

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 **June 30, 2002**

OR

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: 1-6081

COMFORCE Corporation

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

36-2262248
(IRS Employer Identification No.)

415 Crossways Park Drive, P.O. Box 9006, Woodbury, New York 11797
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (516) 437-3300

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 the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class
Common stock, \$.01 par value

Outstanding at August 8, 2002
16,659,330 shares

COMFORCE Corporation

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

COMFORCE CORPORATION AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS (in thousands, except share and per share amounts)

	<u>June 30, 2002</u>	<u>December 30, 2001</u>
ASSETS:	(unaudited)	
Current assets:		
Cash and cash equivalents	\$ 5,031	\$ 4,067
Accounts receivable, net	46,799	44,091
Funding and service fees receivable, net	28,809	35,938
Prepaid expenses and other current assets	3,235	5,733
Total current assets	<u>83,874</u>	<u>89,829</u>
Deferred income taxes, net	1,619	--
Property and equipment, net	12,958	12,590
Intangible assets, net	231	--
Goodwill, net	79,242	134,283
Deferred financing costs, net	2,882	3,307
Total assets	<u>\$ 180,806</u>	<u>\$ 240,009</u>
LIABILITIES AND STOCKHOLDERS' EQUITY:		
Current liabilities:		
Accounts payable	\$ 1,995	\$ 3,440
Accrued expenses	29,743	28,487
Total current liabilities	<u>31,738</u>	<u>31,927</u>
Long-term debt	150,609	154,720
Deferred income taxes, net	--	581
Other liabilities	425	244
Total liabilities	<u>182,772</u>	<u>187,472</u>
Commitments and contingencies		
Stockholders' (deficit) equity:		
Common stock, \$.01 par value; 100,000,000 shares authorized; 16,659,334 shares and 16,659,173 shares issued and outstanding at June 30, 2002 and December 30, 2001, respectively	167	167
Additional paid-in capital	49,589	49,581
Accumulated other comprehensive loss	(94)	(309)
(Accumulated deficit) retained earnings	(51,628)	3,098
Total stockholders' (deficit) equity	<u>(1,966)</u>	<u>52,537</u>
Total liabilities and stockholders' (deficit) equity	<u>\$ 180,806</u>	<u>\$ 240,009</u>

The accompanying notes are an integral part of the unaudited consolidated financial statements.

COMFORCE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands except per share amounts)
(unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2002	July 1, 2001	June 30, 2002	July 1, 2001
Revenue:				
Net sales of service	\$ 94,387	\$ 112,207	\$188,225	\$ 235,559
Costs and expenses:				
Cost of services	76,355	88,237	153,042	185,117
Selling, general and administrative expenses	13,840	16,736	27,680	34,495
Depreciation and amortization	1,092	1,955	1,981	3,873
Total costs and expenses	91,287	106,928	182,703	223,485
Operating income	3,100	5,279	5,522	12,074
Other income (expense):				
Interest expense	(4,043)	(5,129)	(8,040)	(10,822)
Gain on debt extinguishment	--	--	--	6,536
Other income, net	158	27	163	29
	(3,885)	(5,102)	(7,877)	(4,257)
Income (loss) before tax	(785)	177	(2,355)	7,817
Provision (benefit) for income taxes	153	578	(429)	4,199
Income (loss) before a cumulative effect of a change in accounting principle	(938)	(401)	(1,926)	3,618
Cumulative effect of a change in accounting principle -- goodwill impairment, net of tax benefit of \$2,200	--	--	(52,800)	--
Net income (loss)	\$ (938)	\$ (401)	\$ (54,726)	\$ 3,618
Basic income (loss) per common share:				
Income (loss) before a cumulative effect of a change in accounting principle	\$ (0.06)	\$ (0.02)	\$ (0.12)	\$ 0.22
Cumulative effect of a change in accounting principle - goodwill impairment	--	--	(3.17)	--
Net income (loss)	\$ (0.06)	\$ (0.02)	\$ (3.29)	\$ 0.22
Diluted income (loss) per common share:				
Income (loss) before a cumulative effect of a change in accounting principle	\$ (0.06)	\$ (0.02)	\$ (0.12)	\$ 0.21
Cumulative effect of a change in accounting principle - goodwill impairment	--	--	(3.17)	--
Net income (loss)	\$ (0.06)	\$ (0.02)	\$ (3.29)	\$ 0.21
Weighted average common shares outstanding, basic	16,659	16,659	16,659	16,659
Weighted average common shares outstanding, diluted	16,659	16,659	16,659	16,867

The accompanying notes are an integral part of the unaudited consolidated financial statements.

COMFORCE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)
(unaudited)

	Six Months Ended	
	June 30, 2002	July 1, 2001
Cash flows from operating activities:		
Net income (loss)	\$ (54,726)	\$ 3,618
Adjustments to reconcile net income (loss)		
to net cash provided by operating activities:		
Depreciation and amortization	1,981	3,873
Amortization of deferred financing fees	505	394
Issuance of notes in lieu of interest	1,104	1,923
Gain on repurchase of Senior Notes	--	(3,790)
Gain on repurchase of PIK Debentures	--	(2,746)
Write-off of goodwill, net of tax	52,800	--
Gain on sale of fixed assets	156	--
Changes in assets and liabilities, net of effects of acquisitions of businesses:		
Accounts receivable and funding service fees receivable	4,636	14,243
Prepaid expenses and other current assets	1,688	135
Accounts payable and accrued expenses	(221)	(3,381)
Decrease in income tax receivable	810	--
Net cash provided by operating activities	8,421	14,269
Cash flows from investing activities:		
Purchases of property and equipment	(2,200)	(2,037)
Cash proceeds from sale of fixed assets	434	--
Payments of contingent consideration	(323)	(672)
(Increase) in deferred costs and other assets	--	(250)
Net cash used in investing activities	(2,089)	(2,959)
Cash flows from financing activities:		
Net repayments under capital lease obligations	(73)	(58)
Net (repayments) borrowings under line of credit agreements	(5,215)	761
Repurchase of Senior Notes and PIK Debentures	--	(11,336)
Debt financing costs	(80)	(163)
Net cash used in financing activities	(5,368)	(10,796)
Net increase in cash and cash equivalents	964	514
Cash and cash equivalents at beginning of period	4,067	4,940
Cash and cash equivalents at end of period	\$ 5,031	\$ 5,454
Supplemental disclosures:		
Cash paid for:		
Interest	\$ 6,287	\$ 6,756
Income taxes	269	3,584

The accompanying notes are an integral part of the unaudited consolidated financial statements.

