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

Form 10-K

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

For the fiscal year ended December 31, 2006

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

For the transition period from _____ to _____

Commission File Number 0-51148

Tri-S Security Corporation
(Exact Name of Registrant as Specified in Its Charter)

Georgia	**30-0016962**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**

Royal Centre One
11675 Great Oaks Way
Suite 120
Alpharetta, GA 30022
(Address of Principal Executive Offices)

(678) 808-1540
(Registrant's Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Act: common stock, par value $0.001 per share; and warrants to purchase common stock, par value $0.001 per share

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

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filed and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated Filer ☐ Accelerated Filer ☐ Non-accelerated filer ☒

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates completed by reference to the price at which the common equity was last sold as of the last business day of the registrant's most recently completed second fiscal quarter is $7,379,593.

As of March 25, 2007, 3,503,280 shares of common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE: The information required by Part III of this Annual Report is incorporated by reference to the registrant's definitive proxy statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A of the Securities Exchange Act of 1934, as amended, not later than 120 days after the end of the fiscal year covered by this Annual Report.

Annual Report on Form 10-K
For the Year Ended December 31, 2006

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PART I

Note Regarding Forward-Looking Statements

Tri-S Security Corporation, a Georgia corporation ("Tri-S Security"), and its subsidiaries (together, the "Company" or "we") have made forward-looking statements in this Annual Report on Form 10-K for the year ended December 31, 2006 (the "Annual Report"), including, without limitation, in the sections herein titled

"Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Business," that are based on our management's beliefs and assumptions and on information currently available to our management. Forward-looking statements include information concerning our possible or assumed future results of operations, business strategies, financing plans, competitive position, potential growth opportunities, the effects of future regulation and the effects of competition. Forward-looking statements include all statements that are not historical facts. Words such as "believes," "expects," "anticipates," "intends," "seeks," "could," "will," "predicts," "potential," "continue," "may," "plans," "estimates" and similar expressions, or the negative of these and similar expressions, are intended to identify such forward-looking statements.

Forward-looking statements are based on factors that involve risks, uncertainties and assumptions, and actual results may differ from those expressed or implied by the forward-looking statements. These factors include, among others: the legal claims against us; the cost of defending such claims; the consequences to us if we do not prevail on such claims; our substantial debt and our inability to make scheduled debt service payments; our dependence on the factoring facility; the restrictions imposed on us by the credit agreement with our lenders; the impact of terrorist activity or breach of security on our business; our ability to retain and manage our guards; our plans for expansion and growth of our business; our ability to compete effectively in our industry; our expectations regarding the likelihood of introduction of new regulations that would adversely affect our business; our estimates of our capital requirements and needs for additional financing; risks related to Federal government contracts; Federal government audits and cost adjustments; differences between authorized amounts and amounts received by us under Federal government contracts; changes in Federal government (or other applicable) procurement laws, regulations, policies and budgets; our ability to retain contracts during re-bidding processes; and the other factors that we describe in this Annual Report under the sections herein titled "Management's Discussion and Analysis of Financial Condition and Results of Operations", "Business", and "Risk Factors." You should not put undue reliance on any forward-looking statement. You should understand that many important factors, in addition to those discussed in the sections herein titled "Management's Discussion and Analysis of Financial Condition and Results of Operations", "Business", "Risk Factors", and elsewhere in this Annual Report, could cause our results to differ materially from those expressed in forward-looking statements.

All forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements set forth in this Annual Report. Forward-looking statements speak only as of the date they are made, and we undertake no obligation to update publicly any of these statements in light of new information or future events.

Item 1. Business

Overview

Tri-S Security is an aggregator of elite guard services companies. Through our two direct, wholly-owned subsidiaries, Paragon Systems, Inc. ("Paragon Systems") and The Cornwall Group, Inc. ("Cornwall"), we provide equipment and security services to various government agencies and the private sector. Our government customers include local, state and Federal government agencies. Our private sector customers include commercial customers, such as universities, public school systems, corporate complexes, hospitals, and residential customers, such as condominiums, high-end apartments and high-security homes.

We strive to provide cost-effective solutions to ensure the safety and security of the assets and personnel of our customers and to continually improve the protection we provide for their personnel, programs, resources and facilities. Our goal is to provide demonstrably superior contract guard services with the highest degree of integrity and responsiveness.

Paragon Systems formed Southeastern Paragon ("SEP"), a joint venture between Paragon Systems and Southeastern Protective Services, Inc. SEP has been certified by the U.S. Small Business Administration (the "SBA") as a small and disadvantaged business (an "8(a) firm") and is therefore qualified to bid on security contracts specially designated for 8(a) firms. Paragon Systems owns 49% of SEP and is the manager of the SEP business. SEP was awarded three Federal security contracts during 2006.

Tri-S Security was incorporated in Georgia in October 2001 under the name "Diversified Security Corporation" and changed its name to "Tri-S Security Corporation" in August 2004. We were formed for the purpose of acquiring and consolidating electronic and physical security companies in order to take advantage of the operating efficiencies created by a larger company. Our acquisition strategy involves the acquisition and integration of complementary businesses in order to increase our scale within certain geographic areas and capture market share in the markets in which we operate and improve our profitability. We may pursue acquisition opportunities in the contract guard services and system integration services segments of the security industry. We frequently evaluate acquisition opportunities and, at any given time, may be in various stages of due diligence or preliminary discussions with respect to a number of potential acquisitions. From time to time, we may enter into non-binding letters of intent, but we are not currently subject to any definitive agreement with respect to any acquisition material to our operations or otherwise so far advanced in any discussions as to make an acquisition material to our operations reasonably certain. During 2006, we did not pursue acquisitions as aggressively as in the past because we were focused on the integration of the companies previously acquired. In the future, we plan to resume our acquisition plan if opportunities are available.

We made our first acquisition on February 27, 2004, when we acquired all of the outstanding capital stock of Paragon Systems, a contract guard services and logistics provider for a purchase price of $16,000,000 (the "Paragon Acquisition"). At the closing of the Paragon Acquisition, we: (i) paid $10 million, of which $2.3 million was paid in cash and $7.7 million was paid through issuance of promissory notes to the former shareholders of Paragon Systems (the "Paragon Notes"); and (ii) issued to the former shareholders an aggregate of 100 shares of our Series C Redeemable Preferred Stock, with an aggregate redemption value of $6.0 million (the "Series C Redeemable Preferred Stock"), payable no later than February 27, 2007. Our payment obligations under the Series C Redeemable Preferred Stock are secured by a pledge of 40% of the outstanding capital stock of Paragon Systems. On February 27, 2006, we filed a lawsuit against the former shareholders of Paragon Systems alleging, among other things, that they breached certain representations made by them in the Stock Purchase Agreement between us and the former shareholders dated as of February 23, 2004, pursuant to which we acquired Paragon Systems (the "Paragon Purchase Agreement"). Under the Paragon Purchase Agreement and all applicable common law, we are exercising our rights of offset against the dividend and redemption payments otherwise payable by us in respect of the Series C Redeemable Preferred Stock. Accordingly, we did not make dividend payments on the Series C Redeemable Preferred Stock on February 28, 2006, or at any point thereafter, and we have not redeemed the Series C Redeemable Preferred Stock, which has a redemption value of $6.0 million and was otherwise redeemable by us on February 27, 2007. See the section of this Annual Report entitled "Legal Proceedings."

On February 8, 2005, pursuant to an Exchange and Recapitalization Agreement, we effected an exchange and recapitalization of our outstanding common stock, Series A Convertible Preferred Stock and Series B Convertible Preferred Stock and rights to acquire our common stock. Pursuant to the Exchange and Recapitalization Agreement, all of our outstanding (i) common stock, Series A Convertible Preferred Stock and Series B Convertible Preferred Stock was exchanged for an aggregate of 1,200,000 shares of common stock and (ii) rights to acquire our common stock were exchanged for rights to purchase an aggregate of 113,269 shares of common stock (the "Exchange and Recapitalization").

On February 9, 2005, we commenced an initial public offering of 1,800,000 units (plus up to additional 270,000 units upon the exercise of the underwriters' over-allotment option), with each unit consisting of one share of common stock and a publicly-traded warrant to purchase one share of common stock, at an initial offering price per unit of $6.00. In connection with our initial public offering, our units commenced trading on The Nasdaq Capital Market under the symbol "TRISU" on February 9, 2005. Our initial public offering closed with respect to the initial 1,800,000 units on February 14, 2005 and with respect to the additional 270,000 units on March 17, 2005. Our units separated and ceased trading as units on April 9, 2005, and the common stock and publicly-traded warrants commenced trading on The Nasdaq Capital Market on April 11, 2005, under the symbols "TRIS" and "TRISW," respectively.

We made our second acquisition on October 18, 2005, when we acquired all of the outstanding capital stock of Cornwall, a provider of security and investigative services, including armed and unarmed uniform guards, video and alarm monitoring, alarm installation, and GPS monitoring, to government and private sector

customers in the Miami, Florida area (the "Cornwall Acquisition"). Cornwall has nine wholly-owned subsidiaries: International Monitoring, Inc.; Protection Technologies Corporation; Vanguard Security, Inc.; Armor Security, Inc.; Forestville Corporation; Vanguard of Broward County, Inc.; On Guard Security and Investigations, Inc., Guardsource Corp. and Virtual Guard Service, Inc. At the closing of the Cornwall Acquisition, we paid a total purchase price of $13,500,000 payable as follows: (i) payment of $12,825,000 in cash; (ii) delivery of a promissory note in principal amount of $250,000 payable to the former Cornwall shareholders (the "Cornwall Promissory Note"); and (iii) deposit of $425,000 with an escrow agent to secure the indemnification obligations of the former Cornwall shareholders under the Stock Purchase Agreement between us and the former Cornwall shareholders dated as of August 11, 2005 (the "Cornwall Purchase Agreement). After adjusting for certain working capital items, the net purchase price was $12,753,000. On January 26, 2007, we entered into a Settlement Agreement and General Release (the "Cornwall Settlement Agreement") with David Shopay, on behalf of himself and the other former shareholders of Cornwall, in his capacity as the representative of such shareholders. Pursuant to the Cornwall Settlement Agreement (i) the parties waived and released each other from all claims and liabilities, with the exception of certain claims and liabilities specified in the Cornwall Settlement Agreement, arising from the Cornwall Purchase Agreement; (ii) the shareholder representative forgave and discharged all amounts owed by us to the former shareholders of Cornwall under the Cornwall Promissory Note; and (iii) the shareholder representative and the Company instructed the escrow agent administering the escrow fund to release $200,000 from such fund to us and the remaining balance of such fund to the former shareholders of Cornwall.

Our principal executive offices are located at Royal Centre One, 11675 Great Oaks Way, Suite 120, Alpharetta, Georgia 30022. Our telephone number at that address is (678) 808-1540.

Our Contract Guard Services Operations

Through Paragon Systems and Cornwall, we provide equipment and security services to various government agencies and the private sector. Our services include providing uniformed and armed guards for access control, plant security, personnel security, theft prevention, surveillance, vehicular and foot patrol, crowd control and the prevention of sabotage, terrorist and criminal activities. We provide guards and other personnel who are, depending on the particular requirements of the customer, uniformed or plain-clothed, armed or unarmed, and who patrol in marked radio cars or stand duty on the premises at stationary posts. Our guards maintain contact with headquarters or supervisors via car radio or hand-held radios. In addition, our guards respond to emergency situations and report to appropriate authorities for fires, natural disasters, work accidents and medical crises.

In connection with providing these services, we assume responsibility for a variety of functions, including recruiting, hiring, training and supervising the guards deployed to the customers we serve, as well as paying all security guards and providing them with firearms, uniforms, fringe benefits, workers' compensation insurance and any required bonding. We are responsible for preventing the interruption of guard services as a consequence of illness, vacations or resignations.

Paragon Systems

Paragon Systems was incorporated in 1987 in Alabama and has provided contract guard services to Federal government agencies since 1994. Initially, Paragon Systems was established as an engineering company to service contracts with the Federal government agencies and with the U.S. Army Missile Command in both space and defense related areas of business. Paragon Systems has participated in high level engineering projects for the U.S. Army, the National Aeronautics and Space Administration ("NASA"), other government agencies and local industry.

While serving as an engineering company, Paragon Systems contracted with Lockheed Martin to furnish assistance in Federal contract administration on a sub-contract for construction at the NASA missile plant located in Iuka, Mississippi. Paragon Systems also provided engineering and technical support for contract cost management to NASA's Orbital Maneuvering Vehicle program, which developed an orbital vehicle that would be carried aloft by the space shuttle and maintained in orbit to perform specific tasks for the International Space

Station. Paragon Systems also performed a number of high level engineering projects for Control Dynamics Corporation, including conducting preliminary design tasks for development of a heavy launch lift vehicle, which was at that time planned to be a robotic successor for the space shuttle.

In 1991, Paragon Systems applied to be certified as an 8(a) firm (a small and disadvantaged business) SBA. In 1993, Paragon Systems was certified as an 8(a) firm and, in 1994, was awarded its first guard contract to provide security guard services for the U.S. Army Corps of Engineers. Since such time, Paragon Systems has obtained contracts with various other Federal government agencies and has developed contract guard security services as its core business. Paragon Systems' certification as an 8(a) firm expired in September 2002, and its revenues from its security guard service business have grown to a level which makes it ineligible to qualify once again for certification as an 8(a) firm. Paragon Systems is now expanding its security guard service business by bidding on larger contracts than it was first awarded when certified as an 8(a) firm.

In 1994, Paragon Systems applied its engineering expertise and management skills to the security industry. Paragon Systems was awarded its first contract in 1994 to provide security services for the U.S. Army Corps of Engineers. Since such time, Paragon Systems has obtained contracts with various other Federal government agencies and has provided high-level, expert security services. Paragon Systems has, through the utilization of its systems engineering skills, developed contract guard security services as its core business. Paragon Systems no longer provides engineering services.

Through Paragon Systems, we employ approximately 900 persons in the course of providing contract guard services and maintain field offices located in Alabama; Kentucky; Maryland; Mississippi; Washington, and Washington, DC. Paragon Systems moved its Huntsville, Alabama offices to Chantilly, Virginia in December 2005. A full staff supports the majority of field operations in the Chantilly, Virginia office, including human resources, accounting, payroll, quality control, logistics, computer services, training, and other supporting functions as needed. Accounts payable support is now managed in Tri-Security's headquarters in Alpharetta, Georgia.

The following table sets forth the number of our Federal government contracts serviced by Paragon Systems during the time periods and within the revenue ranges indicated:

Annual Revenues	Year Ended December 31, 2006	Year Ended December 31, 2005	Year Ended December 31, 2004
Less Than $1.0 Million per Contract	8	4	5
$1.0 to $3.0 Million per Contract	4	3	8
Greater than $3.0 Million per Contract	4	5	5

During the 2006, 2 contracts expired and 3 new contracts were commenced. On December 31, 2006, 11 contracts were active. At December 31, 2006, SEP was serving 3 Federal contracts with aggregate annual contract revenue of approximately $5.6 million.

Cornwall

The Cornwall Acquisition diversified our customer base and allowed us to enter the private sector of contract guard services, including commercial and residential outlets.

Cornwall offers comprehensive, state-of-the-art customized electronic and manned security systems for commercial, residential and government outlets. Cornwall provides armed and unarmed uniformed security services as well as video, and investigative services to a variety of customers. In addition, Cornwall provides security system integration products (security systems which combine the features of security products) to its customers. Cornwall's communication systems leverage specialized software in order to improve overall security system performance. In response to client needs, Cornwall can combine these integrated security systems with trained professional security guards in order to provide a higher level of security.

Cornwall was incorporated in 1980 and today employs approximately 1,500 employees in five offices throughout the Miami/Dade, Broward and Palm Beach counties of Florida. Each of Cornwall's security professionals undergo extensive training, and many have prior military or government training.

Our Equity Interest in Army Fleet Support, LLC

Until May 2006, we owned, through Paragon Systems, a 10% equity interest in Army Fleet Support, LLC ("Army Fleet Support") which provides all logistics support for U.S. Army aviation training at Fort Rucker, Alabama. In providing this support, Army Fleet Support provides personnel, management, material parts, supplies, transportation and equipment to perform aviation unit maintenance, aviation unit intermediate maintenance and approved depot maintenance.

L-3 Communications Integrated Systems owns the majority equity interest in Army Fleet Support. L-3 Communications Integrated Systems provides comprehensive logistics support and services, including extensive rotary-wing aircraft systems integration, modification and maintenance. Additionally, through its recent acquisition of Vertex Aerospace LLC, they have the capabilities for aviation and aerospace technical services, managing and servicing rotary-wing aircraft, as well as other equipment, primarily for government customers.

During May 2006, we sold our 10% equity interest in Army Fleet Support for $10.8 million cash.

Sales and Marketing

Our sales and marketing approach is designed to develop business with respect to government and private sector customers. Sales promotions are managed through the offices of our subsidiaries, Paragon Systems and Cornwall, located in the Washington DC area and Miami/Palm Beach area, respectively. Our company-wide marketing strategy is developed and implemented at Tri-S Security's headquarters in Alpharetta, Georgia, where we have a dedicated marketing employee whose responsibilities include developing our market presence within the investment and security industries. This individual also develops an overall marketing plan designed to achieve higher name recognition and, accordingly, increased contract bid invitations and opportunities. Our key marketing vehicles are our website, trade and industry media publications, email marketing, Federal government bulletin board sites on the Internet, word of mouth, customer referrals and potentially direct marketing.

Employees

As of December 31, 2006, we employed approximately 2,400 people, consisting of security guards, managerial and administrative employees. Our business is labor intensive and, as a result, is affected by the availability of qualified personnel and the cost of labor. Although the contract guard services industry is characterized by high turnover, we believe our experience compares favorably with that of the industry. We have not experienced any material difficulty in employing suitable numbers of qualified security guards, although when labor has been in short supply, we have been required to pay higher wages and incur overtime charges.

We believe that the quality of our security guards is essential to our ability to offer effective and reliable service, and we believe diligence in their selection and training produces the level of performance required to maintain customer satisfaction and internal growth. Our policy requires that all selected applicants for a security guard position with us undergo a detailed pre-employment interview and a background investigation covering such areas as employment, education, military service, medical history and, subject to applicable state laws and criminal record checks. Personnel are selected based upon physical fitness, maturity, experience, personality, stability and reliability. We treat all employees and applicants for employment without unlawful discrimination as to race, creed, color, national origin, sex, age, disability, marital status or sexual orientation in all employment-related decisions. However, all Federal guard service contracts require that guards be a minimum of 21 years of age.

Our comprehensive training programs for our security guards include pre-assignment training, on-the-job assignment training and refresher training. Pre-assignment training explains the duties and powers of a guard, report preparation, emergency procedures, ethics and professionalism, grounds for discharge, general orders,

uniforms and personal appearance, and basic post responsibilities. It also includes jurisdiction and legal responsibilities, use of force, arrest authority and procedures, search and seizure procedures, crime scene protection, rules of evidence, hostage situations, bomb threats and incidents, workplace violence, sabotage and espionage, terrorism/anti-terrorism and weapons of mass destruction. On-the-job assignment training covers specific duties as required by the post and job orders. Ongoing refresher training is given on an annual basis as the need arises as determined by the local area supervisor and manager, or quality control personnel.

Unionized employees account for approximately 20% of our employees and work under collective bargaining agreements with the United Union of Security Guards and the Security Police and Fire Professionals of America. These collective bargaining agreements do not permit work stoppages. Our relations with our employees have generally been satisfactory. Guards and other personnel supplied by us to its customers are our employees, even though they may be stationed regularly at the customer's premises.

Insurance

We maintain all appropriate forms of insurance, including comprehensive general liability, performance and crime bonding, professional liability and automobile coverage. Special coverage is sometimes added in response to unique customer requirements. We also maintain compliance with all state workers' compensation laws. A certificate of insurance, which meets individual contract specifications, is made available to every customer.

Customers

Since the Cornwall Acquisition, we have provided our contract guard services to customers in 8 states and Washington, DC. We provide contract guard services for the following Federal government agencies: (i) the Department of Homeland Security; (ii) the Social Security Administration; (iii) the Army Corps of Engineers; (iv) the U.S. Coast Guard; (v) ASA; and (vi) the Department of Defense. We also provide contract guard services to the following state and local government agencies and private sector organizations: (a) Miami/Dade local government (municipal government); (b) Florida Department of Transportation; (c) Citicorp of North America; (d) Miami/Dade County Public Schools; (e) The University of Miami; (f) Miami Free Zone; (g) Eagle Logistics; (h) Citibank; (i) JobForce; and (j) DHL Danzas.

Our typical customer contract may provide for an hourly or monthly billing rate used for all security guards at a site or variable hourly billing rates for different guards. Our contracts are usually multi-year contracts with renewal options. For the year ended December 31, 2006, six contracts represented more than 49% of our revenues. For the year ended December 31, 2006, our contracts with (i) the Social Security Administration (Baltimore) accounted for approximately 14% of our revenue for such period; (ii) Miami/Dade County accounted for approximately 14% of our revenue for such period; (iii) GSA (Alabama) accounted for approximately 7% of our revenue for such period; (iv) GSA (Kentucky) accounted for approximately 5%; (v) the NASA John C. Stennis Space Center accounted for approximately 6% of our revenue for such period; and (vi) the National Headquarters Complex of the Department of Homeland Security accounted for approximately 4% of our revenue for such period.

Competition in Contract Guard Services

The contract guard services segment of the security industry is highly competitive but fragmented. Contract guard services generally compete with each other on price and the quality of service provided; the scope of the services performed; name recognition; the extent and quality of the guard supervision, recruiting, selection and training; and the ability to handle multiple worksites nationwide.

In the bidding process for our Federal government contracts, there are may be 30 bidders or more. However, typically only 5 or 6 bidders have the technical qualifications as established by the government agency's request for proposal. In the bidding process for our private sector contracts, there are typically five to seven other bidders. In each bidding process, we compete primarily on price, the quality of our service and our history of providing contract guard services in the Southeast for over a decade.

Our largest competitors in the contract guard services market include contract security service providers such as Coastal International Security and Wackenhut/Alletug. These competitors are much larger than we are and have significantly greater resources with which to target our markets, including name recognition. The guard industry also contains a large number of smaller regional and local security service providers in the United States in addition to those listed above which also directly compete with us, including Alpha Protective Services, Inter-Con Security, Knight Protective Services, Inc., Capital Consulting Group, MVM, Akal Security and Security Consultants Group.

We believe that we have highly skilled accounting and cost management personnel and an excellent reputation for providing services to our customers on time and within budget. These competitive advantages contribute to our ability to obtain contracts through the competitive bidding process and negotiated contracting. Another competitive advantage is our capability to leverage our field offices in conjunction with our two management offices and one corporate headquarters to maximize efficiency throughout our operations.

Because of the contract guard services industry's low barriers to entry, competitors easily enter the industry. Furthermore, traditional guard companies will increasingly compete with the electronics side of the security industry, as customers increase their level of automation and replace guards with more sophisticated electronic hardware.

Government Regulation

We are subject to city, county and state firearm and occupational licensing laws that apply to security guards and private investigators. In addition, many states have laws or regulations requiring training and registration of security guards, regulating the use of badges and uniforms, prescribing the use of identification cards or badges, and imposing minimum bond, surety or insurance standards. We may be subjected to penalties or fines as the result of licensing irregularities or the misconduct of one of our guards from time to time in the ordinary course of our business.

We are also subject to certain Federal regulations, including regulations concerning the use and distribution of firearms. Violations of these regulations may result in criminal penalties. Furthermore, we are subject to Federal laws and regulations relating to the formation, administration and performance of Federal government contracts, including the Federal Acquisition Regulations and supplemental GSA regulations, the Truth in Negotiations Act and the Cost Accounting Standards.

The Security Industry

The security industry encompasses a variety of high-tech and low-tech products and services. The service segment of the security industry includes contract guard services, armored car services, executive protection, fire suppression, alarm monitoring, closed circuit television ("CCTV"), access control, biometric, home automation and system integration services.

The global security industry has grown largely due to an increasing fear of crime and terrorism. In the United States, the demand for security-related products and central station monitoring services also has grown steadily. We believe that there is continued heightened attention to and demand for security due to the events of September 11, 2001 and the ensuing threat, or perceived threat, of criminal and terrorist activities.

Despite the size and prospects for growth of the services segment of the security industry, the services segment, including the contract guard services and system integration services, remains highly fragmented. We believe this high degree of fragmentation in the security industry makes it a prime candidate for future consolidation.

Contract Guard Service

The contract guard services segment of the security industry includes security and patrol services, as well as various types of investigation services, including background, undercover, insurance claims and financial fraud. Contract guard services are provided under contracts in which the guard company agrees to recruit, hire, train,

supervise, schedule and pay security guards deployed to certain specified sites, as well as to provide firearms, uniforms and equipment. Typical functions for security guards include patrolling the premises, checking identification for access control, staffing a security control center, monitoring activities on CCTV and responding to emergency requests for assistance. Contract guard services are customarily charged to the customer at an hourly or monthly rate (which can be fixed or variable). A contract guard company's profit is based on the "spread" of the hourly or monthly rate over the cost of the guard.

Demand for guard services is dependent upon a number of factors, including demographic trends, general economic variables such as growth in the gross domestic product, unemployment rates, consumer spending levels, perceived and actual crime rates, government legislation, terrorism sensitivity, war/external conflicts and technology.

Security System Integration

The term "integrated systems" refers to security systems which combine the features of security products like CCTV and intrusion control. The critical concept in system integration is that the components of the system communicate with one another in order to improve system performance. This communication among system components is accomplished through the use of specialized software. The most highly complex integrated systems utilize a common database, which is often managed and maintained by the systems integrator. Because of their complexity and reliance on software, integrated systems require a higher degree of proficiency than ordinary add-on type systems like CCTV or access control.

As a result of the Cornwall Acquisition, we acquired capabilities, operations and contracts in the system integration segment of the security industry. Cornwall services system integration contracts in the Miami, Florida, area providing monitoring systems. We believe that offering system integration services will increasingly complement, and create synergies with, the contract guard services we currently offer. In the course of providing contract guard services under our current and past contracts, for example, our security guards monitor and operate integrated systems sold and installed by providers of integrated systems. Now with our capabilities through Cornwall, we are able to sell and install integrated systems to our clients, in addition to monitoring and operating such systems, we are able to grow our business organically through complementary products and services. We also believe that offering system integration products and services will increase our profitability because contracts for system integration products and services generally have higher profit margins than contracts for guard services and the system integration segment is anticipated to grow more rapidly than the contract guard segment.

Our Strategy

Operations

Our objective is to increase our revenues, profitability and market position, while maintaining the highest level of service to our customers. The key elements of our operations strategy include the following:

- managing personnel costs by minimizing turnover through effective recruitment, training and supervision of guards;
- retaining existing customers and engaging new customers by servicing clients with the highest degree of integrity and responsiveness;
- developing cost-effective solutions for the security needs of our customers;
- capitalize on the growing trend among businesses and Federal government agencies to outsource non-core functions such as security officer services; and
- developing our consolidated operating infrastructure for all acquired companies' accounts payable to leverage larger company efficiencies.

Federal Government Contracts

Typically, a service provider is awarded a multi-year contract through a Federal government facility with renewal options each year of the contract in order to comport with Congressional funding as well as performance reviews. With our standard Federal government contracts, we are awarded a multi-year contract, then an extension for each of the subsequent years of the contract and the opportunity to bid for the overall contract renewal.

A significant number of our current contracts for contract guard services were awarded by the Federal government through a competitive bid process. We intend to grow our business by obtaining new Federal government contracts through the competitive bidding process and by providing additional services under our current Federal government contracts.

The Federal government awards substantially all contracts for contract guard services through a competitive bidding process; however, certain agencies permit negotiated contracting through the GSA. Contracts awarded through a competitive bidding process generally have lower profit margins than negotiated contracts because in a competitive bidding process bidders compete predominantly on price. The Federal government is the largest procurer of products and services in the world, and the Federal contract market provides significant business opportunities for contract guard service providers approved to contract with the Federal government.

We have hired full-time employees to provide business development and marketing services for us. These job responsibilities focus on identifying new contract opportunities with Federal government agencies and preparing and submitting bids for such contracts.

We intend to bid on Federal government contracts for contract guard services valued between an aggregate of over $1 billion over the next five-years. Our ability to bid on larger contracts is constrained because we do not currently have sufficient capital to cover the substantial start-up costs we would incur if awarded a significant number of contracts with higher values.

Private Sector Contracts

Private sector contracts are awarded through a competitive bidding process and through a negotiating process. Unlike the Federal government contracts, the terms of private sector contracts can vary based on individual client situations. Price is not the only key element in winning contracts with this market segment. Other elements such as service quality, responsiveness and various peripheral offerings other than traditional guard services come into consideration. We believe that the private sector represents our largest growth potential.

The private sector customers, however, generally do not obtain contract guard services through a competitive bid process, but privately negotiate contracts for such services, resulting in contracts with higher profit margins because price is not always the primary basis for competition. The private sector provides an opportunity for contract guard service providers to grow through acquisitions.

As a result of the Cornwall Acquisition, we obtained a number of contracts for commercial and residential customers. We intend to expand our business in the private sector by bidding and negotiating contracts for guard services for commercial and residential customers.

We have dedicated employees to provide business development and proposal submissions for us. Job responsibilities of these individuals focus on identifying new bidding opportunities, bid proposal development and competitive negotiations.

We intend to continually bid on private sector contracts for guard services.

Acquisitions

We intend to develop and expand our business by selectively pursuing acquisition opportunities in the contract guard services and system integration services segments of the security industry. We intend to target for acquisition existing companies with established reputations for quality customer service.

In the contract guard services market, we seek to acquire organizations which provide contract guard services to the private sector. We are also looking to acquire organizations which provide contract guard services to the private sector, including residential and commercial facilities, and which have contracts with higher profit margins than our current Federal government contracts. Although we intend our initial acquisition activities to be concentrated in the Southeast, Midwest and Atlantic coastal portions of the United States, we have not placed any geographic restrictions on our future acquisition strategy. We believe we will have significantly more acquisition possibilities in the private sector than in the Federal government sector. In the system integration market, we seek to identify and acquire organizations offering customized, integrated systems in the premiere commercial and residential electronic security markets.

We frequently evaluate acquisition opportunities and, at any given time, may be in various stages of due diligence or preliminary discussions with respect to a number of potential acquisitions. From time to time, we may enter into non-binding letters of intent, but we are not currently subject to any definitive agreement with respect to any acquisition material to our operations or otherwise so far advanced in any discussions as to make an acquisition material to our operations reasonably certain.

Because the security industry is still very highly fragmented, we believe there will be no lack of opportunities for acquiring the type of companies that are the focus of our planned acquisition efforts. Both industry segments are marked by concentration by several of the well known larger providers of security services, such as Tyco International Ltd. on the electronic side of the business and Allied Security, Inc., Securitas Security Services USA and Rentokil Initial plc on the physical security side. While there is concentration among the larger providers, we believe there remains a number of quality, sizable regional and local providers that are available for acquisition.

Item 1A. Risk Factors

Risks Relating to Our Indebtedness and Litigation

If we are in default under our Credit Agreement or our Factoring Agreement, then all amounts due there under will become immediately due and payable, which will have a material adverse effect on our business and financial condition.

On October 18, 2005, we entered into a Credit Agreement (as amended from time to time, the "Credit Agreement") with LSQ Funding Group, L.C. ("LSQ") and BRE LLC ("BRE" and, together with LSQ, our "lenders"), pursuant to which we borrowed $1,650,000 pursuant to a term loan with a maturity date of October 1, 2007 ("Term Loan A") and $3,500,000 pursuant to a term loan with a maturity date of October 1, 2009 ("Term Loan B" and, together with Term Loan A, the "Initial Term Loans"). During May 2006, the Initial Term Loans were paid in full.

In connection with the Credit Agreement, we entered into a Factoring and Security Agreement (the "Factoring Agreement") with LSQ, pursuant to which LSQ will purchase from us from time to time certain accounts receivable at a discount of 0.7% and provide us with a professional accounts receivable management service for a funds usage fee of the prime rate plus 1.0% on the funds advanced on the outstanding accounts receivable purchased. The Factoring Agreement has a $12,000,000 initial purchase limit and a four-year term which will automatically renew unless we provide notice of our intent to terminate. The Factoring Agreement amends and restates the Factoring Agreement dated as of April 1, 2005 between LSQ and Paragon Systems, pursuant to which LSQ purchased from Paragon Systems from time to time certain accounts receivable at a discount of 0.7% under a factoring facility with a funds usage fee equal to the prime rate plus 1.00%, a $6,500,000 initial purchase limit and a one-year term subject to annual renewal.

Pursuant to the Credit Agreement, in October 2005, we also entered into (i) a Guaranty Agreement pursuant to which we unconditionally and irrevocably guarantee to the lenders the prompt payment and performance of all of our obligations, indebtedness and liabilities to the lenders, whether currently existing or subsequently arising (the "Obligations"); and (ii) a Security Agreement, pursuant to which we granted to the lenders a security interest in substantially all of our assets to secure all of the Obligations. Additionally, in October 2005, we also entered into a Pledge Agreement pursuant to which we have pledged to the lenders the capital stock of Paragon Systems to secure all of our obligations under the Credit Agreement and related documents.

On June 27, 2006, Paragon Systems executed a Guaranty of Joint Venture (the "JV Guaranty") pursuant to which Paragon Systems unconditionally guarantees to LSQ the prompt payment and performance of all obligations, indebtedness and liabilities, whether currently existing or subsequently arising, of SEP (the "JV Obligations"). The JV Obligations include the obligations, indebtedness and liabilities of SEP to LSQ under that certain Factoring and Security Agreement between SEP and LSQ dated as of June 27, 2006 (the "JV Factoring Agreement"), pursuant to which LSQ will purchase from SEP from time to time certain accounts receivable at a discount of 0.7% and provide SEP with a professional accounts receivable management service for a funds usage fee equal to the prime rate plus 1.0% on the funds advanced on the outstanding accounts receivable purchased. The JV Factoring Agreement has a $1,000,000 initial purchase limit and a one-year term which will automatically renew unless SEP provides notice of its intent to terminate.

The outstanding balance under the Credit Agreement as of December 31, 2006 is approximately $7.8 million. At December 31, 2006, we had less than $500,000 of availability under our Credit Agreement. Additionally, from time to time during 2006, we had borrowed more than the maximum amount allowable under the availability formula in the Credit Agreement. Accordingly, on those occasions when the outstanding balance exceeded the availability, we were charged the default interest and fees by our lenders.

