EXHIBIT I

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

FORM 10-Q

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

For the quarterly period ended September 30, 2010

☐ **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 0-28685

VERTICAL COMPUTER SYSTEMS, INC.
(Exact Name of Small Business Issuer as Specified in its Charter)

Delaware	**65-0393635**
(State of Incorporation)	(I.R.S. Employer Identification No)

101 West Renner Road, Suite 300
Richardson, TX 75082
(Address of Principal Executive Offices) (Zip Code)

(972) 437-5200
(Issuer's Telephone Number)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes ☐ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐		Accelerated filer ☐
Non-accelerated filer ☐	(Do not check if a smaller reporting company)	Smaller reporting company ☒

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

As of November 15, 2010, the issuer had 998,835,151 shares of common stock, par value $.00001, issued and outstanding.

In October 2009, the FASB issued amendments to the guidance on software revenue recognition altering the scope of revenue recognition guidance for software deliverables to exclude items sold that include hardware with software that is essential to the hardware's functionality. This authoritative guidance will be effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. The Company is still assessing the potential impact of adopting the new authoritative guidance.

No other new accounting pronouncement issued or effective has had, or is expected to have, a material impact on the Company's consolidated financial statements.

Note 2. Going Concern

The accompanying condensed consolidated financial statements for the nine months ended September 30, 2010 and 2009 have been prepared assuming that we will continue as a going concern, and accordingly realize our assets and satisfy our liabilities in the normal course of business.

While we have been profitable for the years ended December 31, 2009 and 2008, we suffered significant recurring operating losses prior to those periods. Since December 31, 2009, we have used substantial funds in further developing our product line and in conducting present and new operations, and we need to raise additional funds and/or generate additional revenue through our existing businesses to accomplish our objectives.

Negative stockholders' equity at September 30, 2010 was $21.2 million. Additionally, at September 30, 2010, we had negative working capital of approximately $11.7 million (although this figure includes deferred revenue of approximately $2.1 million) and have defaulted on several of our debt obligations. These conditions raise substantial doubt about our ability to continue as a going concern. The carrying amounts of assets and liabilities presented in the financial statements do not purport to represent realizable or settlement values.

Our management is continuing its efforts to secure funds through equity and/or debt instruments for our operations, expansion and possible acquisitions, mergers, joint ventures, and/or other business combinations. We will require additional funds to pay down our liabilities, as well as finance our expansion plans consistent with our anticipated changes in operations and infrastructure. However, there can be no assurance that we will be able to secure additional funds and that if such funds are available, whether the terms or conditions would be acceptable to us, or whether we will be able to become profitable and generate positive operating cash flow. The consolidated financial statements contain no adjustment for this uncertainty.

Note 3. Common and Preferred Stock Transactions

In March 2010, the Company transferred 610,000 shares of Series A Convertible Preferred Stock of VHS (a wholly-owned subsidiary of the Company) to Mr. Robert Farias in exchange for the following: (a) an irrevocable waiver by Mr. Farias of the conversion rights in respect of 37,500 shares of the Company's Series "C" 4% Cumulative Convertible Preferred Stock owned by Mr. Farias; (b) cancellation by Mr. Farias of $100,000 of debt owed by the Company to Mr. Farias; and (c) cancellation by Mr. Farias of three separate common stock purchase warrants held by Mr. Farias, exercisable for an aggregate of 15,000,000 shares of common stock of the Company. As a consequence of the waiver of conversion rights and the cancellation of warrants, the Company is no longer obligated to issue up to 30,000,000 shares of its common stock. Mr. Farias is an employee of VHS, a Director of NOW Solutions, Inc. ("NOW Solutions"), and a Director of Priority Time Systems, Inc ("PTS").

In March 2010, the Company further amended the Transfer and Indemnity Agreement (amendment originally entered into in January 2010) with Mountain Reservoir Corporation ("MRC"). Pursuant to this amendment, MRC received 300,000 shares of the Series A Convertible Preferred Stock of Vertical Healthcare Solutions, Inc. ("VHS") in exchange for the cancellation of the Company's obligation to issue 10,000,000 shares of common stock of the Company to MRC. MRC is a corporation controlled by the W5 Family Trust. Mr. Wade, our President and CEO, is the trustee of the W5 Family Trust.

In March 2010, the Company and Luiz Valdetaro entered into an amendment of two indemnity and reimbursement agreements whereby the obligation to reimburse Mr. Valdetaro an aggregate 3,000,000 common shares of Vertical was cancelled. These shares were initially transferred by Mr. Valdetaro to third parties on behalf of the Company (in connection with certain extensions of loans of the Company in April 2008). In return, Mr. Valdetaro received 90,000 shares of VHS Series A Preferred Stock. Mr. Valdetaro is our Chief Technology Officer.

The above transactions were determined to be a forgiveness of debt and accordingly, the value of the conversion option given up of $149,074, the cancellation of related party liability of $100,000 and the cancellation of warrants and the obligation to deliver common stock to the related parties totaling $357,000 were credited to additional paid in capital.

VHS is a wholly-owned subsidiary of the Company, with minimal assets, liabilities and operations. VHS has two classes of preferred stock:

(a) The Series A Convertible Preferred Stock is convertible into VHS common shares at a ratio of three common shares for one preferred share, has voting rights, and has a cumulative annual dividend of $0.60 per share.

(b) The Series B Convertible Preferred Stock is convertible into VHS common shares at a ratio of one common share for one preferred share, is non-voting, and has a cumulative annual dividend of $0.60 per share.

On May 21, 2010, VHS granted 100,000 shares of Series B Convertible Preferred Stock to members of Pelican Applications, LLC ("Pelican"), a California limited liability company, in connection with the purchase of the business and substantially all the assets of Pelican (see Note 5).

On June 1, 2010, VHS granted 50,000 shares of Series B Convertible Preferred Stock to a consultant acting as its Chief Operating Officer in consideration for services to be rendered on behalf of VHS and SnAPPnet, Inc., a newly formed Texas subsidiary of the Company. SnAPPnet was formed to hold the assets acquired from Pelican (see Note 5, Acquisition of SnAPPnet) and is wholly owned by and consolidated into the parent company.

VHS has authorized 10,000,000 common shares, of which 5,100,000 shares have been issued to the Company and 4,000,000 shares have been reserved for conversions of the VHS Series A Convertible Preferred Stock and Series B Convertible Preferred Stock.

In September 2010, the Company cancelled 100,000 shares of the Company's common stock as a result of an employee leaving the Company.

During the nine months ended September 30, 2010, 416,666 shares of the Company's common stock, valued at $7,550, vested.

As of the date of this Report (for the nine months ended September 30, 2010), we have determined that we currently have (i) the following shares of common stock issued, and (ii) outstanding shares of preferred stock which are convertible into the shares of common stock indicated below and a contractual commitment to issue the shares of common stock indicated below:

998,835,151	Common Stock Issued
24,250,000	Common Shares convertible from Series A Preferred Stock (48,500 shares outstanding)
27,274	Common Shares convertible from Series B Preferred Stock (7,200 shares outstanding)
5,000,000	Common Shares convertible from Series C Preferred Stock (50,000 shares outstanding of which 12,500 shares are convertible)
94,700	Common Shares convertible from Series D Preferred Stock (25,000 shares outstanding)
1,309,983	Common Shares Company Is Obligated to Reimburse to officer of Company within 1 year for Pledged Shares
1,029,517,108	**Total Common Shares Outstanding and Accounted For/Reserved**

Accordingly, given the fact that the Company currently has 1,000,000,000 shares of common stock authorized, the Company could exceed its authorized shares of common stock by approximately 30,000,000 shares if all of the shares of preferred stock described in the table above were converted into shares of common stock and the Company met its contractual obligation to issue additional shares of common stock.

Note 4. Notes Payable

The following table reflects our debt activity, including our convertible debt, for the nine months ended September 30, 2010:

December 31, 2009	$ 3,461,841
Repayment	(195,295)
Issued	192,011
Notes assumed in SnAPPnet acquisition	66,660
September 30, 2010	$ 3,525,217