COMFORCE CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. GENERAL

The accompanying unaudited interim consolidated financial statements of COMFORCE Corporation (“COMFORCE”) and its subsidiaries, including COMFORCE Operating, Inc. (“COI”) (collectively, the “Company”) have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures normally included in annual financial statements have been condensed or omitted pursuant to those rules and regulations. In the opinion of management, all adjustments, consisting of normal recurring adjustments considered necessary for a fair presentation, have been included. Although management believes that the disclosures made are adequate to ensure that the information presented is not misleading, it is suggested that these financial statements be read in conjunction with the financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 30, 2001. The results for the three and six months ended June 30, 2002 are not necessarily indicative of the results of operations for the entire year.

2. DEBT

Notes payable and long-term debt at June 30, 2002 and December 30, 2001 consisted of (in thousands):

	June 30, 2002	December 30, 2001
12% Senior Notes, due 2007	\$ 87,000	\$ 87,000
15% Senior Secured PIK Debentures, due 2009	11,158	10,379
8% Subordinated Convertible Notes due 2009	8,446	8,121
Revolving line of credit, due December 14, 2003, with interest payable monthly at LIBOR plus 3.0% with a weighted average rate of 4.49% at June 30, 2002 and LIBOR plus 2.25% with a weighted average rate of 4.33% at December 30, 2001	44,005	49,220
Total long-term debt	\$ 150,609	\$ 154,720

The debt service costs associated with COMFORCE’s 15% Senior Secured PIK Debentures due 2009 (the “PIK Debentures”) may be satisfied through issuance of new PIK Debentures through December 1, 2002 and the debt service costs associated with COMFORCE’s 8% Subordinated Convertible Notes due 2009 (the “Convertible Notes”) may be satisfied through issuance of new Convertible Notes through December 1, 2003. Beginning with the interest payment due June 1, 2003, COMFORCE will be required to pay interest on the PIK Debentures in cash, and beginning with the interest payment due June 1, 2004, COMFORCE will be required to pay interest on the Convertible Notes in cash. Its ability to do so will be dependent on the ability of COI to borrow funds for this purpose under the IBJ Credit Facility and to upstream funds under the restricted payments test. In addition, COMFORCE’s ability to repay the PIK Debentures and the Convertible Notes at their respective maturity dates in December 2009, or on any earlier required repayment or repurchase dates, will also be dependent on the ability of COI to upstream funds for these purposes under the restricted payments test, unless COMFORCE separately obtains a loan or sells its capital stock or other securities to provide funds therefor.

Effective as of May 10, 2002, the Company entered into an amendment to the IBJ Credit Facility to, among other things (i) waive the Company’s non-compliance with the fixed-charge coverage ratio for the period ended March 31, 2002, (ii) reduce the fixed-charge coverage ratio in future periods, and (iii) increase each level of the applicable rate and LIBOR margins by 0.25%.

3. FISCAL YEAR

On March 22, 2001, the Company's Board of Directors adopted a resolution to change the Company's fiscal year, which was previously a calendar year. Beginning in 2001, the fiscal year consists of the 52 or 53 weeks ending on the last Sunday in December. Accordingly, the Company's current fiscal year will end on Sunday, December 29, 2002.

4. INCOME (LOSS) PER SHARE

Basic income (loss) per common share is computed by dividing net income (loss) by the weighted average number of shares of common stock outstanding during each period. Diluted income (loss) per share is computed assuming the conversion of stock options and warrants with a market value greater than the exercise price to the extent such conversion assumption is dilutive. The following represents a reconciliation of the numerators and denominators for basic and diluted income (loss) per share for the three and six month periods ended June 30, 2002 and July 1, 2001 (in thousands):

	Three Months Ended		Six Months Ended	
	June 30, 2002	July 1, 2001	June 30, 2002	July 1, 2001
Numerator:				
Income (loss) before a cumulative effect of a change in accounting principle	\$ (938)	\$ (401)	\$ (1,926)	\$ 3,618
Cumulative effect of a change in accounting principle -- goodwill impairment, net of tax benefit	--	--	(52,800)	--
Net income (loss)	<u>\$ (938)</u>	<u>\$ (401)</u>	<u>\$ (54,726)</u>	<u>\$ 3,618</u>
Denominator:				
Weighted average shares -- basic	16,659	16,659	16,659	16,659
Effect of dilutive securities:				
Warrants and Employee stock options	<u>--</u>	<u>--</u>	<u>--</u>	<u>208</u>
Denominator for diluted income (loss) per share -- adjusted weighted average shares and assumed conversions	<u>16,659</u>	<u>16,659</u>	<u>16,659</u>	<u>16,867</u>

Outstanding options and warrants to purchase shares of common stock, representing approximately 3.6 million shares of common stock, were not included in the computations of diluted net income (loss) per share for the three and six months ended June 30, 2002 because their effect would be anti-dilutive.

5. STOCK OPTIONS

During the first six months of 2002, the Company granted options to purchase in aggregate of 60,000 shares of the Company's common stock at an exercise price of \$1.10 per share and 535,000 shares of the Company's common stock at an exercise price of \$1.45, which was equal to or greater than the fair market value of the common stock on the date of grant. These options were granted to 23 individuals who are officers, directors, employees or agents of the Company. These options were granted under the Company's Long-Term Stock Investment Plan. The options granted to directors provide for vesting on the first anniversary of the date of grant and the remaining options provide for vesting 6, 18 and 30 months after the date of grant in equal increments.