During March 2007, we secured an additional $2.5 million term loan (the "2007 Term Loan") with our lenders to provide additional financing as needed to provide the capital we estimate is necessary to continue to operate the business during 2007. In connection with obtaining the 2007 Term Loan, we also pledged to the lenders the capital stock of all of our subsidiaries to secure all of our obligations under the Credit Agreement and related documents. If the business does not begin to generate enough cash to fund the operations and the debt service requirements, additional capital may be necessary to continue to operate the business. There can be no assurance that the Company will be able to raise additional capital in the future or that such capital can be raised on terms acceptable to U.S.

If an event of default under the Credit Agreement, the Factoring Agreement or any agreement we have with out lenders occurs, then the entire balance outstanding under all such agreements shall become immediately due and payable. We will not be able to repay this balance unless we raise significant capital by selling assets or issuing debt or equity securities, which we may not be able to do on terms acceptable to us, if at all. If the balance outstanding under our agreements with our lenders becomes immediately due and payable and we are unable to raise significant capital or obtain from our lenders an additional waiver and an agreement to forbear, then we will not be able to satisfy our obligations to our lenders, our lenders may proceed to foreclose on the collateral and our business and financial condition will be materially and adversely affected.

If our lenders stop advancing funds to us under the Factoring Agreement or the Credit Agreement, then we may not be able to satisfy our current operating payables, which would have a material adverse impact on our business and financial condition.

We rely on advances under the Factoring Agreement and borrowings under the 2007 Term Loan for funds to satisfy our cash flow needs for our daily operations. Our lenders are not obligated to advance additional funds to us under the Factoring Agreement or the 2007 Term Loan if the funds advanced to us and outstanding under the Factoring Agreement exceed our maximum availability or if we are otherwise in default under our agreements with our lenders. If our lenders stop advancing funds to us under the Factoring Agreement or does not allow us to borrow under the 2007 Term Loan, then we may not be able to satisfy our current operating payables, which would make it difficult for us to satisfy our contractual obligations to our customers. If we are not able to satisfy our current operating payables or our contractual obligations to our customers, then our business and financial condition will be materially and adversely affected. Further, our lenders will not be obligated to advance additional funds to us under the Factoring Agreement or Credit Agreement until we reduce the amount of the advances outstanding under the Factoring Agreement to an amount which is less than our maximum availability. We may not be able to do so unless we raise significant capital by selling assets or issuing debt or equity securities, which we may not be able to do on terms acceptable to us, if at all.

We have substantial debt.

As of December 31, 2006, we had approximately $21.1 million of outstanding debt (excluding obligations to trade creditors and taxing authorities including the IRS). We may incur substantial additional debt in the future, including additional debt under the Factoring Agreement. It will be difficult for us to satisfy our payment obligations. Our considerable indebtedness could have important consequences to you, including, but not limited to, the following:

- our ability to obtain additional financing for working capital, capital expenditures, acquisitions or general corporate purposes may be impaired;
- we are exposed to fluctuations in interest rates because the Factoring Agreement and the 2007 Term Loan have variable rates of interest;
- we may have more debt than some of our competitors, which may put us at a competitive disadvantage and reduce our flexibility in planning for, or responding to, changing conditions in our industry, including increased competition; and
- we are more vulnerable to general economic downturns and adverse developments in our business.

We may not be able to generate sufficient cash to service all of our indebtedness, and we may be forced to take other actions to satisfy our payment obligations, which actions may not be successful.

Our ability to make scheduled debt service depends on our financial and operating performance, which is subject to prevailing economic and competitive industry conditions and to certain financial, business and other factors beyond our control. These factors include, but are not limited to:

- interest rates and general economic conditions;
- competitive conditions in our industry;
- operating difficulties, operating costs or pricing pressures that we may experience;
- passage of legislation or other regulatory developments that affect us adversely; and
- delays or difficulties in implementing our business strategies.

We cannot assure you that we will maintain a level of cash flows from operating activities sufficient to permit us to make our scheduled debt service payments or otherwise satisfy indebtedness. If our cash flows and capital resources are insufficient to fund our debt service obligations, we may be forced to reduce or delay capital expenditures, seek additional capital, sell assets or restructure or refinance our indebtedness. These alternative measures may not be successful and may not permit us to meet our scheduled debt service payments. If our cash flows and capital resources are insufficient to fund our debt service obligation, then we could face substantial liquidity problems and might be required to scale back our operations or dispose of material assets to meet our debt service obligations. The Credit Agreement restricts our ability to dispose of our assets requires that all proceeds from any such disposition be used to reduce our obligations under the Credit Agreement. Even if we are able to dispose of certain assets, we may not be able to make such dispositions at prices that we believe are fair or use the proceeds from such dispositions to make payments on our indebtedness, other than under the Credit Agreement.

The Credit Agreement imposes significant restrictions on us, which may prevent us from capitalizing on business opportunities and taking certain corporate actions.

The Credit Agreement imposes significant operating and financial restrictions on us. These restrictions limit our ability to:

- incur or guarantee additional indebtedness;
- pay dividends and make distributions;

- make certain investments;
- repurchase stock;
- incur liens;
- enter into certain transactions with affiliates;
- enter into sale and leaseback transactions;
- merge or consolidate; and
- transfer or sell assets.

These covenants may adversely affect our ability to finance our future operations or capital needs, pursue available business opportunities or take certain corporate actions.

We may not prevail in our lawsuit against the former shareholders of Paragon Systems which may materially and adversely affect our business and financial condition.

On February 27, 2006, we filed a lawsuit against the former shareholders of Paragon Systems alleging, among other things, that they breached certain representations in the Paragon Purchase Agreement. In the complaint, we seek, among other things, an award of damages and a decree invalidating the Series C Redeemable Preferred Stock which was issued to the former shareholders as part of the purchase price for the Paragon Acquisition and the security agreements pursuant to which we pledged 40% of the outstanding capital stock of Paragon Systems to secure our obligations under the Series C Redeemable Preferred Stock. Accordingly, we exercised our right of offset under the Paragon Purchase Agreement and applicable common law and have not paid the dividend payments on the Series C Redeemable Preferred Stock on February 28, 2006, or at any point thereafter, and have not redeemed the Series C Redeemable Preferred Stock, which has a redemption value of $6.0 million and was otherwise redeemable by us on February 27, 2007. If we do not prevail in the lawsuit, then we may be required to redeem the Series C Redeemable Preferred Stock and pay all accrued and unpaid interest thereon. If we do not do so, then the former shareholders may be able to foreclose on the stock of Paragon Systems pledged to them. If we are required to redeem the Series C Redeemable Preferred Stock, or if the former shareholders foreclose on the stock of Paragon Systems pledged to them, then our business and financial condition will be materially and adversely affected.

If we are unable to satisfy or otherwise settle the claims with respect to the Series C Redeemable Preferred Stock by February 28, 2008, we will be in default under our Credit Agreement, which requires that the litigation with respect to the Series C Redeemable Preferred Stock be settled and that the lien on the 40% of the stock of Paragon Systems held by the former shareholders of Paragon Systems be eliminated by February 28, 2008. If the Series C Redeemable Preferred Stock remains outstanding or the lien on the stock of Paragon Systems remains outstanding on February 28, 2008, we will be in violation of our Credit Agreement and all amounts outstanding under the Credit Agreement, the Factoring Agreement, and all other agreements with our lenders will become immediately due and payable.

If we are unable to satisfy or otherwise settle our indebtedness, then we may lose control of our subsidiaries, which generate all of our revenue.

We have pledged 40% of the outstanding capital stock of Paragon Systems to the former shareholders of Paragon Systems to secure our payment obligations with respect to the Series C Redeemable Preferred Stock. As discussed above, we are exercising our right of offset under the Paragon Purchase Agreement and applicable common law and have not made dividend or redemption payments with respect to the Series C Redeemable Preferred Stock. If it is finally determined that we were not entitled to exercise such rights, then the former shareholders of Paragon Systems may foreclose on the stock of Paragon Systems pledged to them.

Furthermore, we have granted to our lenders a security interest in all of the capital stock of all of our subsidiaries to secure our obligations to our lenders. If we are in default under the Credit Agreement, the Factoring Agreement or any other agreement with our lenders, then our lenders could foreclose

on such stock. If either the former shareholders or our lenders, or both, foreclose on the stock pledged to them, then we will lose a significant portion or all of our revenue, and our business and financial condition will be materially and adversely affected.

Upon filing our tax return, we expect to have a tax liability of $1.2 million which we may be unable to pay due to liquidity issues.

As of December 31, 2006, we expect to have a federal tax liability of approximately $1.2 million. In order to pay the IRS to satisfy the obligation, we will be required to draw upon our debt facilities. We may be unable to pay our tax liability in the ordinary course because (i) we may not have the availability under our credit facilities to make the payment or (ii) our lender may be unwilling to advance the funds under the Factoring Agreement to make the payment.

Risks Relating to Our Industry and Business

We depend on the Factoring Agreement to meet our cash flow needs, which reduces our profit margin.

Pursuant to the Factoring Agreement, our lenders from time to time purchase certain accounts receivable from us at a discount of 0.7% with a funds usage fee of prime plus 1.0% on the outstanding funds advanced on the accounts receivable purchased. If we are in default under our Factoring Agreement or the Term Loans, then the interest note on the Factoring Agreement increases to 18% and a 1% fee is charged on all advances made to us under the Factoring Agreement. This discount and usage fee reduces our profit margins. We cannot, however, cease factoring our receivables because the funds provided by our lenders are necessary to satisfy our cash flow needs. In fact, we utilize the Factoring Agreement to the maximum extent permitted by our lenders which historically has allowed us to factor substantially all of our accounts receivable. We believe that if the Factoring Agreement with our lenders were to terminate, then we would need to obtain a new factoring agreement. Our obligations to our lenders are secured by a lien on all of our assets; consequently, if we are liquidated, then there may not be any assets available for distribution to shareholders or creditors other than our lenders.

Our service contracts often provide for fixed hourly bill rates or permit limited fee adjustments, and our business, financial condition and results of operations will be materially and adversely affected if increases in our costs cannot be charged to our customers.

Our largest expenses are payroll, payroll taxes and employee related benefits. Most of our service contracts provide for a fixed hourly bill rate and some of our service contracts provide for payments of either fixed fees or fees that increase by only small amounts during the terms of such service contracts or not at all. Competitive pressures also may prevent us from raising our fees or hourly bill rates when contracts are renewed. If, due to inflation or other causes, including increases in statutory payroll taxes, we must increase the wages, salaries and related taxes and benefits of our employees at rates faster than we can increase the fees charged under our service contracts, then our profitability will be adversely affected.

If we lose our executive officers or operation employees, our operations could be materially and adversely affected.

Our success is dependent to a significant extent upon the continuing efforts, abilities and business generation capabilities of our executive officers and senior operation employees. We have programs in place to motivate, reward and retain our executive officers and senior operation employees, including cash bonus and equity incentive plans. However, the loss or unavailability of any of our executive officers or senior operation employees could harm our ability to properly service or retain existing clients or operate new businesses. Our success and plans for future growth will also depend on our ability to hire and retain our executive officers and senior operation employees.

If we are unable to attract, retain and manage security guards and administrative staff, then our business, financial condition and results of operation will be materially affected.

Our business involves the labor-intensive delivery of contract security services. We derive our revenues largely from contract security guard services performed by our security guards. Our future performance depends in large part upon our ability to attract, develop, motivate and retain skilled security guards and administrative staff. Qualified security guards and administrative staff are in demand, particularly after the terrorist activity of September 11, 2001, and there is significant competition for these individuals from other security firms, government agencies and other similar enterprises. As a result, we may not be able to attract and retain sufficient numbers of these qualified individuals in the future, which may adversely affect our business.

Turnover of contract security guards is significant. The loss of the services of, or the failure to recruit, a significant number of skilled security guards and administrative staff would have a materially adverse affect on our business, financial condition and results of operations, including our ability to secure and complete service contracts. Furthermore, if we do not successfully manage our existing security guards and administrative staff, we may not be able to achieve the anticipated billing rates, engagement quality, level of overtime and other performance measures that are important to our business, financial condition and results of operations.

Organized labor action or occupational health and safety laws and regulations could have a material adverse effect on our business, financial condition and results of operations.

Our industry has been the subject of campaigns to increase the number of unionized employees. Although we believe that our relationships with our employees are good, we cannot provide you with any assurances that organized labor action at one or more of our facilities will not occur, or that any such activities, or any other labor difficulties at our facilities or the facilities of any of our customers, would not materially affect our business, financial condition and results of operations.

In addition, we are subject to, among other laws and regulations, comprehensive U.S. occupational health and safety laws and regulations. Such laws and regulations may become more stringent and result in necessary modifications to our current practices and facilities that could force us to incur additional costs that could materially affect our business, financial conditions and results of operations.

If we cannot successfully compete with new or existing security service providers, then our business, results of operations and financial condition will be adversely affected.

The contract security guard services industry is intensely competitive. We directly compete with companies that are national and international in scope and some of our competitors have significantly greater personnel, financial, technical and marketing resources than we do, generate greater revenues than we do and have greater name recognition than we do. The recent trend toward consolidation in our industry will likely lead to increased competition from these companies. We also compete with smaller local and regional companies that may have better knowledge of the local conditions in their regions, are better known locally and are better able to gain customers in their regions. There are relatively low barriers to entry into the contract security services industry, and we have faced and expect to continue to face additional competition from new entrants into the contract security officer services industry. In addition, some of our competitors may be willing to provide services at lower prices, accept a lower profit margin or expend more capital in order to obtain or retain business. If we cannot successfully compete with new or existing security service providers, then our business, financial condition and results of operations will be adversely affected.

In the Federal government security services sector, we have experienced compressed margins for our services on new contracts relative to the margins earned on older contracts. We expect that future contract wins will be at profit levels which are lower than our current contract base due to increased competition for these contracts.

Changes in available security technology may have an adverse effect on our business, results of operations and financial condition.

Our business involves the labor intensive delivery of contract security services performed by our security guards. Changes in technologies that provide alternatives to security guard services or that decrease the number of security guards required to effectively perform their services may decrease our customers' demand for our security guard services. In addition, if such technologies become available for use in the industry, these technologies may be proprietary in nature and not be available for use by us in servicing our customers. Even if these technologies are available for use by us, we may not be able to successfully integrate such technologies into our business model or may be less successful in doing so than our competitors or new entrants in the industry. A decrease in demand for our security guard services or our inability to effectively utilize such technologies may adversely affect our business, financial condition and results of operations.

The security services we provide may subject us to liability for substantial damages not covered by insurance which could have a material adverse affect on our business, financial condition and results of operations.

We provide security services at various customer locations. We may be held liable for the negligent acts or misconduct of our security guards or other employees performed while on duty and in the course and scope of their employment. We experience a significant volume of claims and litigation asserting that we are liable for damages as a result of the conduct of our security guards or other employees. We may from time to time be subject to claims that our security guards have physically or emotionally harmed individuals in the course of providing these services, or members of the public may be otherwise injured by events occurring on client premises, including events that are not under the immediate control of our security officers. Individuals may bring personal injury lawsuits against us seeking substantial damages based on alleged negligence or other theories of liability in our provision of security services, including with respect to injuries not directly caused by, or within the control of, our security officers. Under principles of common law, we can generally be held liable for wrongful acts or omissions to act of our agents or employees during the course, and within the scope, of their agency or employment with us.

In many cases, our security service contracts also require us to indemnify our clients or may otherwise subject us to additional liability for events occurring on client premises. In addition, some states have adopted statutes that make us responsible for the conduct of our agents and employees. While we maintain insurance programs that provide coverage for certain liability risks, including personal injury, death and property damage, the laws of many states limit or prohibit insurance coverage for punitive damages arising from willful or grossly negligent conduct. Consequently, insurance may not be adequate to cover all potential claims or damages. If a plaintiff brings a successful claim against us for punitive damages in excess of our insurance coverage, then we could incur substantial liabilities which would have a material adverse affect on our business, results of operations and financial condition.

Terrorist activity at locations where we provide security services could have a material adverse effect on our business by subjecting us to liability. Whether or not terrorist activity occurs at a client location, our insurance costs could increase, and we could be required to comply with more burdensome regulations.

If any locations where we provide security related services are attacked by terrorists, then liabilities resulting from such attacks may not be covered by insurance and could have a material adverse effect on our business, financial condition and results of operations by requiring us to incur additional personnel costs as a result of compliance with expanded security rules and regulations. In addition, terrorist attacks that do not directly involve locations serviced by us could have a material impact on us by increasing our insurance coverage costs or making insurance coverage unavailable altogether.

We may be unable to obtain liability insurance at a reasonable cost, which would increase our exposure to catastrophic claims.

Insurance premiums have increased substantially since the terrorist attacks on September 11, 2001. If certain coverages are unavailable at premiums deemed reasonable by management, then our exposure for catastrophic claims would be increased.

We are subject to government regulation, and our failure or inability to comply with these regulations could materially restrict our operations and subject us to substantial penalties.

We are subject to a large number of city, county and state occupational licensing laws and regulations that apply to security officers. Most states have laws, or legislation pending, requiring qualification, training and registration of security officers, regulating the use of identification cards, badges and uniforms and imposing minimum bond surety or insurance standards. Any liability we may have from our failure to comply with these regulations may materially and adversely affect our business by restricting our operations and subjecting us to substantial penalties. In addition, our current and future operations may be subject to additional regulation as a result of, among other factors, new statutes and regulations and changes in the manner in which existing statutes and regulations are or may be interpreted.

We may not be successful in identifying suitable acquisition opportunities, and, if we do identify such opportunities, then we may not be able to obtain acceptable financing for the acquisition, reach agreeable terms with acquisition targets or successfully integrate acquired businesses.

An element of our growth strategy is the acquisition and integration of complementary businesses in order to increase our density within certain geographic areas, capture market share in the markets in which we operate and improve our profitability. We will not be able to acquire other businesses if we cannot identify suitable acquisition opportunities, obtain financing on acceptable terms or reach mutually agreeable terms with acquisition targets. In addition, to the extent that consolidation becomes more prevalent in our industry, the prices for suitable acquisition targets may increase to unacceptable levels thereby limiting our ability to grow.

Our growth through selective acquisitions may place significant demands on our management, operational and financial resources. Acquisitions involve numerous risks, including the diversion of our management's attention from other business concerns, the possibility that current operating and financial systems and controls may be inadequate to deal with our growth, and the potential loss of key employees.

We also may encounter difficulties in integrating any businesses we may acquire with our existing operations. The success of these transactions depends on our ability to:

- successfully merge corporate cultures and operational and financial systems;
- integrate and retain the customer base of the acquired business;
- realize cost reduction synergies, including those cost reduction synergies that we expect to realize; and
- as necessary, retain key management members and technical personnel of acquired companies.

If we fail to integrate acquired businesses successfully or to manage our growth, it could have a material adverse effect on our business. Further, we may be unable to maintain or enhance the profitability of any acquired business, consolidate its operations to achieve cost savings, or maintain or renew any of its contracts.

In addition, there may be liabilities that we fail, or are unable, to discover in the course of performing due diligence investigations on any Company that we may acquire, or have recently acquired. Also, there may be additional costs relating to acquisitions including, but not limited to, possible purchase price adjustments. Any of our rights to indemnification from sellers to us, even if obtained, may not be enforceable, collectible or sufficient in amount, scope or duration to fully offset the possible liabilities associated with the business or property acquired. Any such liabilities, individually or in the aggregate, could have a material adverse effect on our business.

We may not have, or be able to obtain, sufficient capital to pursue our acquisition strategy.

Our acquisition strategy will require substantial capital. Such capital may be obtained by borrowings under credit facilities, through the issuance of long-term or short-term indebtedness or through the issuance of equity securities in private or public transactions. The Credit Agreement restricts our ability to incur additional debt without the approval of our lenders. If we are able to incur additional debt to pursue our acquisition strategy, then our interest expense will increase. Furthermore, we may not be able to obtain financing for future acquisitions on suitable terms, if at all.

In addition, executing our acquisition strategy may be more expensive than we anticipate because the purchase price for acquisition targets may increase due to mergers and other transactions recently completed in the security industry, and the growing interest in future mergers and consolidations. If the purchase price for acquisition targets we find appealing increases, then we will need more capital than we anticipate to execute our acquisition strategy, or we may not be able to execute our acquisition strategy at all.

We may not be able to obtain additional financing that may be necessary to fund our operations.

In order to fund our operations and increase revenues, additional financing may be required, which additional financing may not be available to us on commercially reasonable terms, if at all. We may not be successful in raising additional capital, and the proceeds of any future financings may not be sufficient to meet our future capital needs. We may need to seek additional financing sooner than we anticipate as a result of any of changes in operating plans, lower than anticipated sales, or increased operating costs.

Compliance with the corporate governance requirements to which we are subject as a public corporation will cause us to incur significant costs, and the failure to comply with such requirements will expose us to investigations and sanctions by regulatory authorities.

We face corporate governance requirements under the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"), as well as new rules and regulations subsequently adopted by the SEC, the Public Corporation Accounting Oversight Board and The Nasdaq Stock Market, LLC. (the "Nasdaq"). In particular, we will be required to include a management report on internal control as part of our annual report for the year ending December 31, 2007 pursuant to Section 404 of Sarbanes-Oxley. Although we believe we have adequate internal control procedures in place, we are in the process of evaluating our internal controls systems in order (i) to allow management to report on our internal controls, as required by these laws, rules and regulations, (ii) to provide reasonable assurance that our public disclosure will be accurate and complete, and (iii) to help ensure that we will be able to comply with the other provisions of Section 404 of Sarbanes-Oxley. We cannot be certain as to the timing of the completion of our evaluation, testing and remediation actions or the impact of the same on our operations. If we are not able to implement the requirements relating to internal controls and all other provisions of Section 404 in a timely fashion or otherwise achieve adequate compliance with such requirements, then we might be subject to sanctions or investigation by regulatory authorities, such as the SEC or Nasdaq. Any such action may materially adversely affect our reputation, financial condition and the value of our securities, including the common stock. In addition, we expect that these laws, rules and regulations will increase our legal and financial compliance costs and make certain corporate governance activities more difficult, time-consuming and costly. We also expect that these new requirements will make it more difficult and expensive for us to maintain director and officer liability insurance.

If our professional reputation is harmed, then we will have difficulty obtaining new customers and retaining existing customers, either of which would adversely affect our revenues.

We depend upon our reputation and the individual reputations of our senior professionals to obtain new customers and retain existing customers. Any factor that diminishes our reputation or the individual reputations of our senior professionals, including an ineffective response to terrorist activity or breach of security at any location we service, will make it more difficult for us to compete successfully for new customers or to retain existing customers and, therefore, would adversely affect our revenues.

Economic downturns or recessions may dampen the demand for our services, which will reduce our revenues.

During economic declines, some decisions to implement security programs and install systems may be deferred or cancelled. In other cases, customers may increase their purchases of security systems because they fear more inventory shrinkage and theft will occur due to increasing economic need. We are not able accurately to predict to what extent an economic slowdown will decrease the demand for our services. If demand for our services decreases, then our revenues will decline.

Risks Related to Government Contracting

We derive a significant portion of our revenue from Federal government contracts which the government may terminate at any time or determine not to extend after their scheduled expiration. If we are unable to replace any contract which is not extended or is terminated, then our revenues will decline.

During 2006, we derived approximately 46% of our consolidated revenue from contracts with the Federal government. Federal government contracts typically span one or more base years and one or more option years. The option periods may cover more than half of the contract's potential duration. Federal government agencies generally have the right not to exercise these option periods. In addition, our contracts typically also contain provisions permitting a government customer to terminate the contract for its convenience, as well as for our default. A decision by a government agency not to exercise option periods or to terminate contracts could result in significant revenue shortfalls.

If the government terminates a contract for convenience, then we may recover only our incurred or committed costs, settlement expenses and profit on work completed prior to the termination. We cannot recover anticipated profit on terminated work. If the government terminates a contract for default, then we may not recover even those amounts, and instead may be liable for excess costs incurred by the government in procuring undelivered items and services from another source. We cannot predict if the government will terminate or choose not to extend our Federal government contracts. The government has never terminated any of our contracts; however, it may do so at any time.

Because we have a highly concentrated customer base, the loss of any of our Federal government customers could have a significant effect on our revenues.

During 2007, we expect to derive approximately 54% of our consolidated revenue from contracts with our Federal government agencies. If any of our current Federal government customers determines not to renew or terminate its contract, then our revenues may significantly decline.

The Federal government has rights and remedies under its contracts not typically found in commercial contracts that may reduce or eliminate our revenue under these contracts, as well as our ability to enter into other government contracts.

Federal government contracts contain provisions and are subject to laws and regulations that give the government rights and remedies not typically found in commercial contracts. The government may terminate its contracts for convenience or decline to exercise an option to renew. The government may also:

- reduce or modify its contracts or subcontracts;
- cancel multi-year contracts and related orders if funds for contract performance for any subsequent year become unavailable; and
- suspend or bar us from doing business with the Federal government.

If the Federal government were to exercise any of these rights or remedies, then our revenues would decline.

Our failure to comply with complex procurement laws and regulations could result in the termination of our Federal government contracts or our failure to be awarded any new contracts, and changes in laws and regulations could impose added costs on our business.

We must comply with and are affected by laws and regulations relating to the formation, administration and performance of Federal government contracts, which affect how we do business with our customers and may impose added costs on our business. Among the most significant regulations are:

- the Federal Acquisition Regulations and other agency regulations supplemental to the Federal Acquisition Regulations, which comprehensively regulate the formation, administration and performance of government contracts;
- the Truth in Negotiations Act, which requires certification and disclosure of all cost and pricing data in connection with contract negotiations;
- the Cost Accounting Standards and Cost Principles, which impose accounting requirements that govern our right to reimbursement under certain cost-based government contracts; and
- laws, regulations and executive orders restricting the use and dissemination of information classified for national security purposes and the exportation of certain products and technical data.

Moreover, we are subject to industrial security regulations of the Department of Defense and other Federal agencies that are designed to safeguard against foreigners' access to classified information. If we were to come under foreign ownership, control or influence, then our Federal government customers could terminate or decide not to renew our contracts, and it could impair our ability to obtain new contracts.

If we do not comply with the procurement laws and regulations discussed above, then we may be fined, we may not be reimbursed for costs incurred by us in servicing our contracts, our contracts may be terminated and we may be unable to obtain new contracts, any of which would cause our revenues to decline.

Our status as a General Services Administration ("GSA") Federal Supply Schedule Contractor may be withdrawn, which would make us ineligible to obtain certain Federal government contracts and would result in a significant decrease in our revenues.

The GSA secures the buildings, products, services, technology and other workplace essentials which Federal agencies need to operate. GSA Federal Supply Schedule contracts are contract vehicles under which Federal government agencies may purchase professional services or products. Federal government agencies may choose to award contracts only to GSA Federal Supply Schedule contractors to reduce the number of qualified bidders and to expedite the bidding process. Paragon Systems has been approved by the GSA as a GSA Federal Supply Schedule contractor and, therefore, is able to bid on Federal government contracts awarded using the GSA Federal Supply Schedule. Currently, seven of our contracts with annualized revenues of approximately $21.1 million have been procured under the GSA Federal Supply Schedule. During the year ended December 31, 2006, the revenues on our contracts procured under the GSA Federal Supply Schedule totaled approximately 24% of our consolidated revenues for such period.

Our status as a GSA Federal Supply Schedule contractor may be withdrawn if we do not comply with the complex procurement laws and regulations applicable to us. We continually review and monitor our compliance with these laws and regulations as well as modifications to the GSA Federal Supply Schedule affecting our business. We believe that we are currently in material compliance with these laws, regulations and modifications; however, if we are not in compliance and our status as a GSA Federal Supply Schedule contractor is withdrawn, then we may not be able to obtain new contracts with Federal government agencies or renew our existing contracts which have been procured under the GSA Federal Supply Schedule. If we are unable to obtain new Federal government contracts or renew our existing contracts, then our revenues will decline significantly.

All of our contracts with the Federal government are subject to audits and cost adjustments by the Federal government that could result in decreased revenues and the imposition on us of civil or criminal penalties or administrative remedies.

We generate a significant portion of our revenue from Federal government contracts, each of which is subject to audit by the Federal government. In these audits, the Federal government audits and reviews our performance, pricing practices, cost structure and compliance with applicable laws, regulations and standards. Like most government contractors, our direct and indirect contract costs are audited and reviewed on a continual basis. Many of the audits for costs incurred or work performed in recent years remain ongoing or have not yet commenced. In addition, non-audit reviews by the government may still be conducted on all our government contracts. An audit of our work, including an audit of work performed by companies we may acquire, could result in a substantial adjustment to our revenue because any costs found to be improperly allocated to a specific contract will not be reimbursed and revenue we have already recognized may need to be refunded. If a government review or investigation uncovers improper or illegal activities, then we may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of claims and profits, suspension of payments, treble damages, statutory penalties, fines and suspension or barment from doing business with Federal government agencies, any of which would cause a significant decline in our revenue.

Our participation in the competitive bidding process, pursuant to which we obtain most of our Federal government contracts, presents a number of risks.

During the year ended December 31, 2006, we derived substantially all of our revenue from Federal government contracts that were awarded through a competitive bidding process. Most of the business that we expect to seek from the Federal government in the foreseeable future likely will be awarded through competitive bidding. Competitive bidding presents a number of risks, including the:

- need to bid on programs in advance of finalizing the services to be provided, which may result in unforeseen difficulties and cost overruns;
- substantial cost and managerial time and effort that we spend to prepare bids and proposals for contracts that may not be awarded to us;
- need to accurately estimate the resources and cost structure that will be required to service any contract we are awarded; and
- expense and delay that may arise if our competitors protest or challenge contract awards made to us pursuant to competitive bidding, which could result in the resubmission of bids on modified specifications or in termination, reduction or modification of the awarded contract.

If we are unable to win particular contracts that are awarded through the competitive bidding process, we may not be able to operate in the market for services that are provided under those contracts for a number of years. If we are unable to consistently win new contract awards over any extended period, then we will not be able to grow our business, and our business, financial condition and results of operations will be materially and adversely affected.

The Miami/Dade County contracts at Cornwall represent a significant portion of our revenue and are subject to renewal in the 4th quarter of 2007

During the year ended December 31, 2006, two of Cornwall's subsidiaries generated revenue from contracts with Miami/Dade County of $11.7 million. These contracts are subject to renewal in the fourth quarter of 2007 and will be awarded through a competitive bidding process.

The bid process will be based on a number of factors including price and experience in providing the specific security services called for in the bid process. Competitive bidding represents a number of risks including:

- the substantial cost and managerial time and effort that we spend to prepare bids and proposals for contracts that may not be awarded to us;
- the requirement to post a bid bond in order to participate in the bidding process and a performance bond if we win the bid. The bonding requirement may require us to provide a letter of credit or other collateral to the bonding company which may be problematic given our financial condition.
- The need to accurately estimate the resources and cost structure that will be required to service any contract we are awarded; and
- The expense and delay that may arise if our competitors protest or challenge contract awards made to us pursuant to competitive bidding, which could result in the resubmission of bids on modified specifications or in termination, reduction or modification of the awarded contract.

If we are unable to win contracts with Miami/Dade County, we may not be able to provide services to Miami/Dade County for several years. The failure to win Miami/Dade County contracts will significantly reduce the revenue and profits of the Cornwall Group and our business, financial condition and the results of operations will be materially and adversely affected.

Our cash flow may be reduced due to significant expenses we may incur in connection with attempting to obtain Federal government contracts.

A significant portion of Federal government contracts for contract guard services is awarded through a competitive bid process. As stated above, substantial costs may be incurred in connection with preparing bids. In the past we have not, and most likely in the future will not, be awarded all the contracts on which we bid. Furthermore, if and when we do obtain a contract, we are generally required to start providing services pursuant to such contract no later than 30-45 days after the contract is awarded. As a result, we may incur significant start-up expenses. The costs of bidding on contracts and the start-up costs associated with new contracts we may obtain may significantly reduce our cash flow and liquidity.

The long sales cycles of Federal government contracts make it difficult for us to predict our financial results and cause us to expend a significant amount of effort and funds in bidding on contracts that are not awarded to us.

The sales cycle of a Federal government contract is often lengthy due to the protracted bid and approval process. Typically, many months may elapse between the time the Federal government solicits a bid for a contract and the time the contract is awarded. The lengthy sales cycles of our contracts make forecasting the volume and timing of contracts we may obtain difficult. During this period, we will generally expend substantial funds and management resources but recognize no associated revenue.

We may not receive the full amount authorized under contracts into which we have entered; consequently, our backlog may not accurately estimate our revenue.

The maximum contract value specified under a government contract that we enter into is not necessarily indicative of revenue that we will realize under that contract. In fact, even if we enter into a Federal government contract, we will not be paid for our services unless the Federal government has appropriated or budgeted the funds for such contract. Congress often appropriates funds for a particular program on a yearly basis, even though the contract may call for performance that is expected to take a number of years. As a result, contracts typically are only partially funded at any point during their term, and all or some of the work to be performed under the contracts may remain unfunded unless and until Congress makes subsequent appropriations and the procuring agency allocates funding to the contract. As described above, most of our existing contracts are subject to modification and termination at the Federal government's discretion. Moreover, there is no assurance that any

contract included in our estimated contract value that generates revenue will be profitable. Nevertheless, we look at these contract values, including values based on the assumed exercise of options relating to these contracts, in estimating the amount of our backlog. Because we may not receive the full amount we expect under a contract, our backlog may not accurately estimate our revenue.

If we are unable to obtain and maintain security clearances for our employees, then we will not be able to satisfy existing contracts or obtain new contracts.

Many of our Federal government contracts require our employees to maintain various levels of security clearances, and we are required to maintain certain facility security clearances complying with Federal government requirements. Obtaining and maintaining security clearances for employees involve a lengthy process, and it is difficult to identify, recruit and retain employees who already hold security clearances. If our employees are unable to obtain or retain security clearances or if our employees who hold security clearances terminate employment with us, then the customer whose work requires cleared employees could terminate the contract or decide not to renew it upon its expiration. In addition, we expect that many of the contracts on which we will bid will require us to demonstrate our ability to obtain facility security clearances and perform work with employees who hold specified types of security clearances. To the extent we are not able to obtain facility security clearances or engage employees with the required security clearances for a particular contract, we may not be able to satisfy our existing contracts, bid on or win new contracts or effectively re-compete on expiring contracts or follow-on task orders. To the extent we are unable to do any of the foregoing, our existing contracts may be terminated, we will not be able to grow our business and our revenues may decline.

Risks Relating to Our Securities

Management beneficially owns a significant percentage of the common stock and has the ability to influence all matters requiring the approval of our board of directors and our shareholders.

Management owns shares of the common stock which represent approximately 24% of the combined voting power of our outstanding capital stock. Management has the power to influence the election of our directors and all decisions made by our shareholders and, in general, to influence the outcome of any corporate transaction or other matter submitted to the shareholders for approval, including mergers, consolidations and the sale of all or substantially all of our assets. The interests of management may conflict with the interests of our other shareholders.

