

ARGAN INC
Form 8-K/A
January 26, 2007

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

FORM 8-K/A

CURRENT REPORT

Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Date of report (Date of earliest event reported): December 8, 2006

ARGAN, INC.

(Exact Name of Registrant as Specified in Its
Charter)

Delaware (State or other Jurisdiction of Incorporation)	001-31756 (Commission File Number)	13-1947195 (I.R.S. Employer Identification No.)
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**One Church Street, Suite 401, Rockville, MD
20850**

(Address of Principal Executive Offices) (Zip
Code)

Registrant's telephone number, including area code: (301) 315-0027

Not Applicable

(Former Name or Former Address, if Changed
Since Last Report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

- Written communications pursuant to Rule 425 under Securities Act (17 CFR 230.425)
- Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
- Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
- Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Explanatory Note

This Form 8-K/A is filed to amend the Form 8-K filed December 15, 2006 to include financial statements of businesses acquired and related pro forma financial information.

Item 9.01 Financial Statements and Exhibits

(a) Financial Statements of Businesses Acquired

Audited combined balance sheets of Gemma Power Systems, LLC and affiliates as of December 8, 2006, December 31, 2005 and 2004 and related combined statements of income and comprehensive income, changes in equity and cash flows for the 49 weeks ended December 8, 2006 and for the years ended December 31, 2005 and 2004.

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GEMMA POWER SYSTEMS, LLC AND AFFILIATES

Combined Financial Statements

December 8, 2006

INDEPENDENT AUDITORS' REPORT

To the Members and Boards of Directors
Gemma Power Systems, LLC and Affiliates
Glastonbury, Connecticut

We have audited the accompanying combined balance sheet of Gemma Power Systems, LLC and Affiliates as of December 8, 2006, and the related combined statements of income and comprehensive income, changes in equity, and cash flows for the 49 weeks then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these combined financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the combined financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the combined 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 combined financial statements referred to above present fairly, in all material respects, the financial position of Gemma Power Systems, LLC and Affiliates as of December 8, 2006, and the results of their operations and cash flows for the 49 weeks then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ Kostin, Ruffkess & Company, LLC

Farmington, Connecticut
January 5, 2007

GEMMA POWER SYSTEMS, LLC AND AFFILIATES**Combined Balance Sheet****December 8, 2006**

Assets	
Current assets:	
Cash and cash equivalents	\$ 35,829,568
Cash in escrow	2,691,887
Contract receivables	8,955,043
Investments available-for-sale	2,292,829
Costs and estimated earnings in excess of billings on uncompleted contracts	1,117,618
Prepaid expenses and other current assets	129,598
Total current assets	51,016,543
Property and equipment, net of accumulated depreciation and amortization	69,646
Other assets	1,250
Total assets	\$ 51,087,439
Liabilities and Equity	
Current liabilities:	
Accounts payable	\$ 29,444,461
Accrued expenses	1,253,063
Accrued payroll and related items	526,376
Billings in excess of costs and estimated earnings on uncompleted contracts	14,278,682
Total current liabilities	45,502,582
Equity	5,584,857
Total liabilities and equity	\$ 51,087,439

The accompanying notes are an integral part of the combined financial statements

GEMMA POWER SYSTEMS, LLC AND AFFILIATES

Combined Statement of Income and Comprehensive Income

For the 49 Weeks Ended December 8, 2006

Sales revenues:	
Project income	\$ 105,222,311
Consulting income	569,081
Total sales revenues	105,791,392
Cost of sales:	
Project costs	97,939,862
Consulting costs	496,489
Total cost of sales	98,436,351
Gross profit	7,355,041
Operating expenses	2,497,767
Income from operations	4,857,274
Other income (expense):	
Interest income	996,644
Incentive compensation	(627,000)
Other expenses - net	(104,931)
Total other income	264,713
Net income	5,121,987
Other comprehensive income:	
Unrealized holding gains arising during the period	2,384
Comprehensive income	\$ 5,124,371

The accompanying notes are an integral part of the combined financial statements

GEMMA POWER SYSTEMS, LLC AND AFFILIATES**Combined Statement of Cash Flows****For the 49 Weeks Ended December 8, 2006**