At the annual meeting of stockholders of the Company held June 13, 2002, the stockholders approved the COMFORCE Corporation 2002 Stock Option Plan under which options to purchase up to 1,000,000 shares of the Company's common stock may be granted by the Company to officers, directors, employees and agents of the Company at exercise prices not less than market prices at the date of grant. To date, no options have been issued under this plan.

6. INDUSTRY SEGMENT INFORMATION

COMFORCE has determined that its reportable segments can be distinguished principally by the types of services offered to the Company's clients.

The Company reports its results through three operating segments -- Staff Augmentation, Human Capital Management Services and Financial Outsourcing Services. The Staff Augmentation segment provides information technology (IT), telecom, healthcare support, and technical and engineering services. The Human Capital Management Services segment provides contingent workforce management services. The Financial Outsourcing Services segment provides funding and back office support services to independent consulting and staffing companies.

The accounting policies of the segments are the same as those described in Note 2 to the consolidated financial statements of the Company included in the Company's Annual Report on Form 10-K for the year ended December 30, 2001. COMFORCE evaluates the performance of its segments and allocates resources to them based on operating contribution, which represents segment revenues less direct costs of operations, excluding the allocation of corporate general and administrative expenses. Assets of the operating segments reflect primarily net accounts receivable and goodwill associated with segment activities; all other assets are included as corporate assets. The Company does not account for expenditures for long-lived assets on a segment basis.

The table below presents information on the revenues and operating contribution for each segment for the three and six months ended June 30, 2002 and July 1, 2001, and items which reconcile segment operating contribution to COMFORCE's reported pre-tax income (loss) (in thousands):

	Three Months Ended		Six Months Ended	
	June 30, 2002	July 1, 2001	June 30, 2002	July 1, 2001
Net sales of services:				
Staff Augmentation	\$ 51,259	\$ 77,786	\$ 105,800	\$ 165,149
Human Capital Management Services	40,718	31,237	77,767	63,934
Financial Outsourcing Services	2,410	3,184	4,658	6,476
	<u>\$ 94,387</u>	<u>\$ 112,207</u>	<u>\$ 188,225</u>	<u>\$ 235,559</u>
Operating contribution:				
Staff Augmentation	\$ 4,755	\$ 8,387	\$ 9,352	\$ 18,525
Human Capital Management Services	1,554	772	2,907	1,203
Financial Outsourcing Services	1,700	2,472	2,780	5,068
	<u>8,009</u>	<u>11,631</u>	<u>15,039</u>	<u>24,796</u>
Consolidated expenses(income):				
Interest and other, net	3,885	5,102	7,877	10,793
Depreciation and amortization	1,092	1,955	1,981	3,873
Gain on debt extinguishment	--	--	--	(6,536)
Corporate general and administrative expenses	3,817	4,397	7,536	8,849
	<u>8,794</u>	<u>11,454</u>	<u>17,394</u>	<u>16,979</u>
Income (loss) before taxes	<u>\$ (785)</u>	<u>\$ 177</u>	<u>\$ (2,355)</u>	<u>\$ 7,817</u>

	<u>At June 30, 2002</u>	<u>At Dec. 30, 2001</u>
Total assets:		
Staff Augmentation	\$ 99,427	\$ 143,009
Human Capital Management Services	26,614	25,965
Financial Outsourcing Services	28,809	45,338
Corporate	25,956	25,697
	<u>\$ 180,806</u>	<u>\$ 240,009</u>

7. ACCOUNTING FOR BUSINESS COMBINATIONS, GOODWILL AND OTHER INTANGIBLE ASSETS

In July 2001, the Financial Accounting Standards Board (“FASB”) issued Statement No. 141, *Business Combinations* (“SFAS 141”), Statement No. 142, *Goodwill and Other Intangible Assets* (“SFAS 142”) and in August 2001 the FASB issued Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (“SFAS 144”). SFAS 141 specifies criteria that intangible assets acquired in a purchase method business combination must meet to be recognized and reported apart from goodwill. SFAS 142 eliminates the requirement to amortize goodwill and intangible assets with indefinite useful lives. Instead, they will be tested for impairment at least annually in accordance with the provisions of SFAS 142. SFAS 142 also requires that intangible assets with definite useful lives be amortized over their respective estimated useful lives and to their estimated residual values, and reviewed for impairment in accordance with SFAS 144.

The Company has adopted the provisions of SFAS 141 upon issuance and the provisions of SFAS 142 as of the beginning of fiscal year 2002. The Company has evaluated its existing intangible assets and goodwill that were acquired in prior purchase business combinations and has reclassified \$264,000 net carrying value of goodwill to intangible assets in order to conform to the new criteria in SFAS 141 for recognition apart from goodwill. The Company has reassessed the useful lives and residual values of the intangible assets acquired, and has determined that no amortization period adjustments were necessary.

