:				
Research and development (1)	8,504	11,165	16,209	26,096
Sales and marketing (1)	4,476	9,417	8,447	16,876
General and administrative (1)	1,456	1,192	3,295	3,779
Stock-based compensation	645	4,918	1,569	11,717
Amortization of purchased intangible assets	602	1,190	1,204	2,380
Restructuring charges, net	—	1,013	—	5,765
Total operating expenses	<u>15,683</u>	<u>28,895</u>	<u>30,724</u>	<u>66,613</u>
Income (loss) from operations	<u>(7,582)</u>	<u>3,220</u>	<u>(17,507)</u>	<u>(30,778)</u>
Interest expense	(148)	(136)	(278)	(275)
Interest income	461	512	842	1,104
Income (loss) before income taxes	<u>(7,269)</u>	<u>3,596</u>	<u>(16,943)</u>	<u>(29,949)</u>
Provision for income taxes	32	21	65	43
Net income (loss)	<u>\$ (7,301)</u>	<u>\$ 3,575</u>	<u>\$ (17,008)</u>	<u>\$ (29,992)</u>
Net income (loss) per share:				
Basic	<u>\$ (0.03)</u>	<u>\$ 0.02</u>	<u>\$ (0.08)</u>	<u>\$ (0.16)</u>
Diluted	<u>\$ (0.03)</u>	<u>\$ 0.02</u>	<u>\$ (0.08)</u>	<u>\$ (0.16)</u>

Shares used in computing net income (loss) per share (Note

3(p)):				
Basic	<u>215,970</u>	<u>190,540</u>	<u>207,483</u>	<u>188,825</u>
Diluted	<u>215,970</u>	<u>200,509</u>	<u>207,483</u>	<u>188,825</u>

(1) Excludes non-cash, stock-based compensation expense as follows:

Cost of revenues	\$ 10	\$ 246	\$ 22	\$ 364
Research and development	252	2,763	629	6,325
Sales and marketing	274	1,589	679	3,661
General and administrative	109	320	239	1,367
	<u>\$ 645</u>	<u>\$ 4,918</u>	<u>\$ 1,569</u>	<u>\$ 11,717</u>

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

SONUS NETWORKS, INC.
Condensed Consolidated Statements of Cash Flows
(In thousands)
(Unaudited and As Restated)

	<u>Six Months ended June 30,</u>	
	2003	2002
Cash flows from operating activities:		
Net loss	\$ (17,008)	\$ (29,992)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	5,465	8,148
Write-off of inventory	—	6,865

Stock-based compensation	1,569	11,717
Amortization of purchased intangible assets	1,204	2,380
Changes in current assets and liabilities:		
Accounts receivable	(6,382)	2,054
Inventory	(4,957)	19,739
Other current assets	(3,636)	4,269
Accounts payable	302	(8,096)
Accrued expenses	(2,764)	(6,951)
Deferred revenue	15,412	(30,352)
Net cash used in operating activities	(10,795)	(20,219)
Cash flows from investing activities:		
Purchases of property and equipment	(1,659)	(2,072)
Maturities of marketable securities	19,682	26,701
Purchases of marketable securities	(4,697)	(14,739)
Other assets	136	(6)
Net cash provided by investing activities	13,462	9,884
Cash flows from financing activities:		
Net proceeds from sale of common stock to public	56,730	—
Sale of common stock in connection with employee stock purchase plan	447	2,304
Proceeds from exercise of stock options	503	99
Payments of long-term liabilities	(847)	(290)
Repurchase of common stock	(5)	(119)
Net cash provided by financing activities	56,828	1,994
Net increase (decrease) in cash and cash equivalents	59,495	(8,341)
Cash and cash equivalents, beginning of period	57,278	49,069
Cash and cash equivalents, end of period	\$ 116,773	\$ 40,728
Supplemental disclosure of cash flow information:		
Cash paid during the period for interest	\$ 278	\$ 275

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

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SONUS NETWORKS, INC.
Notes to Condensed Consolidated Financial Statements
(Unaudited)

(1) Description of Business

Sonus Networks, Inc. (Sonus) was incorporated on August 7, 1997 and is a leading provider of packet voice infrastructure solutions for wireline and wireless service providers. Sonus offers a new generation of carrier-class switching equipment and software that enable telecommunications service providers to deliver voice services over packet-based networks.

(2) Restatement of Consolidated Financial Statements

As reported in Sonus' 2003 Annual Report on Form 10-K/A filed with the SEC on July 28, 2004, Sonus has restated its consolidated financial statements for the years ended December 31, 2002 and 2001 and the nine months ended September 30, 2003. Sonus also reported in its 2003 Annual Report on Form 10-K/A that it anticipated amending its previously filed quarterly reports for each of the first three quarters of 2003. Sonus has filed this Amendment No. 1 on Form 10-Q/A to its Quarterly Report on Form 10-Q for the quarter ended June 30, 2003, filed with the SEC on August 14, 2003, for the purpose of restating its condensed consolidated financial statements and related disclosures for the three and six months ended June 30, 2003 and 2002. Amounts disclosed with respect to the December 31, 2002 balance sheet have previously been restated in our Form 10-K/A filed with the SEC on July 28, 2004 and are not reported as restated herein.

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The following summarizes the effects of the restatement adjustments on various line items of Sonus' condensed consolidated statements of operations for the three and six months ended June 30, 2003 and 2002.

Condensed Consolidated Statements of Operations
(In thousands, except per share data)
(Unaudited)

Three Months Ended June 30, 2003			Six Months Ended June 30, 2003		
As Reported	Adjustments	As Restated	As Reported	Adjustments	As Restated

Revenues:												
Product	\$	14,929	\$	(6,674)	\$	8,255	\$	26,056	\$	(14,284)	\$	11,772
Service		<u>6,427</u>		<u>684</u>		<u>7,111</u>		<u>11,319</u>		<u>1,484</u>		<u>12,803</u>
Total revenues		<u>21,356</u>		<u>(5,990)</u>		<u>15,366</u>		<u>37,375</u>		<u>(12,800)</u>		<u>24,575</u>
Cost of revenues:												
Product		5,662		(1,766)		3,896		8,892		(3,458)		5,434
Service		3,131		238		3,369		6,066		(142)		5,924
Write-off (benefit) of inventory and purchase commitments		<u>—</u>		<u>—</u>		<u>—</u>		<u>(735)</u>		<u>735</u>		<u>—</u>
Total cost of revenues		<u>8,793</u>		<u>(1,528)</u>		<u>7,265</u>		<u>14,223</u>		<u>(2,865)</u>		<u>11,358</u>
Gross profit		<u>12,563</u>		<u>(4,462)</u>		<u>8,101</u>		<u>23,152</u>		<u>(9,935)</u>		<u>13,217</u>
Operating expenses:												
Research and development		8,245		259		8,504		15,947		262		16,209
Sales and marketing		5,643		(1,167)		4,476		10,917		(2,470)		8,447
General and administrative		1,188		268		1,456		2,268		1,027		3,295
Stock-based compensation		739		(94)		645		1,633		(64)		1,569
Amortization of purchased intangible assets		<u>271</u>		<u>331</u>		<u>602</u>		<u>542</u>		<u>662</u>		<u>1,204</u>
Total operating expenses		<u>16,086</u>		<u>(403)</u>		<u>15,683</u>		<u>31,307</u>		<u>(583)</u>		<u>30,724</u>
Loss from operations		<u>(3,523)</u>		<u>(4,059)</u>		<u>(7,582)</u>		<u>(8,155)</u>		<u>(9,352)</u>		<u>(17,507)</u>
Interest expense		(148)		—		(148)		(278)		—		(278)
Interest income		461		—		461		842		—		842
Loss before income taxes		<u>(3,210)</u>		<u>(4,059)</u>		<u>(7,269)</u>		<u>(7,591)</u>		<u>(9,352)</u>		<u>(16,943)</u>
Provision for income taxes		<u>—</u>		<u>32</u>		<u>32</u>		<u>—</u>		<u>65</u>		<u>65</u>
Net loss	\$	<u>(3,210)</u>	\$	<u>(4,091)</u>	\$	<u>(7,301)</u>	\$	<u>(7,591)</u>	\$	<u>(9,417)</u>	\$	<u>(17,008)</u>
Basic and diluted net loss per share	\$	<u>(0.01)</u>	\$	<u>(0.02)</u>	\$	<u>(0.03)</u>	\$	<u>(0.04)</u>	\$	<u>(0.04)</u>	\$	<u>(0.08)</u>
Shares used in computing net loss per share												
		<u>215,970</u>		<u>—</u>		<u>215,970</u>		<u>207,483</u>		<u>—</u>		<u>207,483</u>

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	Three Months Ended June 30, 2002			Six Months Ended June 30, 2002								
	As Reported	Adjustments	As Restated	As Reported	Adjustments	As Restated						
Revenues:												
Product	\$	16,247	\$	29,863	\$	46,110	\$	31,634	\$	27,595	\$	59,229
Service		<u>5,048</u>		<u>617</u>		<u>5,665</u>		<u>10,819</u>		<u>2,235</u>		<u>13,054</u>
Total revenues		<u>21,295</u>		<u>30,480</u>		<u>51,775</u>		<u>42,453</u>		<u>29,830</u>		<u>72,283</u>
Cost of revenues:												
Product		7,038		9,600		16,638		13,906		9,670		23,576
Service		2,910		112		3,022		5,917		90		6,007
Write-off of inventory and purchase commitments		<u>—</u>		<u>—</u>		<u>—</u>		<u>9,434</u>		<u>(2,569)</u>		<u>6,865</u>
Total cost of revenues		<u>9,948</u>		<u>9,712</u>		<u>19,660</u>		<u>29,257</u>		<u>7,191</u>		<u>36,448</u>
Gross profit		<u>11,347</u>		<u>20,768</u>		<u>32,115</u>		<u>13,196</u>		<u>22,639</u>		<u>35,835</u>
Operating expenses:												
Research and development		12,225		(1,060)		11,165		26,840		(744)		26,096
Sales and marketing		8,280		1,137		9,417		16,687		189		16,876
General and administrative		1,691		(499)		1,192		3,157		622		3,779
Stock-based compensation		5,949		(1,031)		4,918		11,692		25		11,717
Amortization of purchased intangible assets		<u>383</u>		<u>807</u>		<u>1,190</u>		<u>789</u>		<u>1,591</u>		<u>2,380</u>
Restructuring charges (benefit), net		<u>1,013</u>		<u>—</u>		<u>1,013</u>		<u>(11,128)</u>		<u>16,893</u>		<u>5,765</u>
Total operating expenses		<u>29,541</u>		<u>(646)</u>		<u>28,895</u>		<u>48,037</u>		<u>18,576</u>		<u>66,613</u>
Income (loss) from operations		<u>(18,194)</u>		<u>21,414</u>		<u>3,220</u>		<u>(34,841)</u>		<u>4,063</u>		<u>(30,778)</u>
Interest expense		(136)		—		(136)		(275)		—		(275)
Interest income		512		—		512		1,104		—		1,104
Income (loss) before income taxes		<u>(17,818)</u>		<u>21,414</u>		<u>3,596</u>		<u>(34,012)</u>		<u>4,063</u>		<u>(29,949)</u>
Provision for income taxes		<u>—</u>		<u>21</u>		<u>21</u>		<u>—</u>		<u>43</u>		<u>43</u>
Net income (loss)	\$	<u>(17,818)</u>	\$	<u>21,393</u>	\$	<u>3,575</u>	\$	<u>(34,012)</u>	\$	<u>4,020</u>	\$	<u>(29,992)</u>

Net income (loss) per share:												
Basic	\$	(0.09)	\$	0.11	\$	0.02	\$	(0.18)	\$	0.02	\$	(0.16)
Diluted	\$	(0.09)	\$	0.11	\$	0.02	\$	(0.18)	\$	0.02	\$	(0.16)
Shares used in computing net income (loss) per share:												
Basic		189,183		1,357		190,540		187,593		1,232		188,825
Diluted		189,183		11,326		200,509		187,593		1,232		188,825

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The following summarizes the effects of the restatement adjustments on various line items of Sonus' condensed consolidated balance sheet as of June 30, 2003.