Cash flows from operating activities:	
Net income	\$ 5,121,987
Adjustments to reconcile net income to net cash provided by operating activities:	
Depreciation and amortization	70,856
Realized (gain) loss on sale of fixed assets	4,694
(Increase) decrease in:	
Cash in escrow	(2,002,406)
Contract receivables	(3,292,385)
Costs and estimated earnings in excess of billings on uncompleted contracts	(1,112,757)
Prepaid expenses and other current assets	(105,089)
Increase (decrease) in:	
Accounts payable	22,223,544
Accrued expenses	555,452
Accrued payroll and related items	252,900
Billings in excess of costs and estimated earnings on uncompleted contracts	4,989,262
Cash flows provided by operating activities	26,706,058
Cash flows from investing activities:	
Purchase of investments	(11,611,333)
Proceeds from sale of investments	11,525,000
Acquisition of property and equipment	(1,377)
Proceeds from sale of property and equipment	18,059
Cash flows used in investing activities	(69,651)
Cash flows from financing activities:	
Distributions	(9,003,800)
Contributions	1,600,000
Issuance of stock	3,900
Cash flows used in financing activities	(7,399,900)
Net increase in cash and cash equivalents	19,236,507
Cash and cash equivalents, beginning of period	16,593,061
Cash and cash equivalents, end of period	\$ 35,829,568

The accompanying notes are an integral part of the combined financial statements

GEMMA POWER SYSTEMS, LLC AND AFFILIATES**Combined Statement of Changes in Equity****For the 49 Weeks Ended December 8, 2006**

	Gemma Power Systems, LLC		Gemma Power Systems California, Inc.		Gemma Power Inc.		
	Accumulated Other Comprehensive Income	Equity	Common Stock*	Retained Earnings	Common Stock**	Retained Earnings	Combined Total Equity
Balance at December 31, 2005	\$ (1,711)	\$ 6,950,429	\$ 100	\$ 911,568	\$ -	\$ -	\$ 7,860,386
Net income	-	5,420,853	-	(301,502)	-	2,636	5,121,987
Comprehensive income	2,384	-	-	-	-	-	2,384
Stock issuance	-	-	-	-	3,900	-	3,900
Contributions	-	1,600,000	-	-	-	-	1,600,000
Distributions	-	(9,003,800)	-	-	-	-	(9,003,800)
Balance at December 8, 2006	\$ 673	\$ 4,967,482	\$ 100	\$ 610,066	\$ 3,900	\$ 2,636	\$ 5,584,857

* - Common stock, authorized 100 shares, no par value; issued and outstanding 100 shares

** - Common stock, authorized 20,000 shares, no par value; issued and outstanding 3,900 shares

The accompanying notes are an integral part of the combined financial statements

GEMMA POWER SYSTEMS, LLC AND AFFILIATES

Notes to the Combined Financial Statements

For the 49 Weeks Ended December 8, 2006

Note 1 - Summary of Significant Accounting Policies:

Principles of Combination

The combined financial statements of Gemma Power Systems, LLC and Affiliates include the accounts of Gemma Power Systems, LLC, its wholly owned subsidiary, Gemma Power Hartford, LLC, Gemma Power Systems California, Inc. and Gemma Power, Inc. These entities together are referred to as the "Company" in the accompanying notes. Significant intercompany accounts and transactions have been eliminated in combination. The members' liability in the entities organized as limited liability companies is limited to the net assets of the respective entity.

Nature of Operations

Gemma Power Systems, LLC and Affiliates, located in Glastonbury, Connecticut, are engaged in the engineering and construction of biodiesel and ethanol production facilities and power energy systems. The Company also provides consulting, owner's representative, operating, and maintenance services to the energy market.

The Company's work is performed under cost-plus-fee contracts, fixed-price contracts, and time and materials contracts. The length of the Company's contracts varies, but is typically between six months and two years.

Revenue Recognition

Revenues from fixed price construction contracts are recognized on the percentage of completion method, measured by the costs incurred to date to estimated total costs for each contract. Revenues from cost-plus-fee contracts are recognized on the basis of costs incurred during the period plus the fee earned, measured by the cost-to-cost method.