The intangible assets with definite useful lives are comprised of covenants not to compete (being amortized over periods ranging from 8 to 10 years) with a gross carrying amount of \$558,000 and accumulated amortization of \$327,000 as of June 30, 2002. The amortization expense for the three months ended June 30, 2002 was \$17,000 and generated a tax benefit of \$6,900. The amortization expense for the six months ended June 30, 2002 was \$33,000 and generated a tax benefit of \$13,000. The estimated amortization expense for the following years is as follows (in thousands):

For year ended 12/29/02	\$ 66
For year ended 12/28/03	41
For year ended 12/26/04	41
For year ended 12/25/05	41
For year ended 12/31/06	20

The Company has tested goodwill for impairment in accordance with the provisions of SFAS 142 as of the beginning of fiscal year 2002. In connection with the goodwill test, the Company engaged an independent firm to determine the fair values of its reporting units (as defined by SFAS 142). In its determination of the fair values, the firm engaged by the Company utilized various valuation approaches, including (a) discounted cash flow analysis, (b) recent values paid by investors and purchasers of companies in businesses similar to that of the Company, (c) capitalization multiples of companies with investment characteristics resembling those of the reporting units, (d) the enterprise value of the Company, and (e) asset and liability structure. Based on management’s assessment of the circumstances, considering the firm’s findings, the Company recognized an impairment loss of \$55.0 million (\$43.7 million for Staff Augmentation, \$9.4 million for Financial Outsourcing Services and \$1.9 million for Human Capital Management Services) as a cumulative effect of a change in accounting principle in the accompanying financial statements. These impairment losses relate primarily to the goodwill attributable to staffing companies acquired by the Company in 1996 and 1997, during which time (i) staffing companies were

customarily valued at higher levels than they currently command and (ii) the market price of the Company's common stock was substantially higher than the current market price.

The changes in the carrying amount of goodwill for the six months ended June 30, 2002 is as follows (in thousands):

	Staff Augmentation	Human Capital Management	Financial Outsourcing	Total
Balance as of December 30, 2001	\$ 113,783	\$ 11,100	\$ 9,400	\$ 134,283
Goodwill acquired during year	223	--	--	223
Impairment losses	(43,700)	(1,900)	(9,400)	(55,000)
Amounts reclassified to intangible assets, net	(264)	--	--	(264)
Balance as of June 30, 2002	<u>\$ 70,042</u>	<u>\$ 9,200</u>	<u>\$ --</u>	<u>\$ 79,242</u>

Goodwill amortization for the three and six months ended July 1, 2001 was \$1.1 million and \$2.1, respectively, and generated tax benefits of \$69,000 and \$139,000, respectively. The following table shows the results of operations as if SFAS 142 was applied to prior periods (in thousands, except per share amounts):

	Three Months Ended		Six Months Ended	
	June 30, 2002	July 1, 2001	June 30, 2002	July 1, 2001
Income (loss) before a cumulative effect of a change in accounting principle, as reported	\$ (938)	\$ (401)	\$ (1,926)	\$ 3,618
Plus:				
Goodwill amortization, net of tax	<u>--</u>	<u>981</u>	<u>--</u>	<u>1,961</u>
Adjusted income (loss) before a cumulative effect of a change in accounting principle	<u>\$ (938)</u>	<u>\$ 580</u>	<u>\$ (1,926)</u>	<u>\$ 5,579</u>
Basic income (loss) per common share:				
Income (loss) before a cumulative effect of a change in accounting principle, as reported	\$ (0.06)	\$ (0.02)	\$ (0.12)	\$ 0.22
Goodwill amortization, net of tax	<u>--</u>	<u>0.06</u>	<u>--</u>	<u>0.12</u>
Adjusted income (loss) before a cumulative effect of a change in accounting principle	<u>\$ (0.06)</u>	<u>\$ 0.04</u>	<u>\$ (0.12)</u>	<u>\$ 0.34</u>
Diluted income (loss) per common share:				
Income (loss) before a cumulative effect of a change in accounting principle, as reported	\$ (0.06)	\$ (0.02)	\$ (0.12)	\$ 0.21
Goodwill amortization, net of tax	<u>--</u>	<u>0.06</u>	<u>--</u>	<u>0.12</u>
Adjusted income (loss) before a cumulative effect of a change in accounting principle	<u>\$ (0.06)</u>	<u>\$ 0.04</u>	<u>\$ (0.12)</u>	<u>\$ 0.33</u>

8. ACCOUNTING FOR EXTINGUISHMENT OF DEBT

The Financial Accounting Standard Board (“FASB”) issued Statement No. 145, *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections* (“SFAS 145”). SFAS 145 rescinds Statement 4, which required all gains and losses from extinguishment of debt to be aggregated and, if material, classified as an extraordinary item, net of related income tax effect. As a result, the criteria in Opinion 30 will now be used to classify those gains and losses both on a prospective and retrospective basis. The provisions of SFAS 145 are effective for fiscal years beginning after May 15, 2002, with early adoption of the provisions related to the rescission of Statement 4 encouraged. As a result, the Company adopted SFAS 145 during the second fiscal quarter of 2002.

The adoption of SFAS 145 had no impact upon the Company’s consolidated balance sheet or net income in its consolidated statement of operations for any period, but required a reclassification of the gain on the extinguishment of debt, net of related income tax effect, for fiscal 2000 and 2001 and the quarterly periods during such years in which the Company repurchased its debt at a discount. For these periods, the gain, before any tax effect, has been recorded as other income and the income (loss) before tax and the provision for income taxes line items have been adjusted accordingly. The Company’s consolidated statement of operations for the six months ended July 1, 2001 has been reclassified as described, and the reclassifications for other periods will be reflected in future quarterly and annual reports of the Company in which statements for the relevant periods are required to be included.

9. NEW ACCOUNTING STANDARDS

In August 2001, the FASB issued Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (“SFAS 144”). SFAS 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets and supersedes SFAS 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*. However, SFAS 144 retains the fundamental provisions of SFAS 121 for (a) recognition and measurement of the impairment of long-lived assets to be held and used and (b) measurement of long-lived assets to be disposed of by sale. SFAS 144 supersedes the accounting and reporting provisions of APB Opinion No. 30, *Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*, for the disposal of a segment of a business. However, SFAS 144 retains the requirement of Opinion 30 to report discontinued operations separately from continuing operations and extends that reporting to a component of an entity that either has been disposed of (by sale, by abandonment, or in distribution to owners) or is classified as held for sale. SFAS 144 also amends ARB No. 51, *Consolidated Financial Statement*, to eliminate the exception to consolidation for a temporarily controlled subsidiary. The Company adopted SFAS 144 effective for calendar year 2002. The impact of the adoption did not have a material impact on its consolidated financial statements since the impairment assessment under SFAS 144 is largely unchanged from SFAS 121. The provisions of this statement for assets held for use or other disposal generally are required to be applied prospectively to newly initiated disposal activities and therefore, will depend on future actions initiated by management. As a result, the Company cannot determine the potential effects that the adoption of SFAS 144 will have on its financial statements with respect to future disposal decisions, if any.