Condensed Consolidated Balance Sheet
June 30, 2003
(In thousands)
(Unaudited)

	<u>As Reported</u>	<u>Adjustments</u>	<u>As Restated</u>
Assets			
Current assets:			
Cash and cash equivalents	\$ 115,189	\$ 1,584	\$ 116,773
Marketable securities	45,875	—	45,875
Accounts receivable, net	6,076	4,928	11,004
Inventory, net	11,552	3,854	15,406
Other current assets	6,464	688	7,152
Total current assets	185,156	11,054	196,210
Property and equipment, net	7,271	469	7,740
Purchased intangible assets, net	632	2,974	3,606
Other assets	365	(65)	300
	<u>\$ 193,424</u>	<u>\$ 14,432</u>	<u>\$ 207,856</u>
Liabilities and Stockholders' Equity			
Current liabilities:			
Accounts payable	\$ 4,655	\$ (728)	\$ 3,927
Accrued expenses	31,299	(16,026)	15,273
Accrued restructuring expenses	1,204	—	1,204
Current portion of deferred revenue	34,182	32,559	66,741
Current portion of long-term liabilities	1,431	—	1,431
Total current liabilities	72,771	15,805	88,576
Long-term deferred revenue, less current portion	—	8,423	8,423
Long-term liabilities, less current portion	2,200	—	2,200
Convertible subordinated note	10,000	—	10,000
Commitments and contingencies			
Stockholders' equity:			
Preferred stock	—	—	—
Common stock	228	—	228
Capital in excess of par value	915,698	(4,693)	911,005
Accumulated deficit	(805,459)	(4,975)	(810,434)
Deferred compensation	(1,748)	(128)	(1,876)
Treasury stock, at cost	(266)	—	(266)
Total stockholders' equity	108,453	(9,796)	98,657
	<u>\$ 193,424</u>	<u>\$ 14,432</u>	<u>\$ 207,856</u>

These restated financial statements include a number of adjustments, which primarily relate to revenue, deferred revenue, inventory reserves, purchase accounting, accrued expenses and stock-based compensation. Adjustments to revenue result primarily in revenue being deferred and recognized in subsequent periods. Adjustments to inventory and accrued expenses are primarily to increase or decrease reserve levels previously reported. Adjustments to purchase accounting and stock-based compensation relate primarily to the timing of expense recognition. The following discussion provides additional information regarding these adjustments.

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Revenue Adjustments

Deferral of product revenue

Sonus has deferred revenues of \$36.7 million previously reported in 2001 and the first quarter of 2002 from a particular customer transaction. The amount of \$27.5 million was subsequently recognized in the second quarter of 2002, while the remainder was allocated to maintenance revenue and

recognized over the period the services are provided. This transaction involved a complex multiple element arrangement that required significant analysis with respect to the facts surrounding the transaction and technical accounting analysis to determine when revenue should be recognized. Sonus previously recognized revenue in 2001 under this contractual arrangement upon delivery and acceptance of certain product and software releases. As a result of a comprehensive review and analysis of this arrangement, and based on the application of complex revenue recognition guidance, Sonus has now determined that there was insufficient support to establish vendor specific objective evidence of fair value (VSOE) with respect to certain undelivered software releases and Sonus has determined the existence of certain previously unidentified specified software releases. As a result, Sonus has deferred product revenues associated with products and software releases shipped to this customer in 2001 and the first quarter of 2002 until the second quarter of 2002, when all software releases under the arrangement were delivered.

In the fourth quarter of 2002, Sonus amended its arrangement with this customer to include, among other items, certain additional future software releases. Sonus previously recognized revenue from this arrangement in the fourth quarter of 2002 and in each of the first three quarters of 2003 upon delivery of the products and software releases. Upon review and analysis of the arrangement, Sonus has determined that, based on a technical analysis of software revenue recognition rules, that VSOE was not established for certain undelivered software releases. As a result, Sonus has deferred revenues of \$16.2 million associated with products and software releases shipped to this customer during the fourth quarter of 2002 and the first three quarters of 2003, including the deferral of \$6.3 million and \$12.4 million of products and software releases shipped during the three and six months ended June 30, 2003. Sonus recognized \$10.9 million of those revenues in the fourth quarter of 2003 when the final software release specified in the amendment was delivered to the customer, and the remaining amount was deferred and allocated to maintenance services and estimated discounts on future purchases.

Maintenance revenue

A number of Sonus' customer transactions involve multiple elements, including the delivery of product and maintenance services as part of a bundled offering. Statement of Position (SOP) 97-2, *Software Revenue Recognition*, requires maintenance revenue to be recognized over the period services are provided. Based on Sonus' review and analysis, Sonus identified certain circumstances in which it offered maintenance services at no additional charge or at discounted rates to certain customers but did not separate the fair value for the maintenance from product revenue. This resulted in revenue associated with the value of the undelivered maintenance services not being recognized over the service period. In the restated financial statements, Sonus has recognized maintenance revenue ratably over the period in which the maintenance services were provided based on the deferral of the applicable VSOE of maintenance services. In such cases, Sonus has reclassified maintenance services from product revenue to service revenue for the applicable periods presented. Based on Sonus' review and analysis, Sonus also identified certain circumstances in which insufficient value was allocated to maintenance. In such cases, Sonus has reclassified additional amounts from product revenue to service revenue for the applicable periods presented. In connection with the recognition of the deferred product revenue described above in the second quarter of 2002 and the fourth quarter of 2003, a significant portion of the product revenue was allocated to the value of undelivered maintenance services and deferred over the five-year period in which the maintenance services are provided.

Delivery

Sonus identified transactions where it delivered some, but not all, of the product required under an arrangement. Previously, Sonus deferred a portion of the revenue for these undelivered products based on the pricing in the arrangement, and recognized the remaining revenue on the delivered products. On a restated basis, Sonus has deferred all revenue until all elements of the transaction were delivered because it was not able to establish VSOE for the undelivered product or, in some instances, because such undelivered product was essential to the functionality of the delivered

product.

Customer acceptance

Sonus identified certain circumstances where revenue was recognized in a period other than the one in which acceptance was achieved or other contingencies were resolved. As restated, revenue from such arrangements is recorded in the period in which customer acceptance occurred or other contingencies were resolved.

Summary

The following table is a reconciliation of revenue as previously reported to amounts as restated for the periods indicated, in thousands:

	Three months ended June 30, 2003	Three months ended June 30, 2002	Six months ended June 30, 2003	Six months ended June 30, 2002
Revenues, as previously reported	\$ 21,356	\$ 21,295	\$ 37,375	\$ 42,453
Revenue Restatement Adjustments:				
Deferral of product revenue	(6,285)	36,550	(12,380)	33,134
Maintenance revenue	(840)	(8,675)	(189)	(10,359)
Delivery	(9)	2,965	(320)	3,920
Customer acceptance	993	(1,105)	(71)	1,657
Other	151	745	160	1,478
Total Revenue Restatement Adjustments	(5,990)	30,480	(12,800)	29,830
Revenues, as restated	\$ 15,366	\$ 51,775	\$ 24,575	\$ 72,283

Expense Adjustments

Accrued expenses

During Sonus' review and analysis, Sonus identified several accrued expense accounts that required adjustment to be in accordance with Statement of Financial Accounting Standards (SFAS) No. 5, *Accounting for Contingencies*. Accounting for accrued expenses requires estimates and judgments, which can be complex. Sonus adjusted accrual balances as the result of: (1) using more appropriate business assumptions to estimate certain liabilities, such as warranty reserves and post-shipment obligations to customers; (2) in those instances lacking available foundation or support for recorded balances at the time

the original accrual was established, using currently known information, including actual disbursements and contemporaneous documentation in order to record the appropriate balances, such as royalties and professional fees; and (3) appropriately classifying certain balance sheet items, such as customer deposits to deferred revenues.

The following table is a reconciliation of accrued expense adjustments by category as of the dates indicated, in thousands:

	June 30, 2003	December 31, 2002
Accrued expense adjustments—increase/(decrease) for:		
Employee compensation and related costs	\$ (1,378)	\$ 208
Professional fees	(1,183)	(1,239)
Royalties	1,203	1,492
Warranty reserve	(3,132)	(3,385)
Post-shipment obligations to customers	(2,527)	(2,527)
Customer deposits	(6,760)	(7,240)
Other	(2,249)	(4,199)
Total accrued expense adjustments	\$ (16,026)	\$ (16,890)

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Restructuring expense and benefits

In connection with Sonus' review and analysis, Sonus determined that a restructuring benefit of \$16,557,000 for a lease renegotiation originally recorded in the first quarter of 2002 should have been recorded in 2001. In addition, Sonus increased 2002 expenses by \$336,000. The effect of these adjustments was to adjust the restructuring item from a benefit of \$11,128,000 to an expense of \$5,765,000 in the six months ended June 30, 2002.

Valuation of Intangibles

During 2001, Sonus acquired two companies, telecom technologies, inc. (TTI) and Linguatq, Inc. (Linguatq). Sonus accounted for the TTI acquisition as a purchase in accordance with Accounting Principles Board (APB) No. 16, *Business Combinations*, and for Linguatq as a purchase in accordance with SFAS No. 141, *Business Combinations*. As part of Sonus' re-examination of these acquisitions, Sonus hired an independent third party appraiser. In connection with the TTI acquisition re-appraisal, Sonus has re-examined the total consideration paid, net liabilities assumed, and certain assumptions and calculations supporting the original appraisal of the identified intangible assets acquired from TTI. These assumptions included the customer turnover rate, the gross and operating margin percentages and inconsistencies in the profit assumptions used to value in-process research and development compared to other identified intangible assets. The results of these changes to the purchase price and related allocation for the TTI acquisition are as follows, in thousands:

Purchase Price of TTI	As Reported	Adjustments	As Restated
Fair market value of shares issued	\$ 527,613	\$ (612)	\$ 527,001
Liabilities assumed	21,184	(1,375)	19,809
Acquisition expenses	5,833	(67)	5,766
Total	\$ 554,630	\$ (2,054)	\$ 552,576

As a result of re-appraisal of assets acquired, the final purchase price has been allocated to the tangible and intangible assets acquired based upon their fair values as follows, in thousands:

Purchase Price Allocation of TTI	As Reported	Adjustments	As Restated
Tangible assets	\$ 8,296	\$ 1,096	\$ 9,392
Intangible assets:			
Workforce	3,000	3,900	6,900
Developed technology	11,900	2,100	14,000
Customer relationships	17,400	6,800	24,200
In-process research and development	40,000	800	40,800
Deferred compensation related to unvested stock options	22,600	—	22,600
Goodwill	451,434	(16,750)	434,684
Total	\$ 554,630	\$ (2,054)	\$ 552,576

In connection with the revised appraisals, Sonus has determined that the useful life of the TTI customer relationships and goodwill should be five years, compared to three years as previously reported. The impact to amortization expense as a result of the change in estimated useful lives and valuation of intangibles was an increase of \$331,000 and \$807,000 for the three months ended June 30, 2003 and 2002 and \$662,000 and \$1,591,000 for the six months ended June 30, 2003 and 2002.

Stock-based Compensation

Sonus identified items in the calculation of stock-based compensation and related items that required adjustments to the stockholders' equity section of its balance sheet, and stock-based compensation expense. These items pertain to errors involving the amortization and recapture of deferred compensation, the 2002 exchange of outstanding employee

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stock options, and intrinsic value charges for restricted stock and stock options grants and modifications.

Sonus previously adopted the accelerated method of amortizing all deferred compensation defined under Financial Accounting Standards Board (FASB) Financial Interpretation No. (FIN) 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans*. In the event of forfeiture of a stock-based award, FIN 44, *Accounting for Certain Transactions Involving Stock Compensation, an interpretation of APB Opinion No. 25*, requires that compensation expense be adjusted to recapture the compensation expense previously recorded related to unvested stock-based awards, in the period of forfeiture. Sonus previously had not recorded recapture of any such excess compensation expense upon the forfeiture of a stock-based award upon employee termination. As a result, Sonus has decreased stock-based compensation by \$121,000 and \$1,544,000 for the three months ended June 30, 2003 and 2002 and \$171,000 and \$2,068,000 for the six months ended June 30, 2003 and 2002, in these restated financial statements, which includes the recapture of excess compensation expense related to the items discussed in the following two paragraphs.