Project costs include both direct and indirect expenses related to contract performance. General and administrative costs are charged to expense as incurred. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined. Changes in job performance, job conditions and estimated profitability and final contract settlements may result in revisions to costs and income and are recognized in the period in which the revisions are determined.

Costs and estimated earnings in excess of billings on uncompleted contracts represent revenues recognized in excess of amounts billed. Billings in excess of costs and estimated earnings on uncompleted contracts represents billings in excess of revenues recognized.

Off Balance Sheet Risk

During the 49 weeks ended December 8, 2006, the Company had amounts in excess of \$100,000 in a single bank. Amounts over \$100,000 are not insured by the Federal Deposit Insurance Corporation. These balances fluctuate greatly during the year and can exceed this \$100,000 limit. Management regularly monitors the financial institutions, together with its cash balances, and tries to keep this potential risk to a minimum.

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 estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

GEMMA POWER SYSTEMS, LLC AND AFFILIATES

Notes to the Combined Financial Statements

For the 49 Weeks Ended December 8, 2006

Note 1 - Summary of Significant Accounting Policies: (Continued)

Income Taxes

Gemma Power Systems, LLC and Gemma Power Hartford, LLC are treated as a partnership for income tax purposes. As such, income and deductions flow through to the members, who include their share of income and losses on their respective income tax returns. Gemma Power Systems California, Inc. and Gemma Power, Inc. have elected to be taxed under Subchapter-S of the Internal Revenue Code. As such, income and deductions flow through to the shareholders, who include their share of income and losses on their respective income tax returns. Accordingly, since the Company has no federal tax liability, a provision for federal income tax expense has not been made.

The Company is subject to income tax in certain states in which it operates. These statements include a provision of \$76,080 for these state income taxes.

Cash and Cash Equivalents

Cash equivalents are short-term, highly liquid investments that are readily convertible to known cash amounts and have maturities of three months or less from the date of acquisition so as to minimize risks of value changes. Supplemental cash flow information includes state income taxes paid by the Company of \$48,890 for the 49 weeks ended December 8, 2006.

Principles of Consolidation

The Company previously adopted Financial Accounting Standards Board Interpretation No. 46R (FIN No. 46R), *Consolidation of Variable Interest Entities*. The Company has evaluated its relationship with a related party (see Note 6 - Related Party Transactions) and has determined that, although the entity is a variable interest entity, it is not required to be consolidated in the Company's financial statements pursuant to FIN No. 46R because the Company is not the primary beneficiary and has no exposure to loss as a result of its involvement with this entity.

Property and Equipment

Property and equipment are stated at cost. Major renewals and improvements are charged to the property accounts, while maintenance and repairs that do not improve or extend the life of the assets are expensed currently.

The Company follows the policy of providing for depreciation of property and equipment by charging against earnings amounts sufficient to amortize the cost of property on their estimated useful lives as follows:

Computer software	3 years
Computer equipment	3-5 years
Office equipment	5-7 years
Furniture and fixtures	7 years
Automobiles	5 years
Construction equipment	5-7 years

Depreciation and amortization are provided on various methods over the estimated useful lives of the assets for financial statement purposes.

GEMMA POWER SYSTEMS, LLC AND AFFILIATES**Notes to the Combined Financial Statements****For the 49 Weeks Ended December 8, 2006****Note 2 - Cash in Escrow:**

Cash in escrow is a restricted interest bearing account which substitutes for retainage held by the project owner on a certain job. The amounts will be released to the Company upon completion of the job. During the construction period, the Company will earn the interest on these funds.

Note 3 - Contract Receivables:

Billed:	
Contracts in progress	\$ 7,704,600
Retainage	1,250,443
	\$ 8,955,043

Balances billed but not paid by customers pursuant to retainage provisions in construction contracts are due upon completion of the contracts and acceptance by the owner.