In July 2002, the FASB issued Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* (“SFAS 146”). SFAS 146 requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. SFAS 146 will be applied to exit or disposal activities after December 31, 2002 and is not expected to have a material effect on the Company.

10. RECLASSIFICATIONS

Certain reclassifications have been made to conform prior period amounts to the current period presentation. See also notes 7 and 8.

11. CONTINGENCIES

The Company is currently undergoing a payroll tax audit by the Internal Revenue Service for the fiscal year 1999. The results of this audit are not yet known.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The discussion set forth below supplements the information found in the unaudited consolidated financial statements and related notes of COMFORCE Corporation ("COMFORCE") and its subsidiaries, including COMFORCE Operating, Inc. ("COI") (collectively, the "Company").

Overview

From the time it entered the staffing business in October 1995 through January 1998, the Company completed 10 acquisitions. In February 2000, it completed one additional acquisition. Each of these acquisitions has been accounted for on a purchase basis and the results of operations of each of the businesses acquired have been included in the Company's historical consolidated financial statements from the date of acquisition. Certain of these acquisitions provide for contingent payments by the Company as a part of the purchase consideration based upon the operating results of the acquired businesses for specified future periods. The acquisitions were financed by the Company principally through the issuance of debt and equity securities and borrowings under credit facilities.

Staffing personnel placed by the Company are employees of the Company. The Company is responsible for employee related expenses for its employees, including workers' compensation, unemployment compensation insurance, Medicare and Social Security taxes and general payroll expenses. The Company offers health, dental, disability and life insurance to its eligible billable employees. Staffing and consulting companies, including the Company, typically pay their billable employees for their services before receiving payment from their customers, often resulting in significant outstanding receivables. To the extent the Company grows, these receivables will increase and there will be greater requirements for borrowing availability under its credit facility to fund current operations.

The Company reports its results through three operating segments -- Staff Augmentation, Human Capital Management Services and Financial Outsourcing Services (formerly known as Financial Services). The Staff Augmentation segment provides information technology (IT), telecom, healthcare support, technical and other staffing services. The Human Capital Management Services segment provides contingent workforce management services. The Financial Outsourcing Services segment provides payroll, funding and back office support services to independent consulting and staffing companies.

Results of Operations

Three Months Ended June 30, 2002 Compared to Three Months Ended July 1, 2001

Net sales of services for the three months ended June 30, 2002 were \$94.4 million, a decrease of 15.9% from net sales of services for the three months ended July 1, 2001 of \$112.2 million. The Company suffered a decrease in net sales of services in Staff Augmentation and Financial Outsourcing Services segments, offset by an increase in the Human Capital Management Services segment. Due to an increase in the Human Capital Management segment client base, net sales of services increased \$9.5 million, or 30.4%. In the Staff Augmentation segment, the decrease of \$26.5 million or 34.1% is principally attributable to a decline in the telecom industry resulting in lower sales to telecom customers, and the continued economic slowdown within IT, technical and other staffing services. Also, as a result of the current economic recession, net sales of services decreased \$774,000 or 24.3% in the Financial Outsourcing Services segment.

Cost of services for the three months ended June 30, 2002 was 80.9% of net sales of services as compared to cost of services of 78.6% for the three months ended July 1, 2001. The cost of services as a percentage of net sales for the second

quarter of 2002 increased from the comparable period in 2001 principally as a result of a decrease in permanent placement fees and a higher growth in the Human Capital Management Services segment which has a higher cost of services as a percentage of net sales of services.

Selling, general and administrative expenses as a percentage of net sales of services were 14.7% for the three months ended June 30, 2002, compared to 14.9% for the three months ended July 1, 2001. Due to lower sales, as discussed above, management continued to undertake initiatives to reduce selling, general and administrative costs, and has been successful in controlling costs as sales decreased. These costs were further reduced by lower commissions as a result of the decrease of sales discussed above.

Operating income for the three months ended June 30, 2002 was \$3.1 million as compared to operating income of \$5.3 million for the three months ended July 1, 2001. This 41.3% decrease in operating income for the three months ended June 30, 2002 resulted principally from a decrease in sales and gross margins in Staff Augmentation and Financial Outsourcing Services segments, partially offset by a reduction of \$1.1 million in goodwill amortization.

The Company's interest expense for the three months ended June 30, 2002 is attributable to the revolving credit facility agented by IBJ Whitehall Business Credit Corporation (the "IBJ Credit Facility"), the Convertible Notes, the 12% Senior Notes due 2007 (the "Senior Notes") and the PIK Debentures. The Company's interest expense for the three months ended July 1, 2001 is attributable to the IBJ Credit Facility, the Senior Notes and the PIK Debentures. During the first quarter of 2001, the Company repurchased \$13.0 million principal amount of Senior Notes for \$8.9 million and \$5.2 million principal amount of PIK Debentures for \$2.5 million (including accrued and unpaid interest of \$340,000), the repurchase prices of which were paid from lower interest rate borrowings under the IBJ Credit Facility. In September 2001, the Company completed the exchange of \$18.0 million principal amount of PIK Debentures for its Convertible Note in the original principal amount of \$8.0 million (bearing interest at the per annum rate of 8%), plus \$1.0 million in cash. The interest expense was lower for the three months ended June 30, 2002 as compared to the three months ended July 1, 2001 due to lower market interest rates and lower borrowing levels under the IBJ Credit Facility as well as the reduction of Senior Notes and PIK Debentures through the transactions described above.