Provisions of our articles of incorporation and Georgia law may have anti-takeover effects that could prevent a change in control which the shareholders consider favorable and could negatively affect your investment.

Provisions in our articles of incorporation and our bylaws could delay or prevent a change of control of the Company or a change in our management that would provide shareholders with a premium to the market price of their common stock. Our articles of incorporation currently authorize the issuance of 10,000,000 shares of our preferred stock. Our board of directors has the power to issue any or all of these additional shares without shareholder approval, and such shares can be issued with such rights, preferences and limitations as may be determined by our board of directors. The rights of the holders of common stock will be subject to, and may be adversely affected by, the rights of any holders of preferred stock that may be issued in the future. We presently have no commitments or contracts to issue any shares of preferred stock. Authorized and unissued preferred stock could delay, discourage, hinder or preclude an unsolicited acquisition of the Company, could make it less likely that shareholders receive a premium for their shares as a result of any such attempt and could adversely affect the market price of, and the voting and other rights, of the holders of outstanding shares of common stock. Currently, we have outstanding 100 shares of our Series C Redeemable Preferred Stock. Our articles of incorporation and bylaws also contain provisions that:

- create a classified board of directors that prevents a majority of the board from being elected at one time;
- prohibit cumulative voting in the election of directors, which would otherwise allow less than a majority of shareholders to elect director candidates;

- limit the ability of shareholders to call special meetings of shareholders; and

- establish advance notice requirements for nominations for election to the board of directors or for proposing matters that can be acted upon by shareholders at shareholder meetings.

We may experience significant volatility in the price of the common stock even if our business is doing well, which could cause you to lose all or part of your investment.

The stock markets have experienced extreme price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many companies. These fluctuations often have been unrelated or disproportionate to the operating performance of those companies. The market price of the common stock may also fluctuate as a result of variations in our operating results. Due to the nature of our business, the market price of the common stock may fall in response to a number of factors, some of which are beyond our control, including:

- announcements of competitive developments by us or others;

- changes in estimates of our financial performance or changes in recommendations by securities analysts;

- any loss by us of a major customer;

- additions or departures of key management or other personnel;

- our failure to meet financial analysts' performance expectations or

- guidance we provide;

- future sales of the common stock or preferred stock;

- volume fluctuations;

- acquisitions or strategic alliances by us or our competitors;

- our historical and anticipated operating results;

- quarterly fluctuations in our financial and operating results;

- changes in market valuations of other companies that operate in our

- business markets or in our industry; and

- general market and economic conditions.

Accordingly, market fluctuations, as well as general economic, political and market conditions such as recessions and interest rate changes, may negatively impact the market price of the common stock, and you may not be able to sell your shares without incurring a loss.

We do not intend to pay dividends on the common stock, and you may not experience a return on investment without selling your securities.

We have never declared or paid, nor do we intend in the foreseeable future to declare or pay, any cash dividends on the common stock. Because we intend to retain all future earnings to finance the operation and growth of our business, you will likely need to sell your shares in order to realize a return on your investment, if any. Further, the Credit Agreement restricts our ability to pay dividends on our capital stock.

Item 2. Properties

Our corporate headquarters and principal executive offices are located in Alpharetta, Georgia, and our contract guard services operations are located at the offices of our wholly-owned subsidiaries, Paragon Systems and Cornwall, in Chantilly, Virginia and Miami, Florida, respectively. We lease space at each of the foregoing locations. We are obligated to pay rent on the (i) Alpharetta, Georgia facility of approximately $4,124 per month,

with 3% annual increases, through November 2008; (ii) Chantilly, Virginia facility of approximately $5,880 per month, with 3% annual increases, through August 2008; and (iii) the Miami, Florida facility of approximately $7,321 per month, with 3% annual increases, through April 2008.

We believe our leased facilities are adequate to meet our needs and that additional facilities are available to us to meet our expansion needs for the foreseeable future on commercially reasonable terms.

Item 3. Legal Proceedings

Except as set forth below, we believe that, based on currently known facts, there are no claims or litigation pending against us the disposition of which would materially affect our financial position or future operating results, although we cannot be certain as to the ultimate outcome of any such claim or litigation. In addition, exposure to litigation is inherent in our ongoing business and may harm our business in the future.

Litigation with the Former Shareholders of Paragon Systems

The Georgia Action

On February 27, 2006, we filed a complaint in the United States District Court, Northern District of Georgia, Atlanta Division ("Georgia Action"), against Charles Keathley, Robert Luther, Harold Bright and John Wilson, the former shareholders of Paragon Systems, alleging, among other things, that: (i) the former shareholders breached certain representations set forth in the Paragon Purchase Agreement; (ii) Messrs. Keathley and Luther violated Section 10(b) of the Securities Exchange Act of 1934, as amended, and Rule 10b-5 promulgated thereunder in connection with the Paragon Acquisition; and (iii) Messrs. Keathley and Luther committed fraud in connection with the Paragon Acquisition. In the complaint, we seek, among other things, (a) an award of damages against the former shareholders; (b) a decree invalidating all the outstanding shares of the Series C Redeemable Preferred Stock, all of which shares are held by the former shareholders and were issued as part of the consideration for the Paragon Acquisition; (c) a decree invalidating the Security Agreements we entered into with the former shareholders in connection with the Paragon Acquisition, pursuant to which we have pledged an aggregate of 40% of the outstanding shares of capital stock of Paragon Systems to secure our payment obligations under the Series C Redeemable Preferred Stock; (d) an award of punitive damages against Messrs. Keathley and Luther; and (e) an award of attorneys' fees and costs.

On April 28, 2006, Messrs. Bright and Wilson filed their answer and counterclaim in the Georgia Action, pursuant to which, among other things, they deny any wrongdoing, claim that we failed to pay the February 28, 2006 dividend payment with respect to the Series C Redeemable Preferred Stock held by them, and seek damages with respect thereto and an award of attorneys' fees and expenses.

On May 8, 2006, Messrs. Keathley and Luther filed their answer and counterclaim in the Georgia Action, pursuant to which they deny any wrongdoing, allege that we breached our obligations by failing to pay the February 28, 2006 dividend payment with respect to the Series C Redeemable Preferred Stock held by them, and seek, among other things, damages and an award of attorneys' fees, costs, and expenses. They further assert that they are entitled to bring their counterclaim as part of the Alabama Action (discussed below) and that, if necessary, the court should dismiss the complaint filed by us in the Georgia Action.

Based upon the claims we have made in the Georgia Action and pursuant to the Paragon Purchase Agreement and applicable common law, we are exercising our rights of offset against the dividend and redemption payments otherwise payable by us with respect to the Series C Redeemable Preferred Stock. Accordingly, we did not make dividend payments on the Series C

Redeemable Preferred Stock on February 28, 2006, or at any point thereafter, and we have not redeemed the Series C Redeemable Preferred Stock, which has a redemption value of $6.0 million and was otherwise redeemable by us on February 27, 2007.

The parties are in the process of consolidating the Georgia Action with the Declaratory Judgment Action (discussed below).

The Alabama Action

On or about October 5, 2005, Messrs. Luther and Keathley filed a compliant against Paragon Systems in the Circuit Court for Madison County, Alabama claiming breach of contract and seeking recovery of unspecified damages (the "Alabama Action"). Messrs. Keathley and Luther allege that Paragon Systems owes to them unpaid compensation for accrued, vested benefits earned pursuant to their employment agreements with Paragon Systems and certain amounts as reimbursement for taxes incurred by them in 2003.

On June 12, 2006, Messrs. Keathley and Luther filed an amended complaint in the Alabama Action naming Tri-S Security as a defendant. The claim reiterates their counterclaim in the Georgia Action that we breached our obligations by failing to make the February 28, 2006 dividend payment with respect to the Series C Redeemable Preferred Stock held by them. In the amended complaint, Messrs. Keathley and Luther seek damages, interest, and an award of attorneys' fees and expenses.

We filed our answer to the amended complaint on July 19, 2006, pursuant to which we deny any wrongdoing and deny that Messrs. Keathley and Luther are entitled to judgment against us.

On March 7, 2007, Messrs. Keathley and Luther filed a motion for leave to further amend the complaint. The motion seeks leave to add claims against us alleging that we (i) failed to make August 31, 2006 and February 28, 2007 dividend payments with respect to the Series C Redeemable Preferred Stock held by them and (ii) failed to redeem their shares of the Series C Redeemable Preferred Stock on February 27, 2007. We have opposed the motion by Messrs. Keathley and Luther.

The Arbitration

On September 22, 2006, Paragon Systems filed a demand for arbitration and statement of claim with the American Arbitration Association against Messrs. Bright and Wilson (the "Arbitration") asserting, among other things, that they misused corporate information of Paragon Systems, organized a competing business while employed at Paragon Systems, and diverted business from Paragon Systems to that competing business, all in breach of their employment agreements with Paragon Systems and their fiduciary duties owned to Paragon Systems.

On October 17, 2006, Messrs. Bright and Wilson filed an answer and counterclaim against us, Paragon Systems, and our Chief Executive Officer in the Arbitration. The counterclaim alleges, among other things, (i) breaches by Paragon Systems of the employment agreements with Messrs. Bright and Wilson and (ii) fraudulent acts and omissions in connection with a letter agreement dated December 14, 2004, among us, Paragon Systems and Messrs. Bright and

Wilson regarding the repayment of the Paragon Notes, among other things. The counterclaim seeks, among other things, $1,797,674 in damages, as well as attorneys' fees and expenses.

We responded to the counterclaim filed in the Arbitration on November 6, 2006. We asserted that the claims against us are not subject to arbitration and that we are not party to any arbitration agreement with Messrs. Bright and Wilson. Paragon Systems denied that it breached the employment agreements with Messrs. Bright and Wilson and denied that it engaged in any fraudulent conduct in connection with the December 14, 2004 letter agreement.

The Declaratory Judgment Action

On January 16, 2007, we filed an action for declaratory judgment in the United States District Court for the Northern District of Georgia, seeking a judgment declaring that we may not redeem the shares of Series C Redeemable Preferred Stock until such time as the redemption will not violate the Official Code of Georgia Section 14-2-640(c), which prohibits a corporation from making a distribution, if after giving effect to the distribution, the (i) corporation would not be able to pay its debts as they become due in the usual course of business or (ii) corporation's total assets would be less than the sum of its total liabilities plus the preferential rights of those who are superior to those receiving the distribution.

On March 7, 2007, Messrs. Keathley and Luther filed an answer in the Declaratory Judgment Action seeking dismissal of the action and attorneys' fees, costs, and expenses, among other things.

On March 16, 2007, Messrs. Bright and Wilson filed an answer and counterclaim in the Declaratory Judgment Action pursuant to which they assert breach of contract and allege that we failed to make dividend payments on the Series C Redeemable Preferred Stock and failed to redeem their shares of Series C Redeemable Preferred Stock. Messrs. Bright and Wilson seek damages and attorneys' fees, among other things.

Litigation Regarding Our Initial Public Offering

On November 1, 2006, a purported class action complaint was filed in the State Court of Fulton County, State of Georgia, against us, our Chief Executive Officer, our former Chief Financial Officer and the lead underwriters in our initial public offering, alleging, among other things, violations of Sections 11, 12(a)(2) and 15 of the Securities Act of 1933, as amended, in connection with our initial public offering. More specifically, the complaint alleges that the registration statement relating to our initial public offering was materially inaccurate and misleading because it failed to disclose certain problems with the operations and financial condition of Paragon Systems of which the complaint alleges we were aware. The complaint seeks unspecified compensatory damages or recission, as appropriate, and costs and disbursements relating to the lawsuit, including reasonable attorneys' fees. On December 1, 2006, we removed the lawsuit to the United States District Court for the Northern District of Georgia. A motion by plaintiff to remand the case back to the state court is pending. Our time to respond to the complaint has been extended until thirty (30) days after the ruling on the motion to remand. We intend to vigorously defend the action and believe that any potential financial obligation that we may have in this action should be covered by existing insurance.

Item 4. Submission of Matters to a Vote of Security Holders

Our annual meeting of shareholders was held on November 7, 2006 in Alpharetta, Georgia (the "Meeting"). At the Meeting, our shareholders voted on proposals to (i) elect one Class I director for a three-year term of office ("Proposal 1"); (ii) amend and restate our 2004 Stock Incentive Plan ("Proposal 2"); and (iii) ratify the appointment of Tauber & Balser, P.C. as our independent registered public accountants for the year ending December 31, 2006. Each of the foregoing proposals was approved by our shareholders at the Meeting.

With respect to Proposal 1, there were 2,935,941 votes cast for the election of James M. Logsdon as the Class I director and 428,777 votes cast to withhold authority with respect to the election of James M. Logsdon as the Class I director. There were no abstentions or broker non-votes with respect to the election of Mr. Logsdon. After the Meeting, James A. Verbrugge, Lee K. Toole and Ronald G. Farrell, who serve as Class II, Class III and Class III directors, respectively, continued their respective terms of office as directors of the Company.

The results of the vote on Proposal 2 and Proposal 3 were as follows:

PROPOSAL	VOTES FOR	VOTES AGAINST	VOTES ABSTAINED	BROKER NON-VOTES
Proposal 2	1,500,249	681,050	7,100	1,176,319
Proposal 3	3,156,787	197,621	10,310	0

The proposals presented at the Meeting were set forth and described in our Notice of Annual Meeting of Shareholders and Proxy Statement dated October 6, 2006.

Item 4.5 Executive Officers of the Registrant

Pursuant to General Instruction G (3) of Form 10-K under the Exchange Act, the information regarding the Company's executive officers required by Item 401 of Regulation S-K is hereby included in Part I of this Annual Report.

The following table sets forth the name of each executive officer of the Company, the office held by such officer and the age, as of March 30, 2007, of such officer:

Name	Age	Position
Ronald G. Farrell	63	Chairman of the Board, President and Chief Executive Officer
Robert K. Mills	43	Chief Financial Officer

Certain additional information concerning the individuals named above is set forth below:

Ronald G. Farrell serves as our Chief Executive Officer and President and as a director of the Company. He served as our sole director and officer from our formation in October 2001 to our initial public offering in February 2005. From December 1998 to December 2001, Mr. Farrell served as Chairman of the Board and Chief Executive Officer of Golf Entertainment, Inc. At various times from 1986 through 1998, Mr. Farrell founded and served as Chairman of the Board and Chief Executive Officer of Computer Integration Corporation, Sports Leisure, Inc., Automotive Industries, Inc. and Builders Design, Inc.

Robert K. Mills has served as our Chief Financial Officer since August 2005. From 1999 to 2005, Mr. Mills served as Chief Financial Officer for Knology, Inc., a publicly-traded broadband telecommunications services provider which filed for protection under Chapter 11 of the United States Bankruptcy Code in 2002. From 1994 through 1999, Mr. Mills served as Treasurer of Powertel, Inc., a provider of wireless telecommunications services. From 1987 to 1994, Mr. Mills was an auditor with an international accounting firm. Mr. Mills is a Certified Public Accountant.

There are no family relationships among any of our executive officers or directors. Except as disclosed in the section of this Annual Report titled "Executive Compensation", no arrangement or understanding exists between any executive officer and any other person pursuant to which any executive officer was selected to serve as an executive officer. To the best of our knowledge, (i) there are no material proceedings to which any executive officer of the Company is a party, or has a material interest, adverse to the Company; and (ii) there have been no events under any bankruptcy act, no criminal proceedings and no judgments or injunctions that are material to the evaluation of the ability or integrity of any executive officer during the past five years. Our executive officers of the Company are elected or appointed by our board of directors and hold office until their successors are elected and qualified, or until their death, resignation or removal, subject to the terms of applicable employment agreements.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issue Purchases of Equity Securities

Market for Common Equity

The common stock and publicly-traded warrants are currently traded on The Nasdaq Capital Market under the symbols "TRIS" and "TRISW," respectively. The common stock and publicly-traded warrants first became publicly traded as separate quotations on The Nasdaq Capital Market on April 11, 2005. From February 9, 2005, the date of our initial public offering, until April 10, 2005, only the units sold in our initial public offering were publicly traded.

The following table sets forth the quarterly high and low sales prices for the common stock for the periods indicated below, as reported by The Nasdaq Capital Market. The stock prices set forth below do not include adjustments for retail mark-ups, markdowns or commissions, and represent inter-dealer prices and do not necessarily represent actual transactions.

Year Ended December 31, 2005	High	Low
Fourth Quarter of 2005	$5.38	$4.09
Third Quarter of 2005	$6.27	$3.50
Second Quarter of 2005	$5.24	$2.76

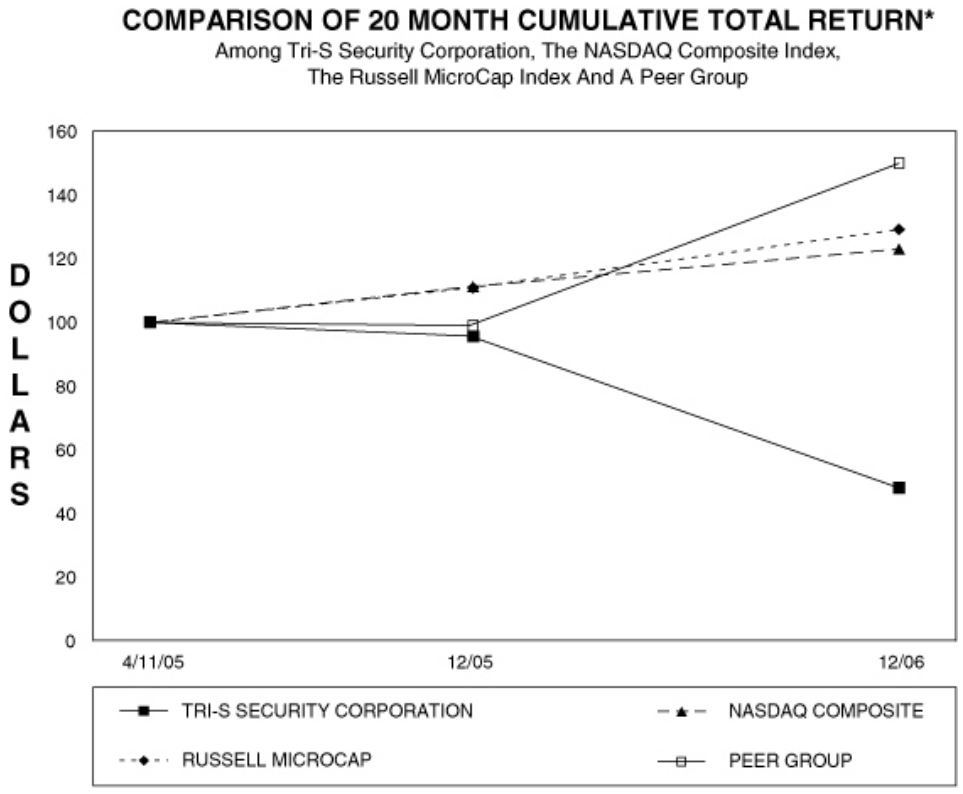
Year Ended December 31, 2006	High	Low
Fourth Quarter of 2006	$3.20	$1.85
Third Quarter of 2006	$3.21	$2.20
Second Quarter of 2006	$4.10	$2.61
First Quarter of 2006	$4.62	$2.65

As of March 25, 2007, there were approximately 19 holders of record of the common stock.

We have never declared or paid cash dividends on the common stock. We currently intend to retain any earnings for use in our operations and do not anticipate paying cash dividends on the common stock in the foreseeable future. In addition, the Credit Agreement prohibits the payment of cash dividends on the common stock without our lenders' prior written consent.

Performance Graph

Set forth below is a line graph comparing the change in the cumulative total shareholder return on our common stock against the Nasdaq Composite, the Russell Microcap Index and a peer group for the period from April 11, 2005 (the date on which our common stock first became publicly-traded) through December 31, 2006. The peer group selected is comprised of one company, Command Security, Inc. The comparisons in this table are required by the SEC and are not intended to forecast or be indicative of possible future performance of our common stock.



* $100 invested on 4/11/05 in stock or on 3/31/05 in index-including reinvestment of dividends.
Fiscal year ending December 31.

	4/11/05	12/05	12/06
Tri-S Security Corporation	**100.00**	**95.65**	**48.04**
NASDAQ Composite	**100.00**	**111.20**	**122.96**
Russell MicroCap	**100.00**	**110.80**	**129.13**
Peer Group	**100.00**	**98.95**	**150.00**

Pursuant to the regulations of the SEC, this performance graph is not "soliciting material," is not deemed filed with the SEC and is not to be incorporated by reference in any filing of the Company under the Securities Act or the Exchange Act.

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
December 22, 2006	45,424(1)	$ 2.312(2)	0	0

(1) Pursuant to Mr. Farrell's employment agreement with us, Mr. Farrell, our Chief Executive Officer and President, would have otherwise been entitled to receive during 2004 an aggregate bonus of $435,000; however, in order to improve the financial position of the Company prior to our initial public offering in February 2005, he agreed to forfeit $290,000 of such bonus and accept a cash bonus of $145,000. At the time Mr. Farrell agreed to such change in his compensation, we had already paid to Mr. Farrell $245,000 with respect to his 2004 bonus. Accordingly, Mr. Farrell agreed to repay us $100,000 pursuant to the terms of a promissory note issued by Mr. Farrell to us dated December 31, 2004, which accrued interest at a rate of 2.48% per year and was payable on December 31, 2006. Pursuant to its terms, the note was prepayable at any time without penalty and payable at the election of Mr. Farrell in cash or shares of common stock or any combination thereof. Accordingly, on December 22, 2006, Mr. Farrell surrendered to us 45,424 shares of common stock in full repayment of the $105,021 of outstanding principal and interest under the note.

(2) Pursuant to the terms of the note, the shares of common stock surrendered in payment thereof were valued at the arithmetic average of the per share closing price of the common stock for the five trading day period immediately prior to the date of payment.

Item 6. Selected Financial Data

We did not have an operating business before the Paragon Acquisition. Consequently, the historical selected financial data set forth in the accompanying summary of historical and selected financial data presents the historical selected financial data of Paragon Systems prior to the Paragon Acquisition and the financial information of Tri-S Security for periods prior to the Paragon Acquisition and Tri-S Security consolidated with Paragon Systems for the nine months ended September 30, 2004, the year ended December 31, 2004 and the nine months ended September 30, 2005. The selected historical financial data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations," and our historical consolidated financial statements included elsewhere in this Annual Report.

Basic income (loss) per share is computed by dividing income (loss) available to common shareholders by the weighted average number of common shares outstanding for the period after giving effect to the Exchange and Recapitalization. Diluted earnings per share reflects the potential dilution that would occur if securities or other contracts to issue common stock were exercised or converted into common stock.

Paragon Systems was formerly a S corporation; consequently, pro forma income tax expense, pro forma net income and pro forma income per share are presented on the face of the summary of historical selected financial data for the periods presented for Paragon Systems. The necessary adjustments include only taxes at a statutory rate of 38% for each period presented. The pro forma income per share calculation of Paragon Systems' operations is based on the weighted average number of common shares outstanding, after giving effect to the Exchange and Recapitalization and the Paragon Acquisition.

Tri-S Security was incorporated during the fourth quarter of 2001. For purposes of calculating the weighted average shares outstanding for the pro forma income per share calculation for the year ended December 31, 2001 and prior periods, it is assumed that Tri-S Security was incorporated on January 1, 1999.

Selected Financial Data	2006	2005	Tri-S Security Corporation and Subsidiary Consolidated 2004	Paragon Systems, Inc. Jan. 1, 2004 to Feb. 27, 2004	2003	2002	2001
	(In thousands, except per share data)						
Statement of Operations Data:							
Revenues	$75,725	$41,985	$ 25,425	$4,706	$29,395	$21,364	$16,491
Direct labor	47,353	24,406	13,810	2,481	16,070	11,983	9,092
% of revenues	62.5%	58.1%	54.3%	52.7 %	54.7%	56.1%	55.1%
Indirect labor and other contract support costs	19,256	14,054	10,223	2,113	11,151	7,615	6,000
% of revenues	25.4%	33.5%	40.2%	44.9 %	37.9%	35.6%	36.4%
Amortization of government contracts	1,638	677	298	—	—	—	—
% of revenues	2.2%	1.61%	1.17%	—	—	—	—
Gross profit	7,478	2,848	1,094	111	2,174	1,766	1,399
% of revenues	10.0%	6.8%	4.3%	2.4%	7.4%	8.3%	8.5%
Selling, general and administrative expenses	11,682	6,133	2,115	230	1,466	1,179	896
% of revenues	15.4%	14.6%	8.3%	4.9%	5.0%	5.5%	5.4%
Amortization expense	928	279	—	—	—	—	—
Operating income (loss)	(5,132)	(3,564)	(1,021)	(119)	708	587	503
% of revenues	-6.8%	-8.5%	-4.0%	-2.5 %	2.4%	2.7%	3.1%
Interest income	12	44	3	—	12	23	28
Interest expense	(3,146)	(1,383)	(1,380)	(11)	(30)	(7)	(11)
Interest on redeemable preferred stock	(300)	(300)	(250)	—	—	—	—
Income (loss) before income taxes	(5,527)	(3,692)	(1,011)	(130)	690	603	520
Income tax (benefit)	(1,694)	(1,414)	(384)				
Pro forma income tax expense (benefit)				(49)	262	229	198
Net loss	(3,833)	(2,278)	(627)				
Pro forma net income (loss)				(81)	428	374	322
Basic and diluted net (loss) per common share	(1.11)	(0.74)	(.76)				
Pro forma basic net income (loss) per common share				(0.10)	0.52	0.46	0.40
Pro forma diluted net income (loss) per common share				(0.10)	0.39	0.40	0.40
Balance Sheet Data (at Period End):							
Cash	$ 66	$ 463	$ 313	$ 275	$ 846	$ 877	$ 647
Current assets	14,028	12,453	6,636	6,803	5,713	5,911	5,003
Total assets	37,101	47,345	24,618	7,230	6,883	6,114	5,147
Long term obligations	9,247	22,456	10,446	175	185	—	—
Total liabilities	30,245	36,911	24,886	3,720	3,243	3,124	2,760
Cash dividends	—	—	—	—	—	—	—

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The results of operations set forth below for the years ended December 31, 2006, 2005 and 2004 are based on historical results for the Company. Historical amounts for the period ended January 1, 2004 to February 27, 2004 for Paragon Systems prior to the Paragon Acquisition are combined for presentation and discussion purposes. The results of Cornwall are included in our consolidated financial statements beginning on October 1, 2005.

Paragon Systems was formerly a subchapter S corporation; consequently, pro forma income tax expense and pro forma net income are presented on the face of the historical statements of operations for all periods presented. The adjustments include only taxes at a statutory rate of 38% for each period presented.

In accordance with requirements of purchase accounting, the assets and liabilities of Paragon Systems and the Cornwall Group were adjusted to their estimated fair values and the resulting goodwill computed for the both acquisition. The application of purchase accounting generally results in higher depreciation and amortization expense in periods subsequent to the acquisitions.

Overview

We are an aggregator of elite guard services companies. Through our two direct, wholly-owned subsidiaries, Paragon Systems and Cornwall, we provide equipment and security services to various government agencies and the private sector. Our services include uniformed guards, electronic monitoring systems, personnel protection, access control, crowd control and the prevention of sabotage, terrorist and criminal activities. In connection with providing these services, we assume responsibility for a variety of functions, including recruiting, hiring, training, arming and supervising guards deployed to the customers we serve as well as paying all guards and providing them with uniforms, fringe benefits and workers' compensation insurance.

During 2006, Paragon Systems formed SEP with Southeastern Protective Services, Inc. to provide security services pursuant to certain federal government contracts. The services provided by SEP are substantially the same as those provided by Paragon Systems. Paragon Systems owns 49% of SEP and manages the operations. Accordingly, the operations of SEP are included in the Tri-S Security's consolidated financial statements.

Our government customers include local, state and Federal government agencies. Our private sector customers include commercial customers, such as universities, public school systems, corporate complexes and hospitals, and residential customers, such as condominiums, high-end apartments and high-security homes.

We strive to provide cost-effective solutions to ensure the safety and security of the assets and personnel of our customers and to continually improve the protection we provide for their personnel, programs, resources and facilities. Our goal is to provide demonstrably superior contract guard services with the highest degree of integrity and responsiveness.

In addition to our core business of providing equipment and security services, we owned a non-core business interest of providing logistics services. Through Paragon Systems, we owned a 10% equity interest in Army Fleet Support, which provides logistics support for U.S. Army aviation training at Fort Rucker, Alabama. We sold our 10% interest in Army Fleet Support for $10.8 million in May 2006.

We were incorporated in Georgia in October 2001 under the name "Diversified Security Corporation" and changed our name to "Tri-S Security Corporation" in August 2004. We were formed for the purpose of acquiring and consolidating electronic and physical security companies in order to take advantage of the operating efficiencies created by a larger company. Our acquisition strategy involves the acquisition and integration of complementary businesses in order to increase our scale within certain geographic areas, capture market shares in the markets in which we operate and improve our profitability. We intend to pursue acquisition opportunities in the contract guard services and system integration services segments of the security industry. We frequently evaluate acquisition opportunities and, at any given time, may be in various stages of due diligence or preliminary discussions with respect to a number of potential acquisitions. From time to time, we may enter into non-binding letters of intent, but we are not currently subject to any definitive agreement with respect to any

acquisition material to our operations or otherwise so far advanced in any discussions as to make an acquisition material to our operations reasonably certain.

We made our first acquisition on February 27, 2004, when we acquired all of the outstanding capital stock of Paragon Systems, a contract guard services and logistics provider for a purchase price of $16,000,000. We made our second acquisition on October 18, 2005, when we acquired all of the outstanding capital stock of Cornwall, a provider of security and investigative services, including armed and unarmed uniform guards, video and alarm monitoring, alarm installation, and GPS monitoring, to government and private sector customers in the Miami, Florida area, for a total purchase price of $13,500,000. In the first quarter of 2006, we announced the sale of International Monitoring, Inc., a wholly-owned subsidiary of Cornwall, which provides residential security system monitoring.

Renewing and extending existing contracts and obtaining new contracts are crucial to our ability to generate revenue and manage cash flow. Our Federal government contracts, which generate a significant portion of our revenue, may be terminated at any time by the Federal government, or the Federal government may determine not to renew or extend any of such contracts upon their scheduled expiration. The Cornwall Acquisition has allowed us to diversify our customer base to include commercial customers. We must continue to sell commercial services to commercial customers in order to maintain our revenue system and to grow our business.

Critical Accounting Policies and Estimates

The following discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of these financial statements requires us to make judgments regarding estimates that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures. We base our judgments on historical experience and on various assumptions that we believe are reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. We believe our judgments and related estimates regarding the following accounting policies are critical in the preparation of our consolidated financial statements.

Revenue Recognition. Revenue is recorded monthly as guard services are provided to our customers under contracts. We bill guard services in arrears at hourly or monthly rates based on the number of hours worked under some contracts and as fixed monthly amounts under other contracts. Hourly and monthly rates are based on contractual terms.

The terms of our contracts are complex and may be subject to differing interpretations. We make estimates and judgments about terms of the contracts in providing services and in billing and recording revenue. At times, our Federal contracts require interpretations. Typically, differences in interpretation are resolved on a mutual basis in discussions with the government agency involved. The resolution of differences may result in a determination that amounts previously billed are not in accordance with contract terms and adjustments of amounts initially recorded as revenue may be material.

Contracts with Federal government agencies may be subject to cessation of funding. Cessation of funding may result in amounts billed and recorded as revenue as being uncollectible. We work with the appropriate government agency to resolve funding issues. When funding issues become known, we make estimates and judgments about the extent of potential losses and adjust revenues accordingly. Amounts estimated could differ from amounts ultimately collected and these amounts could be material. During 2004, 2005 and 2006, none of our contracts have been subject to cessation of funding.

Cost of Revenues. Cost of revenues is primarily comprised of labor, related payroll taxes, employee benefits, workers compensation, liability insurance, and the pro rata portion of the costs of customer contracts required.

We make estimates and judgments of amounts recorded for accruals of labor related costs. Expenses most subject to estimation and judgment are accrued vacation and workers compensation costs. The terms of vacation policies may be complex and subject to interpretation. Workers compensation insurance is subject to retroactive audit. Actual amounts could differ from the amounts initially recorded.

Impairment of Long-lived Assets, Goodwill and Intangible Assets. We evaluate impairment of long-lived assets, including property and equipment and intangible assets with finite lives, whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. If the sum of the expected future undiscounted cash flows is less than the carrying amount of the asset, then an impairment loss is recognized. Measurement of an impairment loss for long-lived assets is based on discounted cash flows and the fair value of an asset.

Investment in Army Fleet Support. We accounted for our 10% equity in Army Fleet Support, a joint venture which provides logistics support for U.S. Army aviation training at Fort Rucker, Alabama, using the equity method of accounting. Accordingly, our investment in Army Fleet Support is increased by our share of Army Fleet Support's earnings and reduced by the amortization of our investment in Army Fleet Support and the cash we receive from Army Fleet Support with respect to our investment. During the second quarter of 2006, we sold our equity interest in Army Fleet Support.

SFAS No. 123(R). On January 1, 2006, we adopted SFAS No. 123R using the modified-prospective-transition approach method. The adoption increased our net loss by $377,000 for the year ended December 31, 2006 compared to our previous method of accounting for share-based compensation under Accounting Principal Board Opinion No. 25, *Accounting for Stock Issued to Employees*. The adoption of SFAS No. 123(R) would have increased our net loss for year ended December 31, 2005 and 2004 by $87,000 and $171,000, respectively. We will incur approximately $542,000 of expense over a weighted average of 3 years for all unvested options.

Results of Operations for the Years Ended December 31, 2006, 2005 and 2004

The following table sets forth absolute dollar and percentage changes in our selected financial data from period to period for the periods described below. The table below combines results of Paragon Systems with Tri-S Security for periods prior to the Paragon Acquisition (dollars in thousands):

	Change from Year Ended December 31, 2005 to Year Ended December 31, 2006		Change from Year Ended December 31, 2004 to Year Ended December 31, 2005		Change from Year Ended December 31, 2003 to Year Ended December 31, 2004	
	$	%	$	%	$	%
					(restated)	
Revenues	$33,740	80.4%	$11,855	39.3%	$ 735	2.5%
Operating expenses:						
Direct labor	22,947	94.0	8,115	49.8	221	1.4
Indirect labor and other contract support costs	5,202	37.0	1,718	13.9	1,185	10.6
Selling, general and administrative	5,549	90.5	3,788	161.5	879	29.3
Amortization of customer contracts and intangible assets	1,610	168.4	658	220.8	298	—
Operating income (loss)	(1,568)	44.0	(2,424)	212.6	(1,848)	415.8
Income from investment in Army Fleet Support	(1,393)	78.4	140	8.6	1,637	N/A
Interest income	(32)	72.7	41	1,366.7	(9)	75.0
Interest expense	(1,763)	127.5	8	0.6	(1,361)	4,536.7
Interest on Series C Redeemable Preferred Stock	—	—	(50)	20.0	(250)	—
Other income(expense)	2,921	1,098.1	(266)	N/A	—	—
Loss before income taxes	(1,835)	49.7	(2,551)	223.6	(1,831)	266.0

Revenue

The increase in revenue from 2005 to 2006 is primarily the result of (1) the inclusion of Cornwall's revenue for all of 2006 versus only the fourth quarter for 2005. Cornwall was acquired on October 18, 2005; (2) the increase in revenue at Paragon Systems and its consolidated subsidiary, SEP due to three new contracts for each of Paragon Systems and SEP, net of two contract expirations during 2006 for Paragon Systems.