Note 4 - Investments Available-for-Sale:

Investments are classified as available-for-sale according to the provisions of Financial Accounting Standards Board Statement No. 115, "Accounting for Certain Investments in Debt and Equity Securities". The cost of investments sold was based on specific identification at the time of sale. The summary of these investments is as follows:

Description	Cost	Fair Value	Unrealized Holding Gains	Proceeds From Sales	Realized Gains
Municipal bonds	\$ 2,292,156	\$ 2,292,829	\$ 673	\$ 11,525,000	\$ -
Maturity of Debt	Within 1 Year	1 - 5 Years	Over 5 Years	Total	
Municipal bonds	\$ 1,333,388	\$ 959,441	\$ -	\$ 2,292,829	

Note 5 - Costs and Estimated Earnings on Uncompleted Contracts:

Costs incurred on uncompleted contracts	\$ 147,395,255
Estimated earnings	6,868,315
	154,263,570
Less: billings to date	167,424,634
	\$ (13,161,064)

Included in accompanying balance sheets under the following captions:

Costs and estimated earnings in excess of billings on uncompleted contracts	\$	1,117,618
Billings in excess of costs and estimated earnings on uncompleted contracts		(14,278,682)
	\$	(13,161,064)

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GEMMA POWER SYSTEMS, LLC AND AFFILIATES**Notes to the Combined Financial Statements****For the 49 Weeks Ended December 8, 2006****Note 6 - Related Party Transactions:**

The Company's agreement with Gemma Development, Inc. for management services ended on December 8, 2006. The management fee paid for the 49 weeks ended December 8, 2006 was \$975,000.

Note 7 - Property and Equipment:

Assets:	
Computer software	\$ 40,114
Computer equipment	289,178
Office equipment	261,279
Furniture and fixtures	65,858
Automobiles	141,546
Construction equipment	64,337
	862,312
Accumulated depreciation and amortization:	
Computer software	40,114
Computer equipment	265,298
Office equipment	236,255
Furniture and fixtures	62,535
Automobiles	125,187
Construction equipment	63,277
	792,666
Net property and equipment	\$ 69,646

Note 8 - Operating Leases:

The Company conducts its operations in Glastonbury, Connecticut. The Company's Glastonbury facility is leased under an operating lease that expires on October 31, 2007. For the 49 weeks ended December 8, 2006, the Company incurred rental expenses of \$117,630.

At December 8, 2006, the future minimum lease payments for the next year is \$106,936.

Note 9 - Accounts Payable:

Accounts payable include amounts due to subcontractors which have been retained pending completion and customer acceptance of jobs. These amounts were \$2,780,139 at December 8, 2006.

Note 10 - Surety Bonds:

The Company, as a condition for entering into some of its construction contracts, had outstanding surety bonds as of December 8, 2006.

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GEMMA POWER SYSTEMS, LLC AND AFFILIATES

Notes to the Combined Financial Statements

For the 49 Weeks Ended December 8, 2006

Note 11 - Profit Sharing Plan:

The Company has a qualified profit sharing plan that covers substantially all eligible employees. Pursuant to Internal Revenue Code Section 401(k), employees may elect to defer a portion of their salary or wages. Contributions by the Company are discretionary. There was no Company contribution expense for the 49 weeks ended December 8, 2006.

Note 12 - Incentive Compensation:

The Company pays its employees incentive compensation based on project and Company performance. Incentive compensation incurred by the Company for the 49 weeks ended December 8, 2006 was \$627,000.

Note 13 - Subsequent Events:

On December 8, 2006, the Company was purchased by Argan, Inc.

Note 14 - Backlog:

The backlog of gross revenue on work to be performed on signed contracts was \$181,303,027 at December 8, 2006.

GEMMA POWER SYSTEMS, LLC AND AFFILIATE

Combined Financial Statements

December 31, 2005 and 2004

INDEPENDENT AUDITORS' REPORT

To the Members and Board of Directors
Gemma Power Systems, LLC and Affiliate
Glastonbury, Connecticut

We have audited the accompanying combined balance sheets of Gemma Power Systems, LLC and Affiliate as of December 31, 2005 and 2004, and the related combined statements of income and comprehensive income, changes in equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these combined financial statements based on our audits.

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

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of Gemma Power Systems, LLC and Affiliate as of December 31, 2005 and 2004, 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.