The income tax provision for the three months ended June 30, 2002 was \$153,000 on a loss before tax of \$785,000. The income tax provision for the three months ended July 1, 2001 was \$578,000 on income before tax of \$177,000. The Company provides for income taxes based upon the estimated effective rate (on a year-to-date basis). As a result of the Company's revised forecasts in the second quarter of 2002, the expected tax rate was reduced. The difference between the federal statutory income tax rate and the Company's effective tax rate relates primarily to the nondeductibility of a portion of the interest expense associated with the PIK Debentures and state income taxes for both periods as well as amortization expense associated with goodwill that was not deductible in 2001.

Six Months Ended June 30, 2002 Compared to Six Months Ended July 1, 2001

Net sales of services for the six months ended June 30, 2002 were \$188.2 million, a decrease of 20.1% from net sales of services for the six months ended July 1, 2001 of \$235.6 million. The Company suffered a decrease in net sales of services in Staff Augmentation and Financial Outsourcing Services segments, partially offset by an increase in the Human Capital Management Services segment. Net of sales of services in the Human Capital Management Services segment increased by \$13.8 million or 21.6% due to an increase in its client base. In the Staff Augmentation segment, the decrease of \$59.4 million (35.9%) is principally attributable to a sharp decline in the telecom industry resulting in lower sales to telecom customers, and the continued economic slowdown within IT, technical and other staffing services. Also, as a result of the current economic recession, net sales of services were lower by \$1.8 million (28.1%) in the Financial Outsourcing Services segment.

Cost of services for the six months ended June 30, 2002 was 81.3% of net sales of services as compared to cost of services of 78.6% for the six months ended July 1, 2001. The cost of services as a percentage of net sales for the six months ended June 30, 2002 increased from the comparable period in 2001 principally as a result of lower sales (and gross margin percentages on sales) to telecom customers, a decrease in permanent placement fees and a higher growth in Human Capital Management Services which has a higher cost of services as a percentage of net sales of services.

Selling, general and administrative expenses as a percentage of net sales of services were 14.7% for the six months ended June 30, 2002, compared to 14.6% for the six months ended July 1, 2001. This percentage increase is principally a result of significantly lower net sales of services during the first six months of 2002. Due to these lower sales, as discussed above, management continues to undertake initiatives to reduce selling, general and administrative costs. These costs were further reduced by lower commissions as a result of the decrease of sales discussed above.

Operating income for the six months ended June 30, 2002 was \$5.5 million as compared to operating income of \$12.1 million for the six months ended July 1, 2001. This 54.3% decrease in operating income for the six months ended June 30, 2002 resulted principally from a decrease in sales and gross margins in Staff Augmentation and Financial Outsourcing Services segments, partially offset by a reduction of \$2.1 million in goodwill amortization.

The Company's interest expense for the six months ended June 30, 2002 is attributable to the revolving credit facility agented by IBJ Whitehall Business Credit Corporation (the "IBJ Credit Facility"), the Convertible Notes, the 12% Senior Notes due 2007 (the "Senior Notes") and the PIK Debentures. The Company's interest expense for the six months ended July 1, 2001 is attributable to the IBJ Credit Facility, the Senior Notes and the PIK Debentures. During the first quarter of 2001, the Company repurchased \$13.0 million principal amount of Senior Notes for \$8.9 million and \$5.2 million principal amount of PIK Debentures for \$2.5 million (including accrued and unpaid interest of \$340,000), the repurchase prices of which were paid from lower interest rate borrowings under the IBJ Credit Facility. In September 2001, the Company completed the exchange of \$18.0 million principal amount of PIK Debentures for its Convertible Note in the original principal amount of \$8.0 million (bearing interest at the per annum rate of 8%), plus \$1.0 million in cash. The interest expense was lower for the six months ended June 30, 2002 as compared to the six months ended July 1, 2001 due to lower market interest rates and lower borrowing levels under the IBJ Credit Facility as well as the reduction of Senior Notes and PIK Debentures through the transactions described above.

The income tax benefit for the six months ended June 30, 2002 was \$429,000 on a loss before tax of \$2.4 million. The income tax provision for the six months ended July 1, 2001 was \$4.2 million on income before tax of \$7.8 million. Applying SFAS 145 (in accordance with the criteria in APB Opinion 30), the gain on the extinguishment of debt, net of related income tax effect, for the six months ended July 1, 2001 was recorded as other income (before any tax effect), which in turn required that the income before tax and the provision for income taxes line items be adjusted accordingly. The Company provides for income taxes based upon the estimated effective rate (on a year-to-date basis). As a result of the Company's revised forecasts in the second quarter of 2002, the expected tax rate was reduced. The difference between the federal statutory income tax rate and the Company's effective tax rate relates primarily to the nondeductibility of a portion of the interest expense associated with the PIK Debentures and state income taxes for both periods as well as amortization expense associated with goodwill that was not deductible in 2001.

Financial Condition, Liquidity and Capital Resources

The Company generally pays its billable employees weekly for their services, and remits certain statutory payroll and related taxes as well as other fringe benefits. Invoices are generated to reflect these costs plus the Company's markup. These bills are typically paid within 45 days. Increases in the Company's net sales of services, resulting from expansion of existing offices or establishment of new offices, will require additional cash resources.

The Company is under certain contractual commitments associated with operating agreements, obligations to financial institutions and other long-term debt obligations and earnout (contingent payment) agreements described under "Financial Condition, Liquidity and Capital Resources" in Item 7 of the Company's Annual Report on Form 10-K for the year ended December 30, 2001.

During the three months ended June 30, 2002, the Company's primary sources of funds to meet working capital needs were from borrowings under the IBJ Credit Facility. Cash and cash equivalents increased \$964,000 during the three months ended June 30, 2002. Cash flows provided by operating activities of \$8.4 million exceeded cash flows used in financing activities of \$5.4 million and cash flows used in investing activities of \$2.1 million.

As of June 30, 2002, the Company had outstanding \$44.0 million principal amount under the IBJ Credit Facility bearing interest at a weighted average rate of 4.5% per annum. In addition, as of June 30, 2002, the Company had

outstanding \$11.2 million principal amount of PIK Debentures bearing interest at a rate of 15% per annum, \$87.0 million principal amount of Senior Notes bearing interest at a rate of 12% per annum and \$8.5 million principal amount of Convertible Notes bearing interest at the rate of 8% per annum. As more fully described below, interest on the PIK Debentures and the Convertible Notes may be satisfied through the issuance of new PIK Debentures and Convertible Notes. To date, the Company has chosen to issue new PIK Debentures and Convertible Notes to pay interest thereon.

The Company entered into the IBJ Credit Facility in December 2000 to provide greater borrowing availability and flexibility. The IBJ Credit Facility has been amended six times since it was entered into, most recently to ensure the Company's compliance with financial covenants at March 31, 2002, described below and to lessen the requirements through December, 2003. The IBJ Credit Facility, as amended, has permitted the Company to execute its strategy of reducing its higher interest rate debt and improving its balance sheet by retiring Senior Notes and PIK Debentures. The IBJ Credit Facility currently provides for borrowing availability of up to \$95.0 million based upon a specified percentage of the Company's eligible accounts receivable. At June 30, 2002, the Company had remaining availability based upon then outstanding eligible accounts receivable of \$14.0 million.

Effective as of May 10, 2002, the Company has entered into an amendment to the IBJ Credit Facility to, among other things (i) waive the Company's non-compliance with the fixed-charge coverage ratio for the period ended March 31, 2002, (ii) reduce the fixed-charge coverage ratio in future periods, and (iii) increase each level of the applicable rate and LIBOR margins by 0.25%. As of June 30, 2002, the incremental rate was 3.0%.

The scheduled maturity date of the IBJ Credit Facility is December 14, 2003. The Company intends to seek to extend the IBJ Credit Facility or to seek to obtain alternative financing.

Substantially all of the consolidated net assets of the Company are assets of COI and all of the net income that has been generated by the Company through June 30, 2002 is net income attributable to the operations of COI. Accordingly, except for permitted distributions, these assets and net income are restricted as to their use by COMFORCE. The indenture governing the Senior Notes imposes restrictions on COI making specified payments, which are referred to as "restricted payments," including making distributions or paying dividends (referred to as upstreaming funds) to COMFORCE. Under the indenture, COI is not permitted to make cash distributions to COMFORCE other than (1) to upstream \$2.0 million annually (\$1.25 million annually prior to 2000) to pay public company expenses, (2) to upstream up to \$10.0 million to pay income tax related to deemed forgiveness of PIK Debentures to facilitate the purchase or exchange by COMFORCE of PIK Debentures at less than par, (3) under certain circumstances in connection with a disposition of assets, to upstream proceeds therefrom to repay the PIK Debentures, and (4) to upstream funds to the extent COI meets the restricted payments test under the indenture.

Management believes that \$2.0 million annually (if COI has funds available for this purpose) will be sufficient to pay COMFORCE's annual public company expenses for the foreseeable future. As of June 30, 2002, COI had approximately \$1.6 million remaining available for distribution to COMFORCE as permitted restricted payments (representing 50% of consolidated net income of COI for the period from January 1, 1998 through June 30, 2002, less the total amount of restricted payments through such date).

Through December 1, 2002, interest under the PIK Debentures is payable, at the option of COMFORCE, in cash or in kind through the issuance of additional PIK Debentures. In addition, through December 1, 2003, interest on the Convertible Notes is payable, at the option of COMFORCE, in cash or in kind through the issuance of additional Convertible Notes. To date, COMFORCE has paid all interest under the PIK Debentures and Convertible Notes in kind. Beginning with the interest payment due June 1, 2003, COMFORCE will be required to pay interest on the PIK Debentures in cash, and beginning with the interest payment due June 1, 2004, COMFORCE will be required to pay interest on the Convertible Notes in cash. Its ability to do so will be dependent on the ability of COI to borrow funds for this purpose under the IBJ Credit Facility and to upstream funds under the restricted payments test. In addition, COMFORCE's ability to repay the PIK Debentures and the Convertible Notes at their respective maturity dates in December 2009, or on any earlier required repayment or repurchase dates, will also be dependent on the ability of COI to upstream funds for these purposes under the restricted payments test, unless COMFORCE separately obtains a loan or sells its capital stock or other securities to provide funds therefor.

The Convertible Note is convertible into the Company's common stock based on a price of \$1.70 per share of common stock, provided that if such conversion would result in a change of control occurring under the terms of the indentures governing the PIK Debentures or the Senior Notes, the Convertible Note will be convertible into shares of non-voting preferred stock having a nominal liquidation preference (but no other preferences), which in turn will be convertible into common stock at the holder's option at any time so long as the conversion would not result in a change of control. Notice of conversion must be given at least 61 days in advance.

As of June 30, 2002, approximately \$79.2 million, or 43.8%, of the Company's total assets were goodwill recorded in connection with the Company's acquisitions. Effective December 31, 2001, the Company ceased recording amortization expense relating to goodwill amounting to approximately \$4.2 million annually upon its required adoption of a new accounting standard (SFAS 142), as described under note 6 to the consolidated financial statements. As also described under note 6, the Company evaluated the recoverability of goodwill on its books under the new standards under SFAS 142, resulting in its write-off of \$55.0 million of goodwill in the first quarter of 2002.

The Company was obligated under various agreements to make earn-out payments to the sellers of companies acquired by the Company and to sellers of franchised businesses repurchased by the Company, subject to the sellers meeting specified contractual requirements. During fiscal 2002, the Company made earn-out payments totaling \$323,000. It has no remaining obligation to make earn-out payments to any person in future periods.