Sonus also determined that option grants made to certain newly hired employees had intrinsic value on the start date of the new employee. Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, requires that such intrinsic value be recorded as deferred stock-based compensation and amortized over the vesting period. Previously, Sonus had not recorded any deferred stock-based compensation expense for these grants, and Sonus is now recording an adjustment of \$1,215,000 to deferred compensation and additional paid-in-capital in 2001. As a result and under Sonus' policy of amortization under FIN 28, Sonus has increased stock-based compensation expense by \$24,000 and \$101,000 for the three months ended June 30, 2003 and 2002 and \$54,000 and \$248,000 for the six months ended June 30, 2003 and 2002, in these restated financial statements.

Sonus recorded employee deferred stock-based compensation prior to its initial public offering and in connection with Sonus' acquisition of TTI, and established a policy to amortize these amounts on an accelerated method under FIN 28. Sonus determined as a result of its review and analysis that the deferred stock-based compensation related to one category of employees was incorrectly amortized using the straight-line method and has made adjustments to consistently apply the FIN 28 method. As a result, Sonus increased stock-based compensation by \$20,000 and \$54,000 for the three and six months ended June 30, 2003 and decreased stock-based compensation by \$114,000 and \$171,000 for the three and six months ended June 30, 2002, in these restated financial statements.

Sonus has determined that it improperly calculated deferred stock-based compensation and the related amortization associated with the restricted stock issued under the TTI Retention Plan. As a result, Sonus decreased stock-based compensation by \$17,000 and \$1,000 for the three and six months ended June 30, 2003 and increased stock-based compensation by \$498,000 and \$1,957,000 for the three and six months ended June 30, 2002 to reflect the amortization of deferred stock-based compensation that should have been recorded.

Sonus also determined that it improperly calculated stock-based compensation expense for any intrinsic value associated with the modification of certain stock options and restricted stock to accelerate the vesting of a portion or all of these awards in connection with certain employee terminations. These adjustments resulted in increases in stock-based compensation expense of \$28,000 and \$59,000 for the three and six months ended June 30, 2002.

The following table is a summary of stock-based compensation restatement adjustments by type for the periods indicated, in thousands:

	Three months ended June 30, 2003	Three months ended June 30, 2002	Six months ended June 30, 2003	Six months ended June 30, 2002
Stock-based Compensation				
Adjustments—increase/(decrease) for:				
Recapture of compensation expense in connection with employee terminations	\$ (121)	\$ (1,544)	\$ (171)	\$ (2,068)
Amortization related to the intrinsic value of options granted to new employees	24	101	54	248
Adjusted amortization under accelerated method prescribed by FIN 28	20	(114)	54	(171)
Amortization related to restricted stock issued in connection with TTI Retention Plan	(17)	498	(1)	1,957
Charge for modification in connection with employee terminations	—	28	—	59
Total Stock-based Compensation Restatement Adjustments	\$ (94)	\$ (1,031)	\$ (64)	\$ 25

As described in Note 3 (l) to Sonus' condensed consolidated financial statements, Sonus calculated the fair value of its stock options and the options under our employee stock purchase plan for disclosure purposes as required under SFAS No. 123, *Accounting for Stock-Based Compensation*. These calculations depend, among other factors, on the characteristics of Sonus' 2000 Employee Stock Purchase Plan (ESPP) and options with intrinsic value at the grant date. Sonus' calculation did not properly consider these two items.

Inventory Reserves

As of June 30, 2003 and June 30, 2002 Sonus' originally reported excess, obsolete and evaluation reserve balances were \$17,904,000 and \$17,364,000. Sonus has determined that its excess, obsolete and evaluation reserve balances were not consistently calculated and, as a result of review of its reserves and consideration of contemporaneous facts and circumstances, Sonus decreased its reserves and reduced cost of product revenues by \$2,292,000 as of and for the six months ended June 30, 2003 and increased its reserves and increased cost of product revenues by \$512,000 as of and for the six months ended June 30, 2002.

Other Balance Sheet Adjustments

Sonus identified certain customer checks received by it prior to the end of fiscal year 2002 and the quarter ended June 30, 2003, which were deposited after the reporting period and not recorded in the period received. Accordingly, Sonus has increased its cash and cash equivalents and deferred revenue balances by \$1,584,000 and \$6,971,000 as of June 30, 2003 and December 31, 2002.

Sonus previously did not record deferred revenue for product shipments and related services for which customers had been invoiced but for which no revenue was recognized and for which payment had not been collected. In this restatement, customer billings for which Sonus has a contractual right to

invoice and collectibility is probable have been recorded as accounts receivable on the balance sheet, with a corresponding increase to deferred revenue. Accounts receivable and deferred revenue have increased by \$3,764,000 and \$90,000 at June 30, 2003 and December 31, 2002.

Sonus previously reported customer deposits as accrued liabilities. In connection with Sonus' review and analysis, Sonus has determined that it should report customer deposits as deferred revenue rather than accrued expenses. Accordingly, deferred revenue has increased and accrued liabilities have decreased by \$6,760,000 and \$7,240,000 as of June 30, 2003 and December 31, 2002.

Other Statement of Operations Adjustments

As described in Note 3 (p) to Sonus' condensed consolidated financial statements, Sonus calculated the weighted average common shares outstanding utilized in the determination of loss per share in accordance with the treasury stock method as required under SFAS No. 148, *Earnings Per Share*. Sonus' calculation did not properly consider certain activity and, accordingly, Sonus has modified the weighted average common shares outstanding for the three months and six months ended June 30, 2002.

(3) Summary of Significant Accounting Policies

The accompanying condensed consolidated financial statements reflect the application of certain significant accounting policies as described in this note and elsewhere in the accompanying condensed consolidated financial statements and notes.

(a) Basis of Presentation and Principles of Consolidation

The accompanying unaudited condensed consolidated financial statements have been prepared by Sonus and reflect all adjustments, consisting only of normal recurring adjustments that in the opinion of management are necessary for a fair statement of the results for the interim periods. The unaudited condensed consolidated financial statements have been prepared in accordance with the regulations of the Securities and Exchange Commission (SEC), and omit or condense certain information and footnote disclosures pursuant to existing SEC rules and regulations. Results for the interim period are not necessarily indicative of results to be expected for any other interim period or the entire fiscal year. These statements should be read in conjunction with the consolidated financial statements and related notes included in Sonus' Annual Report on Form 10-K/A for the year ended December 31, 2003 filed with the SEC on July 28, 2004.

The accompanying condensed consolidated financial statements include the accounts of Sonus and its wholly owned subsidiaries. All material intercompany transactions and balances have been eliminated.

(b) Use of Estimates and Judgments

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Significant estimates relied upon in preparing these financial statements include revenue recognition for multiple element arrangements, allowances for doubtful accounts, estimated fair value of investments, including whether any decline in such fair value is other-than-temporary, expected future cash flows used to evaluate the recoverability of long-lived assets, estimated fair values of long-lived assets used to record impairment charges related to intangible assets, restructuring and other related charges, contingencies associated with revenue contracts, contingent liabilities, and recoverability of Sonus' net deferred tax assets and related valuation allowance. Although Sonus regularly assesses these estimates, actual results could differ materially from these estimates. Changes in estimates are recorded in the period in which they become known. Sonus bases its estimates on historical experience and various other assumptions that it believes to be reasonable under the circumstances. Actual results may differ from Sonus' estimates if past experience or other assumptions do not turn out to be substantially accurate.

(c) Cash Equivalents and Marketable Securities

Cash equivalents are stated at cost plus accrued interest, which approximates market value, and have maturities of three months or less at the date of purchase.

Marketable securities are classified as held-to-maturity, as Sonus has the intent and ability to hold to maturity. Marketable securities are reported at amortized cost. Cash equivalents and marketable securities are invested in high-quality credit instruments, primarily U.S. Government obligations and corporate obligations. Current marketable securities have remaining contractual maturities of less than one year as of the balance sheet date. There have been no material gains or losses to date.

(d) Concentrations of Credit and Off-Balance Sheet Risk, Significant Customers and Limited Suppliers

The financial instruments that potentially subject Sonus to concentrations of credit risk are cash, cash equivalents, marketable securities and accounts receivables. Sonus has no off-balance sheet concentrations such as foreign exchange contracts, options contracts or other foreign hedging arrangements. Sonus' cash and cash equivalent holdings are diversified among four financial institutions.

For the three months ended June 30, 2003 and 2002, three customers and one customer each contributed 10% or more of Sonus' revenues, representing an aggregate of 54% and 66% of total revenues. For the six months ended June 30, 2003 and 2002, three and two customers each contributed 10% or more of Sonus' revenues, representing an aggregate of 49% and 58% of total revenues. The following customers contributed 10% or more of Sonus' revenues in the three and six months ended June 30, 2003 and 2002:

Customer:	Three months ended June 30,		Six months ended June 30,	
	2003 (As Restated)	2002 (As Restated)	2003 (As Restated)	2002 (As Restated)

Verizon Global Networks	22%	*%	14%	*%
Global Crossing	16	*	21	*
Nissho Electronics Corporation	16	*	14	*
Qwest Communications	*	66	*	48
Touch America	*	*	*	10

* Represents less than 10% of revenues.

As of June 30, 2003 and December 31, 2002, four and three customers each accounted for 10% or more of Sonus' accounts receivable balance, representing an aggregate of 78% and 78% of total accounts receivable. Sonus performs ongoing credit evaluations of its customers and generally does not require collateral on accounts receivable. Sonus maintains allowances for potential credit losses and such losses have been within management's expectations.

International revenues, primarily attributable to Asia and Europe, were 31% and 13% of total revenues for the three months ended June 30, 2003 and 2002. International revenues, primarily attributable to Asia and Europe, were 29% and 16% of total revenues for the six months ended June 30, 2003 and 2002.

Certain components and software licenses from third parties used in Sonus' products are procured from single sources of supply. The failure of a supplier, including a subcontractor, to deliver on schedule could delay or interrupt Sonus' delivery of products and thereby materially adversely affect Sonus' revenues and operating results.

(e) Accounts Receivable

Accounts receivable consist of the following, in thousands

	June 30, 2003 (As Restated)	December 31, 2002
Earned accounts receivable	\$ 7,383	\$ 4,873
Unearned accounts receivable	3,764	90
Accounts receivable, gross	11,147	4,963
Allowance for doubtful accounts	(143)	(341)
Accounts receivable, net	<u>\$ 11,004</u>	<u>\$ 4,622</u>

Unearned accounts receivable represent products shipped to customers where Sonus has a contractual right to bill the customer and collectibility is probable prior to satisfying Sonus' revenue recognition criteria. The allowance for doubtful accounts is based on Sonus' detailed assessment of the collectibility of specific customer accounts.

(f) Inventory

Inventory consists of the following, in thousands:

	June 30, 2003 (As Restated)	December 31, 2002
On-hand final assemblies and finished goods inventory	\$ 13,583	\$ 12,292
Unearned inventory	14,843	10,441
Evaluation inventory	2,591	6,022
Inventory, gross	31,017	28,755
Excess, obsolete and evaluation reserve	(15,611)	(18,306)
Inventory, net	<u>\$ 15,406</u>	<u>\$ 10,449</u>

Unearned inventory represents deferred cost of revenues for product shipments prior to satisfaction of Sonus' revenue recognition criteria.

Sonus values inventory at the lower of cost or net realizable value and provides inventory reserves based on excess and obsolete inventories determined primarily by future demand forecasts and records changes to such reserves through charges to cost of revenues. Sonus also records a full inventory reserve for evaluation equipment at the time of shipment to its customers as a charge to sales and marketing expense as Sonus' experience with this type of inventory indicates it is probable that the inventory will not be realizable. If these evaluation shipments should convert to revenue, Sonus records a benefit to sales and marketing expense and records the full cost of revenues in the period of revenue recognition.

(g) Property and Equipment

Property and equipment are stated at cost, net of accumulated depreciation. Expenditures for maintenance and repairs are charged to expense as incurred. Depreciation is computed using the straight-line method over the estimated useful life of the related assets, which ranges from three to five years. Leasehold improvements are amortized over the lesser of the life of the lease or five years. When an item is sold or retired, the cost and related accumulated depreciation is relieved, and the resulting gain or loss, if any, is recognized in the statement of operations.