/s/ Kostin, Ruffkess & Company, LLC

Farmington, Connecticut
January 23, 2006

GEMMA POWER SYSTEMS, LLC AND AFFILIATE**Combined Balance Sheets****December 31, 2005 and 2004**

	2005	2004
Assets		
Current assets:		
Cash and cash equivalents	\$ 16,593,061	\$ 5,764,499
Cash in escrow	689,481	-
Contract receivables	5,662,658	2,014,176
Investments available-for-sale	2,204,112	2,471,493
Costs and estimated earnings in excess of billings on uncompleted contracts	4,861	4,498
Prepaid expenses and other current assets	24,509	69,885
Total current assets	25,178,682	10,324,551
Property and equipment, net of accumulated depreciation and amortization	161,878	252,764
Other assets	1,250	5,070
Total assets	\$ 25,341,810	\$ 10,582,385
Liabilities and Equity		
Current liabilities:		
Accounts payable	\$ 7,220,917	\$ 1,313,367
Accrued expenses	697,611	1,367,945
Accrued payroll and related items	273,476	46,216
Billings in excess of costs and estimated earnings on uncompleted contracts	9,289,420	1,219,481
Total current liabilities	17,481,424	3,947,009
Equity	7,860,386	6,635,376
Total liabilities and equity	\$ 25,341,810	\$ 10,582,385

The accompanying notes are an integral part of the combined financial statements

GEMMA POWER SYSTEMS, LLC AND AFFILIATE**Combined Statements of Income and Comprehensive Income****For the Years Ended December 31, 2005 and 2004**

	2005	2004
Sales revenues:		
Project income	\$ 48,311,858	\$ 18,902,714
Consulting income	310,253	357,366
Total sales revenues	48,622,111	19,260,080
Cost of sales:		
Project costs	42,477,625	8,186,057
Consulting costs	265,880	365,606
Total cost of sales	42,743,505	8,551,663
Gross profit	5,878,606	10,708,417
Operating expenses	2,081,910	3,483,007
Income from operations	3,796,696	7,225,410
Other income (expense):		
Interest income	436,882	346,760
Incentive compensation	(76,000)	4,708,543
401(k) Company contribution	(282,697)	(8,538)
Realized gain (loss) on sale of investments	(7,254)	71,315
Other expenses - net	(15,346)	(71,483)
Total other income	55,585	5,046,597
Net income	3,852,281	12,272,007
Other comprehensive loss:		
Unrealized holding losses:		
Unrealized holding losses arising during the period	(37,590)	(150,293)
Less: reclassification adjustment for (gains) losses included in net income	7,254	(71,315)
Other comprehensive loss	(30,336)	(221,608)
Comprehensive income	\$ 3,821,945	\$ 12,050,399

The accompanying notes are an integral part of the combined financial statements

GEMMA POWER SYSTEMS, LLC AND AFFILIATE**Combined Statements of Cash Flows****For the Years Ended December 31, 2005 and 2004**

	2005	2004
Cash flows from operating activities:		
Net income	\$ 3,852,281	\$ 12,272,007
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	131,383	175,135
Realized (gain) loss on sale of investments available-for-sale	7,254	(71,315)
Realized (gain) loss on sale of fixed assets	(36,657)	(1,835)
(Increase) decrease in:		
Cash in escrow	(689,481)	-
Contract receivables	(3,648,482)	2,560,524
Costs and estimated earnings in excess of billings on uncompleted contracts	(363)	(4,498)
Prepaid expenses and other current assets	45,376	(51,931)
Other assets	3,820	-
Increase (decrease) in:		
Accounts payable	5,907,550	(2,939,985)
Accrued expenses	(670,334)	40,810
Accrued payroll and related items	227,260	(5,581,873)
Billings in excess of costs and estimated earnings on uncompleted contracts	8,069,939	(3,919,288)
Cash flows provided by operating activities	13,199,546	2,477,751
Cash flows from investing activities:		
Purchase of investments	(3,082,116)	(324,210)
Proceeds from sale of investments	3,311,907	5,544,813
Acquisition of property and equipment	(37,840)	(43,222)
Proceeds from sale of property and equipment	34,000	28,042
Cash flows provided by investing activities	225,951	5,205,423
Cash flows used in financing activities:		
Distributions	(2,596,935)	(17,636,498)
Net increase (decrease) in cash and cash equivalents	10,828,562	(9,953,324)
Cash and cash equivalents, beginning of year	5,764,499	15,717,823
Cash and cash equivalents, end of year	\$ 16,593,061	\$ 5,764,499