The increase in revenue for the periods prior to 2005 is directly attributable to the number and value of our contacts during successive periods. Generally, the revenue generated by a contract is dependent upon the number of labor hours required to service such contract. During 2005, one of the contracts serviced by Paragon Systems expired, and Paragon Systems did not obtain any new contracts. Revenues generated by Paragon Systems increased from 2004 to 2005 as a result of additional services related to the Hurricane Katrina relief effort rendered by Paragon Systems under a contract with GSA. Subsequent to December 31, 2005, two of Paragon System's contracts, which generated approximately $5.0 million in annual revenue, expired.

Prior to 2005, substantially all of our revenues were generated by Federal government contracts awarded to us through a competitive bidding process. In 2004, we obtained one new contract in the fourth quarter returning the number of managed contracts to thirteen. Revenue for 2004 increased by approximately $700,000 over 2003 primarily because the four new contracts we obtained in 2003 were included for a full year in 2004 offset partially by the reduction in revenue related to the two contracts that expired during 2003.

Also in 2004, we recognized revenue of $699,000 with respect to two Federal government contracts to recover costs imposed on us in excess of our original bid that we expected to recover based on meetings and negotiations with the Federal agency party to the contracts. Subsequent to December 31, 2004, the Federal agency denied all of our claims to recover these costs. We recorded a provision in the amount of $434,000 against our 2004 revenue in anticipation that we may not succeed with appeals that we plan to initiate. After lengthy negotiations with the Federal agency party to the contracts, we received a payment in the first quarter of 2006 related to the claims which payment satisfied the receivables with respect to such claims as of December 31, 2005.

The following table sets forth the number of our Federal government contracts for Paragon during the periods and in the revenue ranges indicated in the table:

Annual Revenues	Year Ended December 31, 2006	Year Ended December 31, 2005	Year Ended December 31, 2004
Less Than $1.0 Million per Contract	8	4	5
$1.0 to $3.0 Million per Contract	4	3	8
Greater than $3.0 Million per Contract	4	5	5

During 2006, two contracts expired and three new contracts were commenced. On December 31, 2006, 11 contracts were active. In addition to the Paragon Systems contracts, at December 31, 2006, SEP was serving three Federal contracts with aggregate annual contract revenue of approximately $5.6 million.

The following table sets forth the years in which our contracts existing as of December 31, 2006 will expire:

Number of Contracts	Year Expiring
3	2007
5	2008
—	2009
—	2010
5	2011

The three contracts scheduled to expire in the fourth quarter of 2007. These contracts generated revenue of approximately $ 12.9 million during 2006.

Costs of Revenues

We categorize our cost of revenues into three areas: (i) direct labor; (ii) indirect labor and other contract support costs; and (iii) amortization of government contracts.

Direct Labor. Direct labor is the most significant expense in providing guard services on any contract. Direct labor was approximately 63% of revenue in 2006, 58% of revenue in 2005 and 54% of revenue in 2004. When bidding on contracts, we must anticipate labor rates during the contract term.

Indirect Labor and Other Contract Support Costs. This category of expenses consists primarily of indirect labor (guard supervisors), our portion of payroll taxes, employee benefit costs and other expenses. Other expenses comprise a relatively small portion of costs in this category. As with direct labor, when bidding on contracts, we must anticipate the cost of providing supervisory oversight of the guards performing the actual guard services and the related payroll taxes and employee benefits that are provided to both guards and supervisors. Indirect labor and other contract support costs was approximately 25% of revenue in 2006, 33% of revenue in 2005 and 41% of revenue in 2004.

Amortization of Government Contracts. Upon the consummation of each of the Paragon Acquisition and the Cornwall Acquisition, the existing contracts were valued in accordance with purchase accounting rules and the resulting asset values are being amortized over the remaining term of each contract proportionate to estimated future discounted cash flows based on an independent appraisal.

General. Our ability to accurately anticipate the costs of providing guard services is critical to our profitability. In accordance with our strategy to bid on and obtain higher value contracts in 2001, we reduced our anticipated profit margins on our contract bids in order to be more competitive in the bid process and obtain more contracts. Thus, it is more important than ever that we correctly anticipate all of the above mentioned costs. When bidding on contracts in 2002, we failed to accurately anticipate the cost of providing supervisory oversight on two contracts which we subsequently obtained. The costs of providing the necessary oversight increased our indirect labor costs and reduced our profit margins in 2003 and 2004 with respect to these two contracts. These two contracts differ from our other contracts in that they covered multiple locations over wide geographic areas. We successfully negotiated with the Federal agency which is a party to these contracts to reach profitability on one of these contracts as of the end of 2005.

Our cost of revenue was 90.1% of revenue in 2006, 93.2% of revenue in 2005 and 96.0% of revenue in 2004. Our cost of revenue as a percent of our revenue is the result of our aggressive approach to pricing strategy on our contract bids. The reduced cost of revenue as a percent of revenue is primarily due to the acquisition of Cornwall in October 2005.

Selling, General and Administrative Expenses

Selling, general and administrative expenses as a percentage of revenue was 15.4% in 2006, 14.6% in 2005 and 7.8% in 2004. Selling, general and administrative expenses consist primarily of payroll and related expenses for administrative personnel in our operations offices located in Chantilly, Virginia and Miami, Florida and in our corporate office located in Alpharetta, Georgia. It also includes occupancy costs at the office locations, consulting and professional fees, and certain miscellaneous office and corporation expenses. General and Administrative expenses increased by $5.5 million from 2005 to 2006. The increase is partially due to the $4 million increase of Cornwall costs because Cornwall expenses were included for the entire year in 2006 compared to only the fourth quarter in 2005. Cornwall was acquired on October 18, 2005. The remaining $1.5 million increase relates to higher General and Administrative costs at Paragon Systems and corporate costs to support the growth of the Company and the public company requirements. We expect our selling, general and administrative expenses to decline as a percentage of revenue as we increase our revenue while stabilizing or reducing our selling, general and administrative costs.

Joint Venture

Until May 2006, the Company owned a 10% equity interest in Army Fleet Support. We recognized as income 10% of the Army Fleet Support's net earnings or net loss less the amortization of the difference between our cost and our share of the net equity of Army Fleet Support. In 2006 and 2005, we recognized income of $659,000 and $2,601,000 less amortization of $275,000 and $824,000 for income of $384,000 and $1,777,000 with respect to our interest in Army Fleet Support, respectively. In addition, we recognized a gain on the sale of the Army Fleet Support of $1,903,000.

Interest Income and Interest Expense

The interest expense for 2006 relates to the interest incurred on our Factoring Agreement and our outstanding Series C Redeemable Preferred Stock, and the interest expense incurred on our 10% convertible promissory notes. Interest expense was also incurred on our term loans until the loans were repaid in May 2006.

Income Tax Expense and Pro Forma Income Tax Expense

The income tax benefit for 2006 and 2005 was $1.7 and $1.4 million, respectively, which was 30.6% and 38.4% of the loss before income taxes generated during 2006 and 2005, respectively.

Prior to the Paragon Acquisition, Paragon Systems only recognized income tax expense relating to built in gain taxes for periods before its S election. Income tax expense reported by Paragon Systems has been replaced with pro forma income tax expense at 38% in all periods. This includes Federal income taxes at 34% and state income taxes at 4% which is net of the Federal effect. For the year ended December 31, 2004, the results of operations of Tri-S consolidated with Paragon Systems shows a loss before income taxes of $1.1 million and an income tax benefit of $384,000.

Liquidity and Capital Resources

As of December 31, 2006, we had $66,000 of cash on hand. Cash used by operating activities was $7.5 million for the year ended December 31, 2006. The cash used by operations was primarily due to a net loss during 2006 of $3.8 million, an increase in our accounts receivable of $2.3 million and a reduction of accrued liabilities of $1.8 million. In addition, during 2006, cash generated from investing activities was $12.1 million due primarily to the $10.8 million proceeds from the sale of investment in Army Fleet Support, the $608,000 of proceeds from the sale of assets, including certain home monitoring customer contracts, of International Monitoring, Inc., and the $700,000 of proceeds from the sale of property and equipment. We used $4.9 million of cash for financing activities primarily due to the reduction of debt obligations by $5.0 million.

The Series C Redeemable Preferred Stock outstanding at December 31, 2006 was redeemable on February 27, 2007 for an aggregate value of $6.0 million. All of the outstanding Series C Redeemable Preferred Stock was issued in connection with the Paragon Acquisition and is held by the former shareholders of Paragon Systems. On February 26, 2006, we filed a complaint against the former shareholders of Paragon Systems alleging, among other things, that the former shareholders breached certain representations set forth in the Paragon Purchase Agreement, pursuant to which the Paragon Acquisition was consummated on February 27, 2004, and that certain former shareholders committed fraud in connection with the Paragon Acquisition. In the complaint we seek, among other things, an award of damages against the former shareholders and a decree invalidating all of the outstanding shares of the Series C Redeemable Preferred Stock. Accordingly, we exercised our right of offset under the Paragon Purchase Agreement and applicable common law and have not paid the dividend payments which were otherwise due in respect of the Series C Redeemable Preferred Stock on February 28, 2006 or on any date thereafter. In addition, we did not pay the $6,000,000 redemption payment payable on February 27, 2007. In the event that our complaint is unsuccessful and we are required to pay the dividend and redemption payments with respect to the Series C Redeemable Preferred Stock, we will need to raise additional debt and/or equity capital or sell assets to satisfy the obligation.

Subsequent to year-end, we entered into agreement with our lender, BRE, LLC for the 2007 Term Loan to borrow up to $2.5 million. The 2007 Term Loan will provide liquidity for the business for 2007. In addition to

our need for cash to fund our operating needs, we have an income tax liability of approximately $1.2 million at December 31, 2006. Our liquidity position in the future will be determined by our ability to generate sufficient cash from operations and our borrowing availability under the Factoring Agreement and the 2007 Term Loan and future financings.

Subsequent to year-end, we were notified by Miami/Dade County, Florida that our security services contracts with the county were extended through September 30, 2007. The contracts were originally scheduled to expire on March 31, 2007.

Off-Balance Sheet Arrangements

We do not have any material off-balance sheet arrangements.

Recent Accounting Pronouncements

In July 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes," ("FIN 48"), which clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." The interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax provision taken or expected to be taken in a tax return. It also provides guidance on derecognizing, classification, interest and penalties, accounting in interim periods, disclosure and transition. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006. The Company does not believe the impact of FIN 48 will have a material impact on the Company's results of operations, financial position or cash flows.

In February 2007, the Financial Accounting Standards Board ("FASB") issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities — Including an Amendment of FASB Statement No. 115" ("SFAS 159"). SFAS 159 permits many financial instruments and certain other items to be measured at fair value at the option of the Company. Most of the provisions in SFAS 159 are elective; however, the amendment to SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," applies to all entities with available-for-sale and trading securities. The fair value option established by SFAS 159 permits the choice to measure eligible items at fair value at specified election dates. Unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings at each subsequent reporting date. The fair value option: (a) may be applied instrument by instrument, with a few exceptions, such as investments otherwise accounted for by the equity method; (b) is irrevocable (unless a new election date occurs); and (c) is applied only to entire instruments and not to portions of instruments. SFAS 159 is effective for financial statements issued for the first fiscal year beginning after November 15, 2007. Early adoption is permitted provided that the choice be made in the first 120 days of that fiscal year and SFAS No. 157, "Fair Value Measurements" is also adopted. The Company is currently evaluating the impact, if any, that this new standard will have on the Company's results of operations, financial position or cash flows.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosure of fair value measurements. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements and, accordingly, does not require any new fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact, if any, that this new standard will have on the Company's results of operations, financial position or cash flows.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to various market risks, including changes in interest rates. Market risk is the potential loss arising from adverse changes in market rates and prices, such as interest rates and foreign currency exchange rates. We do not enter into derivatives or other financial instruments for trading or speculative purposes. We have

not entered into financial instruments to manage and reduce the impact of changes in interest rates and foreign currency exchange rates, although we may enter into such transactions in the future.

Our 10% Notes carry interest rates which are fixed. The Factoring Facility has a funds usage fee which varies with the prime rate. Accordingly, if we sell our accounts receivable to our lenders and such accounts remain unpaid, then any increase in the prime rate will increase the funds usage fee we owe on such unpaid accounts and, therefore, reduce our earnings.

Item 8. Financial Statements and Supplementary Data

The financial statements required to be filed with this Annual Report are filed under Item 15 hereof and are listed on the "Index to Consolidated Financial Statements" on page F-1 hereof.

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Our Chief Executive Officer and Chief Financial Officer have evaluated our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) or 15d-15(e) of the Exchange Act), as of the end of the period covered by this Quarterly Report, as required by paragraph (b) of Rules 13a-15 or 15d-15 of the Exchange Act. Based on such evaluation, such officers have concluded that, as of the end of the period covered by this Quarterly Report, our disclosure controls and procedures are effective.

During the fourth quarter of 2006, there were no changes in our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Rules 13a-15 or 15d-15 of the Exchange Act that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information

On March 23, 2007, we entered into an Amendment and Forbearance Agreement with our lenders pursuant to which they have waived certain defaults under our Credit Agreement relating to our litigation with the former shareholders of Paragon Systems and the Series C Redeemable Preferred Stock and have agreed to forbear from exercising any of the remedies available to them under the Credit Agreement in connection with such defaults until February 28, 2008. The Amendment and Forbearance Agreement also provides for the 2007 Term Loan, which makes available to us a $2.5 million term loan to be used for general corporate purposes. The interest rate on the term loan is prime plus 5.5% with maturity on February 28, 2009. We will be required to pay a prepayment fee of $50,000 per month for every month the term loan is prepaid prior to maturity.

On February 2, 2007, the SEC notified us that (i) our Annual Reports on Form 10-K and Form 10-K/A for the years ended December 31, 2005 and 2004, respectively (the "Prior Annual Reports"), are not in compliance with the requirements of Form 10-K and Regulation S-X and are considered to be materially deficient because such reports do not include the separate financial statements of Army Fleet Support for the applicable years as required by Form 10-K and Regulation S-X; and (ii) this Annual Report will not be in compliance with the requirements of Form 10-K and Regulation S-X unless audited financial statements for Army Fleet Support are included herein for the three years ended December 31, 2006. (Such financial statements are not included in this Annual Report.)

The SEC's notification was made in connection with it denying our request, made on January 29, 2007, that the SEC waive the disclosure requirements of Form 10-K and Regulation S-X with respect to us including the financial statements of Army Fleet Support in our periodic filings. We are unable to include such financial statements in our periodic filings because (i) the financial statements of Army Fleet Support which are required to be so included do not currently exist; (ii) we are unable to prepare them based upon the limited financial information with respect to Army Fleet Support which we received from Army Fleet Support; and (iii) L-3 Communications Corp., the majority owner of Army Fleet Support, has denied us access to the financial information with respect to Army Fleet Support that would be necessary for us to prepare the required financial statements for Army Fleet Support.
Consequently, the Prior Annual Reports and this Annual Report are not in compliance with the requirements of Form 10-K and Regulation S-X. As a result of the foregoing, the SEC will not declare effective any registration statements filed by us, and our securities may not be offered and sold under effective registration statements, subject to certain exceptions.

PART III.

ITEM 10. Directors, Executive Officers of the Registrant and Corporate Governance

The information required by this Item is incorporated herein by reference to the sections of our proxy statement for our 2007 Annual Meeting of Shareholders (the "Proxy Statement") titled "Proposal I: Election of Directors," "Section 16(a) Beneficial Ownership Reporting Compliance" and "Code of Ethics."

ITEM 11. Executive Compensation

The information required by this Item is incorporated herein by reference to the section of our Proxy Statement titled "Compensation of Directors and Executive Officers."

ITEM 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this Item is incorporated herein by reference to the sections of our Proxy Statement titled "Security Ownership of Management and Certain Beneficial Owners" and "Equity Compensation Plans."

ITEM 13. Certain Relationships and Related Transactions and Director Independence

The information required by this Item is incorporated herein by reference to the sections of our Proxy Statement titled "Certain Relationships and Related Transactions" and "Proposal I: Election of Directors."

ITEM 14. Principal Accountant Fees and Services

The information required by this Item is incorporated herein by reference to the section of our Proxy Statement titled "Proposal 2 – Ratification of Appointment of Independent Registered Public Accountants."

ITEM 15. Index to Financial Statements

(a) The following documents are filed as part of this Annual Report:

(1) Index to Consolidated Financial Statements

(2) Financial Statement Schedules

(3) Exhibits. The exhibits required to be filed with this Annual Report are listed on the "Exhibit Index" filed herewith.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders
Tri-S Security Corporation

We have audited the accompanying consolidated balance sheets of Tri-S Security Corporation and subsidiaries (the "Company") as of December 31, 2006 and 2005, and the related consolidated statements of operations, shareholders' equity and cash flows for the years then ended. Our audits also included the financial statement schedule listed at Item 15. These financial statements and the financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and the financial statement schedule based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Tri-S Security Corporation and subsidiaries at December 31, 2006 and 2005, and the results of their operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respect the information set forth therein.

As discussed in Note 3 to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards No. 123(R), *Shared-Based Payment,* effective January 1, 2006.

/s/ Tauber & Balser, P.C.

Atlanta, Georgia
March 27, 2007

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders
Tri-S Security Corporation

We have audited the accompanying consolidated statements of operations, shareholders' equity and cash flows for the year ended December 31, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the results of operations and cash flows of Tri-S Security Corporation and subsidiary for the year ended December 31, 2004 in conformity with accounting principles generally accepted in the United States.

/s/ Miller Ray Houser & Stewart LLP

Atlanta, Georgia
March 15, 2005

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders
Tri-Security Corporation

We have audited the accompanying statements of operations, shareholders' equity and cash flows of Paragon Systems, Inc. (predecessor company to Tri-S Security Corporation) for the period from January 1, 2004 to February 27, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the results of operations and cash flows of Paragon Systems, Inc., for the period from January 1, 2004 to February 27, 2004 in conformity with accounting principles generally accepted in the United States.

/s/ Miller Ray Houser & Stewart LLP

Atlanta, Georgia
March 15, 2005

Tri-S Security Corporation and Subsidiaries

Consolidated Balance Sheets

(In thousands, except per share data)

	December 31, 2006	December 31, 2005
Assets		
Current assets:		
Cash and cash equivalents	$ 66	$ 463
Unbilled revenues and trade accounts receivable, net of allowance for doubtful accounts of $797 and $1,181, respectively	13,313	10,988
Income taxes receivable	—	20
Prepaid expenses and other assets	649	982
Total current assets	14,028	12,453
Property and equipment, less accumulated depreciation	597	1,467
Note receivable—officer	—	102
Investment in joint venture	—	8,698
Goodwill	16,078	15,615
Intangibles, net		
Customer contracts	4,264	5,990
Deferred loan cost	1,143	1,756
Other	991	1,264
Total assets	$37,101	$47,345
Liabilities and Stockholders' Equity		
Current liabilities:		
Trade accounts payable	$ 1,104	$ 1,199
Accrued interest expense	400	100
Accrued expenses	4,467	5,690
Income taxes payable	1,237	—
Factoring facility	7,506	7,191
Term loans	—	275
Long term debt – current portion	284	—
Series C preferred stock subject to mandatory redemption	6,000	—
Total current liabilities	20,998	14,455
Other liabilities:		
10% convertible notes	7,273	6,300
Deferred income taxes	1,974	5,069
Term loans	—	4,817
Long term debt	—	270
Series C preferred stock subject to mandatory redemption	—	6,000
Total liabilities	30,245	36,911
Stockholders' equity :		
Common stock, $0.001 par value, 25,000,000 shares authorized, 3,503,280 and 3,338,700 shares issued	3	3
Treasury stock – 45,424 shares at cost	(105)	—
Additional paid-in capital	14,109	13,749
Deficit	(7,151)	(3,318)
Total stockholders' equity	6,856	10,434
Total liabilities and stockholders' equity	$37,101	$47,345

See accompanying notes to consolidated financial statements.

Tri-S Security Corporation and Subsidiaries

Consolidated Statements of Operations

(In thousands, except per share data)

	Year Ended December 31,			Predecessor Basis- Paragon Systems, Inc.
	2006	2005	2004	January 1, 2004 to February 27, 2004
Revenues	$75,725	$41,985	$25,425	$ 4,705
Cost of revenues:				
Direct labor	47,353	24,406	13,810	2,481
Indirect labor and other contract support costs	19,256	14,054	10,223	2,113
Amortization of customer contracts	1,638	677	298	—
	68,247	39,137	24,331	4,594
Gross profit	7,478	2,848	1,094	111
Selling, general and administrative	11,682	6,133	2,115	230
Amortization of intangible assets	928	279		
Operating loss	(5,132)	(3,564)	(1,021)	(119)
Income from joint venture, net	384	1,777	1,637	—
Interest and other income (expense):				
Interest income	12	44	3	—
Interest expense	(3,146)	(1,383)	(1,380)	(11)
Interest on preferred stock subject to mandatory redemption	(300)	(300)	(250)	—
Gain on sale of non-core assets	2,381	—	—	—
Other income (expense)	274	(266)	—	—
	(779)	(1,905)	(1,627)	(11)
Loss before income taxes	(5,527)	(3,692)	(1,011)	(130)
Income tax benefit	(1,694)	(1,414)	(384)	—
Net loss	$ (3,833)	$ (2,278)	$ (627)	(130)
Pro forma income tax benefit				(49)
Proforma net loss				$ (81)
Basic and diluted net (loss) per common share	$ (1.11)	$ (0.74)	$ (0.76)	$ 2,481
Basic and diluted weighted average number of common shares	3,448	3,097	828	2,113

See accompanying notes to consolidated financial statements.

Tri-S Security Corporation and Subsidiaries

Consolidated Statements of Shareholders' Equity

(In thousands)

	Paragon Systems, Inc. Common Stock		Common Stock		Treasury Stock		Series A Convertible Preferred Stock		Series B Convertible Preferred Stock		Additional Paid-in Capital	Retained Earnings (Deficit)	Total
	Shares	Cost	Shares	Cost	Shares	Cost	Shares	Cost	Shares	Cost			
Predecessor Basis													
Balance at December 31, 2003	940	$ 1		$		$		$		$	$	$ 3,639	$ 3,640
Net loss												(130)	(130)
Balance at February 27, 2004	940	1										3,509	3,510
Successor Basis													
Balance at February 27, 2004	940	1										3,509	3,510
Reverse capital structure of predecessor	(940)	(1)										(3,509)	(3,510)
Capital structure of successor at December 31, 2004			828	1			100	460	40	196	115	(413)	359
Net loss												(627)	(627)
Balance at December 31, 2004			828	1			100	460	40	196	115	(1,040)	(268)
Recapitalization			372				(100)	(460)	(40)	(196)			(656)
IPO including warrants related to IPO, net of issue costs of $633			2,070	2							10,885		10,887
Shares issued for services and interest			69								334		334
Options issued for services											59		59
Beneficial conversion of convertible notes											1,093		1,093
Warrants issued											1,263		1,263
Net loss												(2,278)	(2,278)
Balance at December 31, 2005			3,339	3							13,749	(3,318)	10,434
Shares issued for services			40								180		180
Shares issued for conversion of notes payable			73								326		326
Note receivable repaid through issuance of treasury stock					45	(105)							(105)
Options exercised			97								12		12
IPO expenses											(108)		(108)
Beneficial conversion of convertible notes											(425)		(425)
Stock compensation											375		375
Net loss												(3,833)	(3,833)
Balance at December 31, 2006	—	$ —	3,549	$ 3	45	$ (105)	—	$ —	—	$ —	$ 14,109	$ (7,151)	$ 6,856

See accompanying notes to consolidated financial statements.

Tri-S Security Corporation and Subsidiaries

Consolidated Statements of Cash Flows

(In thousands)

	Year Ended December 31,			Predecessor Basis Paragon Systems, Inc For the period January 1, 2004 to February 27, 2004
	2006	2005	2004	
Cash flow from operating activities:				
Net loss	$ (3,833)	$ (2,278)	$ (627)	$ (130)
Adjustments to reconcile net loss to net cash used by operating activities:				
Gain on sale of non-core assets	(2,381)	—	—	—
Income from joint venture, net	(384)	(1,777)	(1,637)	—
Depreciation and amortization	2,909	1,065	617	28
Deferred income tax benefits	(3,095)	(1,193)	(414)	—
Common shares, options and warrants in exchange for services and interest	377	334	—	—
Non-cash interest expense	875	369	—	—
Changes in operating assets and liabilities, net of effects of acquisition:				
Unbilled revenues and trade accounts receivable, net	(2,286)	(1,883)	544	(1,161)
Prepaid expenses and other assets	418	21	393	(499)
Trade accounts payable	(95)	601	(262)	62
Accrued liabilities	(1,478)	(697)	437	944
Income taxes payable	1,426	(242)	(207)	(111)
Net cash used by operating activities	(7,547)	(5,680)	(1,156)	(867)
Cash flow from investing activities:				
Acquisition of subsidiary, net of cash acquired	(3)	(12,286)	(2,300)	—
Proceeds from sale of investment in joint venture	10,810	—	—	—
Distributions from investment in joint venture	175	1,381	1,437	715
Proceeds from sale of assets	1,301	—	14	—
Purchase of property and equipment	(203)	(100)	(67)	—
Net cash provided (used) by investing activities	12,080	(11,005)	(916)	715
Cash flow from financing activities:				
Proceeds from initial public offering	—	10,887	—	—
Repayment of notes issued for purchase of Paragon	—	(7,764)	—	—
Proceeds from issuance of notes and warrants	—	8,015	—	—
Proceeds from exercise of stock options	9	—	—	—
Proceeds of (repayments on) factoring facility	315	2,107	3,067	(405)
Proceeds of (repayments on) term loans	(5,092)	5,150	—	—
Deferred financing costs	(43)	(1,560)	—	—
Repayments of capital lease obligations	(8)	—	(65)	(13)
Deferred initial public offering costs	(111)	—	(599)	—
Payments for intangible assets	—	—	(120)	—
Net cash provided (used) by financing activities	(4,930)	16,835	2,283	(418)
Net increase (decrease) in cash and cash equivalents	(397)	150	211	(570)
Cash and cash equivalents at beginning of period	463	313	102	846
Cash and cash equivalents at end of period	$ 66	$ 463	$ 313	$ 276
Supplemental disclosures of cash flow information:				
Interest paid	$ 1,873	$ 1,491	$ 931	$ 6
Income taxes paid	149	423	224	—
Satisfaction of officer note receivable through issuance of treasury stock	105	—	—	—
Issuance of notes and preferred stock in business acquisition	—	—	13,706	—

See accompanying notes to consolidated financial statements.

Tri-S Security Corporation and Subsidiaries

Notes to Consolidated Financial Statements

(dollars in thousands, except per share data)

1. Organization and Nature of Business

Tri-S Security Corporation, a Georgia corporation ("Tri-S", the "Company" or "We") was incorporated in October 2001 under the name "Diversified Security Corporation." We changed our name to "Tri-S Security Corporation" on August 16, 2004. We provide contract guard services to (i) various Federal government agencies through our subsidiaries, Paragon Systems, Inc., an Alabama corporation with its principal office located in Washington, DC ("Paragon Systems") and Southeastern Paragon ("SEP") (ii) commercial and state and local government customers through our subsidiary, The Cornwall Group ("Cornwall"), a Florida Corporation with its principal offices located in Miami, Florida.

We provide cost-effective solutions to ensure the safety and security of the assets and personnel of our customers and to continually improve the protection we provide for their personnel, programs, resources and facilities. Our goal is to provide demonstrably superior contract guard services with the highest degree of integrity and responsiveness. The Company has two reportable segments: Cornwall and Paragon/SE Paragon.

2. Basis of Presentation and Principles of Consolidation

Summary of Significant Accounting Policies

Tri-S was formed for the purpose of acquiring and consolidating electronic and physical security companies in order to take advantage of the operating efficiencies created by a large company. Tri-S has acquired and continues to pursue acquisition opportunities in the contract guard services and system integration services segments of the security industry.

Tri-S did not have any operating businesses prior to the acquisition of Paragon Systems. Expenses consisted primarily of services performed and fees incurred associated with the creation and capitalization of the Company and the pursuit of acquisition opportunities. The financial statements of Paragon Systems, as an operating entity, are the more relevant information available prior to the acquisition of Paragon by Tri-S. Consequently, the accompanying financial statements present the financial statements of Paragon as the "Predecessor" prior to the acquisition and the consolidated financial statements of Tri-S as the "Successor" subsequent to the Paragon Systems acquisition.

On February 27, 2004, the Company acquired all of the outstanding capital stock of Paragon Systems for a total purchase price of $16 million payable in cash, redeemable preferred stock, and notes payable.

On October 18, 2005, the Company acquired all of the outstanding capital stock of The Cornwall Group, Inc. ("Cornwall") for a total purchase price of $13.5 million, payable in cash and a note. Both acquisitions were accounted for as a purchase and the results of their operations are included in the Tri-S consolidated financial statements from the date of acquisition.

In January 2006, Paragon Systems entered into a Joint Venture Agreement with Southeastern Protective Services, Inc. ("Southeastern Protective Services") to form Southeastern Paragon. Paragon Systems owns 49% and Southeastern Protective Services owns 51% of SEP. SEP was formed to bid on certain contracts, and Paragon Systems will manage the contracts awarded to SEP. We are accounting for the joint venture in accordance with FIN 46 (R) "Variable Interest Entities" because we believe that SE Paragon is a VIE in which we are the primary beneficiary.

All significant intercompany transactions have been eliminated.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make certain estimates and judgments that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosure of contingent assets and liabilities. Actual results may differ from estimates.

Revenue Recognition

Revenue is recorded monthly as guard services are provided to our customers under contracts. We bill guard services in arrears at hourly or monthly rates based on the number of hours worked under some contracts and at fixed monthly amounts under other contracts. Hourly and monthly rates are based on contractual terms.

The terms of our contracts are complex and may be subject to differing interpretations. We make estimates and judgments about terms of the contracts in providing services and in billing and recording revenue. At times, our Federal contracts require interpretations. Typically, differences in interpretation are resolved on a mutual basis in discussions with the government agency involved. The resolution of differences may result in a determination that amounts previously billed are not in accordance with contract terms and adjustments of amounts initially recorded as revenue may be material.

Contracts with Federal government agencies may be subject to cessation of funding. Cessation of funding may result in amounts billed and recorded as revenue as being uncollectible. We work with the appropriate government agency to resolve funding issues. When funding issues become known, we make estimates and judgments about the extent of potential losses and adjust revenues accordingly. Amounts estimated could differ from amounts ultimately collected and these amounts could be material. During 2006, 2005 and 2004, none of our contracts have been subject to cessation of funding.

Contract losses, if any, are recorded as they become known.

Cost of Revenues

Cost of revenues is primarily comprised of labor, related payroll taxes, employee benefits, workers compensation, liability insurance, and the pro rata portion of the costs of customer contracts acquired.

We make estimates and judgments of amounts recorded for accruals of labor related costs. Expenses most subject to estimation and judgment are accrued vacation and workers compensation costs. The terms of vacation policies may be complex and subject to interpretation. Workers compensation insurance is subject to retroactive audit. Actual amounts could differ from the amounts initially recorded.

Impairment of Long-lived Assets, Goodwill and Intangible Assets

We evaluate impairment of long-lived assets, including property and equipment and intangible assets with finite lives, whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. If the sum of the expected future undiscounted cash flows is less than the carrying amount of the asset, then an impairment loss is recognized. Measurement of an impairment loss for long-lived assets is based on discounted cash flows and the fair value of an asset.

We evaluate goodwill and other intangible assets with an indefinite useful life for impairment on an annual basis. Additionally goodwill is tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of an entity below its carrying value. These events or circumstances would include a significant change in the business climate, legal factors, operating performance indicators, competition, sale or disposition of a significant portion of the business or other factors. The carrying value of goodwill and other intangibles is evaluated in relation to the operating performance and estimated future discounted cash flows of the entity.

Investment in Joint Venture

We account for our 10% equity in Army Fleet Support, a joint venture which provides logistics support for U.S. Army aviation training at Fort Rucker, Alabama, using the equity method of accounting. Accordingly, our investment in Army Fleet is increased by our share of Army Fleet Support's earnings and reduced by the amortization of our investment in Army Fleet Support and the cash we receive from Army Fleet Support with respect to our investment. During May 2006, we sold our equity interest in Army Fleet Support.

Fair Value of Financial Instruments

The carrying amounts of the Company's financial instruments, including cash and cash equivalents, accounts receivable, note receivable, accounts payable and accrued liabilities, approximate fair value because of their short maturities. Management does not believe it is practicable to determine the fair value of its series C Preferred Stock because of the uncertainties in related party aspects of this liability. The carrying amounts of the Company's debt, including the factoring facility and capital lease obligations approximate fair value of these obligations based upon management's best estimates of interest rates that would be available for similar debt obligations at December 31, 2006 and 2005.

Retirement Plan

Substantially all of Paragon's employees are eligible to participate in a 401(k) profit sharing plan. Under the terms of the plan, employees may elect to defer up to ten percent of their compensation subject to Internal Revenue Service limitations. Paragon provides discretionary matching contributions on these deferrals each year based upon determinations by the board of directors. Paragon did not make any matching contributions for 2006, 2005 and 2004.

Cash Equivalents

The Company considers all highly liquid investments with maturities of three months or less when purchased to be cash equivalents.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable are stated at amounts management expects to collect. The allowance for doubtful accounts represents the Company's best estimate of probable losses in the accounts receivable balance. The allowance is based on known troubled accounts, amounts that have been charged back to us by our factor, and other currently available evidence. Accounts that are determined to be uncollectable are written off against the allowance for doubtful accounts.

Property and Equipment

Property and equipment are recorded at cost and depreciated over their estimated useful lives using the double-declining method or the straight line method. Repairs and maintenance costs are expensed as incurred.

Income Taxes

The Company utilizes the liability method of accounting for income taxes, as set forth in SFAS No. 109, *Accounting for Income Taxes*. Under the liability method, deferred taxes are determined based on the difference between the financial and tax bases of assets and liabilities using enacted tax rates in effect in the years in which the differences are expected to reverse and for net operating loss carryforwards. Deferred tax expense or benefit represents the change in the deferred tax asset and liability balances.

Beginning with its S corporation election on January 1, 1999, and prior to its acquisition by Tri-S on February 27, 2004, Paragon was taxed as a S corporation. All income and losses of Paragon were allocated to the shareholders for inclusion in their respective income tax returns. Prior to its election as a S corporation, Paragon was taxed as a C corporation and was subject to taxes on income earned prior to its election as an S corporation.

These are termed built-in gain taxes by the Internal Revenue Service as they relate to differences between the fair market value and the tax basis of assets as of the date a C corporation elects S status. These taxes paid by the S corporation are deductible by shareholders. The provision for income taxes of Paragon Systems as the Predecessor consists of built-in gains taxes. Paragon System's election was automatically terminated upon its acquisition by Tri-S.

Paragon Systems used the cash basis of accounting for income taxes prior to its acquisition, at which time it was required to change its tax method to the accrual basis. Effective February 28, 2004, the Company filed a consolidated income tax return that includes the accounts of Tri-S and Paragon.

The accompanying financial statements present the financial statements of Paragon Systems as the Predecessor prior to the Acquisition and the consolidated financial statements of Tri-S as the Successor subsequent to the Acquisition. The Predecessor company was a S corporation; consequently, pro forma tax expense and pro forma net loss per share are presented on the face of the historical statements of operations for the periods presented as the Predecessor.

In July 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes," ("FIN 48"), which clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." The interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax provision taken or expected to be taken in a tax return. It also provides guidance on derecognizing, classification, interest and penalties, accounting in interim periods, disclosure and transition. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006. We are presently evaluating whether the adoption of this interpretation will have a material impact on our financial statements.

Stock-based Compensation

On January 1, 2006, we adopted SFAS No. 123R (revised 2004), *Share-Based Payment* ("SFAS No. 123R"), using the modified-prospective-transition approach method. Under this transition method, compensation costs for 2006 include costs for options granted prior to, but not vested at, December 31, 2005, and options vested in 2006. Therefore, results for prior periods have not been restated.

Net loss per share

The Company follows SFAS No. 128, *Earnings Per Share*. That statement requires the disclosure of basic net loss per share and diluted net loss per share. Basic net loss per share is computed by dividing net loss available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted net loss per share gives effect to all potentially dilutive securities. The effect of the Company's warrants and stock options were not included in the computation of diluted EPS as their effect was antidilutive.

3. Stock-based Compensation

The adoption of SFAS No. 123R increased net loss by approximately $377,000 for the year ended December 31, 2006, compared to our previous method of accounting for share-based compensation under Accounting Principal Board Opinion No. 25, *Accounting for Stock Issued to Employees*. As of December 31, 2006, there was approximately $542,000 of unrecognized compensation cost related to unvested share-based compensation awards granted. We expect to recognize this cost over the next 3 years.

We used the Black-Scholes method (which models the value over time of financial instruments) to estimate the fair value at grant date of the options. The Black-Scholes method uses several assumptions to value an option. We used the following assumptions:

- Expected Dividend Yield

- Expected Volatility in Stock Price – reflects the historical change in our stock price over the expected term of the stock option.
- Risk-free Interest Rate – reflects the average rate on a United States treasury bond with maturity equal to the expected term of the option.
- Expected Life of Stock Awards – reflects the simplified method to calculate an expected life based on the midpoint between the vesting date and the end of the contractual term of the stock award.

The weighted-average assumptions used in the option pricing model for stock option grants and the resulting fair value were as follows:

Year Ended December 31,	2006	2005
Expected Dividend Yield	—	—
Expected Volatility in Stock Price	48.91 – 51.86%	67.94%
Weighted Average Volatility	51.79%	67.94%
Risk-Free Interest Rate	4.67 – 5.03%	4.13 – 4.43 %
Expected Life of Stock Awards	5 years	5 years
Weighted Average Fair Value at Grant Date	$ 1.51	$ 2.73

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS 123 for the years ended December 31, 2005 and 2004 (in thousands, except per share data):

	2005	2004
Net loss, as reported	$(2,278)	$ (627)
Add: Total stock-based employee compensation, net of tax	—	—
Deduct: Total stock-based employee compensation expense determined under the fair value based method for all awards, net of tax	(87)	(171)
Pro forma net loss	$(2,365)	$ (798)
Earnings per share:		
Basic and diluted—as reported	$ (0.74)	$(0.76)
Basic and diluted—pro forma	$ (0.76)	$(0.96)

4. Acquisition of The Cornwall Group

On October 18, 2005, the Company acquired all of the outstanding capital stock of The Cornwall Group, Inc. (“Cornwall”) for a total purchase price of $13.5 million. Cornwall is comprised of 6 operating subsidiaries which provide security guard services in South Florida. After adjusting for certain working capital items, the net purchase price was $12,753,000.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition. The acquisition date used for accounting purposes was September 30, 2005 (in thousands).

Current assets	$ 4,950
Property, plant and equipment	1,347
Other assets	313
Customer contracts	5,495
Other Intangibles	1,070
Goodwill	8,335
Total assets acquired	21,510
Total liabilities assumed	8,757
Net assets acquired	$12,753

Customer contracts represent the estimated fair value of the customer contracts in place as of the acquisition date and will be amortized over 4 years which represents the estimated life of the contracts.

Goodwill represents the purchase price of the acquired company less the fair value of the net assets acquired.

Other intangible assets include the value of a non-compete agreement, trademarks and trade names and software. Other intangibles are amortized for 1 - 5 years based on the estimated lives of the assets.

As a result of the acquisition of Cornwall, the Company recorded a net deferred tax liability of $2,235,000. This deferred tax liability results from the difference between financial reporting and income tax bases of assets and liabilities purchased.

The following unaudited combined pro forma financial information presents the results of operations of the Company as if the acquisition had occurred at the beginning of each of the periods presented. Adjustments to the combined financial information related to the acquisition that affect the results of operations include the interest expense associated with the debt issued in conjunction with the acquisition and amortization of the fair value of intangible assets. This pro forma information does not purport to be indicative of what would have occurred had the acquisition occurred as of January 1 or of results of operations that may occur in the future.

	Combined Pro Forma Statements of Operations (in thousands)	
	For the year ended December 31, 2005	For the year ended December 31, 2004
Revenues	$70,870	$ 64,610
Operating loss	$ (4,471)	$ (1,377)
Net (loss)	$ (4,635)	$ (3,058)
Basic and diluted net (loss) per common share	$ (1.50)	$ (3.69)

5. Acquisition of Paragon Systems, Inc.

On February 27, 2004, Tri-S completed the Acquisition of Paragon Systems, an Alabama corporation with offices located in Huntsville, Alabama. Tri-S acquired all the outstanding capital stock of Paragon Systems for a total of $16,006,000 payable in cash, preferred shares subject to mandatory redemption and notes as set forth below. The Acquisition has been accounted for as a purchase transaction in accordance with SFAS No. 141, *Business Combinations*. At the closing of the Acquisition, Tri-S:

- paid $2,300,000 in cash to the former shareholders of Paragon Systems;
- issued promissory notes to the former shareholders of Paragon Systems in an aggregate principal amount of $7,706,000 with an annual interest rate of 7.0%; and

- agreed to issue to the former shareholders of Paragon Systems preferred stock subject to mandatory redemptions, with an aggregate redemption value of $6,000,000 with an annual dividend rate of 5.0%.

Simultaneous with the closing of the Acquisition, Paragon sold $4,295,000 in receivables to LSQ Funding, L.L.C. ("LSQ"), an unaffiliated company which factors receivables. The proceeds of the transaction were utilized as follows:

	(in thousands)
Cash payment to sellers of Paragon	$ 2,300
Pay off outstanding borrowings under the Paragon line-of-credit	1,175
Additional cash for working capital at Paragon	700
Fees and interest costs	120
	$ 4,295

The purchase price was allocated among tangible and intangible assets acquired and liabilities assumed based on an independent appraisal of fair values at the transaction date. Amounts previously estimated and reported have been adjusted to give effect to the independent appraisal. The change in valuation of the assets acquired did not have any effect on the results of operations previously reported. The following represents the allocation of the purchase price at the time of the acquisition:

	(in thousands)
Book value of net assets acquired	$ 3,511
Investment in joint venture	8,102
Federal contracts	1,470
Non-compete agreements	380
Income tax liabilities	(1,423)
Deferred income tax liabilities	(3,751)
Goodwill	7,717
Allocated purchase price	$ 16,006

The investment in the joint venture was valued based on the expected future distributions from the investment. The joint venture is accounted for using the equity method of accounting. Federal contracts will be amortized over a period of nine years and non-compete agreements will be amortized over five years. The $7,717,000 excess of the purchase price over the estimated fair values of the net tangible assets and separately identifiable intangible assets was recorded as goodwill.

Paragon Systems used the cash basis of accounting for income taxes prior to its acquisition, at which time Paragon Systems was required to change its method to the accrual basis. Income taxes as a result of the change in method become due in four annual installments and were recorded as an adjustment of $1,423,000 to the purchase price of Paragon in accordance with business combination purchase accounting.

As a result of the acquisition of Paragon Systems, the Company recorded a net deferred tax liability of $3,751,000. This deferred tax liability results from the difference between financial reporting and income tax bases of assets and liabilities purchased.

The following unaudited combined pro forma financial information presents the results of operations of the Company as if the Acquisition had occurred at the beginning of each of the periods presented. Adjustments to the combined financial information related to the Acquisition that affect the results of operations include the interest expense associated with the debt and redeemable preferred shares issued in conjunction with the Acquisition and amortization of the fair value of intangible assets. This pro forma information does not purport to be indicative of what would have occurred had the Acquisition occurred as of January 1 or of results of operations that may occur in the future. The combined pro forma statement of operations for the year ended December 31, 2004 is as follows (in thousands):

Revenues	$30,130
Operating loss	$ (1,209)
Net loss	$ (1,850)
Basic loss per common share	$ (2.23)
Diluted loss per common share	$ (2.23)

Tri-S did not have an operating business prior to the Acquisition. Expenses consisted primarily of services performed and fees incurred associated with the creation and capitalization of the Company and the pursuit of acquisition opportunities. The financial statements of Paragon Systems, as an operating entity, are the more relevant information available prior to the acquisition of Paragon Systems by Tri-S. Consequently, the combined pro forma financial information represents the financial statement of Paragon Systems as the Predecessor Company prior to the acquisition date of February 27, 2004 combined with the expenses of Tri-S prior to the acquisition date of February 27, 2004.

6. Sales to Major Customers

During 2006, 2005 and 2004, 46%, 76% and 100% of the Company's revenue was earned under contracts with various Federal government agencies through its Paragon Systems/SEP subsidiary. At December 31, 2006 and 2005, approximately 57% and 53% of accounts receivable were due from various Federal government agencies, respectively.

7. Related Party Transactions

Note Receivable from CEO

Pursuant to Mr. Farrell's employment agreement with the Company, Mr. Farrell, Chief Executive Officer and President of the Company, would have otherwise been entitled to receive during 2004 an aggregate bonus of $435,000; however, in order to improve the financial position of the Company, he agreed to forfeit $290,000 thereof and accept a cash bonus of $145,000 and a loan for $100,000. In connection with the loan, Mr. Farrell issued a promissory note to the Company dated December 31, 2004 in the principal amount of $100,000, which bears interest at a rate of 2.48% per year and is payable on December 31, 2006. The note may be prepaid at any time without penalty and may be paid, at the election of Mr. Farrell, in cash or shares of the Company's common stock or any combination thereof. During December 2006, Mr. Farrell repaid the loan balance and accrued interest in 45,424 shares of the Company's common stock. These shares are reflected as treasury stock on the accompanying balance sheet at a cost of $105,021.

Employment Agreements

Pursuant to the employment agreement, as amended, between us and Mr. Farrell, Mr. Farrell has agreed to serve as our Chief Executive Officer and President until June 30, 2010. The agreement provides for (i) payment of a specified base salary which increases by 10% per year; (ii) payment of an annual incentive bonus equal to 5% of our EBITDA, as defined, for such year, provided that such bonus may not exceed 100% of Mr. Farrell's base salary for such year; (iii) prohibitions against Mr. Farrell's disclosure of confidential information, solicitation of our employees and participation in a business competitive with our business during his employment and for a period of one year following the termination of his employment; and (iv) continuation of

Mr. Farrell's compensation and benefits for the remainder of the term of his employment agreement if his employment is terminated by us without "cause" or by Mr. Farrell for "good reason" or upon a "change of control" of the Company. Pursuant to Mr. Farrell's employment agreement, we also provide certain other benefits and expense reimbursements to Mr. Farrell which are consistent with his position as our Chief Executive Officer. Mr. Farrell is also entitled to participate in any employee benefit plan, stock option plan and other fringe benefit plan at the discretion of our board of directors.

8. Property and Equipment

Property and equipment are comprised of the following:

	Estimated Useful Life	December 31, 2006	December 31, 2005
		(in thousands)	
Building	31 years	$ —	$ 566
Vehicles	3 - 5 years	44	44
Computer equipment and software	3 - 5 years	393	376
Field equipment	3 - 5 years	355	247
Furniture and fixtures	5 years	147	129
Leasehold Improvements	5 years	32	32
Land		—	153
		971	1,547
Less accumulated depreciation and amortization		(374)	(80)
Property and equipment, net		$ 597	$1,467

Depreciation expense for Tri-S was $341,000, $76,000, and $14,000 for the years ended December 31, 2006, 2005 and 2004. Depreciation expense was $28,000 for the two months ended February 27, 2004.

9. Investment in Army Fleet Support, LLC

In conjunction with the Acquisition of Paragon Systems on February 27, 2004, the Company acquired a 10% interest in the Joint Venture. The value of the investment in the Joint Venture at the acquisition date was $8,102,000 as established by an independent appraisal. The Company amortized the cost of the investment in excess of the net book value using a 10-year life, which approximated the anticipated length of the contract.

The Company accounted for its investment in the Joint Venture using the equity method. Accordingly, the investment in the Joint Venture was increased by the Company's share of the Joint Venture's earnings and reduced by the amortization of the investment in the Joint Venture and the cash received from the Joint Venture.

During May 2006, we sold our 10% equity interest in Army Fleet Support. The details of the transaction are as follows (in thousands):

Cash received	$10,810
Book value of investment	8,907
Gain on sale	$ 1,903

The investment in the Joint Venture was effected by the following transactions for the years ended 2006, 2005 and 2004 (in thousands):

	2006	2005	2004
Investment in Army Fleet Support – beginning	$ 8,698	$ 8,302	$ 8,102
Company's share of earnings in Army Fleet Support	659	2,601	2,324
Amortization of the investment in Army Fleet Support	(275)	(824)	(687)
Cash received from Army Fleet Support	(175)	(1,381)	(1,437)
Sale of investment in Army Fleet Support	(8,907)	—	—
Investment in Joint Venture – ending	$ —	$ 8,698	$ 8,302

Summarized unaudited balance sheet information for the Joint Venture as of December 31, 2005 is as follows (in thousands):

	Dec 31, 2005
Total assets	$ 60,735
Total liabilities	$ 42,761
Equity	17,974
Total liabilities and equity	$ 60,735

Summarized unaudited statement of operations information for the unconsolidated Joint Venture for the years ended 2005 and 2004 is as follows (in thousands):

	Year Ended Dec 31, 2005	Year Ended Dec 31, 2004
Contract revenues	$ 298,746	$ 221,132
Operating income	25,958	24,805
Net earnings	26,005	23,237

10. Goodwill and Intangible Assets

Intangible assets are summarized as follows (in thousands):

	2006	2005	Amortization Period
Intangible assets:			
Customer Contracts	$ 6,875	$ 6,965	1 -9 years
Non-compete agreements	696	696	1 -5 years
Loan Costs	1,953	1,909	1 -3 years
Other	95	95	—
Gross carrying value of intangible assets subject to amortization	9,619	9,665	
Less accumulated amortization:			
Customer Contracts	(2,614)	(975)	
Non-compete agreements	(415)	(179)	
Loan Costs	(656)	(154)	
Other	(195)	(6)	
Accumulated amortization	(3,880)	(1,314)	
Net carrying value of amortizable intangibles	5,739	8,351	
Nonamortizable intangibles:			
Trademarks	659	659	
Goodwill	16,078	15,615	
Total intangibles, net	$22,476	$24,625	

The changes in the carrying amount of goodwill during the years ended December 31, 2006 and 2005 are as follows (in thousands):

Balance, December 31, 2004	$ 7,747
Acquisition—Cornwall	7,868
Balance, December 31, 2005	15,615
Net adjustments related to the Cornwall acquisition	463
Balance, December 31, 2006	$16,078

Amortization of intangible assets for the year ended December 31, 2006, 2005 and 2004 was $2,566, $1,004 and $462, respectively. The company does not have tax deductable goodwill.

Estimated future amortization expense for intangible assets on the Company's December 31, 2006 consolidated balance sheet for the fiscal years ending December 31, is as follows (in thousands):

2007	$2,480
2008	2,106
2009	1,129
2010	16
2011	8

11. Debt and Other Obligations

The debt of the Company as of December 31, 2006 and 2005 consists of the following (in thousands):

	2006	2005
Short term borrowings under the Factoring Facility	$ 7,506	$ 7,191
Term Loan A, bearing interest at Prime + 4%, payable monthly with the final principal payment due October 1, 2007	—	1,621
Term Loan B, bearing interest at Prime + 4%, payable monthly with the final principal payment due October 1, 2009	—	3,471
Convertible Notes, face value of $8,015 bearing interest at 26.1%, cash interest payable monthly at 10% annual rate, due on various dates in September and October 2008	7,273	6,300
Note payable, bearing interest at 5%, due April 2007	250	250
Other long-term debt	34	20
Series C Preferred Stock	6,000	6,000
Total debt	21,063	24,853
Less: current debt	13,790	7,466
Long term debt	$ 7,273	$17,387

Factoring Agreement

On October 18, 2005, we entered into a Credit Agreement (the "Credit Agreement") with LSQ Funding Group, L.C. ("LSQ") and BRE LLC ("BRE" and, together with LSQ, our "Lenders"), pursuant to which we borrowed $1,650,000 pursuant to a term loan with a maturity date of October 1, 2007 ("Term Loan A") and $3,500,000 pursuant to a term loan with a maturity date of October 1, 2009 ("Term Loan B" and, together with Term Loan A, the "Term Loans"). During the second quarter of 2006, the Term Loans were paid in full.

In connection with the Credit Agreement, we entered into a Factoring and Security Agreement (the "Factoring Agreement") with LSQ, pursuant to which LSQ will purchase from us from time to time certain accounts receivable at a discount of 0.7% and provide us with a professional accounts receivable management service for a funds usage fee of the prime rate plus 1.0% on the funds advanced on the outstanding accounts receivable purchased. The Factoring Agreement has a $6,000,000 initial purchase limit and a four-year term which will automatically renew unless we provide notice of our intent to terminate. The Factoring Agreement amends and restates the Factoring Agreement dated as of April 1, 2005 between LSQ and Paragon Systems, pursuant to which LSQ purchased from Paragon Systems from time to time certain accounts receivable at a discount of 0.7% under a factoring facility with a funds usage fee equal to the prime rate plus 1.00%, a $6,500,000 initial purchase limit and a one-year term subject to annual renewal.

Pursuant to the Credit Agreement, we also entered into (i) a Guaranty Agreement pursuant to which we unconditionally and irrevocably guarantee to the lenders the prompt payment and performance of all of our obligations, indebtedness and liabilities to the lenders, whether currently existing or subsequently arising (the "Obligations"); and (ii) a Security Agreement, pursuant to which we granted to the lenders a security interest in substantially all of our assets to secure all of the Obligations. Additionally, we have entered into a Pledge Agreement pursuant to which we have pledged to the lenders the capital stock of Paragon Systems to secure all of our obligations under the Credit Agreement and related documents.

On June 27, 2006, Paragon Systems executed a Guaranty of Joint Venture (the "JV Guaranty") pursuant to which Paragon Systems unconditionally guarantees to LSQ the prompt payment and performance of all obligations, indebtedness and liabilities, whether currently existing or subsequently arising, of SEP (the "JV Obligations"). The JV Obligations include the obligations, indebtedness and liabilities of SEP to LSQ under that certain Factoring and Security Agreement between SEP and LSQ dated as of June 27, 2006 (the "JV Factoring Agreement"), pursuant to which LSQ will purchase from SEP from time to time certain accounts receivable at a discount of 0.7% and

provide SEP a professional accounts receivable management service for a funds usage fee equal to the prime rate plus 1.0% on the funds advanced on the outstanding accounts receivable purchased. The JV Factoring Agreement has a $1,000,000 initial purchase limit and a one-year term which will automatically renew unless SEP provides notice of its intent to terminate.

The outstanding balance under the Credit Agreement as of December 31, 2006 is approximately $7.8 million. At December 31, 2006, we had less than $500,000 of availability under our Credit Agreement. Additionally, from time to time during 2006, we had borrowed more than the maximum amount allowable under the availability formula in the Credit Agreement. Accordingly, on those occasions when the outstanding balance exceeded the availability, we were charged the default interest and fees by our lenders.

During March 2007, we secured an additional $2.5 million term loan (the "2007 Term Loan") with our lenders to provide additional financing as needed to provide the capital we estimate is necessary to continue to operate the business during 2007 under an Amendment and Forbearance agreement. Interest under the 2007 Term Loan is payable beginning April 1, 2007 and monthly thereafter at an annual interest rate of Prime plus 5.5%. The 2007 Term Loan matures on March 28, 2009. The 2007 Term Loan bears a 0.25% per month fee on the unused portion of the loan. The Lenders were paid an origination fee of $40.000. The 2007 Term Loan requires the company to pay a "Minimum Balance Fee", as described in the agreement, if the loan is repaid prior to maturity.

Convertible Notes

During September and October 2005, we issued in a private placement transaction 10% convertible promissory notes ("10% Notes") with an aggregate principal amount of $8,015,000 and warrants to purchase 834,896 shares of our common stock for a total purchase price of $8,015,000. The 10% Notes and warrants were issued in four closings between September 2, 2005 and October 14, 2005. The face value of the 10% Notes is $8,015,000. Interest is payable monthly on the face value of the 10% Notes at a rate of 10% per annum. The gross proceeds from the offering of 10% Notes and warrants was allocated to the 10% Notes and warrants in accordance with Emerging Issue Tax Force 98-5, Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios ("EITF 98-5"). In accordance with EITF 98-5, $6,107,000 of the gross proceeds was allocated to the 10% Notes and $1,908,000 was allocated to additional paid in capital related to the warrants and the beneficial conversion feature. The conversion of the 10% Notes was restricted at the issue date because of the need for a shareholder vote to approve the contingently issuable shares as well as certain other restrictions. In February 2006, the shareholders approved the shares issuable upon conversion of the 10% Notes. Accordingly, approximately $1.1 million of the in-the-money beneficial conversion feature was recorded to increase the book value of the 10% Notes. Of the $1.1 million of in-the-money beneficial conversion feature, approximately $700,000 was recorded as interest expense during the quarter ended March 31, 2006 and approximately $400,000 was recorded as a reduction to additional paid in capital because of additional conversion restrictions associated with a certain portion of the 10% Notes. The remaining discount on the 10% Notes relative to face value will be amortized to interest expense over the remaining life of the 10% Notes. The 10% Notes mature three years after issuance and may be prepaid at the option of the Company after one year after the issuance thereof subject to the satisfaction of certain conditions.

The 10% Notes are convertible by the holders at an initial conversion price of $4.80 per share subject to certain restrictions. The warrants issued have an exercise price of $4.80 and expire three years from the date of issuance.

Redeemable Preferred Stock

The Series C redeemable preferred stock is classified as preferred shares subject to mandatory redemption in the financial statements. The shares were to be redeemed by the Company at any time were required to must be redeemed no later than February 27, 2007. As of December 31, 2006 and 2005, the Company had accrued interest expense of $400,000 and $100,000 on these shares, respectively. The payment of interest is required semi-annually. However, on February 23, 2006, we filed a lawsuit against the former shareholders of Paragon Systems alleging, among other things, that they breached certain representations in the Stock Purchase Agreement between us and the former shareholders dated as of February 23, 2004 (the "Paragon Purchase Agreement'), pursuant to which we acquired Paragon Systems. In the complaint, we seek, among other things, an award of damages and a decree invalidating the Series C Redeemable Preferred Stock which was issued to the former shareholders as part of the purchase price for the Paragon Acquisition and the security agreements pursuant to which we pledged 40% of the outstanding capital stock of Paragon Systems to secure our obligations under the Series C Redeemable Preferred Stock. Accordingly, we exercised our right of offset under the Paragon agreement and have not paid the accrued interest or principal due of $6,450,000 as of the February 27, 2007 redemption date, which was otherwise due under the Series C Redeemable Preferred Stock Agreement. If we do not prevail in the lawsuit, then we may be required to redeem the Series C Redeemable Preferred Stock (which was redeemable according to the agreement on February 27, 2007) and pay all accrued and unpaid interest thereon. If we do not do so, then the former shareholders may be able to foreclose on the stock of Paragon Systems pledged to them.

If we are unable to satisfy or otherwise settle the claim of the Series C Redeemable Preferred Stock by February 28, 2008, we will be in default of our Amended Credit Agreement, which calls for the Series C Redeemable Preferred Stock claim to be settled and for the lien on the 40% of the Paragon stock to be eliminated by February 28, 2008. If the Series C Redeemable Preferred Stock remains outstanding or the lien on the Paragon stock remains outstanding on February 28, 2008, we will be in violation of our Amended Credit Agreement and the loans outstanding under the Amended Credit Agreement will be payable on demand.

Future Minimum Debt Payments

The future minimum debt payments are as follows (in thousands):

2007	$13,790
2008	7,273
	$21,063

12. Income Taxes

The benefit for income taxes from continuing operations consisted of the following for the years ended December 31, 2006, 2005 and 2004 (in thousands):

	2006	2005	2004
Current	$(1,406)	$ 106	$(213)
Deferred	3,100	1,308	597
Income tax benefit	$ 1,694	$1,414	$ 384

Deferred income taxes reflect the net tax effect of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes and for net operating loss carryforwards. The significant components of deferred tax assets and liabilities as of December 31, 2006 and 2005 are as follows (in thousands):

	2006	2005
Deferred tax assets:		
Net operating loss carryforward	$ 198	$ 61
Allowance for doubtful accounts	27	173
Investment in Southeastern Paragon	77	—
Accrued expenses & other	2	185
Total deferred tax assets	$ 304	$ 419
Deferred tax liabilities:		
Depreciation & amortization	$(1,902)	$(2,701)
Investment in joint venture	—	(2,090)
IRC cash to accrual adjustment	(376)	(697)
Total deferred tax liabilities	(2,278)	$(5,488)
Net deferred income tax liabilities	$(1,974)	$(5,069)

At December 31, 2006, the Company had a cumulative gross federal income tax net operating loss (“NOL”) carryforwards of approximately $274,000 thousand available to reduce future amounts of taxable income, all of which was acquired through the Cornwall acquisition. Under Internal Revenue Code section 382, there is an annual limitation on the use of the NOLs acquired from Cornwall. If not utilized to offset future taxable income, the cumulative NOL amount will expire from 2020 through 2025. The Company also had approximately $2.1

million of tax effected state NOLs most of which were acquired from Cornwall. If not utilized to offset future state taxable income, the state NOLs will expire between 2020 and 2026.

A reconciliation of the income tax provision computed at statutory tax rates of the income tax provision for the years ended December 31, 2006, 2005 and 2004 is as follows:

	2006	2005	2004
Income tax benefit at statutory rate	34.0%	34.0%	34.0%
State income taxes, net of federal benefit	3.6	4.3	4.0
Preferred stock dividends	(1.9)	—	—
Stock option compensation	(2.3)	—	—
Resolution of income tax uncertainties from prior year	(2.3)	—	—
Non-deductible expenses and other	(0.4)	—	—
Income tax benefit	30.7	38.3	38.0

13. Lease Obligations

Operating Leases

The Company leases real property and equipment under operating leases. Lease expense was $1,033, $445 and $108 for 2006, 2005 and 2004, respectively. Lease expense for Paragon Systems was $21 for the two months ended February 27, 2004. Included in lease expense is $1,000 per month paid to two officers for rental of a building during 2004 through February 28, 2005.

Future Minimum Operating Lease Payments

Future minimum rental payments required under the operating leases that have initial or remaining non-cancelable lease terms in excess of one year as of December 31, 2006 are as follows (in thousands):

2007	$ 877
2008	549
2009	275
2010	203
2011	139
Total	$2,043

14. Preferred and Common Stock

Immediately prior to the initial public offering of its common stock on February 9, 2005, we entered into an exchange and recapitalization agreement with all of the holders of common stock, convertible preferred stock and holders of rights to acquire common stock. Pursuant to the agreement, we implemented a reverse stock split of all the outstanding shares of its common stock and stock options and exchanged common stock for all Series A and B convertible preferred stock. The recapitalization was given retroactive treatment in the financial statements and related disclosures.

As of December 31, 2006 and 2005, we had 100 shares outstanding of Series C Redeemable Preferred Stock.

Holders of Series C Mandatory Redeemable Preferred Stock have no voting rights, except as otherwise required by applicable law and have no preemptive, conversion or sinking fund rights. In the event of a liquidation, dissolution or winding up of the Company, holders of the Series C Preferred Shares are entitled to a liquidation preference relative to the common shares.

The Series C Redeemable Preferred Stock has a redemption value of $60,000 per share. The Series C Redeemable Preferred Stock was redeemable by the Company by February 27, 2007. The holders of the Series C Redeemable Preferred Stock were entitled to receive cash dividends at a rate of 5% of the redemption value per annum (or $3,000 per share per annum) which were accrued as interest expense for the year ended December 31, 2006. However, on February 23, 2006, we filed a complaint against the former shareholders of Paragon Systems, alleging, among other things, that the former shareholders breached certain representations set forth in the Stock Purchase Agreement between us and the former shareholders of Paragon Systems dated as of February 23, 2004 (the "Paragon Purchase Agreement"). In the complaint, we seek, among other things, a decree invalidating (i) all the outstanding shares of the Series C Redeemable Preferred Stock, which are held by the former shareholders; and (ii) the Security Agreements entered into between us and the former shareholders in connection with the Paragon Acquisition, pursuant to which we have pledged an aggregate of 40% of the outstanding shares of Paragon Systems to secure our payment obligations under the Series C Redeemable Preferred Stock. Accordingly, we exercised our right of offset under the Paragon Purchase Agreement and have not paid the $150,000 interest payments which were otherwise due in respect to the Series C Preferred Stock on February 28, 2006, or any dividend payment date thereafter. In addition, we did not pay the $6,000,000 due on February 27, 2007, which was the redemption date of the Series C Redeemable Preferred Stock.

We are authorized to issue 25 million shares of common stock with a par value of $0.001 per share. The holders of common stock are entitled to one vote per share on all matters. The common stock does not have cumulative voting rights and no conversion rights. Each share of common stock has an equal and ratable right to receive dividends to be paid from assets legally available when and if declared by the Board of Directors. We have never paid any cash dividends on common stock.

During 2005, we issued 68,700 shares of our common stock for services and interest at an average price of $4.87 per share. The Company recorded expense of $334 related to the shares issued for services and interest.

During the first quarter of 2006, we issued 20,000 shares of our common stock for services at a price of $4.45 per share. We recorded expense of approximately $89,000 related to the shares issued for services.

During the second quarter of 2006, we issued 20,000 shares of our common stock at a price of $4.55 per share to one of the former shareholders of Cornwall pursuant to an employment agreement entered into with such shareholder in connection with the Cornwall Acquisition. Also, during the second quarter of 2006, we issued 62,500 shares of our common stock upon conversion of a 10% convertible promissory note with an outstanding principal amount of $300,000 and a book value of $240,000. During the first quarter of 2006, we issued 10,417 shares of our common stock upon conversion of a 10% convertible promissory note with an outstanding principal amount of $50,000 and a book value of $39,300.

15. Common Stock Options and Warrants

On February 8, 2005, we completed a public offering of 2,070,000 units (including the exercise of the over-allotment option) consisting of one share of common stock and one warrant to purchase common stock at $6.00. The net proceeds of the offering totaled $10,887.

In conjunction with the initial public offering, we sold an option to purchase 180,000 shares ("Share Option") of our common stock and an option to purchase 180,000 warrants ("Warrant Option") for $180. The Share Option became exercisable 180 days after the IPO at an exercise price of $5.00 per share. The Warrant Option became exercisable 180 days after the IPO at an exercise price of $0.15 per share. The warrants underlying the Warrant Option became exercisable 180 days after the IPO at an exercise price of $6.00 per share.

In conjunction with the financing for the Cornwall acquisition, we issued 1,260,365 warrants to purchase common stock exercisable at $4.80. 834,896 warrants were issued to the purchasers of the 10% Convertible Notes, 250,469 warrants were issued to the underwriters of the 10% Convertible Notes Offering and 175,000 were issued to the lender under the Credit Agreement.

Non-qualified stock options for 97,087 shares of the common stock of Tri-S were granted on January 1, 2002 with an exercise price of $0.12 per share. These options vest 32,362 shares each on December 31, 2004, 2003 and 2002 and expire in October 2011. As of December 31, 2006, there have been no other options granted and there have been no options forfeited. During 2006, the options for 97,087 shares were exercised.

Warrants for 16,181 shares of common stock were issued on July 27, 2004 with an exercise price of $3.09 per share. These warrants expired on February 9, 2006.

The 2004 Stock Incentive Plan ("Stock Incentive Plan") was approved and adopted by the board of directors and shareholders on October 13, 2004. The Stock Incentive Plan is administered by the compensation committee of the board of directors in accordance with and subject to the provisions of the Stock Incentive Plan. The committee has the authority to determine all provisions of incentive awards as the committee may deem necessary or desirable and as consistent with the terms of the Stock Incentive Plan. During 2006, the Stock Incentive Plan was amended to revise the maximum number of shares of common stock that are available for issuance under the Stock Incentive Plan from 500,000 to 1,500,000, less the aggregate number of shares already issued pursuant to Stock Incentive Plan, all of which are available for future grant. The Stock Incentive Plan will terminate at midnight no later than October 13, 2014, unless terminated earlier by action of the board of directors.

The Stock Incentive Plan provides for the grants of incentive awards to eligible participants, including employees, officers, directors, consultants and independent contractors. These awards may include options to purchase shares of common stock that qualify as incentive stock options within the meaning of the Internal Revenue Code, non-qualified options, restricted stock awards, and stock bonuses.