Management of the Company believes that cash flow from operations and funds anticipated to be available under the IBJ Credit Facility will be sufficient to service the Company's indebtedness and to meet currently anticipated working capital requirements.

The Company is currently undergoing a payroll tax audit by the Internal Revenue Service for the fiscal year 1999. The results under this audit are not yet known.

Seasonality

The Company's quarterly operating results are affected primarily by the number of billing days in the quarter and the seasonality of its customers' businesses. Demand for technical and engineering services, IT and telecom staffing services has historically been lower during the second half of the fourth quarter through the following first quarter, and, generally, shows gradual improvement until the second half of the fourth quarter; however, the Company's revenues have declined since the first quarter of 2001 as a result of the economic climate generally and in certain of the industries served by the Company or other factors.

Forward Looking Statements

Various statements made in this Report concerning the manner in which the Company intends to conduct its future operations, and potential trends that may impact future results of operations, are forward looking statements. The Company may be unable to realize its plans and objectives due to various important factors, including, but not limited to the following: a continuation of the current recessionary environment, particularly in the aircraft manufacturing, telecom, information technology and other sectors served by the Company (which may reflect cyclical conditions or fundamental changes in these industries), could further reduce demand for contingent personnel and further heighten the competition for customers, resulting in lower revenues and margins and affecting the Company's ability to continue to meet the financial covenants under the IBJ Credit Facility; the Company's significant leverage may leave it with a diminished ability to obtain additional financing for working capital or other capital expenditures, for retiring higher interest rate debt or for otherwise improving the Company's competitiveness and capital structure or expanding its operations; recently adopted SFAS 142, which requires the Company to evaluate annually the recoverability of goodwill on its books, could cause the Company to write-off goodwill in future periods (in addition to the write-off of \$55.0 million in the first quarter of 2002), which could have a material adverse impact on the Company's financial condition and results of operations; or, if COI fails to generate sufficient consolidated net income or have other funds available to upstream to COMFORCE under the restricted payments test of the Senior Notes indenture in order for it to pay cash interest on the PIK Debentures (which is required beginning June 1, 2003) or the Convertible Note (which is required beginning June 1, 2004) or to repay the PIK Debentures or the Convertible Note at their maturity in December 2009, or on any earlier required repayment or repurchase date, then, unless COMFORCE

obtains a loan or sells its capital stock or other securities to provide funds for this purpose, the Company will default under the indentures governing the PIK Debentures and the Senior Notes and under the IBJ Credit Facility.

Additional important factors that could cause the Company to be unable to realize its plans and objectives are described under "Risk Factors" in the Registration Statement on Form S-3 of the Company filed with the Securities and Exchange Commission on December 21, 2000 (Registration No. 333-52356). The disclosure under "Risk Factors" in the Registration Statement may be accessed through the Web site maintained by the Securities and Exchange Commission at "www.sec.gov." In addition, the Company will provide, without charge, a copy of such "Risk Factors" disclosure to each stockholder of the Company who requests such information. Requests for copies should be directed to the attention of Linda Annicelli, Vice President, Administration at COMFORCE Corporation, 415 Crossways Park Drive, P.O. Box 9006, Woodbury, New York 11797, telephone 516-437-3300.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information required by Item 3 has been disclosed in Item 7A of the Company's Annual Report on Form 10-K for the year ended December 30, 2001. There has been no material change in the disclosure regarding market risk.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

Since the date of the filing of the Company's Annual Report on Form 10-K for the year ended December 30, 2001, there have been no material new legal proceedings involving the Company or any material developments to the proceedings described in such 10-K.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS.

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

Not applicable.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

On June 13, 2002, the annual meeting of the stockholders of the Company was held. At this meeting, the stockholders voted on (1) the election of directors, with each to serve for a term of one year, and (2) the approval of the COMFORCE Corporation 2002 Stock Option Plan, and (3) ratification of the appointment of KPMG LLP as the Company's auditors for the year ending December 29, 2002.

The following individuals were elected to the Board of Directors upon the vote shown:

<i>Nominee</i>	<i>For</i>	<i>Withheld</i>
John C. Fanning	14,017,438	118,275
Harry Maccarrone	14,056,944	78,769
Rosemary Maniscalco	14,056,944	78,769
Kenneth J. Daley	14,017,444	118,269
Daniel Raynor	14,056,944	78,769
Gordon Robinett	14,056,944	78,769

The COMFORCE Corporation 2002 Stock Option Plan was approved upon the following vote:

<i>For</i>	<i>Against</i>	<i>Abstentions and Broker non-Votes</i>
7,623,055	287,009	6,225,649

The appointment of KPMG LLP was ratified and approved upon the following vote:

<i>For</i>	<i>Against</i>	<i>Abstentions and Broker non-Votes</i>
14,096,784	32,820	6,109

ITEM 5. OTHER INFORMATION.

Not applicable.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

(a) Exhibits.

10.1 Fourth Amendment, dated as of July 1, 2002, to Employment Agreement dated as of January 1, 1999 and as previously amended as of March 28, 2000, January 23, 2001 and September 27, 2001, among John C. Fanning, COMFORCE Corporation and COMFORCE Operating, Inc.

10.2 Third Amendment, dated as of July 1, 2002, to Employment Agreement dated as of January 1, 1999 and as previously amended as of January 23, 2001 and September 27, 2001, among Harry V. Maccarrone, COMFORCE Corporation and COMFORCE Operating, Inc.

10.3 Deferred Vacation Plan adopted July 17, 2002.

99.1 Certification of Chief Executive Officer and Chief Financial Officer.

(b) Reports on Form 8-K.

None.

SIGNATURES

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

COMFORCE Corporation

By: /s/ Harry Maccarrone
Harry Maccarrone, Executive Vice President
and Chief Financial Officer

Date: August 13, 2002