The accompanying notes are an integral part of the combined financial statements

GEMMA POWER SYSTEMS, LLC AND AFFILIATE**Combined Statement of Changes in Equity****For the Years Ended December 31, 2005 and 2004**

	Gemma Power Systems, LLC		Gemma Power Systems California, Inc.		
	Accumulated Other Comprehensive Income	Equity	Common Stock*	Retained Earnings	Combined Total Equity
Balance at December 31, 2003	\$ 250,233	\$ 11,248,475	\$ 100	\$ 722,667	\$ 12,221,475
Net income	-	12,271,292	-	715	12,272,007
Comprehensive loss	(221,608)	-	-	-	(221,608)
Distributions	-	(17,136,498)	-	(500,000)	(17,636,498)
Balance at December 31, 2004	28,625	6,383,269	100	223,382	6,635,376
Net income	-	3,164,095	-	688,186	3,852,281
Comprehensive loss	(30,336)	-	-	-	(30,336)
Distributions	-	(2,596,935)	-	-	(2,596,935)
Balance at December 31, 2005	\$ (1,711)	\$ 6,950,429	\$ 100	\$ 911,568	\$ 7,860,386

* - Common stock, authorized 100 shares, no par value; issued and outstanding 100 shares in both 2005 and 2004

The accompanying notes are an integral part of the combined financial statements

GEMMA POWER SYSTEMS, LLC AND AFFILIATE

Notes to the Combined Financial Statements

For the Years Ended December 31, 2005 and 2004

Note 1 - Summary of Significant Accounting Policies:

Principles of Combination

The combined financial statements of Gemma Power Systems, LLC and Affiliate include the accounts of Gemma Power Systems, LLC, its wholly owned subsidiary, Gemma Power Hartford, LLC, and Gemma Power Systems California, Inc. These entities together are referred to as the "Company" in the accompanying notes. Significant intercompany accounts and transactions have been eliminated in combination.

Nature of Operations

Gemma Power Systems, LLC and Affiliate, located in Glastonbury, Connecticut, is engaged in the engineering and construction of power energy systems. The Company also provides consulting, owner's representative, operating, and maintenance services to the energy market.

The Company's work is performed under cost-plus-fee contracts, fixed-price contracts, and time and materials contracts. These contracts are undertaken by the Company or in partnership with other contractors through joint ventures. The length of the Company's contracts varies, but is typically between six months and two years.

Revenue Recognition

Revenues from fixed price construction contracts are recognized on the percentage of completion method, measured by the costs incurred to date to estimated total costs for each contract. Revenues from cost-plus-fee contracts are recognized on the basis of costs incurred during the period plus the fee earned, measured by the cost-to-cost method.

Project costs include both direct and indirect expenses related to contract performance. General and administrative costs are charged to expense as incurred. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined. Changes in job performance, job conditions and estimated profitability and final contract settlements may result in revisions to costs and income and are recognized in the period in which the revisions are determined.

Costs and estimated earnings in excess of billings on uncompleted contracts represent revenues recognized in excess of amounts billed. Billings in excess of costs and estimated earnings on uncompleted contracts represents billings in excess of revenues recognized.

Off Balance Sheet Risk

During the years ended December 31, 2005 and 2004, the Company had amounts in excess of \$100,000 in a single bank. Amounts over \$100,000 are not insured by the Federal Deposit Insurance Corporation. These balances fluctuate greatly during the year and can exceed this \$100,000 limit. Management regularly monitors the financial institutions, together with its cash balances, and tries to keep this potential risk to a minimum.

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 estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

GEMMA POWER SYSTEMS, LLC AND AFFILIATE

Notes to the Combined Financial Statements

For the Years Ended December 31, 2005 and 2004

Note 1 - Summary of Significant Accounting Policies: (Continued)

Income Taxes

Gemma Power Systems, LLC and Gemma Power Hartford, LLC are treated as a partnership for income tax purposes. As such, income and deductions flow through to the members, who include their share of income and losses on their respective income tax returns. Gemma Power Systems California, Inc. has elected to be taxed under Subchapter-S of the Internal Revenue Code. As such, income and deductions flow through to the shareholders, who include their share of income and losses on their respective income tax returns. Accordingly, since the Company has no federal tax liability, a provision for federal income tax expense has not been made.