(h) Purchased Intangible Assets

Purchased intangible assets of \$3,606,000 as of June 30, 2003 and \$4,810,000 as of December 31, 2002 are carried at cost less accumulated amortization. Amortization is computed over the estimated useful lives of the respective assets. Sonus expects that the remaining amount of purchased intangible assets will be fully amortized by December 2004.

(i) Deferred Revenue

Deferred revenue consists of the following, in thousands:

	<u>June 30, 2003</u> (As Restated)	<u>December 31,</u> <u>2002</u>
Maintenance and support contracts	\$ 24,922	\$ 24,832
Customer deposits	46,478	34,830
Unearned revenue	3,764	90
Total deferred revenue	75,164	59,752
Less current portion	(66,741)	(51,728)
	<u>\$ 8,423</u>	<u>\$ 8,024</u>

Maintenance and support contracts are recognized ratably over the life of the service contract. Customer deposits represent payments received in advance of revenue recognition. Unearned revenue represents billings for which payment has not been received and revenue recognition criteria have not been met.

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(j) Revenue Recognition

Sonus recognizes revenue from product sales when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable and collectibility of the related receivable is probable under ordinary payment terms. When Sonus has future obligations, including a requirement to deliver additional elements which are essential to the functionality of the delivered elements or for which vendor specific objective evidence of fair value (VSOE) does not exist or customer acceptance is required, Sonus defers revenue recognition and related costs until those obligations are satisfied. The ordering pattern and sales lead times associated with customer orders may vary significantly from period to period.

Many of Sonus' sales are generated from complex contractual arrangements which require significant revenue recognition judgments, particularly in the case of multiple element arrangements. When a sale involves multiple elements, such as products, maintenance or professional services, Sonus allocates the entire sales price to each respective element based on VSOE or using the residual method when VSOE cannot be established for a single delivered element in the arrangement. Sonus then recognizes revenue on each element in accordance with its policies for revenue recognition related to each element. Sonus determines VSOE based upon the price charged when the same element is sold separately. If Sonus cannot establish VSOE for each undelivered element, it defers revenue recognition on the entire arrangement until the earlier of the establishment of VSOE or delivery of the undelivered element.

In addition, if an arrangement with a customer includes a specified upgrade right for which VSOE cannot be established, Sonus defers all revenue related to the arrangement until the earlier of the delivery of the specified upgrade or the establishment of VSOE for the specified upgrade. Sonus has concluded that a specified upgrade right exists if it is included in the customer contract or otherwise becomes part of the arrangement with the customer. Sonus has concluded that communications with customers in the normal course of business regarding customer feature requests and Sonus' product plans do not create specified upgrade rights.

Maintenance and support services are recognized ratably over the life of the maintenance and support service period, which typically is one year when the services are sold separately and up to five years when the fees for the services are bundled with the product fees as part of a multiple element arrangement. Maintenance and support services include telephone support and unspecified rights to product upgrades and enhancements. Maintenance and support VSOE represents a consistent percentage of the sales prices charged to customers. The application of judgment could affect the continued determination of maintenance and support VSOE and Sonus' ability to recognize revenue using the residual method.

Installation service revenues are generally recognized at the time of the related product revenue recognition as installation is typically complete by such time. Professional services are typically recognized as the services are performed.

Sonus sells the majority of its products directly to end-users. For products sold through resellers and distributors, Sonus recognizes revenue on a sell-through method utilizing information provided to Sonus from its resellers and distributors.

Sonus records deferred revenue for product shipped to customers and related services where amounts are billed pursuant to a contractual right and collection is probable, or collected, in the ordinary course of business if the revenue recognition criteria have not been satisfied. Deferred revenues include customer deposits and amounts associated with maintenance contracts. Deferred revenues not expected to be recognized within one year of the balance sheet date are classified as long-term deferred revenues.

Sonus defers recognition of incremental direct costs, such as cost of goods, royalties, commissions and third-party installation costs, until satisfaction of the criteria for recognition of the related revenue.

(k) Software Development Costs

Sonus accounts for its software development costs in accordance with Statement of Financial Accounting

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Standards (SFAS) No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased or Otherwise Marketed*. Accordingly, the costs for the development of new software and substantial enhancements to existing software are expensed as incurred until technological feasibility has been established, at which time any additional costs would be capitalized. Sonus has determined that technological feasibility is established at the time a working model of the software is completed. Because Sonus believes its current process for developing software is essentially completed concurrently with the establishment of technological feasibility, no costs have been capitalized to date.

(l) Stock-Based Compensation

SFAS No. 123, *Accounting for Stock-Based Compensation*. SFAS No. 123 provides that companies may account for stock-based compensation under either the fair value-based method of accounting under SFAS No. 123 or the intrinsic value-based method provided by Accounting Principles Board (APB) No. 25, *Accounting for Stock Issued to Employees*. Sonus uses the intrinsic value-based method of APB No. 25 to account for all of its employee stock-based compensation plans and uses the fair value method of SFAS No. 123 to account for all non-employee stock-based compensation. Sonus follows FASB Interpretation (FIN) No. 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans* and amortizes the intrinsic value for all awards as measured under APB No. 25 on an accelerated basis. SFAS No. 123, as amended by SFAS No. 148, *Accounting for Stock-Based Compensation—Transition and Disclosure—an amendment of FASB Statement No. 123*, requires companies following APB No. 25 to make pro forma disclosure in the notes to the financial statements using the measurement provisions of SFAS No. 123.

Sonus has computed the pro forma disclosures required under SFAS No. 123 for stock options granted to employees and shares purchased under the 2000 Employee Stock Purchase Plan (ESPP) using the Black-Scholes option-pricing model. In valuing the stock options granted, Sonus used an assumed risk-free interest rate of 3% for both the three and six months ended June 30, 2003 and 2002; volatility of 137% for both the three and six months ended June 30, 2003, and 150% for the three and six months ended June 30, 2002; and an expected life of four to five and three to five years for both the three and six months ended June 30, 2003 and 2002, with the assumption that dividends will not be paid. In valuing the ESPP, Sonus used an assumed risk-free interest rate of 1.2 – 3.76% for the three months ended June 30, 2003 and 1.2 – 4.7% for the six months ended June 30, 2003, and of 1.9 – 6.8% for both the three and six months ended June 30, 2002; volatility of 137-150% for both the three and six months ended June 30, 2003, and 80 - 150% for both the three and six months ended June 30, 2002; and an expected life ranging from six months to two years, with the assumption that dividends will not be paid. The pro forma information is as follows (in thousands, except per share data):

	Three months ended		Six months ended	
	June 30,		June 30,	
	2003	2002	2003	2002
	(As Restated)	(As Restated)	(As Restated)	(As Restated)
Net income (loss)—				
As reported	\$ (7,301)	\$ 3,575	\$ (17,008)	\$ (29,992)
Plus: Employee stock-based compensation expense included in net income (loss) under intrinsic value method related to options	538	4,483	1,355	10,763
Less: Employee stock-based compensation under fair value method	(9,647)	(12,154)	(19,397)	(24,117)
Pro forma	\$ (16,410)	\$ (4,096)	\$ (35,050)	\$ (43,346)
Basic and diluted net income (loss) per share—				
As reported	\$ (0.03)	\$ 0.02	\$ (0.08)	\$ (0.16)
Pro forma	\$ (0.08)	\$ (0.02)	\$ (0.17)	\$ (0.23)

(m) Comprehensive Income (Loss)

Sonus applies SFAS No. 130, *Reporting Comprehensive Income*. The comprehensive net income (loss) for the

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three and six months ended June 30, 2003 and 2002 does not differ from the reported net income (loss).

(n) Fair Value of Financial Instruments

The carrying amounts of Sonus' financial instruments, which include cash equivalents, marketable securities, accounts payable, long-term liabilities and the convertible subordinated note, approximate their fair value.

(o) Disclosures about Segments of an Enterprise

SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*, established standards for reporting information regarding operating segments and established standards for related disclosures about products and services and geographic areas. Operating segments are identified as components of an enterprise about which separate discrete financial information is available for evaluation by the chief operating decision maker in making decisions regarding resource allocation and assessing performance. To date, the chief operating decision maker has made such decisions and assessed performance at the company level.

(p) Net Income (Loss) Per Share

Basic net income (loss) per share is computed by dividing the net income (loss) for the period by the weighted average number of shares of unrestricted common stock outstanding during the period. Diluted net income (loss) per share is computed by dividing the net income (loss) for the period by the weighted average number of shares of unrestricted common stock and dilutive potential common shares outstanding based on the average market price of Sonus' common stock (under the treasury stock method). Dilutive potential common shares consist of restricted common stock and common stock issuable upon the exercise of stock options and conversion of a convertible subordinated note.

The following table sets forth the computation of shares used in calculating the basic and diluted net income (loss) per share, in thousands:

	Three months ended		Six months ended	
	June 30,		June 30,	
	2003	2002	2003	2002
	(As Restated)	(As Restated)	(As Restated)	(As Restated)
Weighted average common shares outstanding	220,639	203,741	212,845	203,429

Less weighted average restricted common shares outstanding	(4,669)	(13,201)	(5,362)	(14,604)
Shares used in basic per share calculation	215,970	190,540	207,483	188,825
Add effect of dilutive potential common shares	—	9,969	—	—
Shares used in diluted per share calculation	215,970	200,509	207,483	188,825

Excluded from the shares used in the calculations above are options to purchase shares of common stock and shares of common stock issuable upon conversion of a convertible subordinated note representing an aggregate of 29,748,620 for three and six months ended June 30, 2003; 21,202,969 shares for the three months ended June 30 2002, and 23,562,337 for the six months ended June 30, 2002, as their effects would have been anti-dilutive.

(q) Recent Accounting Pronouncements

In June 2002, the FASB issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. SFAS No. 146 addresses the recognition, measurement and reporting of costs associated with exit and disposal activities, including restructuring activities that were accounted for in accordance with Emerging Issues Task Force 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)*. The scope of SFAS No. 146 includes costs related to terminating a contract that is not a capital lease, costs to consolidate facilities or relocate employees, and certain termination benefits provided to employees who are involuntarily terminated. SFAS No. 146 is effective for exit or disposal activities initiated after December 31, 2002.

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The implementation of this statement did not have a material impact on its financial position or results of operations.

In November 2002, the FASB issued Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (FIN No. 45). FIN No. 45 elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The initial recognition and initial measurement provisions of the interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002 and the disclosure requirements in this interpretation are effective for financial statements of interim or annual periods ending after December 15, 2002. The FIN No. 45 disclosure requirements are included in Note 5 to Sonus' unaudited condensed consolidated financial statements. The adoption of FIN No. 45 did not have a material impact on Sonus' financial position or results of operations.

In December 2002, the FASB issued SFAS No. 148, *Accounting for Stock-Based Compensation—Transition and Disclosure*, an amendment of SFAS No. 123. SFAS No. 148 provides alternative methods of transition for a voluntary change to the fair value-based method of accounting for employee stock-based compensation. These alternative methods will only impact Sonus if it voluntarily changes to the fair value-based method of accounting for employee stock-based compensation. SFAS No. 148 also requires companies who account for employee stock-based compensation under the intrinsic value-based method to disclose additional footnote information in annual financial statements effective for fiscal years ending after December 15, 2002 and in financial statements for interim periods beginning after December 15, 2002. The requisite disclosure appears in Note 3(l) to Sonus' unaudited condensed consolidated financial statements.

In January 2003, the FASB issued Interpretation No. 46, *Consolidation of Variable Interest Entities* (FIN No. 46) to clarify the conditions under which assets, liabilities and activities of another entity should be consolidated into the financial statements of a company. FIN No. 46 requires the consolidation of a variable interest entity 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. Sonus does not have any variable interest entities.

In May 2003, the FASB issued SFAS No. 150, *Accounting For Certain Financial Instruments with Characteristics of Both Liabilities and Equity*, which establishes standards for how an issuer of financial instruments classifies and measures certain financial instruments with characteristics of both liabilities and equity. SFAS No. 150 requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances) because that financial instrument embodies an obligation of the issuer. SFAS No 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of SFAS No. 150 did not have a material impact on Sonus' overall financial position or results of operations.

(r) Warranty Reserve

Sonus' products are covered by a standard warranty of 90 days for software and one year for hardware. In addition, certain customer contracts include warranty-type provisions for epidemic or similar product failures, generally for the contractual period or the life of the product in accordance with published telecommunications standards. Sonus accrues for such contingent obligations when the occurrence of such obligation is probable and the amount of such obligation is reasonably estimable. Sonus has not incurred significant costs related to such obligations. Sonus' customers typically purchase maintenance and support contracts, which encompass its warranty obligations. Sonus' estimates of anticipated rates of warranty claims and costs are primarily based on historical information and future forecasts.

In addition, certain of Sonus' customer contracts include provisions under which Sonus may be obligated to pay penalties generally for the contractual period or for the life of the product if its products fail or do not perform in accordance with specifications. Sonus accrues for such contingent obligations when the occurrence of such obligation is probable and the amount of such obligation is reasonably estimable. Sonus has not incurred significant costs related to such provisions. Sonus periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as

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necessary. Increases in product failures rates, material usage or service delivery costs may result in increases to Sonus' warranty reserve and its gross profit could be adversely affected.

(4) Restructuring Charges

Commencing in the third quarter of fiscal 2001 and extending through fiscal 2002, in response to unfavorable business conditions primarily caused by significant declines in capital spending by telecommunications service providers, Sonus implemented restructuring plans designed to reduce expenses and align its cost structure with its revised business outlook. The restructuring plans included worldwide workforce reductions, consolidation of excess facilities and the write-off of excess inventory and purchase commitments.

2002 Restructuring Accrual

The following table summarizes the activity during the six months ended June 30, 2003 relating to Sonus' accrual for fiscal 2002 restructuring actions, in thousands:

	December 31, 2002 Accrual Balance	Cash Payments	June 30, 2003 Accrual Balance (As Restated)	Current Portion	Long-term Portion
Workforce reduction	\$ 534	\$ (534)	\$ —	\$ —	\$ —
Consolidation of facilities	2,214	(648)	1,566	659	907
Sub-total	2,748	(1,182)	1,566	659	907
Write-off of purchase commitments	340	(180)	160	160	—
Total	\$ 3,088	\$ (1,362)	\$ 1,726	\$ 819	\$ 907

The remaining cash expenditures relating to the consolidation of excess facilities are expected to be paid through 2008. The purchase commitment obligations are expected to be substantially paid by the end of fiscal 2003.

(a) Workforce reduction

The restructuring actions in fiscal 2002 included a reduction in Sonus' workforce. The affected employees were entitled to severance and other benefits for which Sonus recorded a charge of \$5,282,000 in fiscal 2002, of which \$1,508,000 and \$2,848,000 were recorded in the three and six months ended June 30, 2002. In addition, Sonus recorded non-cash stock-based compensation expense of \$1,029,000 and \$1,410,000 in the three and six months ended June 30, 2002 related to the write-off of deferred compensation associated with shares and options held by terminated employees.

(b) Consolidation of excess facilities

Sonus recorded a net restructuring benefit of \$495,000 in the three months ended June 30, 2002 and a net restructuring charge of \$2,917,000 in the six months ended June 30, 2002 for the consolidation of excess facilities, which is included on the balance sheet in accrued restructuring expenses and long-term liabilities. The accrual for the consolidation of excess facilities was determined assuming no sublease income.

(c) Write-off of inventory and purchase commitments

During the six months ended June 30, 2002, Sonus recorded additional cost of revenues of \$6,865,000 consisting of \$4,457,000 for the write-off of inventory determined to be excess and obsolete and \$2,408,000 for materials that were committed to be purchased from third party contract manufacturers and suppliers under purchase commitments, but that were in excess of required quantities. The charge for purchase commitments was recorded on the balance sheet as accrued restructuring expenses.

2001 Restructuring Accrual

The following table summarizes the activity during the six months ended June 30, 2003 relating to Sonus' accrual for fiscal 2001 restructuring actions, in thousands:

	December 31, 2002 Accrual Balance	Cash Payments	June 30, 2003 Accrual Balance (As Restated)	Current Portion	Long-Term Portion
Consolidation of facilities and other charges	\$ 571	\$ (186)	\$ 385	\$ 385	\$ —

Remaining cash expenditures relating to the consolidation of excess facilities and other charges are expected to be paid through the second quarter of fiscal 2004.

(5) Warranty Reserve

The following table summarizes the activity related to product warranty reserve, included in accrued expenses, during the six months ended June 30, 2003, in thousands and as restated:

Balance at December 31, 2002	\$ 1,300
Charges to costs and expenses	—
Deductions	—
Balance at June 30, 2003	\$ 1,300

(6) Long-term Liabilities

Long-term liabilities consist of capital leases, borrowings from a bank for equipment purchases (Note 7) and restructuring expenses (Note 4). Sonus assumed certain capital leases as part of the acquisition of telecom technologies, inc. (TTI). The capital leases are due in monthly installments expiring at various dates through March 2005 and accrue interest at annual rates ranging from 4.6% to 10.3%. The future minimum annual payments under capital leases and amounts due for long-term liabilities, as of June 30, 2003, are as follows, in thousands:

Capital Leases:	
2003 obligations (six months)	\$ 231
2004 obligations	190
2005 obligations	30
Total minimum lease payments	451
Less amount representing interest	(19)
Present value of minimum payments	432
Borrowings under equipment line of credit with bank	2,292
Long-term portion of restructuring expenses	907
Total long-term liabilities	3,631
Less current portion	(1,431)
Long-term liabilities, net of current portion	\$ 2,200

The future principal payments on total long-term liabilities, excluding the capital leases, as of June 30, 2003 are: \$550,000 in 2003 (six months); \$1,209,000 in 2004; \$828,000 in 2005; \$195,000 in 2006; \$204,000 in 2007; and \$213,000 in 2008.

(7) Bank Agreement

In January 2002, Sonus established a \$10,000,000 equipment line of credit and a \$20,000,000 working capital line of credit with a bank at the bank's prime rate. In March 2003, Sonus extended these existing lines of credit at the bank's prime rate (4.25% at June 30, 2003), available through March 23, 2004. Amounts borrowed under the equipment line were repayable over a 36-month period. For both lines of credit, Sonus had to comply with certain restrictive covenants including maintaining certain minimum investment balances with the bank, a minimum tangible stockholders' equity of \$68,350,000 as of June 30, 2003 and a quick ratio of 1.5 to 1.0, as defined in the credit agreement. Under the agreement, all of Sonus' assets, except intellectual property, had been pledged as collateral. As of June 30, 2003, Sonus had \$2,292,000 outstanding under the equipment line of credit (Note 6) and was in compliance with all bank covenants. Interest expense related to the line of credit was \$27,000 and \$56,000 for the three and six months ended June 30, 2003.

(8) Convertible Subordinated Note

In May 2001, Sonus completed a private placement of an aggregate principal amount of \$10,000,000 of a 4.75% convertible subordinated note, due May 1, 2006, with a customer. Interest payments are due semi-annually on May 1 and November 1 of each year through May 2006. The note may be converted by the holder into shares of Sonus' common stock at any time before its maturity or prior to its redemption or repurchase by Sonus. The conversion rate is 33.314 shares per each \$1,000 principal amount of the note, subject to adjustment in certain circumstances. As of May 1, 2004, Sonus has the option to redeem all or a portion of the note at 100% of the principal amount. Also, at any time if the market price of Sonus' common stock exceeds \$60.04 per share for twenty trading days in any thirty trading-day period, Sonus may redeem this note through the issuance of shares of common stock or for cash. In the event of a change of control in Sonus, the holder at its option may require Sonus to redeem the note through the issuance of common stock or cash. Interest expense related to Sonus' convertible subordinated note was \$119,000 for both the three months ended June 30, 2003 and 2002 and \$238,000 for both the six months ended June 30, 2003 and 2002.

(9) Commitments and Contingencies

(a) Leases

Sonus leases its facilities under operating leases, which expire through December 2008. Sonus is responsible for certain real estate taxes, utilities and maintenance costs under these leases. The future minimum payments under operating lease arrangements as of June 30, 2003, are as follows: \$2,743,000 in 2003 (six months); \$1,693,000 in 2004; \$1,068,000 in 2005; \$876,000 in 2006; \$261,000 in 2007; and \$213,000 in 2008.

(b) Pending Litigation

In November 2001, a purchaser of Sonus' common stock filed a complaint in the federal district court for the Southern District of New York against Sonus, two of its officers and the lead underwriters alleging violations of the federal securities laws in connection with Sonus' initial public offering (IPO) and seeking unspecified monetary damages. The purchaser seeks to represent a class of persons who purchased Sonus' common stock between the IPO on May 24, 2000 and December 6, 2000. An amended complaint was filed in April 2002. The amended complaint alleges that Sonus' registration statement contained false or misleading information or omitted to state material facts concerning the alleged receipt of undisclosed compensation by the underwriters and the existence of undisclosed arrangements between underwriters and certain purchasers to make additional purchases in the after market. The claims against Sonus are asserted under Section 10(b) of the Securities Exchange Act of 1934 and Section 11 of the Securities Act of 1933 and against the individual defendants under Sections 11 and 15 of the Securities Act. Other plaintiffs have filed substantially similar class action cases against approximately 300 other publicly traded companies and their IPO underwriters which, along with the actions against Sonus, have been transferred to a single federal judge for purposes of coordinated case management. On July 15, 2002, Sonus, together with the other issuers named as defendants in these coordinated proceedings, filed a collective motion to dismiss the consolidated amended complaints on various legal grounds common to all or most of the issuer defendants. The plaintiffs voluntarily dismissed the claims against the individual defendants, including those Sonus officers named in the complaint. On February 19, 2003,

case proceeded against Sonus on the Section 11 claims. In June 2003, a special committee of Sonus' Board of Directors authorized the Company to enter into a proposed settlement with the plaintiffs on terms substantially consistent with the terms of a Memorandum of Understanding negotiated among representatives of the plaintiffs, the issuer defendants and the insurers for the issuer defendants. The settlement contemplated by the Memorandum of Understanding is subject to a number of conditions including approval by the court. It remains uncertain whether and when the conditions will be met and the settlement will become final. Sonus does not expect that the settlement contemplated by the Memorandum of Understanding would have a material impact on its business or financial results.

Beginning in July 2002, several purchasers of Sonus' common stock filed complaints in federal district court for the District of Massachusetts against Sonus, certain officers and directors and a former officer under Sections 10(b) and 20(a) and Rule 10b-5 of the Securities Exchange Act of 1934 (Class Action Complaints). The purchasers seek to represent a class of persons who purchased common stock of Sonus between December 11, 2000 and January 16, 2002, and seek unspecified monetary damages. The Class Action Complaints were essentially identical and alleged that Sonus made false and misleading statements about its products and business. On March 3, 2003, the plaintiffs filed a Consolidated Amended Complaint. On April 22, 2003, Sonus filed a motion to dismiss the Consolidated Amended Complaint on various grounds. The plaintiffs' filed an opposition to the motion on June 6, 2003. Sonus filed its reply on July 8, 2003. The parties have requested oral argument on the motion, but a date has not yet been set. Sonus believes the claims in the Consolidated Amended Complaint are without merit and that it has substantial legal and factual defenses, which it intends to pursue vigorously.

(10) Stockholders' Equity

(a) Public Offering

In April 2003, Sonus completed a public offering of 20,000,000 shares of its common stock at \$3.05 per share, resulting in net proceeds of \$56,730,000 after deducting offering costs of \$4,270,000.

(b) 1997 Stock Incentive Plan

On January 1 of each year, the aggregate number of shares of common stock available for issuance under the 1997 Stock Incentive Plan (Plan) shall increase by the lesser of (i) 5% of the outstanding shares on December 31 of the preceding year or (ii) an amount determined by the Board of Directors. As of June 30, 2003, 110,611,642 shares were authorized and 35,547,268 shares were available under the Plan for future issuance.

On October 16, 2002, Sonus commenced an offer to exchange (Exchange Offer) outstanding employee stock options granted under the Plan having an exercise price of \$0.67 or more per share for new stock options to be granted by Sonus. Outstanding options granted under the TTI Amended and Restated 1998 Equity Incentive Plan were not eligible for exchange. Also, Sonus' directors, executive officers and non-employees were not eligible to participate in the exchange. On November 22, 2002, the Exchange Offer expired. Outstanding options to purchase 8,973,000 shares of common stock were accepted for exchange and cancelled. On May 27, 2003, employees received an option to purchase one share of common stock for each share of common stock under the exchanged options. The new options were granted at an exercise price of \$4.08 per share, which represented the fair market value of Sonus' common stock on the date of grant.

(c) 2000 Employee Stock Purchase Plan

On January 1 of each year, the aggregate number of shares of common stock available for purchase under the 2000 Employee Stock Purchase Plan (ESPP) shall increase by the lesser of (i) 2% of the outstanding shares on December 31 of the preceding year or (ii) an amount determined by the Board of Directors. As of June 30, 2003, 15,444,657 shares were authorized and 2,727,974 shares were available under the ESPP for future issuance.

(d) Stock-Based Compensation

Stock-based compensation expenses include the amortization of deferred employee compensation and other equity-

related expenses.

In connection with certain employee stock option grants including grants related to the TTI acquisition and the issuance of employee-restricted common stock between 1999 and 2001, Sonus recorded deferred stock-based compensation. This represents the aggregate difference between the exercise price or purchase price and the fair value of the common stock on the date of grant or sale for accounting purposes. The deferred compensation is recognized as an expense over the vesting period of the underlying stock options and restricted common stock based on the accelerated method prescribed by FIN 28.

Sonus recorded stock-based compensation of \$645,000 and \$1,569,000 for the three months ended June 30, 2003 and 2002 and \$4,918,000 and \$11,717,000 for the six months ended June 30, 2003 and 2002.

Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations

This Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements, which are subject to a number of risks and uncertainties. These forward-looking statements are based on our current expectations, assumptions, estimates and

projections about our industry and ourselves, and we do not undertake an obligation to update our forward-looking statements to reflect future events or circumstances. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors. This discussion should be read in conjunction with the unaudited condensed consolidated financial statements and related notes for the periods specified. Further reference should be made to our Annual Report on Form 10-K for the year ended December 31, 2004 and our Quarterly Report on Form 10-Q for the quarter ended March 31, 2005, on file with the SEC.

Overview

We are a leading supplier of packet voice infrastructure solutions for wireline and wireless service providers. Our products are a new generation of carrier-class switching equipment and software that enable voice services to be delivered over packet-based networks.

We began shipping product to customers during the fourth quarter of fiscal 1999 and recorded our first revenues of \$51.8 million in fiscal 2000 and revenues of \$128.8 million in fiscal 2001 and \$93.9 million in fiscal 2002. Revenues for the three and six months ended June 30, 2003 were \$15.4 million and \$24.6 million, compared to \$51.8 million and \$72.3 million for the same periods in fiscal 2002. Significant declines in capital spending by telecommunications service providers, and financial difficulties, including in some cases bankruptcies, experienced by certain emerging service providers, including some of our customers, caused the reduction in our revenues in 2002 and in the first half of 2003. In response to the unfavorable economic conditions, commencing in the third quarter of fiscal 2001 and continuing through fiscal 2002, we implemented restructuring plans designed to reduce expenses and align our cost structure with our revised business outlook. The restructuring plans included worldwide workforce reductions, consolidation of excess facilities and the write-off of excess inventory and purchase commitments.

We sell our products primarily through a direct sales force and, in some markets, through resellers and distributors. Customers' decisions to purchase our products to deploy in commercial networks involve a significant commitment of resources and a lengthy evaluation, testing and product qualification process. We believe our revenues and results of operations may vary significantly and unexpectedly from quarter to quarter as a result of long sales cycles, our expectation that customers will tend to sporadically place large orders with short lead times and the application of complex revenue recognition rules to certain transactions. We expect to recognize revenues from a limited number of customers for the foreseeable future.

Since our inception, we have incurred significant losses and, as of June 30, 2003, had an accumulated deficit of \$810.4 million. Although we achieved profitability in the second quarter of fiscal 2002, as of June 30, 2003 we had not achieved profitability on an annual basis and may incur additional net losses in future quarters and years. The quarterly net income in the second quarter of 2002 was primarily the result of recognizing previously deferred revenue of \$27.5 million from arrangements with a single customer upon the delivery of certain specified software releases in the second quarter of 2002. We have a lengthy sales cycle for our products and, accordingly, we expect to incur sales and other expenses before we realize the related revenues.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements and related disclosures requires management to make judgments, assumptions and estimates that affect the amounts reported in the consolidated financial statements and accompanying disclosures. Management bases its estimates and judgments on historical experience, market trends and other factors that are believed to be reasonable under the circumstances. On an on-going basis, we re-evaluate our estimates for changes in facts and circumstances, and material changes in these estimates could occur in the future if past experience or other assumptions do not turn out to be substantially accurate. Changes in estimates are recorded in the period in which they

become known.

A summary of those accounting policies, significant judgments and estimates that we believe are most critical to fully understanding and evaluating our financial results is set forth below. This summary should be read in conjunction with our unaudited condensed consolidated financial statements and the related notes included elsewhere in this Quarterly Report.

Revenue Recognition. We recognize revenue from product sales when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable and collectibility of the related receivable is probable under ordinary payment terms. When we have future obligations, including a requirement to deliver additional elements which are essential to the functionality of the delivered elements or for which vendor specific objective evidence of fair value (VSOE) does not exist or customer acceptance is required, we defer revenue recognition and related costs until those obligations are satisfied. The ordering pattern and sales lead times associated with customer orders may vary significantly from period to period.

Many of our sales are generated from complex contractual arrangements which require significant revenue recognition judgments, particularly in the case of multiple element arrangements. When a sale involves multiple elements, such as products, maintenance or professional services, we allocate the entire sales price to each respective element based on VSOE or using the residual method when VSOE cannot be established for a single delivered element in the arrangement. We then recognize revenue on each element in accordance with our policies for revenue recognition related to each element. We determine VSOE based upon the price charged when the same element is sold separately. If we cannot establish VSOE for each undelivered element, we defer revenue recognition on the entire arrangement until the earlier of the establishment of VSOE or delivery of the undelivered element.

In addition, if an arrangement with a customer includes a specified upgrade right for which VSOE cannot be established, we defer all revenue related to the arrangement until the earlier of the delivery of the specified upgrade or the establishment of VSOE for the specified upgrade. We have concluded that a specified upgrade right exists if it is included in the customer contract or otherwise becomes part of the arrangement with the customer. We have concluded that communications with customers in the normal course of business regarding customer feature requests and our product plans do not create specified upgrade rights.

Maintenance and support services are recognized ratably over the life of the maintenance and support service period, which typically is one year when the services are sold separately and up to five years when the fees for the services are bundled with the product fees as part of a multiple element arrangement. Maintenance and support services include telephone support and unspecified rights to product upgrades and enhancements. Maintenance and support VSOE represents a consistent percentage of the sales prices charged to customers. The application of judgment could affect the continued determination of maintenance and support VSOE and Sonus' ability to recognize revenue using the residual method.

Installation service revenues are generally recognized at the time of the related product revenue recognition as installation is typically complete by such time. Professional services are typically recognized as the services are performed.

We sell the majority of our products directly to end-users. For products sold through resellers and distributors, we recognize revenue on a sell-through method utilizing information provided to us from our resellers and distributors.

We record deferred revenue for product shipped to customers and related services where amounts are billed pursuant to a contractual right and collection is probable, or collected, in the ordinary course of business if the revenue recognition criteria have not been satisfied. Deferred revenues include customer deposits and amounts associated with maintenance contracts. Deferred revenues not expected to be recognized within one year of the balance sheet date are classified as long-term deferred revenues.

We defer recognition of incremental direct costs, such as cost of goods, royalties, commissions and third-party installation costs, until satisfaction of the criteria for recognition of the related revenue.

Loss Contingencies and Reserves. We are subject to ongoing business risks that affect the estimation process of the carrying value of assets, the recording of liabilities and the possibility of various loss contingencies. Under SFAS No. 5, an estimated loss contingency is accrued when it is probable that a liability has been incurred or an asset has been impaired and the amount of loss can be reasonably estimated. We regularly evaluate current information available to us to determine whether such amounts should be adjusted and record changes in estimates in the period they become known.

Allowance for Doubtful Accounts. We establish billing terms at the time we negotiate purchase agreements with our customers. We continually monitor timely payments and assess any collection issues. The allowance for doubtful accounts is based on our detailed assessment of the collectibility of specific customer accounts. While we believe that our allowance for doubtful accounts is adequate and that the judgment applied is appropriate, if there is a deterioration of a customer's creditworthiness or actual defaults are higher than our historical experience, the actual results could differ from these estimates. While such credit losses have historically been within our expectations and the allowances we established, we cannot guarantee that we will continue to experience the same credit loss rates that we have in the past. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payment, additional allowances may be required. We defer revenue recognition for customers for which we believe collection is less than probable. Our failure to accurately estimate the losses for doubtful accounts or receive payments on a timely basis could have a material adverse effect on our business, financial condition and results of operations.

Inventory Reserves. Inventory purchases and commitments are based upon estimated future demand for our products. We value inventory at the lower of cost or net realizable value. We provide inventory reserves based on excess and obsolete inventory determined primarily by future demand forecasts and returns of deferred product, and record changes to such reserves through adjustments to cost of revenues. We assess such demand forecasts and return history on at least a quarterly basis. If we record a charge to reduce inventory to its estimated net realizable value, we do not increase its carrying value due to subsequent changes in demand forecasts or product repairs. Accordingly, if inventory previously written down to its net realizable value is subsequently sold, we may realize improved gross profit margins on those transactions in the period the related revenue is recognized.

We also record a full inventory reserve for evaluation equipment at the time of shipment to our customers as a charge to sales and marketing expense as our experience with this type of inventory indicates it is probable that the inventory will not be realizable. If these evaluation shipments should convert to revenue, we record a benefit to sales and marketing expenses and record the full cost of revenues in the period of revenue recognition.

We have experienced significant changes in our product demand and, as a result, our required inventory reserves have fluctuated in recent periods. It is possible that significant changes in required inventory reserves may continue to occur in the future if there is a sudden and significant change in the demand for our products, changes in the amount of customer evaluation inventory or higher risks of inventory obsolescence because of rapidly changing technology.

Warranty Reserve. Our products are covered by a standard warranty of 90 days for software and one year for hardware. In addition, certain customer contracts include warranty-type provisions for epidemic or similar product failures, generally for the contractual period or the life of the product in accordance with published telecommunications standards. We accrue for such contingent obligations when the occurrence of such obligation is probable and the amount of such obligation is reasonably estimable. We have not incurred significant costs related to such obligations. Our customers typically purchase maintenance and support contracts, which encompass our warranty obligations. Our estimates of anticipated rates of warranty claims and costs are primarily based on historical information and future forecasts.

In addition, certain of our customer contracts include provisions under which we may be obligated to pay penalties generally for the contractual period or for the life of the product if its products fail or do not perform in accordance with specifications. We accrue for such contingent obligations when the occurrence of such obligation is probable and the amount of such obligation is reasonably estimable. We have not incurred significant costs related to such provisions. We periodically assess the adequacy of our recorded warranty liabilities and adjusts the amounts as necessary. Increases in product failures rates, material usage or service delivery costs may result in increases to our warranty reserve and our gross profit could be adversely affected.

Royalty Accrual. We accrue for royalty-related technology we license from vendors based on established royalty rates and usage. In certain cases, we have been contacted by third parties who claim that our products infringe on certain intellectual property of the third party. We evaluate these claims and accrue for royalties when the amounts are probable and reasonably estimable. While we believe that the amounts accrued for estimated royalties are adequate, the amounts required to ultimately settle royalty obligations may be different.

Reserve for Litigation and Legal Fees. We are subject to various legal claims, including securities litigation and intellectual property claims. We reserve for legal contingencies and legal fees when the amounts are probable and reasonably estimable. Our director and officer liability insurance policies provide only limited liability protection relating to the securities class action and derivative lawsuits against us and certain of our officers and directors. We intend to defend these matters vigorously, although the ultimate outcome of these items is uncertain and the potential loss, if any, may be significantly higher or lower than the amounts we have previously accrued.

Accounting for Income Taxes. SFAS No. 109, *Accounting for Income Taxes*, requires the establishment of a valuation allowance to reflect the likelihood of realization of deferred tax assets. Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. We evaluate all available evidence, such as recent and expected future operating results by tax jurisdiction, and current and enacted tax legislation and other temporary differences between book and tax accounting, to determine whether it is more likely than not that some portion or all of the deferred income tax assets will not be realized.

As a result of net operating losses incurred in prior years in most jurisdictions in which we operate, and uncertainty as to the extent, jurisdiction and timing of profitability in future periods, we have continued to record a full valuation allowance against deferred tax assets. The establishment and amount of the valuation allowance requires significant estimates and judgment and can materially affect our results of operations. If the realization of deferred tax assets in the future is considered more likely than not, an adjustment to the valuation allowance for the deferred tax asset would be made. A portion of the release of the valuation allowance will increase net income in the period such determination was made. Our effective tax rate may vary from period to period based on changes in estimated taxable income or loss in each jurisdiction, changes to the valuation allowance, statutory minimum tax rates or changes to federal, state or foreign tax laws, future expansion into areas with varying country, state, and local income tax rates, including statutory minimum tax rates, deductibility of certain costs and expenses by jurisdiction and as a result of acquisitions.

Three and Six Months Ended June 30, 2003 and 2002

Revenues. Revenues for the three and six months ended June 30, 2003 and 2002 were as follows, in thousands:

	Three Months ended June 30,		Six Months ended June 30,	
	2003	2002	2003	2002
	(As Restated)	(As Restated)	(As Restated)	(As Restated)
Revenues:				
Product	\$ 8,255	\$ 46,110	\$ 11,772	\$ 59,229
Service	7,111	5,665	12,803	13,054
Total revenues	\$ 15,366	\$ 51,775	\$ 24,575	\$ 72,283

Product revenues comprise sales of our voice infrastructure products, including our GSX9000™ Open Services Switch, Insignus™ Softswitch, Sonus Insight™ Management System and related product offerings. Product revenues for the three and six months ended June 30, 2003 decreased 82% and 80% from the same periods in fiscal 2002. The decreases in product revenue for the three and six months ended June 30, 2003 were primarily due to the recognition of \$27.5 million from one customer in the second quarter of 2002 upon completion of the delivery of a specified software upgrade for product shipped in 2001. In addition, there was lower demand caused by significant declines in capital spending by telecommunications service providers and financial difficulties, including in some cases bankruptcies, experienced by certain emerging service providers, including some of our customers.

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Service revenues primarily comprise hardware and software maintenance, network design and other professional services. Service revenues for the three months ended June 30, 2003 increased 26% from the same period in fiscal 2002 and was primarily due to completion of significant professional services and installation projects and an increase in maintenance revenues due to our growing installed customer base. Service revenues for the six months ended June 30, 2003 decreased 2% from the same period in fiscal 2002 and was primarily due to the timing of maintenance contract renewals and a reduction in revenues for product installations.

For the three months ended June 30, 2003 and 2002, three customers and one customer each contributed 10% or more of our revenues, representing an aggregate of 54% and 66% of total revenues. For the six months ended June 30, 2003 and 2002, three and two customers each contributed 10% or more of our revenues, representing an aggregate of 49% and 58% of total revenues. The following customers contributed 10% or more of our revenues in the three and six months ended June 30, 2003 and 2002:

Customer:	Three months ended June 30,		Six months ended June 30,	
	2003	2002	2003	2002
	(As Restated)	(As Restated)	(As Restated)	(As Restated)
Verizon Global Networks	22%	*%	14%	*%
Global Crossing	16	*	21	*
Nissho Electronics Corporation	16	*	14	*
Qwest Communications	*	66	*	48
Touch America	*	*	*	10

* Represents less than 10% of revenues.

International revenues, primarily to Asia and Europe, were 31% and 13% of revenues for the three months ended June 30, 2003 and 2002. International revenues, primarily to Asia and Europe, were 29% and 16% of revenues for the six months ended June 30, 2003 and 2002.

Cost of Revenues/Gross Profit. Cost of revenues consists primarily of amounts paid to third party manufacturers for purchased materials and services, manufacturing and professional services personnel and related costs and inventory obsolescence. Cost of revenues and gross profit as a percentage of revenues for the three and six months ended June 30, 2003 and 2002 were as follows, in thousands except percentages):

	Three months ended June 30,		Six months ended June 30,	
	2003	2002	2003	2002
	(As Restated)	(As Restated)	(As Restated)	(As Restated)
Cost of revenues:				
Product	\$ 3,896	\$ 16,638	\$ 5,434	\$ 23,576
Service	3,369	3,022	5,924	6,007
Write-off of inventory and purchase commitments	—	—	—	6,865

Total cost of revenues	\$ 7,265	\$ 19,660	\$ 11,358	\$ 36,448
Gross profit (% of respective revenues):				
Product	53%	64%	54%	60%
Service	53	47	54	54
Total gross profit	53	62	54	50(1)

(1) Includes the impact of the write-off of inventory and purchase commitments.

The decrease in product gross profit as a percentage of product revenues for the three and six months ended June 30,

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2003, compared to the same periods in the prior year, excluding the write-offs of inventory and purchase commitments for the six months ended June 30, 2002, was primarily due to a higher proportion of fixed costs resulting from the significant decline in revenue, partially offset by reductions in costs resulting from our restructuring actions in fiscal 2002. The increase in service gross profit as a percentage of service revenues for the three months ended June 30, 2003 as compared to the same period in 2002 was primarily due to increased maintenance service revenues resulting from our growing installed base. Our service cost of revenues is relatively fixed in advance of any particular quarter.

During the six months ended June 30, 2002, we recorded included in cost of revenues charges of \$6.9 million, consisting of \$4.5 million for the write-off of inventory determined to be excess and obsolete and \$2.4 million for materials that were expected to be purchased from third party contract manufacturers and suppliers under purchase commitments, but which were in excess of required quantities. Remaining cash expenditures of \$0.2 million at June 30, 2003 for purchase commitments are included on the balance sheet as accrued restructuring expenses.

Research and Development Expenses. Research and development expenses consist primarily of salaries and related personnel costs and prototype costs related to the design, development, testing and enhancement of our products. Research and development expenses were \$8.5 million for the three months ended June 30, 2003, a decrease of \$2.7 million, or 24%, from \$11.2 million for the same period in fiscal 2002. Research and development expenses were \$16.2 million for the six months ended June 30, 2003, a decrease of \$9.9 million, or 38%, from \$26.1 million for the same period in fiscal 2002. These decreases primarily reflect a reduction in salaries and related expenses attributed to restructuring actions and, to a lesser extent, reductions in consulting fees, prototype costs and depreciation expense. The decrease for the three months ended June 30, 2003 as compared to the same period in fiscal 2002 was partially offset by the reinstatement in April 2003 of a temporary salary reduction originally implemented in April 2002. Some aspects of our research and development efforts require significant short-term expenditures, the timing of which can cause significant variability in our expenses.

Sales and Marketing Expenses. Sales and marketing expenses consist primarily of salaries and related personnel costs, commissions, travel and entertainment expenses, promotions, customer evaluations and other marketing and sales support expenses. Sales and marketing expenses were \$4.5 million for the three months ended June 30, 2003, a decrease of \$4.9 million, or 52%, from \$9.4 million for the same period in fiscal 2002. Sales and marketing expenses were \$8.4 million for the six months ended June 30, 2003, a decrease of \$8.5 million, or 50%, from \$16.9 million for the same period in fiscal 2002. These decreases primarily reflect a reduction in salaries and related expenses attributed to restructuring actions, a decrease in commissions due to decreased revenues, a reduction in costs for customer evaluations, and, to a lesser extent, a reduction in costs for travel entertainment and trade shows. The decrease for the three months ended June 30, 2003 as compared to the same period in fiscal 2002 was partially offset by the reinstatement in April 2003 of a temporary salary reduction originally implemented in April 2002.

General and Administrative Expenses. General and administrative expenses consist primarily of salaries and related personnel costs for executive and administrative personnel, recruiting expenses, allowance for doubtful accounts and professional fees. General and administrative expenses were \$1.5 million for the three months ended June 30, 2003, an increase of \$264,000, or 22%, from \$1.2 million for the same period in fiscal 2002. General and administrative expenses were \$3.3 million for the six months ended June 30, 2003, a decrease of \$484,000, or 13%, from \$3.8 million for the same period in fiscal 2002. The increase for the three months ended June 30, 2003 as compared to the same period in fiscal 2002 was primarily due the reinstatement in April 2003 of a temporary salary reduction originally implemented in April 2002. The decrease for the six months ended June 30, 2003 reflects reductions in salaries and related expenses attributed to restructuring actions and, to a lesser extent, a reduction in professional fees and depreciation expenses, partially offset by the reinstatement of the temporary salary reductions.

Stock-based Compensation Expenses. Stock-based compensation expenses include the amortization of stock compensation charges resulting from the granting of stock options, including the telecom technologies, inc. (TTI) stock options assumed by us, stock awards to TTI employees under the 2000 Retention Plan and the sales of restricted common stock. Stock-based compensation expenses were \$645,000 for the three months ended June 30, 2003, a decrease of \$4.3 million, or 87%, from \$4.9 million for the same period in fiscal 2002. Stock-based compensation expenses were \$1.6 million for the six months ended June 30, 2003, a decrease of \$10.1 million, or 86%, from \$11.7 million for the same period in fiscal 2002. The decreases are primarily due to lowered deferred compensation balances resulting from write-offs made in connection with employee terminations and accelerated recognition of deferred compensation expense pursuant to

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FIN 28.

On October 16, 2002, we commenced an offer to exchange outstanding employee stock options for new stock options to be granted on a date that is at least six months and one day from the expiration date of the exchange offer. The exchange offer expired on November 22, 2002, and outstanding options to purchase approximately 8,973,000 shares of common stock were accepted for exchange and cancelled. On May 27, 2003, employees received an option to purchase one share of common stock for each share of common stock under the exchanged options at an exercise price of \$4.08 per share, representing the fair market value of our common stock on the date of grant.

Amortization of Purchased Intangible Assets. In fiscal 2001, we acquired certain intellectual property, in-process research and development and intangible assets in connection with our acquisitions of TTI and LinguatEQ. Amortization of purchased intangible assets was \$602,000 for the three months ended June 30, 2003, a decrease of \$588,000 from \$1.2 million for the same period in fiscal 2002. Amortization of purchased intangible assets was \$1.2 million for the six months ended June 30, 2003, a decrease of \$1.2 million from \$2.4 million for the same period in fiscal 2002. The decreases of amortization of purchased intangible assets were due to the write-off of certain purchased intangibles in fiscal 2002.

Restructuring Charges, net. Commencing in the third quarter of fiscal 2001 and extending through fiscal 2002, in response to unfavorable business conditions primarily caused by significant declines in capital spending by telecommunications service providers, we implemented restructuring plans designed to reduce expenses and align our cost structure with our revised business outlook. The restructuring plans included worldwide workforce reductions, consolidation of excess facilities and the write-off of excess inventory and purchase commitments. We reduced our worldwide workforce for which we recorded charges of \$1.5 million and \$2.8 million for the three and six months ended June 30, 2002. As of June 30, 2003, all cash expenditures had been made related to this reduction. In the three and six months ended June 30, 2002, we recorded a net restructuring benefit of \$495,000 and charge of \$2.9 million for the additional consolidation of excess facilities, which were included on the balance sheet in accrued restructuring expenses and long-term liabilities.

Interest Income, net. Interest income consists of interest earned on our cash balances and marketable securities. Interest expense consists of interest incurred on a convertible subordinated note, equipment bank debt and capital lease arrangements. Interest income, net of interest expense, was \$313,000 for the three months ended June 30, 2003, a decrease of \$63,000 from \$376,000 for the same period in fiscal 2002. Interest income, net of interest expense, was \$564,000 for the six months ended June 30, 2003, a decrease of \$265,000 from \$829,000 for the same period in fiscal 2002. These decreases primarily reflect a reduction in interest rates, partially offset by an increase in our cash balances.

Income Taxes. Provision for income taxes recorded was \$32,000 for the three months ended June 30, 2003, compared to \$21,000 for same period in fiscal 2002. For the six months ended June 30, 2003, provision for income taxes recorded was \$65,000, compared to \$43,000 for same period in fiscal 2002. The income tax provision in all periods is attributable primarily to foreign income taxes and state minimum income taxes in the U.S.

Off-balance Sheet Arrangements

We have no off-balance sheet arrangements that have or are reasonably likely to have a current or future material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

Liquidity and Capital Resources

At June 30, 2003, our principal sources of liquidity were our cash, cash equivalents and marketable securities that totaled \$162.6 million. In April 2003, we completed a public offering of 20,000,000 shares of our common stock at a price of \$3.05 per share resulting in net proceeds of \$56.7 million after deducting offering expenses of \$4.3 million.

Our operating activities used net cash of \$10.8 million for the six months ended June 30, 2003, as compared to \$20.2 million for the same period in fiscal 2002. The decrease in net cash used primarily reflects a reduction in the net loss an increase in deferred revenue as a result of customer payments received prior to meeting revenue recognition criteria, and increases in accounts payable and accrued expenses, partially offset by increases in receivables, inventory and other current

assets and a decrease in non-cash expense items.

Net cash provided by investing activities was \$13.5 million for the six months ended June 30, 2003 primarily reflects net maturities of marketable securities of \$15.0 million, partially offset by purchases of property and equipment of \$1.7 million, as compared to \$9.9 million for the same period in fiscal 2002 which primarily reflects net maturities of marketable securities of \$12.0 million, partially offset by purchases of property and equipment of \$2.1 million.

Net cash provided by financing activities was \$56.8 million for the six months ended June 30, 2003, as compared to \$2.0 million for the same period in fiscal 2002. The net cash provided by financing activities for the six months ended June 30, 2003 primarily resulted from the public offering of common stock completed in April 2003. The net cash provided by financing activities for the six months ended June 30, 2002 primarily resulted from the sale of common stock in connection with our employee stock purchase plan, partially offset by payments on our long-term liabilities.

As of June 30, 2003 we had a \$10.0 million equipment line of credit and a \$20.0 million working capital line of credit with a bank available through March 23, 2004. The lines of credit were collateralized by all of our assets, except intellectual property, and bore interest at the bank's prime rate. We were required to comply with various financial and restrictive covenants. As of June 30, 2003, we had \$2.3 million outstanding under the equipment line of credit and were in compliance with all bank covenants.

The following summarizes our future contractual cash obligations as of June 30, 2003, in thousands:

Contractual Obligations	Payment Due by Period				
	Total	Less than 1 year	1-3 years	3-5 years	Thereafter
Long-term debt obligations	\$ 13,825	\$ 1,653	\$ 12,172	\$ —	\$ —
Capital lease obligations	451	348	103	—	—
Operating lease obligations	6,854	3,850	2,090	806	108
Total	\$ 21,130	\$ 5,851	\$ 14,365	\$ 806	\$ 108

Based on our past performance and current expectations, we believe our current cash, cash equivalents and marketable securities will be sufficient to meet our anticipated cash needs for working capital and capital expenditures for at least 12 months.

Recent Accounting Pronouncements

In June 2002, the FASB issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. SFAS No. 146 addresses the recognition, measurement and reporting of costs associated with exit and disposal activities, including restructuring activities that were accounted for in accordance with Emerging Issues Task Force 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)*. The scope of SFAS No. 146 includes costs related to terminating a contract that is not a capital lease, costs to consolidate facilities or relocate employees, and certain termination benefits provided to employees who are involuntarily terminated. SFAS No. 146 is effective for exit or disposal activities initiated after December 31, 2002. The implementation of this statement did not have a material impact on our financial position or results of operations.

In November 2002, the FASB issued Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (FIN No. 45). FIN No. 45 elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The initial recognition and initial measurement provisions of the interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002 and the disclosure requirements in this interpretation are effective for financial statements of interim or

annual periods ending after December 15, 2002. The FIN No. 45 disclosure requirements are included in Note 5 to our unaudited condensed consolidated financial statements. The adoption of FIN No. 45 did not have a material impact on our financial position or results of operations.

In December 2002, the FASB issued SFAS No. 148, *Accounting for Stock-Based Compensation—Transition and Disclosure*, an amendment of SFAS No. 123. SFAS No. 148 provides alternative methods of transition for a voluntary change to the fair value-based method of accounting for employee stock-based compensation. These alternative methods will only impact us if we voluntarily change to the fair value-based method of accounting for employee stock-based compensation. SFAS No. 148 also requires companies who account for employee stock-based compensation under the intrinsic value-based method to disclose additional footnote information in annual financial statements effective for fiscal years ending after December 15, 2002 and in financial statements for interim periods beginning after December 15, 2002. The requisite disclosure appears in Note 3(l) to our unaudited condensed consolidated financial statements.

In January 2003, the FASB issued Interpretation No. 46, *Consolidation of Variable Interest Entities* (FIN No. 46) to clarify the conditions under which assets, liabilities and activities of another entity should be consolidated into the financial statements of a company. FIN No. 46 requires the consolidation of a variable interest entity 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. We do not have any variable interest entities.

In May 2003, the FASB issued SFAS No. 150, *Accounting For Certain Financial Instruments with Characteristics of Both Liabilities and Equity*, which establishes standards for how an issuer of financial instruments classifies and measures certain financial instruments with characteristics of both liabilities and equity. SFAS No. 150 requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances) because that financial instrument embodies an obligation of the issuer. SFAS No 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of SFAS No. 150 did not have a material impact on our overall financial position or results of operations.

Item 4: Controls and Procedures

Our management, with the participation of our principal executive officer and principal financial officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the Exchange Act)) as of June 30, 2003. Due to the material weaknesses in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) referred to below, we have concluded that our disclosure controls and procedures were not effective as of June 30, 2003.

An initial evaluation of our disclosure controls and procedures was performed shortly following the quarter ended June 30, 2003 by our management. Subsequently, in connection with the restatement of our consolidated financial statements for the years ended December 31, 2002 and 2001 and the nine months ended September 30, 2003, we discovered material weaknesses applicable to the period covered by this periodic report. The material weaknesses in our internal control over financial reporting are described in Item 9A in our Annual Report on Form 10-K for the year ended December 31, 2004, filed with the SEC on March 15, 2005.

Since identifying these material weaknesses, we have made changes that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. The primary such changes are described in Item 4 in our Quarterly Report on Form 10-Q for the quarter ended March 31, 2005, filed with the SEC on May 9, 2005, and Item 9A in our Annual Report on Form 10-K for the year ended December 31, 2004.

We continue to plan and expect to implement additional changes to our infrastructure and related processes that we believe are also reasonably likely to strengthen and materially affect our internal control over financial reporting.

While there have been significant changes in our internal control over financial reporting subsequent to June 30, 2003, as described in the above referenced periodic reports, no change in our internal control over financial reporting occurred during the fiscal quarter ended June 30, 2003 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

The changes in our internal control over financial reporting implemented by us to date will not in and of themselves remediate the material weaknesses, and certain of these remedial measures will require some time to be fully implemented or to take full effect. Prior to the remediation of these material weaknesses, there remains risk that the transitional controls, described below, on which we currently rely will fail to be sufficiently effective, which could result in material misstatement of our financial position or results of operations and require a restatement.

We are currently implementing an enhanced controls environment intended to address the material weaknesses in our internal control over financial reporting and to remedy the ineffectiveness of our disclosure controls and procedures. While this implementation phase is underway, we are relying on extensive manual procedures, including regular reviews and the significant utilization of outside accounting professionals, to assist us with meeting the objectives otherwise fulfilled by an effective controls environment. We expect to establish and implement a policy-based system of controls. While we are undertaking the implementation of this new controls environment, there remains risk that the transitional controls on which we are currently relying will fail to be sufficiently effective. We also note, however, that a control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must include an assessment of the costs and related risks associated with the control and the purpose for which it was intended. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues including instances of fraud, if any, have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, our control systems, as we develop them, may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected and could be material and require a restatement of our financial statements.

The certifications of our principal executive officer and principal financial officer required in accordance with Rule 13a-14(a) under the Exchange Act are attached as exhibits to this Amendment to Quarterly Report on Form 10-Q/A. The disclosures set forth in this Item 4 contain information concerning the evaluation of our disclosure controls and procedures, and changes in internal control over financial reporting, referred to in paragraph 4 of those certifications. Those certifications should be read in conjunction with this Item 4 for a more complete understanding of the matters covered by the certifications.

PART II—OTHER INFORMATION

Item 6: Exhibits and Reports on Form 8-K

(a) Exhibits:

Exhibit Number	Description
31.1	Certificate of Sonus Networks, Inc. Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certificate of Sonus Networks, Inc. Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certificate of Sonus Networks, Inc. Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certificate of Sonus Networks, Inc. Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K:

Sonus furnished a Current Report on Form 8-K dated April 9, 2003 reporting under Item 9 (Regulation FD Disclosure) its actual financial results for the quarter ended March 31, 2003.

Sonus filed a Current Report on Form 8-K dated April 22, 2003 reporting under Item 5 (Other Events and Regulation FD Disclosure) a public offering of 20,000,000 shares of its common stock pursuant to an effective registration statement on Form S-3.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Dated: June 10, 2005

SONUS NETWORKS, INC.

By:

/s/ Ellen B. Richstone

Ellen B. Richstone

Chief Financial Officer (Principal Financial Officer)

SONUS NETWORKS, INC.

By:

/s/ Bradley T. Miller

Bradley T. Miller

Vice President of Finance, Corporate Controller and Chief Accounting Officer (Principal Accounting Officer)

EXHIBIT INDEX

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32.2	Certificate of Sonus Networks, Inc. Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

**CERTIFICATION PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Hassan M. Ahmed, Chief Executive Officer and Chairman of the Board of Directors, of Sonus Networks, Inc., certify that:

1. I have reviewed this Amendment No. 1 to the Quarterly Report on Form 10-Q/A for the period ended June 30, 2003 ("Quarterly Report") of Sonus Networks, Inc. (the "Registrant");

2. Based on my knowledge, this Quarterly Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Quarterly Report;

3. Based on my knowledge, the financial statements, and other financial information included in this Quarterly Report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this Quarterly Report;

4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the Registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this Quarterly Report is being prepared;

(b) Designed such internal control over financial reporting or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this Quarterly Report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this Quarterly Report based on such evaluation; and

(d) Disclosed in this Quarterly Report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's fiscal quarter ended June 30, 2003 that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and

5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors:

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Date: June 10, 2005

/s/ Hassan M. Ahmed

Hassan M. Ahmed

Chief Executive Officer and Chairman of the Board of Directors

(Principal Executive Officer)

**CERTIFICATION PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Ellen B. Richstone, Chief Financial Officer, of Sonus Networks, Inc., certify that:

1. I have reviewed this Amendment No. 1 to the Quarterly Report on Form 10-Q/A for the period ended June 30, 2003 ("Quarterly Report") of Sonus Networks, Inc. (the "Registrant");
2. Based on my knowledge, this Quarterly Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Quarterly Report;
3. Based on my knowledge, the financial statements, and other financial information included in this Quarterly Report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this Quarterly Report;
4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the Registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this Quarterly Report is being prepared;
 - (b) Designed such internal control over financial reporting or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this Quarterly Report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this Quarterly Report based on such evaluation; and
 - (d) Disclosed in this Quarterly Report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's fiscal quarter ended June 30, 2003 that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors:
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Date: June 10, 2005

/s/ Ellen B. Richstone
Ellen B. Richstone
Chief Financial Officer
(Principal Financial Officer)

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q of Sonus Networks, Inc. (the "Company") for the period ended June 30, 2003 as filed with the Securities and Exchange Commission on August 14, 2003 and as amended on the date hereof (the "Report"), the undersigned, Hassan M. Ahmed, Chief Executive Officer and Chairman of the Board of Directors of the Company, hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Hassan M. Ahmed

Hassan M. Ahmed

*Chief Executive Officer and Chairman of the Board of
Directors (Principal Executive Officer)*

Date: June 10, 2005

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q of Sonus Networks, Inc. (the "Company") for the period ended June 30, 2003 as filed with the Securities and Exchange Commission on August 14, 2003 and as amended on the date hereof (the "Report"), the undersigned, Ellen B. Richstone, Chief Financial Officer of the Company, hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: June 10, 2005

/s/ Ellen B. Richstone

Ellen B. Richstone
Chief Financial Officer
(Principal Financial Officer)