The per share price to be paid by a participant upon exercise of an option is determined by the committee at the time of the option grant, provided that the exercise price for incentive stock options must be equal to the fair market value of common stock on the date of grant and 110% of the fair market value if, at the time the incentive stock option is granted, the participant owns, directly or indirectly, more than 10% of the total combined voting power of all classes of stock of the Company or any parent or subsidiary corporation of the Company. An option will become exercisable at such times and in such installments as may be determined by the committee in its sole discretion at the time of grant, provided that no option may be exercisable after 10 years from its date of grant.

The following table summarizes employee stock option activity for the years ended December 31, 2006, 2005 and 2004:

	Shares	Weighted Average Exercise Price	Weighted Average Fair Value
Outstanding at December 31, 2003	97,087	$ 0.12	—
Granted	—	—	—
Exercised	—	—	—
Canceled or Expired	—	—	—
Outstanding at December 31, 2004	97,087	0.12	—
Granted	243,500	4.55	2.72
Exercised	—	—	—
Canceled or Expired	—	—	—
Outstanding at December 31, 2005	340,587	3.29	—
Granted	216,500	2.99	1.50
Exercised	(97,087)	0.12	—
Canceled or Expired	(8,300)	3.00	—
Outstanding at December 31, 2006	451,700	3.83	—

A summary of the status of our nonvested stock options as of December 31, 2006 and changes during the year ended December 31, 2006, is presented below.

	Shares	Weighted-Average Grant-Date Fair Value
Nonvested at January 1, 2006	243,500	$ 2.72
Granted	216,500	$ 1.50
Vested	(148,667)	$ 2.17
Forfeited	(5,000)	$ 1.51
Nonvested at December 31, 2006	306,333	$ 2.15

The total intrinsic value of options exercised during the year ended December 31, 2006 was $212,815.

As at December 31, 2006, there was approximately $542,000 of unrecognized compensation cost related to unvested share-based compensation awards granted. We expect to recognize this cost over the next three years.

Options exercisable at December 31, 2006 and 2005 were 148,667 and 97,087, respectively.

The following table summarizes additional information about employee stock options outstanding at December 31, 2006:

	Options Outstanding			Options Exercisable	
Range of Prices	Number Outstanding at December 31, 2006	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable at December 31, 2006	Weighted Average Exercise Price
$2.46-4.75	451,700	9.0	$ 3.83	148,667	$ 3.85

The following table summarizes the warrants outstanding for the years ended December 31, 2006 and 2005.

	2006	2005	Weighted Average Exercise Price
Warrants issued and outstanding related to purchase of Paragon Systems, Inc	—	16,181	$ 3.09
Warrants issued and outstanding related to IPO	2,430,000	2,430,000	$ 6.18
Warrants issued and outstanding related to issuance of 10% Notes Payable	1,085,365	1,085,365	$ 4.80
Warrants issued and outstanding related to Credit Agreement	175,000	175,000	$ 4.80
Total warrants outstanding	3,690,365	3,706,546	

Restricted stock awards are awards of common stock granted to a recipient which are subject to restrictions on transferability and the risk of forfeiture. The committee may impose such restrictions or conditions to the vesting of restricted stock awards, including that the participant remain in the continuous employ or service of the Company for a specified period of time or that the participant or the Company satisfy specified performance goals or criteria.

Stock bonuses are awards of common stock that are not subject to any restrictions other than, if imposed by the committee, restrictions on transferability. Stock bonuses are subject to such terms and conditions as may be determined by the committee.

16. Sale of Certain Home Monitoring Customer Contracts of International Monitoring, Inc.

On July 21, 2006, International Monitoring, Inc., a wholly-owned subsidiary of Cornwall, sold substantially all of its operating assets, including certain home monitoring customer contracts, to an unrelated purchaser for a purchase price of approximately $680,000, subject to a 10% reduction thereof for customer attrition. Additional customer contracts will be sold to the purchaser if certain provisions are met which qualify such contracts. In addition, the purchaser will service all accounts not sold under a separate servicing agreement.

The details of the transaction are as follows:

Cash received (adjusted for customer attrition)	$607,823
Book value of assets sold	130,285
Gain on sale	$477,538

17. Contingencies

We are involved in various legal proceedings, including employee discrimination suits, from time to time in the normal course of business. In management's opinion, we are not currently involved in any legal proceedings, individually or in the aggregate, which could have a material effect on the financial condition, results of operations or cash flows of the Company.

18. Litigation

Legal Proceedings

Except as set forth below, we believe that, based on currently known facts, there are no claims or litigation pending against us the disposition of which would materially affect our financial position or future operating results, although we cannot be certain as to the ultimate outcome of any such claim or litigation. In addition, exposure to litigation is inherent in our ongoing business and may harm our business in the future.

Litigation with the Former Shareholders of Paragon Systems

The Georgia Action

On February 27, 2006, we filed a complaint in the United States District Court, Northern District of Georgia, Atlanta Division ("Georgia Action"), against Charles Keathley, Robert Luther, Harold Bright and John Wilson, the former shareholders of Paragon Systems, alleging, among other things, that: (i) the former shareholders breached certain representations set forth in the Paragon Purchase Agreement; (ii) Messrs. Keathley and Luther violated Section 10(b) of the Securities Exchange Act of 1934, as amended, and Rule 10b-5 promulgated thereunder in connection with the Paragon Acquisition; and (iii) Messrs. Keathley and Luther committed fraud in connection with the Paragon Acquisition. In the complaint, we seek, among other things, (a) an award of damages against the former shareholders; (b) a decree invalidating all the outstanding shares of the Series C Redeemable Preferred Stock, all of which shares are held by the former shareholders and were issued as part of the consideration for the Paragon Acquisition; (c) a decree invalidating the Security Agreements we entered into with the former shareholders in connection with the Paragon Acquisition, pursuant to which we have pledged an aggregate of 40% of the outstanding shares of capital stock of Paragon Systems to secure our payment obligations under the Series C Redeemable Preferred Stock; (d) an award of punitive damages against Messrs. Keathley and Luther; and (e) an award of attorneys' fees and costs.

On April 28, 2006, Messrs. Bright and Wilson filed their answer and counterclaim in the Georgia Action, pursuant to which, among other things, they deny any wrongdoing, claim that we failed to pay the February 28, 2006 dividend payment with respect to the Series C Redeemable Preferred Stock held by them, and seek damages with respect thereto and an award of attorneys' fees and expenses.

On May 8, 2006, Messrs. Keathley and Luther filed their answer and counterclaim in the Georgia Action, pursuant to which they deny any wrongdoing, allege that we breached our obligations by failing to pay the February 28, 2006 dividend payment with respect to the Series C Redeemable Preferred Stock held by them, and seek, among other things, damages and an award of attorneys' fees, costs, and expenses. They further assert that they are entitled to bring their counterclaim as part of the Alabama Action (discussed below) and that, if necessary, the court should dismiss the complaint filed by us in the Georgia Action.

Based upon the claims we have made in the Georgia Action and pursuant to the Paragon Purchase Agreement and applicable common law, we are exercising our rights of offset against the dividend and redemption payments otherwise payable by us with respect to the Series C Redeemable Preferred Stock. Accordingly, we did not make dividend payments on the Series C Redeemable Preferred Stock on February 28, 2006, or at any point thereafter, and we have not redeemed the Series C Redeemable Preferred Stock, which has a redemption value of $6.0 million and was otherwise redeemable by us on February 27, 2007.

The parties are in the process of consolidating the Georgia Action with the Declaratory Judgment Action (discussed below).

The Alabama Action

On or about October 5, 2005, Messrs. Luther and Keathley filed a compliant against Paragon Systems in the Circuit Court for Madison County, Alabama claiming breach of contract and seeking recovery of unspecified damages (the "Alabama Action"). Messrs. Keathley and Luther allege that Paragon Systems owes to them unpaid compensation for accrued, vested benefits earned pursuant to their employment agreements with Paragon Systems and certain amounts as reimbursement for taxes incurred by them in 2003.

On June 12, 2006, Messrs. Keathley and Luther filed an amended complaint in the Alabama Action naming Tri-S Security as a defendant. The claim reiterates their counterclaim in the Georgia Action that we breached our obligations by failing to make the February 28, 2006 dividend payment with respect to the Series C Redeemable Preferred Stock held by them. In the amended complaint, Messrs. Keathley and Luther seek damages, interest, and an award of attorneys' fees and expenses.

We filed our answer to the amended complaint on July 19, 2006, pursuant to which we deny any wrongdoing and deny that Messrs. Keathley and Luther are entitled to judgment against us.

On March 7, 2007, Messrs. Keathley and Luther filed a motion for leave to further amend the complaint. The motion seeks leave to add claims against us alleging that we (i) failed to make August 31, 2006 and February 28, 2007 dividend payments with respect to the Series C Redeemable Preferred Stock held by them and (ii) failed to redeem their shares of the Series C Redeemable Preferred Stock on February 27, 2007. We have opposed the motion by Messrs. Keathley and Luther.

The Arbitration

On September 22, 2006, Paragon Systems filed a demand for arbitration and statement of claim with the American Arbitration Association against Messrs. Bright and Wilson (the "Arbitration") asserting, among other things, that they misused corporate information of Paragon Systems, organized a competing business while employed at Paragon Systems, and diverted business from Paragon Systems to that competing business, all in breach of their employment agreements with Paragon Systems and their fiduciary duties owned to Paragon Systems.

On October 17, 2006, Messrs. Bright and Wilson filed an answer and counterclaim against us, Paragon Systems, and our Chief Executive Officer in the Arbitration. The counterclaim alleges, among other things, (i) breaches by Paragon Systems of the employment agreements with Messrs. Bright and Wilson and (ii) fraudulent acts and omissions in connection with a letter agreement dated December 14, 2004, among us, Paragon Systems and Messrs. Bright and Wilson regarding the repayment of the Paragon Notes, among other things. The counterclaim seeks, among other things, $1,797,674 in damages, as well as attorneys' fees and expenses.

We responded to the counterclaim filed in the Arbitration on November 6, 2006. We asserted that the claims against us are not subject to arbitration and that we are not party to any arbitration agreement with Messrs. Bright and Wilson. Paragon Systems denied that it breached the employment agreements with Messrs. Bright and Wilson and denied that it engaged in any fraudulent conduct in connection with the December 14, 2004 letter agreement.

The Declaratory Judgment Action

On January 16, 2007, we filed an action for declaratory judgment in the United States District Court for the Northern District of Georgia, seeking a judgment declaring that we may not redeem the shares of Series C Redeemable Preferred Stock until such time as the redemption will not violate the Official Code of Georgia Section 14-2-640(c), which prohibits a corporation from making a distribution, if after giving effect to the distribution, the (i) corporation would not be able to pay its debts as they become due in the usual course of business or (ii) corporation's total assets would be less than the sum of its total liabilities plus the preferential rights of those who are superior to those receiving the distribution.

On March 7, 2007, Messrs. Keathley and Luther filed an answer in the Declaratory Judgment Action seeking dismissal of the action and attorneys' fees, costs, and expenses, among other things.

On March 16, 2007, Messrs. Bright and Wilson filed an answer and counterclaim in the Declaratory Judgment Action pursuant to which they assert breach of contract and allege that we failed to make dividend payments on the Series C Redeemable Preferred Stock and failed to redeem their shares of Series C Redeemable Preferred Stock. Messrs. Bright and Wilson seek damages and attorneys' fees, among other things.

Litigation Regarding Our Initial Public Offering

On November 1, 2006, a purported class action complaint was filed in the State Court of Fulton County, State of Georgia, against us, our Chief Executive Officer, our former Chief Financial Officer and the lead underwriters in our initial public offering, alleging, among other things, violations of Sections 11, 12(a)(2) and 15 of the Securities Act of 1933, as amended, in connection with our initial public offering. More specifically, the complaint alleges that the registration statement relating to our initial public offering was materially inaccurate and misleading because it failed to disclose certain problems with the operations and financial condition of Paragon Systems of which the complaint alleges we were aware. The complaint seeks unspecified compensatory damages or recission, as appropriate, and costs and disbursements relating to the lawsuit, including reasonable attorneys' fees. On December 1, 2006, we removed the lawsuit to the United States District Court for the Northern District of Georgia. A motion by plaintiff to remand the case back to the state court is pending. Our time to respond to the complaint has been extended until thirty (30) days after the ruling on the motion to remand. We intend to vigorously defend the action and believe that any potential financial obligation that we may have in this action should be covered by existing insurance.

19. Segment Information

The Company's two reportable segments are Cornwall and Paragon Systems/SEP. The accounting policies applicable to these reportable segments are the same as those described in the summary of significant accounting policies. The Cornwall segment focuses on contract guard services to commercial and state and local government customers. The Paragon Systems/SEP segment focuses on contract guard services to various Federal government agencies.

We considered our organization and reporting structure and the information used by our chief operating decision makers to make decisions about resource allocation and performance assessment and determined management evaluates the performance of the segments based primarily on revenues and operating income (loss). Revenues, operating income, and assets for each segment are as follows (in thousands):

	Total	Cornwall	Paragon Systems/SEP	Other
2006				
Revenues	$75,725	$40,875	$ 34,850	$ —
Amortization and depreciation	2,724	1,656	398	670
Operating loss	(5,132)	(252)	(1,004)	(3,876)
Current assets	14,028	6,260	7,742	26
Investment in joint venture	—	—	—	—
Goodwill	16,078	8,331	7,747	—
Other Intangibles	6,398	4,530	725	1,143
Total assets	37,101	19,494	16,367	1,240
2005				
Revenues	$41,985	$10,011	$ 31,974	$ —
Amortization and depreciation	1,018	430	432	156
Operating loss	(3,564)	(647)	(453)	(2,464)
Current assets	12,453	6,082	6,187	184
Investment in joint venture	8,698	—	8,698	—
Goodwill	15,615	7,868	7,747	—
Other Intangibles	9,010	6,174	1,080	1,756
Total assets	47,345	21,454	23,787	2,104
2004				
Revenues	$25,425	$ —	$ 25,425	$ —
Amortization and depreciation	313	—	313	—
Operating loss	(1,021)	—	(115)	(906)
Current assets	6,636	—	6,187	449
Investment in joint venture	8,302	—	8,302	—
Goodwill	7,747	—	7,747	—
Other Intangibles	1,508	—	1,508	—
Total assets	24,618	—	23,436	1,182

20. Selected Quarterly Financial Data (Unaudited)

The following table sets forth, for each quarter in the last three fiscal years, selected data from our statements of operations. The operations of Tri-S prior to February 27, 2004 are combined with the operations of Paragon Systems for all periods presented. Paragon Systems was an S corporation and subject to income taxes prior to the Acquisition. Pro forma income taxes are provided for Paragon at 38% of income or loss before income taxes for periods prior to the Acquisition.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(in thousands, except per share data)			
2006				
Revenue	$17,373	$17,704	$19,984	$20,664
Gross profit	1,999	1,806	1,809	1,864
Net loss attributable to common shareholders	(1,649)	(59)	(814)	(1,311)
Basic net loss per share attributable to common shareholders	(0.49)	(0.02)	(0.23)	(0.37)
Diluted net loss per share attributable to common shareholders	(0.49)	(0.02)	(0.23)	(0.37)
2005				
Revenue	7,979	7,745	8,063	18,198
Gross profit	348	753	371	1,376
Net income (loss) attributable to common shareholders	(46)	124	(430)	(1,926)
Basic net loss per share attributable to common shareholders	(0.02)	0.04	(0.13)	(0.58)
Diluted net earnings (loss) per share attributable to common shareholders	(0.02)	0.04	(0.13)	(0.58)
2004				
Revenue	7,283	7,468	7,682	7,697
Gross profit (loss)	565	322	428	(110)
Net income (loss) attributable to common shareholders	(61)	(339)	572	(879)
Basic net loss per share attributable to common shareholders	(0.07)	(0.41)	0.69	(1.07)
Diluted net loss per share attributable to common shareholders	(0.07)	(0.41)	0.45	(1.07)

Tri-S Security Corporation
Schedule II—Valuation and Qualifying Accounts

Column A—Description	Column B—Balance at beginning of period	Column C—Additions: Charged to costs and expenses	Column C—Additions: Charged to other accounts—describe	Column D—Deductions—describe	Column E—Balance at end of period
Bad Debt Reserve (in thousands):					
Year ended December 31, 2006	$ 1,181	$ 59	$ —	$ 442(2)	$ 797
Year ended December 31, 2005	537	329	695(1)	380(2)	1,181
Year ended December 31, 2004	50	497(3)	—	10	537

(1) Established Bad Debt Reserve for accounts receivable acquired as part of Cornwall acquisition estimated to be uncollectible.
(2) Write-offs.
(3) Charged against revenue.

SIGNATURES

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

TRI-S SECURITY CORPORATION

By: /s/ RONALD G. FARRELL
Chairman of the Board and Chief Executive Officer

Date: March 28, 2007

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

Name	Title	Date
/S/ RONALD G. FARRELL Ronald G. Farrell	Chairman of the Board and Chief Executive Officer (Principal Executive Officer)	March 28, 2007
/S/ ROBERT K. MILLS Robert K. Mills	Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)	March 28, 2007
/S/ JAMES M. LOGSDON James M. Logsdon	Director	March 28, 2007
/S/ L.K. TOOLE L.K. Toole	Director	March 28, 2007
/S/ JAMES A. VERBRUGGE James A. Verbrugge	Director	March 28, 2007

Exhibit No.	Description	Method of Filing
1.1	Form of Underwriting Agreement entered into in connection with the Initial Public Offering.	Incorporated by reference to Exhibit 1.1 to the Company's Registration Statement on Form S-1 (No. 333-119737).
2.1	Stock Purchase Agreement dated February 23, 2004, among the Company and Charles Keathley, Robert Luther, Harold Bright and John Wilson.	Incorporated by reference to Exhibit 2.1 to the Company's Registration Statement on Form S-1 (No. 333-119737).
2.2	Stock Purchase Agreement dated as of August 30, 2005, among the Company and the shareholders of The Cornwall Group, Inc. (The schedules to the Stock Purchase Agreement have been omitted from this Current Report pursuant to Item 601(b)(2) of Regulation S-K, and the Company agrees to furnish copies of such omitted schedules supplementally to the Securities and Exchange Commission upon request.)	Incorporated by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K filed on September 2, 2005.
2.3	Amendment No. 1 to Stock Purchase Agreement dated as of October 18, 2005, among the Company and the shareholders of The Cornwall Group, Inc.	Incorporated by reference to Exhibit 2.2 to the Company's Current Report on Form 8-K filed on October 24, 2005.
3.1	Amended and Restated Articles of Incorporation.	Incorporated by reference to Exhibit 3.1 to the Company's Registration Statement on Form S-1 (No. 333-119737).
3.2	Amended and Restated Bylaws.	Incorporated by reference to Exhibit 3.2 to the Company's Registration Statement on Form S-1 (No. 333-119737).
4.1	Form of Representative's Option for the Purchase of Warrants.	Incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-1 (No. 333-119737).
4.2	Form of Representative's Option for the Purchase of Common Stock.	Incorporated by reference to Exhibit 4.2 to the Company's Registration Statement on Form S-1 (No. 333-119737).
4.3	Specimen Common Stock Certificate.	Incorporated by reference to Exhibit 4.3 to the Company's Registration Statement on Form S-1 (No. 333-119737).
4.4	Form of Warrant Agreement.	Incorporated by reference to Exhibit 4.4 to the Company's Registration Statement on Form S-1 (No. 333-119737).
4.5	Form of Warrant Issuable to Underwriters Upon Exercise of Option.	Incorporated by reference to Exhibit 4.5 to the Company's Registration Statement on Form S-1 (No. 333-119737).

4.6	Specimen Warrant Certificate.	Incorporated by reference to Exhibit 4.6 to the Company's Registration Statement on Form S-1 (No. 333-119737).
4.7	Specimen Unit Certificate.	Incorporated by reference to Exhibit 4.7 to the Company's Registration Statement on Form S-1 (No. 333-119737).
4.8	Form of 10% Callable Convertible Promissory Note issued by the Company in connection with the private placement of securities conducted on September 2, 2005.	Incorporated by reference to Exhibit 4.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2005.
4.9	Form of Warrant to purchase shares of the Company's common stock issued by the Company in connection with the private placement of securities conducted on September 2, 2005.	Incorporated by reference to Exhibit 4.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2005.
4.10	Form of Registration Rights Agreement entered into by the Company and the investors signatory thereto in connection with the private placement of securities conducted on September 2, 2005.	Incorporated by reference to Exhibit 4.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2005.
4.11	Form of 10% Callable Convertible Promissory Note issued by the Company in connection with the private placement of securities conducted on September 30, 2005, October 12, 2005 and October 14, 2005.	Incorporated by reference to Exhibit 4.4 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2005.
4.12	Form of Warrant to purchase shares of the Company's common stock issued by the Company in connection with the private placement of securities conducted on September 30, 2005, October 12, 2005 and October 14, 2005.	Incorporated by reference to Exhibit 4.5 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2005.
4.13	Form of Registration Rights Agreement entered into by the Company and the investors signatory thereto in connection with the private placement of securities conducted on September 30, 2005, October 12, 2005 and October 14, 2005.	Incorporated by reference to Exhibit 4.6 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2005.
4.14	Form of Warrant to purchase 150,000 shares of the Company's common stock issued to BRE LLC.	Incorporated by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K filed on May 2, 2006.
4.15	Form of Warrant to purchase 25,000 shares of the Company's common stock issued to LSQ Funding Group, L.C.	Incorporated by reference to Exhibit 99.2 to the Company's Current Report on Form 8-K filed on May 2, 2006.
10.1	Factoring and Security Agreement dated as of February 27, 2004, between Paragon Systems, Inc. and LSQ Funding Group, L.L.C.	Incorporated by reference to Exhibit 10.1 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.2	Assignment of Contract Proceeds dated as of February 27, 2004, between Paragon Systems, Inc. and	Incorporated by reference to Exhibit 10.2 to the Company's

	LSQ Funding Group, L.L.C.	Registration Statement on Form S-1 (No. 333-119737).
10.3	Assignment of Factoring Credit Balances dated as of July 27, 2004, among Paragon Systems, Inc., LSQ Funding Group, L.L.C. and BRE LLC.	Incorporated by reference to Exhibit 10.3 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.4	Promissory Note dated July 27, 2004, made by Paragon Systems, Inc. in favor of BRE LLC in principal amount of $400,000.	Incorporated by reference to Exhibit 10.4 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.5	Security Agreement dated July 27, 2004, between Paragon Systems, Inc. and BRE LLC.	Incorporated by reference to Exhibit 10.5 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.6	Agreement Regarding Notes and Preferred Shares dated as of September 29, 2004, among the Company, Paragon Systems, Inc., Harold Bright, Charles Keathley, Robert Luther and John Wilson.	Incorporated by reference to Exhibit 10.6 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.7	Letter Agreement dated October 6, 2004, between the Company, Paragon Systems, Inc., Charles Keathley and Robert Luther.	Incorporated by reference to Exhibit 10.7 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.8	Consent Agreement to Extend Promissory Notes dated as of September 7, 2004 among the Company, Paragon Systems, Inc., Harold Bright and John Wilson.	Incorporated by reference to Exhibit 10.8 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.9	Promissory Note dated February 24, 2004, made by the Company in favor of Harold Bright in the principal amount of $526,900.	Incorporated by reference to Exhibit 10.9 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.10	Amended and Restated Promissory Note dated September 29, 2004, made by the Company in favor of Charles Keathley in principal amount of $2,983,750.	Incorporated by reference to Exhibit 10.10 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.11	Amended and Restated Promissory Note dated September 29, 2004, made by the Company in favor of Robert Luther in principal amount of $1,462,450.	Incorporated by reference to Exhibit 10.11 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.12	Promissory Note dated February 24, 2004, made by the Company in favor of John Wilson in the principal amount of $526,900	Incorporated by reference to Exhibit 10.12 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.13	Amended and Restated Promissory Note dated September 29, 2004, made by Paragon Systems, Inc. in favor of Charles Keathley, both individually and as agent for Robert Luther, Harold Bright and John Wilson, in principal amount of $706,507.	Incorporated by reference to Exhibit 10.13 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.14	Pledge and Assignment of Stock and Security Agreement dated September 29, 2004, between the	Incorporated by reference to Exhibit 10.14 to the

	Company and Charles Keathley.	Company's Registration Statement on Form S-1 (No. 333-119737).
10.15	Pledge and Assignment of Stock and Security Agreement dated September 29, 2004, between the Company and Robert Luther.	Incorporated by reference to Exhibit 10.15 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.16	Promissory Note dated February 24, 2004, made by the Company in favor of Harold Bright in principal amount of $143,700.	Incorporated by reference to Exhibit 10.16 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.17	Promissory Note dated February 24, 2004, made by the Company in favor of Charles Keathley in principal amount of $813,750.	Incorporated by reference to Exhibit 10.17 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.18	Promissory Note dated February 24, 2004, made by the Company in favor of Robert Luther Bright in principal amount of $398,850.	Incorporated by reference to Exhibit 10.18 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.19	Promissory Note dated February 24, 2004, made by the Company in favor of John Wilson in principal amount of $143,700.	Incorporated by reference to Exhibit 10.19 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.20	Security Agreement dated February 24, 2004, between the Company and Harold Bright.	Incorporated by reference to Exhibit 10.20 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.21	Security Agreement dated February 24, 2004, between the Company and Charles Keathley.	Incorporated by reference to Exhibit 10.21 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.22	Security Agreement dated February 24, 2004, between the Company and Robert Luther.	Incorporated by reference to Exhibit 10.22 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.23	Security Agreement dated February 24, 2004, between the Company and John Wilson.	Incorporated by reference to Exhibit 10.23 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.24	Employment Agreement dated January 1, 2002, between the Company and Ronald G. Farrell. Represents an executive compensation plan or arrangement.	Incorporated by reference to Exhibit 10.24 to the Company's Registration Statement on Form S-1

		(No. 333-119737).
10.25	Employment Agreement dated February 24, 2004, between Paragon Systems, Inc. and Charles Allbritten.	Incorporated by reference to Exhibit 10.25 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.26	Employment Agreement dated February 24, 2004, between Paragon Systems, Inc. and Harold Bright.	Incorporated by reference to Exhibit 10.26 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.27	Employment Agreement dated February 24, 2004, between Paragon Systems, Inc. and Carla J. Cilyok.	Incorporated by reference to Exhibit 10.27 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.28	Employment Agreement dated February 24, 2004, between Paragon Systems, Inc. and Charles Keathley.	Incorporated by reference to Exhibit 10.28 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.29	Employment Agreement dated February 24, 2004, between Paragon Systems, Inc. and Robert N. Luther.	Incorporated by reference to Exhibit 10.29 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.30	Employment Agreement dated February 24, 2004, between Paragon Systems, Inc. and John T. Wilson.	Incorporated by reference to Exhibit 10.30 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.31	Form of Exchange and Recapitalization Agreement among the Company and the holders of the Company's outstanding common stock, Series A Convertible Preferred Stock and Series B Convertible Preferred Stock.	Incorporated by reference to Exhibit 10.31 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.32	Agreement dated May 5, 2003, among Paragon Systems, Inc. and International Union of Security, Police and Fire Professionals of America.	Incorporated by reference to Exhibit 10.37 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.33	Agreement dated December 16, 2003 among Paragon Systems Inc. and International Union, Security, Police, and Fire Professionals of America.	Incorporated by reference to Exhibit 10.38 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.34	Agreement dated March 1, 2002, between Paragon Systems, Inc. and International Technical and Professional Employees Union, AFL-CIO.	Incorporated by reference to Exhibit 10.39 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.35	Agreement dated December 1, 2003 between Paragon	Incorporated by reference to

	Systems, Inc. and United Union of Security Guards.	Exhibit 10.40 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.36	Joint Venture limited Liability Company Agreement for Army Fleet Support, LLC.	Incorporated by reference to Exhibit 10.41 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.37	2004 Stock Incentive Plan, as amended and restated as of November 7, 2006.	Incorporated by reference to Appendix A to the Company's Notice of Annual Meeting of Shareholders and Proxy Statement dated October 6, 2006.
10.38	Form of Indemnification Agreement.	Incorporated by reference to Exhibit 10.43 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.39	Paragon Systems, Inc. 401(k) Profit Sharing Plan, as amended.	Incorporated by reference to Exhibit 10.44 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.40	Letter Agreement dated November 30, 2004 among the Company, Charles Keathley and Robert Luther.	Incorporated by reference to Exhibit 10.62 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.41	Letter Agreement dated December 14, 2004 among the Company, Harold Bright and John Wilson.	Incorporated by reference to Exhibit 10.63 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.42	Amendment No. 1 to Employment Agreement between the Company and Ronald G. Farrell. Represents an executive compensation plan of agreement.	Incorporated by reference to Exhibit 10.64 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.43	Form of Consulting Agreement among the Company, Capital Growth Financial, LLC and Bathgate Capital Partners LLC.	Incorporated by reference to Exhibit 10.65 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.44	Promissory Note made by Ronald G. Farrell in favor of the Company dated December 31, 2004.	Incorporated by reference to Exhibit 10.66 to the Company's Registration Statement on Form S-1 (No. 333-119737).
10.45	Factoring Agreement dated April 2005 between Paragon Systems, Inc. and LSQ Funding Group, L.L.C.	Incorporated by reference to Exhibit 10.3 to the Company's

		Quarterly Report on Form 10-Q for the quarter ended March 31, 2005.
10.46	Summary of Board Compensation	Incorporated by reference to Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2005.
10.47	Factoring Agreement dated April 2005 between Paragon Systems, Inc. and LSQ Funding Group, L.L.C.	Incorporated by reference to Exhibit 99.1 to the Company's Current Report Form 8-K filed on April 26, 2005.
10.48	Office Lease Agreement between the Company and V.V. Georgia, L.P. dated June 29, 2005.	Incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2005.
10.49	Letter Agreement dated August 10, 2005 between the Company and Ronald G. Farrell. Represents an executive compensation arrangement or plan.	Incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2005.
10.50	Employment Agreement dated January 1, 2002, between the Company and Ronald G. Farrell. Represents an executive compensation arrangement or plan	Incorporated by reference to Exhibit 10.24 to the Company's Registration Statement on Form S-1, as amended (No. 333-119737).
10.51	Employment Agreement between Paragon Systems, Inc. and Leslie Kaciban dated July 29, 2005.	Incorporated by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K filed on August 4, 2005.
10.52	Employment Agreement between Paragon Systems, Inc. and Mark Machi dated July 29, 2005.	Incorporated by reference to Exhibit 99.2 to the Company's Current Report on Form 8-K filed on August 4, 2005.
10.53	Form of Qualified Stock Option Agreement.	Incorporated by reference to Exhibit 4.2 to the Company's Registration Statement on Form S-8 (No. 333-129097).
10.54	Form of Non-Qualified Stock Option Agreement.	Incorporated by reference to Exhibit 4.3 to the Company's Registration Statement on Form S-8 (No. 333-129097).
10.55	Letter Agreement between the Company and E. Wayne Stallings dated August 12, 2005.	Incorporated by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K filed on August 18, 2005.
10.56	Earnest Money Escrow Agreement dated as of August 30, 2005, among the Company, The Cornwall Group, Inc., the Shareholder Representative and Berman Renert Vogl & Mandler, P.A.	Incorporated by reference to Exhibit 99.2 to the Company's Current Report on Form 8-K filed on September 2, 2005.
10.57	Promissory Note dated October 18, 2005 in principal	Incorporated by reference to

	amount of $250,000 made by the Company in favor of the Shareholder Representative.	Exhibit 99.2 to the Company's Current Report on Form 8-K filed on October 24, 2005.
10.58	Credit Agreement dated as of October 18, 2005 among the Company, its subsidiaries, LSQ Funding Group, L.C. and BRE LLC.	Incorporated by reference to Exhibit 99.3 to the Company's Current Report on Form 8-K filed on October 24, 2005.
10.59	Factoring and Security Agreement dated as of October 18, 2005 among the Company, its subsidiaries and LSQ Funding Group, L.C.	Incorporated by reference to Exhibit 99.4 to the Company's Current Report on Form 8-K filed on October 24, 2005.
10.60	Security Agreement dated as of October 18, 2005 among the Company, its subsidiaries, LSQ Funding Group, L.C. and BRE LLC.	Incorporated by reference to Exhibit 99.5 to the Company's Current Report on Form 8-K filed on October 24, 2005.
10.61	Pledge Agreement dated as of October 18, 2005 among the Company, LSQ Funding Group, L.C. and BRE LLC	Incorporated by reference to Exhibit 99.6 to the Company's Current Report on Form 8-K filed on October 24, 2005.
10.62	Guaranty Agreement dated as of October 18, 2005 among the Company, its subsidiaries, LSQ Funding Group, L.C. and BRE LLC.	Incorporated by reference to Exhibit 99.7 to the Company's Current Report on Form 8-K filed on October 24, 2005.
10.63	Employment Agreement between The Cornwall Group, Inc. and David H. Shopay dated October 18, 2005.	Incorporated by reference to Exhibit 99.8 to the Company's Current Report on Form 8-K filed on October 24, 2005.
10.64	Escrow Agreement dated as of October 18, 2005 among the Company, SunTrust Bank and the Shareholder Representative.	Incorporated by reference to Exhibit 99.9 to the Company's Current Report on Form 8-K filed on October 24, 2005.
10.65	Amendment to Credit Agreement, dated as of December 30, 2005, among the Company, its subsidiaries, LSQ Funding Group, L.C. and BRE LLC.	Incorporated by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K filed on January 6, 2006.
10.66	Amendment to Pledge Agreement, dated as of October 19, 2005, but executed on December 30, 2005, among the Company, LSQ Funding Group, L.C. and BRE LLC.	Incorporated by reference to Exhibit 99.2 to the Company's Current Report on Form 8-K filed on January 6, 2006.
10.67	Agreement between International Monitoring, Inc. and Devcon Security Services Corporation dated March 2, 2006.	Incorporated by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K filed on March 8, 2006.
10.68	Amendment and Forbearance Agreement dated as of March 29, 2006 by and among the Company, its subsidiaries, LSQ Funding Group, L.C. and BRE LLC.	Incorporated by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K filed on April 4, 2006.
10.69	Agreement to sell certain real property located in Fort Lauderdale, Florida.	Incorporated by reference to Exhibit 10.92 on the Company's Annual Report on Form 10-K for the year ended December 31, 2005.

10.70	Letter Agreement dated April 10, 2006 between International Monitoring, Inc. and Devcon Security Services Corporation.	Incorporated by reference to Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2006.
10.71	Joint Venture Agreement dated January 17, 2006 between Paragon Systems, Inc. and Southeastern Protective Services, Inc.	Incorporated by reference to Exhibit 10.5 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2006.
10.72	Purchase Agreement dated as of May 19, 2006 among the Company, Paragon Systems, Inc. and L-3 Communications Integrated Systems, LP.	Incorporated by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K filed on May 23, 2006.
10.73	Summary of Board Compensation.	Incorporated by reference to Exhibit 10.6 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2006.
10.74	Guaranty of Joint Venture Executed by Paragon Systems, Inc. on June 27, 2006.	Incorporated by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K filed on June 30, 2006.
10.75	Waiver, Consent and Amendment among the Company, its subsidiaries, LSQ Funding Group, L.C. and BRE LLC dated as of June 27, 2007.	Incorporated by reference to Exhibit 99.2 to the Company's Current Report on Form 8-K filed on June 30, 2006.
10.76	Amendment to Employment Agreement between the Company and Ronald G. Farrell dated January 10, 2007.	Incorporated by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K filed on January 11, 2007.
10.77	Settlement Agreement and General Release dated January 26, 2007, between the Company and David Shopay, on behalf of himself and the other former shareholders of The Cornwall Group, Inc.	Incorporated by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K filed on February 1, 2007.
10.78	Copy of the selected portions of the Investor Fact Sheet released on or about January 24, 2007.	Incorporated by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K filed on February 7, 2007.
10.79	Amendment and Forbearance dated as of March 23, 2007 among the Company, its subsidiaries, LSQ Funding Group, L.C. and BRE LLC.	Filed herewith.
10.80	Acknowledgment of Forbearance and Reaffirmation of Guaranty dated as of March 23, 2007, among the Company, its subsidiaries, LSQ Funding Group, L.C. and BLE LLC.	Filed herewith.
10.81	Pledge Agreement dated as of March 23, 2007, among the Company, its subsidiaries, LSQ Funding Group, L.C.	Filed herewith

	and BLE LLC.	
16.1	Letter from Miller Ray Hansen and Stewart LLP dated January 5, 2006.	Incorporated by reference to exhibit 16.1 to the Company's Amendment No. 1 to the Current Report on Form 8-K/A filed on January 6, 2006.
21.1	Subsidiaries of the Company.	Filed herewith.
23.1	Consent of Tauber & Balser, P.C.	Filed herewith.
23.2	Consent of Miller Ray Houser & Stewart LLP (Tri-S Security Corporation).	Filed herewith.
23.3	Consent of Miller Ray Houser & Stewart LLP (Paragon Systems, Inc.).	Filed herewith.
31.1	Rule 13a-14(a)/15d-14(a) Certification of the Company's Chief Executive Officer.	Filed herewith.
31.2	Rule 13a-14(a)/15d-14(a) Certification of the Company's Chief Financial Officer.	Filed herewith.
32.1	Section 1350 Certification of the Company's Chief Executive Officer.	Filed herewith.
32.2	Section 1350 Certification of the Company's Chief Financial Officer.	Filed herewith.

Exhibit 10.79

AMENDMENT AND FORBEARANCE

This **AMENDMENT AND FORBEARANCE** ("Agreement") to is entered into as of March 23, 2007 (the "2007 Closing Date"), by and between LSQ Funding Group, L.C. and BRE LLC (collectively, "Lender"), and Tri-S Security Corporation ("TSS"), and each of TSS's affiliates ("Affiliates"), Paragon Systems, Inc. ("Paragon"), The Cornwall Group, Inc., Vanguard Security, Inc., Forestville Corporation, Vanguard Security of Broward County, Inc., On Guard Security and Investigations, Inc., Armor Security, Inc. ("Armor"), Protection Technologies Corporation, International Monitoring, Inc., Guardsource Corp. and Virtual Guard Source, Inc. (TSS and the Affiliates, collectively, "Borrower").

WHEREAS, Lender and Borrower have, entered into that certain CREDIT AGREEMENT (the "Loan Agreement") and that certain FACTORING AGREEMENT (the "Factoring Agreement"), both dated as of and closed on October 19, 2005, and the other documents entered into and contemplated therein, all as amended hereby; and

WHEREAS, Borrower is or may be in default under the terms of the Loan Documents, by reason of the following: (a) the pending lawsuit filed by Borrower in the United States District Court, Northern District of Georgia, Atlanta Division against the Former Shareholders, the legal proceeding contemplated thereby and any claim for damages that have been commenced prior to the date hereof or may be commenced after the date hereof by the Former Shareholders relating to the Redemption Obligation or otherwise (the "Pending Claims"), and b(b) Borrower's failure to pay the interest otherwise payable in February 2006, August 2006 and February 2007 with respect to the Redemption Obligation, (c) Borrower's failure to redeem by February 27, 2007, the shares of TSS's Series C Redeemable Preferred Stock held by the Former Shareholders, and (d) failure to either submit the Report required under Section 5.17 of the Loan Agreement, or to resolve the Pending Claims on a timely basis (each of the above collectively, the "Existing Defaults"); and

WHEREAS, Borrower has requested that Lender forbear from exercising its rights and remedies against Borrower from the date hereof through the earlier of February 28, 2008, or the occurrence of an Event of Default other than an Existing Default (the "Forbearance Period"). Although Lender is under no obligation to do so, Lender is willing to forbear from exercising its rights and remedies against Borrower through the Forbearance Period on the terms and conditions set forth in this Agreement, so long as Borrower complies with the terms, covenants and conditions set forth in this Agreement in a timely manner; and

WHEREAS, Borrower needs additional funds up to $2.5 million dollars in order to pursue several business opportunities; and

WHEREAS, Lender is willing to make the agreements and the loans that Borrower has requested in consideration of the promises set forth below; and

WHEREAS, Borrower is willing to pay the fees and interest, and grant the rights described below so that it can effectively pursue the opportunities.

AGREEMENT

NOW, THEREFORE, in consideration of the foregoing recitals and other good and valuable consideration, the receipt and adequacy of which is hereby acknowledged, and intending to be legally bound, the parties hereto agree as follows:

1. Definitions. Capitalized terms used but not defined in this Agreement shall have the meanings given to them in the Loan Agreement and Factoring Agreement.

2. Agreements.

2.1 Forbearance. So long as no Event of Default, other than the Existing Defaults, occurs or exists, subject to the terms and conditions set forth herein, Lender agrees that during the Forbearance Period, Lender will not (x) exercise any default remedy available to Lender under any Loan Document or applicable law; (y) enforce collection from any Borrower or any Guarantor of any of the Obligations; or (z) foreclose on its security interest in any of the Collateral (as defined in all Loan Documents).

Except as expressly provided herein, this Agreement does not constitute a waiver or release by Lender of any Obligations or of any Event of Default other than the Existing Defaults, or of any Event of Default which may arise in the future after the date of this Agreement. If Borrower does not comply with the terms of this Agreement and the Loan Documents, as modified herein, Lender shall have no further obligations under this Agreement and shall be permitted to exercise at such time any rights and remedies against Borrower as it deems appropriate in its sole and absolute discretion. Borrower understands that Lender has made no commitment and is under no obligation whatsoever to grant any additional extensions of time at the end of the Forbearance Period.

2.2 Amendments.

(a) Security Interest. Borrower hereby grants and reaffirms the grant to Lender of a security interest in all Collateral to secure all Obligations, including all obligations under the Loan Agreement, the Factoring Agreement, the Loan Documents and this Agreement. The term Collateral shall include the Collateral identified in the Loan Documents, and the collateral identified in Exhibit A hereto. Borrower shall execute such documents as are required by Lender in order to upon a valid perfected security interest in the Collateral, including the Pledge Agreement attached hereto as Exhibit B.

(b) The following sub-sections shall be added to Section 2.2 of the Loan Agreement:

(e) 2007 *Term Loan*. Subject to the terms and conditions hereof, Lender agrees to make an additional Term Loan (the "2007 Term Loan") to Borrower, up to Two Million Five Hundred Thousand Dollars ($2,500,000), the proceeds of which may only be used for working capital needs of Borrower. The term ("Term") of the 2007 Term Loan shall be from the 2007 Closing Date until March 28, 2009 ("2007 Term Loan Due Date"). Upon the execution of this Agreement, Lender will make an initial advance to Borrower of no less than $100,000.00 ("Initial Minimum Balance").

(f) *Amortization of 2007 Term Loan*. Interest on the outstanding balance of the 2007 Term Loan will be due and payable on April 1, 2007, and on the first day of each month thereafter. The outstanding principal balance of the 2007 Term Loan, and all remaining accrued and unpaid interest under the 2007 Term Loan, must be paid in full on the 2007 Term Loan Due Date. Subject to payment of the Minimum Balance Fee, Borrower may repay the 2007 Term Loan at any time prior to the 2007 Term Loan Due Date, but any amounts repaid may not be re-borrowed.

(c) Section 2.4 of the Loan Agreement is deleted and replaced with the following:

2.4 Rates; Payment.

(a) Interest Rates.

(i) Factoring Advances. With respect to the Factoring Advances, Borrower shall pay to Lender the charges and interest due under the Factoring Agreement, including a Fund Usage Fee Rate equal to one percent (1%) per annum in excess of the Prime Rate, but not less than 6.0% per annum.

(ii) Term Loan Interest Rate. With respect to the entire principal outstanding under the 2007 Term Loan, interest shall accrue and be payable at the Base Rate plus the Term Loan Margin, but not less that 12% per annum. From and after 2007 Closing Date, the Term Loan Margin shall be 5.50 percent (550 basis points) per annum.

(b) Other Rates, Fees.

(i) Default Rate; Fees. Upon the occurrence and during the continuance of an Event of Default (other than the Existing Defaults during the Forbearance Period), in addition to any of Lender's other rights and remedies with respect to such Event of Default, Borrower will pay post-Event of Default interest ("Default Interest"), as follows: (i) with respect to the Factoring Advances, Borrower shall pay to Lender the post-default charges and interest due under the Factoring Agreement; (ii) in addition to any other fees and interest chargeable to Borrower on account of the 2007 Term Loan, Borrower shall pay to Lender a fee of $60,000 per month ("Term Loan Default Fee"), which shall be due and payable when interest is otherwise due, but if the 2007 Term Loan has been paid in full within sixty (60) days of a notice by Lender to Borrower of an Event of Default, in lieu of the Term Loan Default Fee, Borrower may pay an amount equal to the Minimum Balance Fee that would be calculated as of the date of the payment in full of the 2007 Term Loan, if within the sixty day period; and (iii) in addition to the Term Loan Default Fee, all Obligations not paid when due will earn interest at the rate of eighteen percent (18%) per annum until paid, including all amounts due under this section.

(ii) Minimum Balance Fee. If there has been no Event of Default, and Borrower has failed to maintain the principal amount outstanding under the 2007 Term Loan at or above the Initial Minimum Balance (i.e., $100,000) for any consecutive five day period during the Term, in addition to all other interest and fees due under the Loan Documents, Borrower must pay to Lender a success fee ("Minimum Balance Fee") equal to the number of months (partial or otherwise) that any portion of the 2007 Term Loan is outstanding during the Term, multiplied by $50,000.00 (e.g., in the event that Borrower successfully pursues opportunities, or is otherwise able to repay the 2007 Term Loan by June of 2007, for the months of March to June of 2007, the Minimum Balance Fee would be $200.000, or, $50,000 per month for the four months that a balance was outstanding during the Term). The Minimum Balance Fee shall be paid upon demand by Lender, or if no demand, upon payment in full of the 2007 Term Loan, but no Minimum Balance Fee shall be owing if the outstanding principal balance of the 2007 Term Loan is, at all times during the Term, greater than the Initial Minimum Balance, or if Borrower is obligated to make the Term Loan Default Fee.

(iii) Unused Line Fee. In addition, Borrower will pay Lender an unused line fee of one-quarter of one percent (.25%) per month, computed on the difference between the monthly average outstanding principal balance of the 2007 Term Loan and $2,500,000.

(d) Section 2.10 of the Loan Agreement is deleted in its entirety, and is replaced with the following

2.10 Crediting Payments. The receipt of any payment by Lender on the Term Loan shall be applied provisionally to reduce the Term Loan obligations, but shall not be considered a payment on account unless such payment is a wire transfer of immediately available federal funds and is made to Lender or unless and until such payment item is honored when presented for payment. All payments or receipts shall, at Lender's discretion, be applied first to any Obligations under the Factoring Agreement, and then to the Term Loan. Should any payment item not be honored when presented for payment, then Borrower shall be deemed not to have made such payment, and interest shall be recalculated accordingly. Any payment that has been received, but which Lender is required to return, for any reason, shall not be deemed a payment. Anything to the contrary contained herein notwithstanding, any payment item shall be deemed received by Lender, on account of a Term Loan, only if it is received by Lender on a Business Day on or before 11:00 a.m., Eastern time. If any payment item is received by Lender on a non-Business Day or after 11:00 a.m., Eastern time on a Business Day, it shall be deemed to have been received by Lender as of the opening of business on the immediately following Business Day.

(e) Section 5.17 of the Loan Agreement is deleted in its entirety, and is replaced with the following:

5.17. *Redemption*. No later than February 28, 2008, Borrower shall deliver to Lender a written report that demonstrates that Borrower has the ability to satisfy the Redemption Obligation as of the due date thereof (the "Report"), which Report shall be in form and content reasonably acceptable to Lender. Lender shall review the Report, and in the event that Lender determines, in its reasonable judgment, that the Report is not acceptable, then Lender shall send Borrower a notice of rejection ("Notice of Rejection"). Upon delivery of a Notice of Rejection by Lender to Borrower, Borrower shall be deemed to be in default of this Section 5.17, and such notice shall constitute an Event of Default under Section 7.1(b) of the Agreement.

(f) Other Terms. The following terms shall be added to the Loan Agreement:

(i) Availability Requirement. From and after February 28, 2008, and through and until the 2007 Term Loan Due Date, Borrower must, at all times, maintain 30 day average availability of not less than $1 million under the Factoring Agreement, as calculated by Lender. In the event of a dispute as to the calculation, Lender's calculation shall prevail in the absence of manifest error, but in any event, Borrower shall be bound by Lender's calculation of availability as to which Borrower has failed to make a written objection within ten days of Lender sending Borrower any such calculation.

(ii) Pledge of Stock. Upon execution of this Agreement, Lender shall have been granted a security interest in all of the shares of stock of the Affiliates listed on Exhibit A to this Agreement. Lender's security interest in the stock of Paragon is subject to a security interest as to 40% of the shares in favor of the Former Shareholders. No later than February 28, 2008, Borrow will have provided Lender with a pledge of all of the stock of Paragon, free of the security interests of the Former Shareholders, and all other security interests or encumbrances.

(iii) Resolution of Pending Claims. The Pending Claims must be completely resolved by February 28, 2008, to Lender's satisfaction.

(iv) Remedies. Failure by Borrower to satisfy any of the above on a timely basis, is an Event of Default, and, in addition to all other remedies, Lender may accelerate all Obligations, it may terminate the Factoring Agreement, it may elect to continue to make advances and perform under the Factoring Agreement on a provisional basis, or it may elect to do any or all of the above.

(v) Section 3.3(e) of the Loan Agreement. Lender acknowledges and agrees that, by virtue of the sale of AFS Interest by Borrower in May 2006 and the payment of the proceeds thereof by Borrower to Lender, the obligations of Borrower set forth in Section 3.3(e) of the Loan Agreement have been satisfied in full.

3. Limitation of Forbearance.

3.1 This Agreement is effective for the purposes set forth herein and shall be limited precisely as written and shall not be deemed to (a) be a consent to any amendment, waiver or modification of any other term or condition of any Loan Document, or (b) otherwise prejudice any right or remedy which Lender may now have or may have in the future under or in connection with any Loan Document.

3.2 This Agreement shall be construed in connection with and as part of the Loan Documents and all terms, conditions, representations, warranties, covenants and agreements set forth in the Loan Documents are hereby ratified and confirmed and shall remain in full force and effect.

4. Representations and Warranties. To induce Lender to enter into this Agreement, Borrower hereby represents and warrants to Lender as follows:

4.1 Immediately after giving effect to this Agreement (a) the representations and warranties contained in the Loan Documents are true, accurate and complete in all material respects as of the date hereof (except to the extent such representations and warranties relate to an earlier date, in which case they are true and correct as of such date), and (b) no Event of Default other than the Existing Defaults has occurred and is continuing;

4.2 Borrower has the power and authority to execute and deliver this Agreement and to perform its obligations under the Loan Agreement;

4.3 The organizational documents of Borrower delivered to Lender on the Effective Date remain true, accurate and complete and have not been amended, supplemented or restated and are and continue to be in full force and effect;

4.4 The execution and delivery by Borrower of this Agreement and the performance by Borrower of its obligations under the Loan Agreement have been duly authorized by all necessary action on the part of Borrower;

4.5 The execution and delivery by Borrower of this Agreement and the performance by Borrower of its obligations under the Loan Documents do not and will not

contravene (a) any law or regulation binding on or affecting Borrower, (b) any contractual restriction with a Person binding on Borrower, (c) any order, judgment or decree of any court or other governmental or public body or authority, or subdivision thereof, binding on Borrower, or (d) the organizational documents of Borrower;

4.6 The execution and delivery by Borrower of this Agreement and the performance by Borrower of its obligations under the Loan Documents do not require any order, consent, approval, license, authorization or validation of, or filing, recording or registration with, or exemption by any governmental or public body or authority, or subdivision thereof, binding on either Borrower, except as already has been obtained or made; and

4.7 This Agreement has been duly executed and delivered by Borrower and is the binding obligation of Borrower, enforceable against Borrower in accordance with its terms, except as such enforceability may be limited by bankruptcy, insolvency, reorganization, liquidation, moratorium or other similar laws of general application and equitable principles relating to or affecting creditors' rights.

5. Prior Agreement. The Loan Documents are hereby ratified and reaffirmed and shall remain in full force and effect. This Agreement is not a novation and the terms and conditions of this Agreement shall be in addition to and supplemental to all terms and conditions set forth in the Loan Documents. In the event of any conflict or inconsistency between this Agreement and the terms of such documents, the terms of this Agreement shall be controlling, but such document shall not otherwise be affected or the rights therein impaired.

6. Release by Borrower.

6.1 FOR GOOD AND VALUABLE CONSIDERATION, Borrower hereby forever relieves, releases, and discharges Lender and its present or former employees, officers, directors, agents, representatives, attorneys, and each of them, from any and all claims, debts, liabilities, demands, obligations, promises, acts, agreements, costs and expenses, actions and causes of action, of every type, kind, nature, description or character whatsoever, whether known or unknown, suspected or unsuspected, absolute or contingent, arising out of or in any manner whatsoever connected with or related to facts, circumstances, issues, controversies or claims existing or arising from the beginning of time through and including the date of execution of this Agreement (collectively "Released Claims"). Without limiting the foregoing, the Released Claims shall include any and all liabilities or claims arising out of or in any manner whatsoever connected with or related to the Loan Documents, the Recitals hereto, any instruments, agreements or documents executed in connection with any of the foregoing or the origination, negotiation, administration, servicing and/or enforcement of any of the foregoing.

6.2 In furtherance of this release, Borrower expressly acknowledges and waives any and all rights under Section 1542 of the California Civil Code, or any equivalent statute or rule that may be applicable, which provides substantially as follows:

> "**A general release** does not extend to claims which the creditor does not know or expect to exist in his favor at the time of executing the release, which if known by him must have materially affected his settlement with the debtor." (Emphasis added.)

6.3 By entering into this release, Borrower recognizes that no facts or representations are ever absolutely certain and it may hereafter discover facts in addition to or different from those which it presently knows or believes to be true, but that it is the intention of Borrower hereby to fully, finally and forever settle and release all matters, disputes and differences, known or unknown, suspected or unsuspected; accordingly, if Borrower should subsequently discover that any fact that it relied upon in entering into this release was untrue, or that any understanding of the facts was incorrect, Borrower shall not be entitled to set aside this release by reason thereof, regardless of any claim of mistake of fact or law or any other circumstances whatsoever. Borrower acknowledges that it is not relying upon and has not relied upon any representation or statement made by Lender with respect to the facts underlying this release or with regard to any of such party's rights or asserted rights.

6.4 This release may be pleaded as a full and complete defense and/or as a cross-complaint or counterclaim against any action, suit, or other proceeding that may be instituted, prosecuted or attempted in breach of this release. Borrower acknowledges that the release contained herein constitutes a material inducement to Lender to enter into this Agreement, and that Lender would not have done so but for Lender's expectation that such release is valid and enforceable in all events.

6.5 Borrower hereby represents and warrants to Lender, and Lender is relying thereon, as follows:

(a) Except as expressly stated in this Agreement, neither Lender nor any agent, employee or representative of Lender has made any statement or representation to Borrower regarding any fact relied upon by Borrower in entering into this Agreement.

(b) Borrower has made such investigation of the facts pertaining to this Agreement and all of the matters appertaining thereto, as it deems necessary.

(c) The terms of this Agreement are contractual and not a mere recital.

(d) This Agreement has been carefully read by Borrower, the contents hereof are known and understood by Borrower, and this Agreement is signed freely, and without duress, by Borrower.

(e) Borrower represents and warrants that it is the sole and lawful owner of all right, title and interest in and to every claim and every other matter which it releases herein, and that it has not heretofore assigned or transferred, or purported to assign or transfer, to any person, firm or entity any claims or other matters herein released. Borrower shall indemnify Lender, defend and hold it harmless from and against all claims based upon or arising in connection with prior assignments or purported assignments or transfers of any claims or matters released herein.

7. Counterparts. This Agreement may be executed in any number of counterparts and all of such counterparts taken together shall be deemed to constitute one and the same instrument.

8. Effectiveness. This Agreement shall be deemed effective upon (a) the due execution and delivery to Lender of this Agreement by each party hereto, (b) Borrower's payment of all legal fees and costs in connection with this Agreement which are outstanding, and (c) Lender's receipt of the Acknowledgment of Forbearance and Reaffirmation of Guaranty substantially in the form attached hereto.

9. Governing Law. This Agreement and the rights and obligations of the parties hereto shall be governed by and construed in accordance with the laws of the State of Florida.

10. Borrower agrees to pay to Lender, as fully earned, and to reimburse Lender as follows: a) in consideration of the Lender's commitment to the 2007 Term Loan, Forty Thousand and No/00 Dollars ($40,000.00); b) legal fees incurred by Lender in an amount estimated at $3000, plus such amounts are as incurred with respect to comments made and changes requested by Borrower in connection with this Agreement.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed and delivered as of the date first written above. In executing this Agreement, the undersigned, in their individual capacity, warrant and represent that the Affiliates are all of the entities with business operations affiliated with TSS.

BORROWER:

TRI-S SECURITY CORPORATION

By: /s/ Robert K. Mills

Name: Robert K. Mills

Title: Chief Financial Officer

PARAGON SYSTEMS, INC.

By: /s/ Robert K. Mills

Name: Robert K. Mills

Title: Secretary

THE CORNWALL GROUP, INC.

By: /s/ Robert K. Mills
Name: Robert K. Mills
Title: Secretary

VANGUARD SECURITY, INC.

By: /s/ Robert K. Mills
Name: Robert K. Mills
Title: Secretary

FORESTVILLE CORPORATION

By: /s/ Robert K. Mills
Name: Robert K. Mills
Title: Secretary

VANGUARD SECURITY OF BROWARD COUNTY, INC.

By: /s/ Robert K. Mills
Name: Robert K. Mills
Title: Secretary

ON GUARD SECURITY AND INVESTIGATIONS, INC.

By: /s/ Robert K. Mills
Name: Robert K. Mills
Title: Secretary

ARMOR SECURITY, INC.

By: /s/ Robert K. Mills
Name: Robert K. Mills
Title: Secretary

PROTECTION TECHNOLOGIES CORPORATION

By: /s/ Robert K. Mills
Name: Robert K. Mills
Title: Secretary

INTERNATIONAL MONITORING, INC.

By: /s/ Robert K. Mills
Name: Robert K. Mills
Title: Secretary

GUARDSOURCE CORP.

By: /s/ Robert K. Mills
Name: Robert K. Mills
Title: Secretary

VIRTUAL GUARD SOURCE CORP.

By: /s/ Robert K. Mills
Name: Robert K. Mills
Title: Secretary

LENDER:

LSQ FUNDING GROUP, L.C.

By: /s/ Maxwell Eliscu
Name: Maxwell Eliscu
Title: Authorized Agent

BRE LLC

By: /s/ Maxwell Eliscu
Name: Maxwell Eliscu
Title: Authorized Agent

EXHIBIT 10.80

ACKNOWLEDGMENT OF FORBEARANCE
AND REAFFIRMATION OF GUARANTY

Section 1. Guarantor hereby acknowledges and confirms that it has reviewed and approved the terms and conditions of the Amendment and Forbearance dated as of even date herewith (the "Forbearance").

Section 2. Guarantor hereby consents to the Forbearance and agrees that the Guaranty relating to the Obligations of Borrower under the Loan Documents shall continue in full force and effect, shall be valid and enforceable and shall not be impaired or otherwise affected by the execution of the Forbearance or any other document or instrument delivered in connection herewith.

Section 3. Guarantor represents and warrants that, after giving effect to the Forbearance, all representations and warranties contained in the Guaranty are true, accurate and complete as if made the date hereof.

Dated as of March 23, 2007.

GUARANTOR:

TRI-S SECURITY CORPORATION

By: /s/ Robert K. Mills
Name: Robert K. Mills
Title: Chief Financial Officer

PARAGON SYSTEMS, INC.

By: /s/ Robert K. Mills
Name: Robert K. Mills
Title: Secretary

THE CORNWALL GROUP, INC.

By: /s/ Robert K. Mills
Name: Robert K. Mills
Title: Secretary

VANGUARD SECURITY, INC.

By: /s/ Robert K. Mills
Name: Robert K. Mills
Title: Secretary

FORESTVILLE CORPORATION

By: /s/ Robert K. Mills
Name: Robert K. Mills
Title: Secretary

VANGUARD SECURITY OF BROWARD COUNTY, INC.

By: /s/ Robert K. Mills
Name: Robert K. Mills
Title: Secretary

ON GUARD SECURITY AND
INVESTIGATIONS, INC.

By: /s/ Robert K. Mills
Name: Robert K. Mills
Title: Secretary

ARMOR SECURITY, INC.

By: /s/ Robert K. Mills
Name: Robert K. Mills
Title: Secretary

PROTECTION TECHNOLOGIES
CORPORATION

By: /s/ Robert K. Mills
Name: Robert K. Mills
Title: Secretary

INTERNATIONAL MONITORING, INC.

By: /s/ Robert K. Mills
Name: Robert K. Mills
Title: Secretary

GUARDSOURCE CORP.

By: /s/ Robert K. Mills
Name: Robert K. Mills
Title: Secretary

VIRTUAL GUARD SOURCE CORP.

By: /s/ Robert K. Mills
Name: Robert K. Mills
Title: Secretary

LENDER:

LSQ FUNDING GROUP, L.C.

By: /s/ Maxwell Eliscu
Name: Maxwell Eliscu
Title: Manager

BRE LLC

By: /s/ Maxwell Eliscu
Name: Maxwell Eliscu
Title: Manager

Exhibit A
(Additional Collateral)

In addition to the Collateral described in the Security Agreement and all other Loan Documents, and in order to secure all Obligations, the Borrower grants to Lender a security interest in the following:

100% of the shares of stock in all affiliates, including:

The Cornwall Group, Inc.,
Vanguard Security, Inc.,
Forestville Corporation,
Vanguard Security of Broward County, Inc.,
On Guard Security and Investigations, Inc.,
Protection Technologies Corporation,
Armor Security, Inc.,
International Monitoring, Inc.,
Guardsource Corp. and
Virtual Guard Source, Inc.

and, subject to any prior security interest, 100% of the shares of stock of Paragon Systems, Inc.

EXHIBIT 10.81

PLEDGE AGREEMENT

THIS PLEDGE AGREEMENT (this "Agreement"), dated as of March 23, 2007, is entered into between **Tri-S Security Corporation,** and its affiliates The Cornwall Group, Inc., Vanguard Security, Inc., Forestville Corporation, Vanguard Security of Broward County, Inc., On Guard Security and Investigations, Inc., Protection Technologies Corporation, International Monitoring, Inc., Armor Security, Inc., Guardsource Corp. and Virtual Guard Source, Inc. (collectively "Pledgor") and **LSQ Funding Group, L.C.** and **BRE LLC** (individually and collectively "Secured Party"), with reference to the following:

WHEREAS, Pledgor and Secured Party are parties to that certain Credit Agreement (as amended, restated, or otherwise modified from time to time, the "Credit Agreement"), of even date herewith, pursuant to which Secured Party has agreed to make certain financial accommodations to Pledgor;

WHEREAS, Pledgor beneficially owns or controls the Equity Interests (as hereinafter defined) in the Issuers (as hereinafter defined);

WHEREAS, to induce Secured Party to make the financial accommodations provided to Pledgor pursuant to the Credit Agreement, Pledgor desires to pledge, grant, transfer, and assign to Secured Party a security interest in the Collateral (as hereinafter defined) to secure the Secured Obligations (as hereinafter defined), as provided herein.

NOW, THEREFORE, in consideration of the mutual promises, covenants, representations, and warranties set forth herein and for other good and valuable consideration, the parties hereto agree as follows:

1.**Definitions and Construction**.

1.1 **Definitions**. All initially capitalized terms used herein and not otherwise defined herein shall have the meaning ascribed thereto in the Credit Agreement. As used in this Agreement:

1.1.1 "**Bankruptcy Code**" means United States Bankruptcy Code (11 U.S.C. Section 101 et seq.), as in effect from time to time, and any successor statute thereto.

1.1.2 "**Business Day**" means any day that is not a Saturday, Sunday, or other day on which national banks are authorized or required to close.

1.1.3 "**Code**" means the Uniform Commercial Code as in effect in the State of from time to time.

1.1.4 "**Credit Agreement**" shall have the meaning ascribed thereto in the recitals to this Agreement.

1.1.5 "**Credit Documents**" shall mean the Credit Agreement and all other agreements, instruments, or other documents entered into or executed in connection therewith, in each case, as amended, restated, or otherwise modified from time to time.

1.1.6 "**Collateral**" shall mean the Pledged Interests, the Future Rights, and the Proceeds, collectively.

1.1.7 "**Equity Interests**" means the securities, shares, units, options, warrants, interests, participations, or other equivalents (regardless of how designated) of or in a corporation, partnership, limited liability company, or similar entity, whether voting or nonvoting, certificated or uncertificated, including general partner partnership interests, limited partner partnership interests, common stock, preferred stock, or any other "equity security" (as such term is defined in Rule 3a11-1 of the General Rules and Regulations promulgated by the Securities and Exchange Commission under the Securities Exchange Act of 1934).

1.1.8 "**Event of Default**" shall have the meaning ascribed thereto in the Credit Agreement.

1.1.9 "**Future Rights**" shall mean: (a) all Equity Interests (other than Pledged Interests) of the Issuers, and all securities convertible or exchangeable into, and all warrants, options, or other rights to purchase, Equity Interests of the Issuers; and (b) the certificates or instruments representing such Equity Interests, convertible or exchangeable securities, warrants, and other rights and all dividends, cash, options, warrants, rights, instruments, and other property or proceeds from time to time received, receivable, or otherwise distributed in respect of or in exchange for any or all of such Equity Interests.

1.1.10 "**Holder**" and "**Holders**" shall have the meanings ascribed thereto in this Agreement.

1.1.11 "**Issuers**" shall mean each of the Persons identified as an Issuer on Schedule 1 attached hereto (or any addendum thereto), and any successors thereto, whether by merger or otherwise.

1.1.12 "**Lien**" shall mean any lien, mortgage, pledge, assignment (including any assignment of rights to receive payments of money), security interest, charge, or encumbrance of any kind (including any conditional sale or other title retention agreement, any lease in the nature thereof, or any agreement to give any security interest).

1.1.13 "**Pledged Interests**" shall mean (a) all Equity Interests of the Issuers identified on Schedule 1; and (b) the certificates or instruments representing such Equity Interests.

1.1.14 "**Pledgor**" shall have the meaning ascribed thereto in the preamble to this Agreement.

1.1.15 "**Proceeds**" shall mean all proceeds (including proceeds of proceeds) of the Pledged Interests and Future Rights including all: (a) rights, benefits, distributions, premiums, profits, dividends, interest, cash, instruments, documents of title, accounts, contract

rights, inventory, equipment, general intangibles, payment intangibles, deposit accounts, chattel paper, and other property from time to time received, receivable, or otherwise distributed in respect of or in exchange for, or as a replacement of or a substitution for, any of the Pledged Interests, Future Rights, or proceeds thereof (including any cash, Equity Interests, or other securities or instruments issued after any recapitalization, readjustment, reclassification, merger or consolidation with respect to the Issuers and any security entitlements, as defined in Section 8-102(a)(17) of the Code, with respect thereto); (b) "proceeds," as such term is defined in Section 9-102(a)(64) of the Code; (c) proceeds of any insurance, indemnity, warranty, or guaranty (including guaranties of delivery) payable from time to time with respect to any of the Pledged Interests, Future Rights, or proceeds thereof; (d) payments (in any form whatsoever) made or due and payable to Pledgor from time to time in connection with any requisition, confiscation, condemnation, seizure or forfeiture of all or any part of the Pledged Interests, Future Rights, or proceeds thereof; and (e) other amounts from time to time paid or payable under or in connection with any of the Pledged Interests, Future Rights, or proceeds thereof.

1.1.16 "**Registered Organization**" shall have the meaning ascribed thereto in Section 9-102(a)(70) of the Code.

1.1.17 "**Secured Obligations**" shall mean all liabilities, obligations, or undertakings owing by Pledgor to Secured Party of any kind or description arising out of or outstanding under, advanced or issued pursuant to, or evidenced by the Credit Agreement, this Agreement, or the other Credit Documents, irrespective of whether for the payment of money, whether direct or indirect, absolute or contingent, due or to become due, voluntary or involuntary, whether now existing or hereafter arising, and including all interest (including interest that accrues after the filing of a case under the Bankruptcy Code) and any and all costs, fees (including attorneys fees), and expenses which Pledgor is required to pay pursuant to any of the foregoing, by law, or otherwise.

1.1.18 "**Secured Party**" shall have the meaning ascribed thereto in the preamble to this Agreement, together with its successors or assigns.

1.1.19 "**Securities Act**" shall have the meaning ascribed thereto in Section 9.3 of this Agreement.

1.2 **Construction**.

1.2.1 Unless the context of this Agreement clearly requires otherwise, references to the plural include the singular and to the singular include the plural, the part includes the whole, the term "including" is not limiting, and the term "or" has, except where otherwise indicated, the inclusive meaning represented by the phrase "and/or." The words "hereof," "herein," "hereby," "hereunder," and other similar terms in this Agreement refer to this Agreement as a whole and not exclusively to any particular provision of this Agreement. Article, section, subsection, exhibit, and schedule references are to this Agreement unless otherwise specified. All of the exhibits or schedules attached to this Agreement shall be deemed incorporated herein by reference. Any reference to any of the following documents includes any and all alterations, amendments, restatements, extensions, modifications, renewals, or supplements thereto or thereof, as applicable: this Agreement, the Credit Agreement, or any of the other Credit Documents.

1.2.2 Neither this Agreement nor any uncertainty or ambiguity herein shall be construed or resolved against Secured Party or Pledgor, whether under any rule of construction or otherwise. On the contrary, this Agreement has been reviewed by both of the parties and their respective counsel and shall be construed and interpreted according to the ordinary meaning of the words used so as to fairly accomplish the purposes and intentions of the parties hereto.

1.2.3 In the event of any direct conflict between the express terms and provisions of this Agreement and of the Credit Agreement, the terms and provisions of the Credit Agreement shall control.

2.**Pledge**. As security for the prompt payment and performance of the Secured Obligations in full by Pledgor when due, whether at stated maturity, by acceleration or otherwise (including amounts that would become due but for the operation of the provisions of the Bankruptcy Code), Pledgor hereby pledges, grants, transfers, and assigns to Secured Party a security interest in all of Pledgor's right, title, and interest in and to the Collateral. This Agreement and the security interest granted hereby shall terminate upon full and timely compliance with section 3.3(d) of the Credit Agreement.

3.**Delivery and Registration of Collateral**.

3.1 With the exception of 40% of the shares of stock of Paragon, upon execution of this Agreement, all certificates or instruments representing or evidencing the Collateral shall be delivered by Pledgor to Secured Party or Secured Party's designee pursuant hereto and shall be held by or on behalf of Secured Party pursuant hereto, and shall be in suitable form for transfer by delivery, or shall be accompanied by duly executed indorsement certificate in the form attached hereto as Exhibit A or other instrument of transfer or assignment in blank, in form and substance satisfactory to Secured Party.

3.2 Upon the occurrence and during the continuance of an Event of Default, Secured Party shall have the right, at any time in its discretion and without notice to Pledgor, to transfer to or to register on the books of the Issuers (or of any other Person maintaining records with respect to the Collateral) in the name of Secured Party or any of its nominees any or all of the Collateral. In addition, Secured Party shall have the right at any time to exchange certificates or instruments representing or evidencing Collateral for certificates or instruments of smaller or larger denominations.

3.3 If, at any time and from time to time, any Collateral (including any certificate or instrument representing or evidencing any Collateral) is in the possession of a Person other than Secured Party or Pledgor (a "Holder"), then Pledgor shall immediately, at Secured Party's option, either cause such Collateral to be delivered into Secured Party's possession, or cause such Holder to enter into a control agreement, in form and substance satisfactory to Secured Party, and take all other steps deemed necessary by Secured Party to perfect the security interest of Secured Party in such Collateral, all pursuant to Sections 9-106 and 9-313 of the Code or other applicable law governing the perfection of Secured Party's security interest in the Collateral in the possession of such Holder.

3.4 Any and all Collateral (including dividends, interest, and other cash distributions) at any time received or held by Pledgor shall be so received or held in trust for Secured Party, shall be segregated from other funds and property of Pledgor and shall be forthwith delivered to Secured Party in the same form as so received or held, with any necessary indorsements; provided that cash dividends or distributions received by Pledgor, may be retained by Pledgor **Error! Reference source not found.** and used in the ordinary course of Pledgor's business.

3.5 If at any time, and from time to time, any Collateral consists of an uncertificated security or a security in book entry form, then Pledgor shall immediately cause such Collateral to be registered or entered, as the case may be, in the name of Secured Party, or otherwise cause Secured Party's security interest thereon to be perfected in accordance with applicable law.

4.**Voting Rights and Dividends**.

4.1 So long as no Event of Default shall have occurred and be continuing, Pledgor shall be entitled to exercise any and all voting and other consensual rights pertaining to the Collateral or any part thereof for any purpose not inconsistent with the terms of the Credit Documents and shall be entitled to receive and retain any cash dividends or distributions paid or distributed in respect of the Collateral.

4.2 Upon the occurrence and during the continuance of an Event of Default, all rights of Pledgor to exercise the voting and other consensual rights or receive and retain cash dividends or distributions that it would otherwise be entitled to exercise or receive and retain, shall cease, and all such rights shall thereupon become vested in Secured Party, who shall thereupon have the sole right to exercise such voting or other consensual rights and to receive and retain such cash dividends and distributions. Pledgor shall execute and deliver (or cause to be executed and delivered) to Secured Party all such proxies and other instruments as Secured Party may reasonably request for the purpose of enabling Secured Party to exercise the voting and other rights which it is entitled to exercise and to receive the dividends and distributions that it is entitled to receive and retain pursuant to the preceding sentence.

5.**Representations and Warranties**. Pledgor represents, warrants, and covenants as follows:

5.1 Pledgor has taken all steps it deems necessary or appropriate to be informed on a continuing basis of changes or potential changes affecting the Collateral (including rights of conversion and exchange, rights to subscribe, payment of dividends, reorganizations or recapitalization, tender offers and voting and registration rights), and Pledgor agrees that Secured Party shall have no responsibility or liability for informing Pledgor of any such changes or potential changes or for taking any action or omitting to take any action with respect thereto.

5.2 Pledgor is a Registered Organization, organized under the laws of its state of incorporation.

5.3 All information herein or hereafter supplied to Secured Party by or on behalf of Pledgor in writing with respect to the Collateral is, or in the case of information hereafter supplied will be, accurate and complete in all material respects.

5.4 Pledgor is and will be the sole legal and beneficial owner of the Collateral (including the Pledged Interests and all other Collateral acquired by Pledgor after the date hereof) free and clear of any adverse claim, Lien, or other right, title, or interest of any party, other than the Liens in favor of Secured Party.

5.5 Other than 40% of the share of stock of Paragon, this Agreement, and the delivery to Secured Party of the Pledged Interests representing Collateral (or the control agreements referred to in this Agreement), creates a valid, perfected, and first priority security interest in one hundred percent (100%) of the Pledged Interests in favor of Secured Party securing payment of the Secured Obligations, and all actions necessary to achieve such perfection have been duly taken.

5.6 Schedule 1 to this Agreement is true and correct and complete in all material respects. Without limiting the generality of the foregoing: (i) except as set forth on Schedule 1, all the Pledged Interests are in certificated form, and, except to the extent registered in the name of Secured Party or its nominee pursuant to the provisions of this Agreement, are registered in the name of Pledgor; and (ii) the Pledged Interests as to each of the Issuers constitute at least the percentage of all the fully diluted issued and outstanding Equity Interests of such Issuer as set forth in Schedule 1 to this Agreement.

5.7 There are no presently existing Future Rights or Proceeds owned by Pledgor.

5.8 The Pledged Interests have been duly authorized and validly issued and are fully paid and nonassessable.

5.9 Neither the pledge of the Collateral pursuant to this Agreement nor the extensions of credit represented by the Secured Obligations violates Regulation T, U or X of the Board of Governors of the Federal Reserve System.

6.**Further Assurances**.

6.1 Pledgor agrees that from time to time, at the expense of Pledgor, Pledgor will promptly execute and deliver all further instruments and documents, and take all further action that may be necessary or reasonably desirable, or that Secured Party may request, in order to perfect and protect any security interest granted or purported to be granted hereby or to enable Secured Party to exercise and enforce its rights and remedies hereunder with respect to any Collateral. Without limiting the generality of the foregoing, Pledgor will: (i) at the request of Secured Party, mark conspicuously each of its records pertaining to the Collateral with a legend, in form and substance reasonably satisfactory to Secured Party, indicating that such Collateral is subject to the security interest granted hereby; (ii) execute and such instruments or notices, as may be necessary or reasonably desirable, or as Secured Party may request, in order to perfect and preserve the first priority security interests granted or purported to be granted hereby; (iii) allow inspection of the Collateral by Secured Party or Persons designated by Secured Party; and (iv) appear in and defend any action or proceeding that may affect Pledgor's title to or Secured Party's security interest in the Collateral.

6.2 Pledgor hereby authorizes Secured Party to file one or more financing or continuation statements, and amendments thereto, relative to all or any part of the Collateral. A carbon, photographic, or other reproduction of this Agreement or any financing statement covering the Collateral or any part thereof shall be sufficient as a financing statement where permitted by law.

6.3 Pledgor will furnish to Secured Party, upon the request of Secured Party: (i) a certificate executed by an authorized officer of Pledgor, and dated as of the date of delivery to Secured Party, itemizing in such detail as Secured Party may request, the Collateral which, as of the date of such certificate, has been delivered to Secured Party by Pledgor pursuant to the provisions of this Agreement; and (ii) such statements and schedules further identifying and describing the Collateral and such other reports in connection with the Collateral as Secured Party may request.

7.**Covenants of Pledgor**. Pledgor shall:

7.1 Perform each and every covenant in the Credit Documents applicable to Pledgor;

7.2 Neither change its jurisdiction of organization nor cease to be a Registered Organization, in each case, without giving Secured Party at least thirty (30) days prior written notice thereof;

7.3 To the extent it may lawfully do so, use its best efforts to prevent the Issuers from issuing Future Rights or Proceeds, except for cash dividends and other distributions to be paid by any Issuer to Pledgor; and

7.4 Upon receipt by Pledgor of any material notice, report, or other communication from any of the Issuers or any Holder relating to all or any part of the Collateral, deliver such notice, report or other communication to Secured Party as soon as possible, but in no event later than five (5) days following the receipt thereof by Pledgor.

8.**Secured Party as Pledgor's Attorney-in-Fact**.

8.1 Pledgor hereby irrevocably appoints Secured Party as Pledgor's attorney-in-fact, with full authority in the place and stead of Pledgor and in the name of Pledgor, Secured Party or otherwise, from time to time at Secured Party's discretion, to take any action and to execute any instrument that Secured Party may reasonably deem necessary or advisable to accomplish the purposes of this Agreement, including: (i) upon the occurrence and during the continuance of an Event of Default, to receive, indorse, and collect all instruments made payable to Pledgor representing any dividend, interest payment or other distribution in respect of the Collateral or any part thereof to the extent permitted hereunder and to give full discharge for the same and to execute and file governmental notifications and reporting forms; (ii) to enter into any control agreements Secured Party deems necessary pursuant to this Agreement; or (iii) to arrange for the transfer of the Collateral on the books of any of the Issuers or any other Person to the name of Secured Party or to the name of Secured Party's nominee.

8.2 In addition to the designation of Secured Party as Pledgor's attorney-in-fact, Pledgor hereby irrevocably appoints Secured Party as Pledgor's agent and attorney-in-fact to make, execute and deliver any and all documents and writings which may be necessary or appropriate for approval of, or be required by, any regulatory authority located in any city, county, state or country where Pledgor or any of the Issuers engage in business, in order to transfer or to more effectively transfer any of the Pledged Interests or otherwise enforce Secured Party's rights hereunder.

9.**Remedies upon Default**. Upon the occurrence and during the continuance of an Event of Default:

9.1 Secured Party may exercise in respect of the Collateral, in addition to other rights and remedies provided for herein or otherwise available to it, all the rights and remedies of a secured party on default under the Code (irrespective of whether the Code applies to the affected items of Collateral), and Secured Party may also without notice (except as specified below) sell the Collateral or any part thereof in one or more parcels at public or private sale, at any exchange, broker's board or at any of Secured Party's offices or elsewhere, for cash, on credit or for future delivery, at such time or times and at such price or prices and upon such other terms as Secured Party may deem commercially reasonable, irrespective of the impact of any such sales on the market price of the Collateral. To the maximum extent permitted by applicable law, Secured Party may be the purchaser of any or all of the Collateral at any such sale and shall be entitled, for the purpose of bidding and making settlement or payment of the purchase price for all or any portion of the Collateral sold at any such public sale, to use and apply all or any part of the Secured Obligations as a credit on account of the purchase price of any Collateral payable at such sale. Each purchaser at any such sale shall hold the property sold absolutely free from any claim or right on the part of Pledgor, and Pledgor hereby waives (to the extent permitted by law) all rights of redemption, stay, or appraisal that it now has or may at any time in the future have under any rule of law or statute now existing or hereafter enacted. Pledgor agrees that, to the extent notice of sale shall be required by law, at least ten (10) calendar days notice to Pledgor of the time and place of any public sale or the time after which a private sale is to be made shall constitute reasonable notification. Secured Party shall not be obligated to make any sale of Collateral regardless of notice of sale having been given. Secured Party may adjourn any public or private sale from time to time by announcement at the time and place fixed therefor, and such sale may, without further notice, be made at the time and place to which it was so adjourned. To the maximum extent permitted by law, Pledgor hereby waives any claims against Secured Party arising because the price at which any Collateral may have been sold at such a private sale was less than the price that might have been obtained at a public sale, even if Secured Party accepts the first offer received and does not offer such Collateral to more than one offeree.

9.2 Pledgor hereby agrees that any sale or other disposition of the Collateral conducted in conformity with reasonable commercial practices of banks, insurance companies, or other financial institutions in the city and state where Secured Party is located in disposing of property similar to the Collateral shall be deemed to be commercially reasonable.

9.3 Pledgor hereby acknowledges that the sale by Secured Party of any Collateral pursuant to the terms hereof in compliance with the Securities Act of 1933 as now in effect or as hereafter amended, or any similar statute hereafter adopted with similar purpose or effect (the

"Securities Act"), as well as applicable "Blue Sky" or other state securities laws, may require strict limitations as to the manner in which Secured Party or any subsequent transferee of the Collateral may dispose thereof. Pledgor acknowledges and agrees that in order to protect Secured Party's interest it may be necessary to sell the Collateral at a price less than the maximum price attainable if a sale were delayed or were made in another manner, such as a public offering under the Securities Act. Pledgor has no objection to sale in such a manner and agrees that Secured Party shall have no obligation to obtain the maximum possible price for the Collateral. Without limiting the generality of the foregoing, Pledgor agrees that, upon the occurrence and during the continuation of an Event of Default, Secured Party may, subject to applicable law, from time to time attempt to sell all or any part of the Collateral by a private placement, restricting the bidders and prospective purchasers to those who will represent and agree that they are purchasing for investment only and not for distribution. In so doing, Secured Party may solicit offers to buy the Collateral or any part thereof for cash, from a limited number of investors reasonably believed by Secured Party to be institutional investors or other accredited investors who might be interested in purchasing the Collateral. If Secured Party shall solicit such offers, then the acceptance by Secured Party of one of the offers shall be deemed to be a commercially reasonable method of disposition of the Collateral.

9.4 If Secured Party shall determine to exercise its right to sell all or any portion of the Collateral pursuant to this Section, Pledgor agrees that, upon request of Secured Party, Pledgor will, at its own expense:

9.4.1 use its best efforts to execute and deliver, and cause the Issuers and the directors and officers thereof to execute and deliver, all such instruments and documents, and to do or cause to be done all such other acts and things, as may be necessary or, in the opinion of Secured Party, advisable to register such Collateral under the provisions of the Securities Act, and to cause the registration statement relating thereto to become effective and to remain effective for such period as prospectuses are required by law to be furnished, and to make all amendments and supplements thereto and to the related prospectuses which, in the opinion of Secured Party, are necessary or advisable, all in conformity with the requirements of the Securities Act and the rules and regulations of the Securities and Exchange Commission applicable thereto;

9.4.2 use its best efforts to qualify the Collateral under the state securities laws or "Blue Sky" laws and to obtain all necessary governmental approvals for the sale of the Collateral, as requested by Secured Party;

9.4.3 cause the Issuers to make available to their respective security holders, as soon as practicable, an earnings statement which will satisfy the provisions of the Securities Act;

9.4.4 execute and deliver, or cause the officers and directors of the Issuers to execute and deliver, to any person, entity or governmental authority as Secured Party may choose, any and all documents and writings which, in Secured Party's reasonable judgment, may be necessary or appropriate for approval, or be required by, any regulatory authority located in any city, county, state or country where Pledgor or the Issuers engage in business, in order to transfer or to more effectively transfer the Pledged Interests or otherwise enforce Secured Party's rights hereunder; and

9.4.5 do or cause to be done all such other acts and things as may be necessary to make such sale of the Collateral or any part thereof valid and binding and in compliance with applicable law.

Pledgor acknowledges that there is no adequate remedy at law for failure by it to comply with the provisions of this Section and that such failure would not be adequately compensable in damages, and therefore agrees that its agreements contained in this Section may be specifically enforced.

9.5 PLEDGOR EXPRESSLY WAIVES TO THE MAXIMUM EXTENT PERMITTED BY LAW: (i) ANY CONSTITUTIONAL OR OTHER RIGHT TO A JUDICIAL HEARING PRIOR TO THE TIME SECURED PARTY DISPOSES OF ALL OR ANY PART OF THE COLLATERAL AS PROVIDED IN THIS SECTION; (ii) ALL RIGHTS OF REDEMPTION, STAY, OR APPRAISAL THAT IT NOW HAS OR MAY AT ANY TIME IN THE FUTURE HAVE UNDER ANY RULE OF LAW OR STATUTE NOW EXISTING OR HEREAFTER ENACTED; AND (iii) ANY REQUIREMENT OF NOTICE, DEMAND, OR ADVERTISEMENT FOR SALE.

10.**Application of Proceeds**. Upon the occurrence and during the continuance of an Event of Default, any cash held by Secured Party as Collateral and all cash Proceeds received by Secured Party in respect of any sale of, collection from, or other realization upon all or any part of the Collateral pursuant to the exercise by Secured Party of its remedies as a secured creditor shall be applied from time to time by Secured Party as provided in the Credit Agreement.

11.**Indemnity and Expenses**. Pledgor agrees:

11.1 To indemnify and hold harmless Secured Party and each of its directors, officers, employees, agents and affiliates from and against any and all claims, damages, demands, losses, obligations, judgments and liabilities (including, without limitation, reasonable attorneys' fees and expenses) in any way arising out of or in connection with this Agreement or the Secured Obligations, except to the extent the same shall arise as a result of the gross negligence or willful misconduct of the party seeking to be indemnified; and

11.2 To pay and reimburse Secured Party upon demand for all reasonable costs and expenses (including, without limitation, reasonable attorneys' fees and expenses) that Secured Party may incur in connection with (i) the custody, use or preservation of, or the sale of, collection from or other realization upon, any of the Collateral, including the reasonable expenses of re-taking, holding, preparing for sale or lease, selling or otherwise disposing of or realizing on the Collateral, (ii) the exercise or enforcement of any rights or remedies granted hereunder, under the Credit Agreement, or under any of the other Credit Documents or otherwise available to it (whether at law, in equity or otherwise), or (iii) the failure by Pledgor to perform or observe any of the provisions hereof. The provisions of this Section shall survive the execution and delivery of this Agreement, the repayment of any of the Secured Obligations, the termination of the commitments of Secured Party under the Credit Agreement and the termination of this Agreement or any other Credit Document.

12.**Duties of Secured Party**. The powers conferred on Secured Party hereunder are solely to protect its interests in the Collateral and shall not impose on it any duty to exercise such powers. Except as provided in Section 9-207 of the Code, Secured Party shall have no duty with respect to the Collateral or any responsibility for taking any necessary steps to preserve rights against any Persons with respect to any Collateral.

13.**Choice of Law and Venue; Submission to Jurisdiction; Service of Process**.

13.1 THE VALIDITY OF THIS AGREEMENT, ITS CONSTRUCTION, INTERPRETATION, AND ENFORCEMENT, AND THE RIGHTS OF THE PARTIES HERETO SHALL BE DETERMINED UNDER, GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH THE LAWS OF THE STATE OF FLORIDA (WITHOUT REFERENCE TO THE CHOICE OF LAW PRINCIPLES THEREOF). THE PARTIES AGREE THAT ALL ACTIONS OR PROCEEDINGS ARISING IN CONNECTION WITH THIS AGREEMENT SHALL BE TRIED AND LITIGATED ONLY IN THE STATE AND FEDERAL COURTS LOCATED IN THE UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF FLORIDA OR ANY COURT OF THE STATE OF FLORIDA LOCATED IN ORANGE COUNTY OR, AT THE SOLE OPTION OF SECURED PARTY, IN ANY OTHER COURT IN WHICH SECURED PARTY SHALL INITIATE LEGAL OR EQUITABLE PROCEEDINGS AND WHICH HAS SUBJECT MATTER JURISDICTION OVER THE MATTER IN CONTROVERSY.

13.2 PLEDGOR HEREBY SUBMITS FOR ITSELF AND IN RESPECT OF ITS PROPERTY, GENERALLY AND UNCONDITIONALLY, TO THE JURISDICTION OF THE AFORESAID COURTS AND WAIVES, TO THE EXTENT PERMITTED UNDER APPLICABLE LAW, ANY RIGHT IT MAY HAVE TO ASSERT THE DOCTRINE OF FORUM NON CONVENIENS OR TO OBJECT TO VENUE TO THE EXTENT ANY PROCEEDING IS BROUGHT IN ACCORDANCE WITH THIS SECTION.

13.3 PLEDGOR HEREBY WAIVES PERSONAL SERVICE OF THE SUMMONS, COMPLAINT, OR OTHER PROCESS ISSUED IN ANY ACTION OR PROCEEDING AND AGREES THAT SERVICE OF SUCH SUMMONS, COMPLAINT, OR OTHER PROCESS MAY BE MADE BY REGISTERED OR CERTIFIED MAIL ADDRESSED TO PLEDGOR AT ITS ADDRESS FOR NOTICES IN ACCORDANCE WITH THIS AGREEMENT AND THAT SERVICE SO MADE SHALL BE DEEMED COMPLETED UPON THE EARLIER OF PLEDGOR'S ACTUAL RECEIPT THEREOF OR THREE DAYS AFTER DEPOSIT IN THE UNITED STATES MAILS, PROPER POSTAGE PREPAID.

13.4 NOTHING IN THIS AGREEMENT SHALL BE DEEMED OR OPERATE TO AFFECT THE RIGHT OF SECURED PARTY TO SERVE LEGAL PROCESS IN ANY OTHER MANNER PERMITTED BY LAW, OR TO PRECLUDE THE ENFORCEMENT BY SECURED PARTY OF ANY JUDGMENT OR ORDER OBTAINED IN SUCH FORUM OR THE TAKING OF ANY ACTION UNDER THIS AGREEMENT TO ENFORCE SAME IN ANY OTHER APPROPRIATE FORUM OR JURISDICTION.

14.**Amendments; etc**. No amendment or waiver of any provision of this Agreement nor consent to any departure by Pledgor herefrom shall in any event be effective unless the same shall be in writing and signed by Secured Party, and then such waiver or consent shall be effective only in the specific instance and for the specific purpose for which given. No failure on the part of Secured Party to exercise, and no delay in exercising any right under this Agreement, any other Credit Document, or otherwise with respect to any of the Secured Obligations, shall operate as a waiver thereof; nor shall any single or partial exercise of any right under this Agreement, any other Credit Document, or otherwise with respect to any of the Secured Obligations preclude any other or further exercise thereof or the exercise of any other right. The remedies provided for in this Agreement or otherwise with respect to any of the Secured Obligations are cumulative and not exclusive of any remedies provided by law.

15.**Notices**. Unless otherwise specifically provided herein, all notices shall be in writing addressed to the respective party as set forth below: and may be personally served, faxed, telecopied or sent by overnight courier service or United States mail:

If to Pledgor as provided in the Credit Agreement:

If to Secured Party as provided in the Credit Agreement.

Any notice given pursuant to this section shall be deemed to have been given: (a) if delivered in person, when delivered; (b) if delivered by fax, on the date of transmission if transmitted on a Business Day before 4:00 p.m. at the place of receipt or, if not, on the next succeeding Business Day; (c) if delivered by overnight courier, two (2) days after delivery to such courier properly addressed; or (d) if by United States mail, four (4) Business Days after depositing in the United States mail, with postage prepaid and properly addressed. Any party hereto may change the address or fax number at which it is to receive notices hereunder by notice to the other party in writing in the foregoing manner.

16.**Continuing Security Interest**. This Agreement shall create a continuing security interest in the Collateral and shall: (a) remain in full force and effect until the indefeasible payment in full of the Secured Obligations, including the cash collateralization, expiration, or cancellation of all Secured Obligations, if any, consisting of letters of credit, and the full and final termination of any commitment to extend any financial accommodations under the Credit Agreement; (b) be binding upon Pledgor and its successors and assigns; and (c) inure to the benefit of Secured Party and its successors, transferees, and assigns. Upon the indefeasible payment in full of the Secured Obligations, including the cash collateralization, expiration, or cancellation of all Secured Obligations, if any, consisting of letters of credit, and the full and final termination of any commitment to extend any financial accommodations under the Credit Agreement, the security interests granted herein shall automatically terminate and all rights to the Collateral shall revert to Pledgor. Upon any such termination, Secured Party will, at Pledgor's expense, execute and deliver to Pledgor such documents as Pledgor shall reasonably request to evidence such termination. Such documents shall be prepared by Pledgor and shall be in form and substance reasonably satisfactory to Secured Party.

17.**Security Interest Absolute**. To the maximum extent permitted by law, all rights of Secured Party, all security interests hereunder, and all obligations of Pledgor hereunder, shall be absolute and unconditional irrespective of:

17.1 any lack of validity or enforceability of any of the Secured Obligations or any other agreement or instrument relating thereto, including any of the Credit Documents;

17.2 any change in the time, manner, or place of payment of, or in any other term of, all or any of the Secured Obligations, or any other amendment or waiver of or any consent to any departure from any of the Credit Documents, or any other agreement or instrument relating thereto;

17.3 any exchange, release, or non-perfection of any other collateral, or any release or amendment or waiver of or consent to departure from any guaranty for all or any of the Secured Obligations; or

17.4 any other circumstances that might otherwise constitute a defense available to, or a discharge of, Pledgor.

18.**Headings**. Section and subsection headings in this Agreement are included herein for convenience of reference only and shall not constitute a part of this Agreement or be given any substantive effect.

19.**Severability**. In case any provision in or obligation under this Agreement shall be invalid, illegal or unenforceable in any jurisdiction, the validity, legality and enforceability of the remaining provisions or obligations, or of such provision or obligation in any other jurisdiction, shall not in any way be affected or impaired thereby.

20.**Counterparts; Telefacsimile Execution**. This Agreement may be executed in one or more counterparts, each of which shall be deemed an original and all of which together shall constitute one and the same Agreement. Delivery of an executed counterpart of this Agreement by telefacsimile shall be equally as effective as delivery of an original executed counterpart of this Agreement. Any party delivering an executed counterpart of this Agreement by telefacsimile also shall deliver an original executed counterpart of this Agreement but the failure to deliver an original executed counterpart shall not affect the validity, enforceability, or binding effect hereof.

21.**Waiver of Marshaling**. Each of Pledgor and Secured Party acknowledges and agrees that in exercising any rights under or with respect to the Collateral: (a) Secured Party is under no obligation to marshal any Collateral; (b) may, in its absolute discretion, realize upon the Collateral in any order and in any manner it so elects; and (c) may, in its absolute discretion, apply the proceeds of any or all of the Collateral to the Secured Obligations in any order and in any manner it so elects. Pledgor and Secured Party waive any right to require the marshaling of any of the Collateral.

22. **Waiver of Jury Trial. PLEDGOR AND SECURED PARTY HEREBY WAIVE THEIR RESPECTIVE RIGHTS TO A JURY TRIAL OF ANY CLAIM OR CAUSE OF ACTION BASED UPON OR ARISING OUT OF THIS AGREEMENT OR ANY OF THE TRANSACTIONS CONTEMPLATED HEREIN, INCLUDING CONTRACT CLAIMS, TORT CLAIMS, BREACH OF DUTY CLAIMS, AND ALL OTHER COMMON LAW OR STATUTORY CLAIMS. PLEDGOR AND SECURED PARTY REPRESENT THAT EACH HAS REVIEWED THIS WAIVER AND EACH KNOWINGLY AND VOLUNTARILY WAIVES ITS JURY TRIAL RIGHTS FOLLOWING CONSULTATION WITH LEGAL COUNSEL. IN THE EVENT OF LITIGATION, A COPY OF THIS AGREEMENT MAY BE FILED AS A WRITTEN CONSENT TO A TRIAL BY THE COURT.**

[Signature page to follow.]

IN WITNESS WHEREOF, Pledgor and Secured Party have caused this Agreement to be duly executed and delivered by their officers thereunto duly authorized as of the date first written above.

TRI-S SECURITY CORPORATION

By: /s/ Robert K. Mills
Name: Robert K. Mills
Title: Chief Financial Officer

PARAGON SYSTEMS, INC.

By: /s/ Robert K. Mills
Name: Robert K. Mills
Title: Secretary

THE CORNWALL GROUP, INC.

By: /s/ Robert K. Mills
Name: Robert K. Mills
Title: Secretary

VANGUARD SECURITY, INC.

By: /s/ Robert K. Mills
Name: Robert K. Mills
Title: Secretary

FORESTVILLE CORPORATION

By: /s/ Robert K. Mills
Name: Robert K. Mills
Title: Secretary

VANGUARD SECURITY OF BROWARD COUNTY, INC.

By: /s/ Robert K. Mills
Name: Robert K. Mills
Title: Secretary

ON GUARD SECURITY AND INVESTIGATIONS, INC.

By: /s/ Robert K. Mills
Name: Robert K. Mills
Title: Secretary

ARMOR SECURITY, INC.

By: /s/ Robert K. Mills
Name: Robert K. Mills
Title: Secretary

PROTECTION TECHNOLOGIES CORPORATION

By: /s/ Robert K. Mills
Name: Robert K. Mills
Title: Secretary

INTERNATIONAL MONITORING, INC.

By: /s/ Robert K. Mills
Name: Robert K. Mills
Title: Secretary

GUARDSOURCE CORP.

By: /s/ Robert K. Mills
Name: Robert K. Mills
Title: Secretary

VIRTUAL GUARD SOURCE CORP.

By: /s/ Robert K. Mills
Name: Robert K. Mills
Title: Secretary

LSQ Funding Group, L.C.

By: /s/ Maxwell Eliscu
Name: Maxwell Eliscu
Title: Manager

BRE LLC

By: /s/ Maxwell Eliscu
Name: Maxwell Eliscu
Title: Manager

Exhibit 21.1

Subsidiary	Jurisdiction
Paragon Systems, Inc.	Alabama
The Cornwall Group, Inc.	Florida
Vanguard Security, Inc.	Florida
Forestville Corporation	Florida
Vanguard Security of Broward County, Inc.	Florida
On Guard Security and Investigations, Inc.	Florida
Armor Security, Inc.	Florida
Protection Technologies Corporation	Florida
International Monitoring, Inc.	Florida
Guardsource Corp.	Florida
Virtual Guard Source, Inc.	California

Exhibit 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference into the Registration Statements on Form S-8 (No. 333-129097) and on Form S-3 (No. 333-131468) of our report dated March 27, 2007, with respect to the consolidated financial statements of Tri-S Security Corporation which are included in the Company's Form 10-K for the year ended December 31, 2006.

/s/ Tauber & Balser, P.C.

Atlanta, Georgia
March 27, 2007

Exhibit 23.2

Consent of Independent Registered Public Accounting Firm

We consent to the incorporation by reference of our report dated March 15, 2005 with respect to the financial statements of Tri-S Security Corporation included in their Annual Report on form 10-K for the year ended December 31, 2006 as well as the incorporation by reference of such report in the Company's previously filed Registration Statements File Nos. 333-119737, 333-129097, and 333-131468.

/s/ Miller Ray Houser & Stewart LLP

Atlanta, Georgia
March 27, 2007

Exhibit 23.3

Consent of Independent Registered Public Accounting Firm

We consent to the incorporation by reference of our report dated March 15, 2005 with respect to the financial statements of Paragon Systems, Inc. included in their Annual Report on form 10-K for the year ended December 31, 2006 as well as the incorporation by reference of such report in the Company's previously filed Registration Statements File Nos. 333-119737, 333-129097, and 333-131468.

/s/ Miller Ray Houser & Stewart LLP

Atlanta, Georgia
March 27, 2007

Exhibit 31.1

Rule 13a-14(a)/15d-14(a) Certification

I, Ronald G. Farrell, certify that:

1. I have reviewed this Annual Report on Form 10-K for the year ended December 31, 2006 of Tri-S Security Corporation;

2. Based on my knowledge, this 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 report;

3. Based on my knowledge, the financial statements, and other financial information included in this 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 report;

4. The registrant's other certifying officer(s) 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 report is being prepared;

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

   (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) 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(s) 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 (or persons performing the equivalent functions):

   (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: March 28, 2007

/s/ Ronald G. Farrell
Ronald G. Farrell,
Chairman of the Board and Chief Executive Officer

Exhibit 31.2

Rule 13a-14(a)/15d-14(a) Certification

I, Robert K. Mills, certify that:

1. I have reviewed this Annual Report on Form 10-K for the year ended December 31, 2006 of Tri-S Security Corporation;

2. Based on my knowledge, this 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 report;

3. Based on my knowledge, the financial statements, and other financial information included in this 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 report;

4. The registrant's other certifying officer(s) 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 report is being prepared;

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

   (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) 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(s) 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 (or persons performing the equivalent functions):

   (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: March 28, 2007

/s/Robert K. Mills
Robert K. Mills,
Chief Financial Officer

Exhibit 32.1

SECTION 1350 CERTIFICATION

I, Ronald G. Farrell, Chairman of the Board and Chief Executive Officer of Tri-S Security Corporation (the "Company"), do hereby certify in accordance with 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

1. The Annual Report on Form 10-K of the Company for the period ended December 31, 2006 (the "Periodic Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (15 U.S.C. §§78m or 78o(d)), except that the Periodic Report does not contain the separate audited financial statements of Army Fleet Support, LLC for the years ended December 31, 2006, 2005 and 2004, as required by Form 10-K and Rule 3-09 of Regulation S-X; and

2. The information contained in the Periodic Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: March 28, 2007

/s/ Ronald G. Farrell
Ronald G. Farrell,
Chief Executive Officer

Exhibit 32.2

SECTION 1350 CERTIFICATION

I, Robert K. Mills, Chief Financial Officer of Tri-S Security Corporation (the "Company"), do hereby certify in accordance with 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

1. The Annual Report on Form 10-K of the Company for the period ended December 31, 2006 (the "Periodic Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (15 U.S.C. §§78m or 78o(d)), except that the Periodic Report does not contain the separate audited financial statements of Army Fleet Support, LLC for the years ended December 31, 2006, 2005 and 2004, as required by Form 10-K and Rule 3-09 of Regulation S-X; and

2. The information contained in the Periodic Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: March 28, 2007

/s/ Robert K. Mills
Robert K. Mills,
Chief Financial Officer