Gemma Power Systems, LLC is subject to an income tax in the state of California. These statements include a provision for this tax, which was \$11,790 and \$-0- in 2005 and 2004, respectively.

Gemma Power Systems California, Inc. is subject to a minimum income tax in the state of California. These statements include a provision for this tax, which was \$10,480 and \$772 in 2005 and 2004, respectively.

Cash and Cash Equivalents

Cash equivalents are short-term, highly liquid investments that are readily convertible to known cash amounts and have maturities of three months or less from the date of acquisition so as to minimize risks of value changes. Supplemental cash flow information includes state income taxes paid by the Company of \$1,600 and \$8,817 in 2005 and 2004, respectively.

Principles of Consolidation

During the year ended December 31, 2005, the Company adopted Financial Accounting Standards Board Interpretation No. 46R (FIN No. 46R), *Consolidation of Variable Interest Entities*. The Company has evaluated its relationship with a related party (see Note 6 - Related Party Transactions) and has determined that, although the entity is a variable interest entity, it is not required to be consolidated in the Company's financial statements pursuant to FIN No. 46R because the Company is not the primary beneficiary.

Property and Equipment

Property and equipment are stated at cost. Major renewals and improvements are charged to the property accounts, while maintenance and repairs that do not improve or extend the life of the assets are expensed currently.

The Company follows the policy of providing for depreciation of property and equipment by charging against earnings amounts sufficient to amortize the cost of property on their estimated useful lives as follows:

Computer software	3 years
Computer equipment	3-5 years
Office equipment	5-7 years
Furniture and fixtures	7 years

Automobiles	5 years
Construction equipment	5-7 years

Depreciation and amortization are provided on various methods over the estimated useful lives of the assets for financial statement purposes.

GEMMA POWER SYSTEMS, LLC AND AFFILIATE**Notes to the Combined Financial Statements****For the Years Ended December 31, 2005 and 2004****Note 2 - Cash in Escrow:**

Cash in escrow is a restricted interest bearing account which substitutes for retainage held by the Project owner on a certain job. The amounts will be released to the Company upon completion of the job. During the construction period, the Company will earn the interest on these funds.

Note 3 - Contract Receivables:

	2005	2004
Billed:		
Contracts in progress	\$ 4,825,523	\$ 1,783,811
Completed contracts	2,619	32,166
Retainage	834,516	198,199
	\$ 5,662,658	\$ 2,014,176

Balances billed but not paid by customers pursuant to retainage provisions in construction contracts are due upon completion of the contracts and acceptance by the owner.

Note 4 - Investments Available-for-Sale:

Investments are classified as available-for-sale according to the provisions of Financial Accounting Standards Board Statement No. 115, "Accounting for Certain Investments in Debt and Equity Securities". The cost of investments sold was based on specific identification at the time of sale. The summary of these investments is as follows:

Description	Cost	2005			
		Fair Value	Unrealized Holding Losses	Proceeds From Sales	Realized Losses
Municipal bonds	\$ 2,205,823	\$ 2,204,112	\$ (1,711)	\$ 3,311,907	\$ (7,254)

Maturity of Debt	Within 1 Year	1 - 5 Years	Over 5 Years	Total
Municipal bonds	\$ 853,811	\$ 1,350,301	\$ -	\$ 2,204,112

Description	Cost	2004			
		Fair Value	Unrealized Holding Gains	Proceeds From Sales	Realized Gains
Municipal bonds	\$ 2,442,868	\$ 2,471,493	\$ 28,625	\$ 3,367,398	\$ (6,100)
Corporate bonds	-	-	-	2,177,415	77,415

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Total \$ 2,442,868 \$ 2,471,493 \$ 28,625 \$ 5,544,813 \$ 71,315

Maturity of Debt	Within 1 Year	1 - 5 Years	Over 5 Years	Total
Municipal bonds	\$ 722,518	\$ 1,748,975	\$ -	\$ 2,471,493

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GEMMA POWER SYSTEMS, LLC AND AFFILIATE

Notes to the Combined Financial Statements

For the Years Ended December 31, 2005 and 2004

Note 5 - Costs and Estimated Earnings on Uncompleted Contracts: