ANDREA ELECTRONICS CORP
Form 10KSB
March 31, 2008

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

FORM 10-KSB

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

For the Fiscal Year Ended December 31, 2007

¨ 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 1-4324

ANDREA ELECTRONICS CORPORATION
(Name of small business issuer in its charter)

New York (State or other jurisdiction of incorporation or organization)	11-0482020 (I.R.S. employer identification no.)
65 Orville Drive, Bohemia, New York (Address of principal executive offices)	11716 (Zip Code)

Issuer's telephone number, including area code: 631-719-1800

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

Securities registered under Section 12(g) of the Exchange Act:

Common Stock, par value $.01 per share

Title of class

Check whether the issuer is not required to file reports Section 13 or 15(d) of the Exchange Act. ¨

Check whether the issuer: (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 x No ¨

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. ¨

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

The issuer's revenues for the fiscal year ended December 31, 2007 were $5,046,213.

The aggregate market value of the voting and non-voting common equity held by non-affiliates was $4,700,683 based upon the closing price of $0.08 as quoted on the Over the Counter Market on March 24, 2008.

The number of shares outstanding of the registrant's Common Stock as of March 24, 2008, was 59,861,193.

DOCUMENTS INCORPORATED BY REFERENCE

None

Transitional Small Business Disclosure Format. Yes ¨ No x

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PART I

ITEM 1. DESCRIPTION OF BUSINESS

Overview

Andrea Electronics Corporation (“Andrea”) designs, develops and manufactures state-of-the-art microphone technologies and products for enhancing speech-based applications software and communications that require high quality, clear voice signals. Our technologies eliminate unwanted background noise to enable the optimum performance of various speech-based and audio applications. We are incorporated under the laws of the State of New York and have been engaged in the electronic communications industry since 1934.

Andrea’s products and technologies optimize the performance of speech-based applications and audio applications in primarily the following markets:

- personal computing (primarily for speech recognition applications and voice communication over the internet);
- audio and video conferencing; and
- in-vehicle communications (to enable untethered, hands-free communication).

Andrea Digital Signal Processing (“DSP”) Microphone and Audio Software business – Our patented and patent-pending digital noise canceling technologies enable a speaker to be several feet from the microphone, and free the speaker from having to hold the microphone (we refer to this capability as “far-field” microphone use). Our Digital Super Directional Array (“DSDA”) and Pure Audio microphone products convert sound received by an array of microphones into digital signals that are then processed to cancel background noise from the signal to be transmitted. These two adaptive technologies represent the core technologies within our portfolio of far-field technologies. In addition to DSDA and Pure Audio, Andrea has developed and commercialized several other digital, far-field noise canceling technologies, including, among others, Andrea EchoStop, a high-quality acoustic echo canceller which enables speaker phone functionality with technology for canceling unwanted stationary noises.

All of our digital, far-field microphone technologies are software-based and operate using either a dedicated DSP or a general purpose processor (for example, the Intel Pentium). The software, which may encompass one or all of our far-field noise canceling technologies, can be applied to improve the performance of a single microphone or multiple microphones. In addition, our digital, far-field, noise canceling technologies can be tailored and implemented into various form factors, for example, into the monitor of a PC, a personal digital assistant, a rear view mirror or, and can be used individually or combined depending on particular customer requirements.

We are currently targeting our far-field technologies at 1) the desktop computing market (primarily through our relationship with Analog Devices, Inc. (“Analog Devices”), 2) the video and audio conferencing market and 3) the market for personal hands free communication designed for use in automobiles, trucks and buses to control PCs and cellular communication and other devices within vehicles. Our far-field, digital noise canceling technologies and related products, together with implementations of other high-end audio technologies (for example, our Active Noise Cancellation technology) comprise our Andrea DSP Microphone and Audio Software line of business. Net revenues of such technologies and products during the years ended December 31, 2007 and 2006 approximated 48% and 55%, respectively, of our total net revenues. We dedicate the majority of our marketing and research and development resources to this business segment, as we believe that communication products will increasingly require high performance, untethered (hands-free and headset-free) microphone technology.

Andrea Anti-Noise Headset Product business – Our headset microphone products help to ensure clear speech in personal computer and telephone headset applications. Our Active Noise Cancellation microphone technology uses electronic circuits that distinguish a speaker's voice from background noise in the speaker's environment and then cancels the noise from the signal to be transmitted by the microphone. Our Active Noise Reduction headphone products use electronic circuits that distinguish the signal coming through an earphone from background noise in the listener's environment and then reduces the noise heard by the listener. Together with our standard noise canceling headset products, these products comprise our Andrea Anti-Noise Headset Product segment. During the years ended December 31, 2007 and 2006, our Andrea Anti-Noise Headset Product segment approximated 52% and 45%, respectively, of our total net revenues.

For more financial information regarding our operating segments, see Note 14 of the audited consolidated financial statements.

Industry Background

Our primary mission is to provide the emerging "voice interface" markets with state-of-the-art microphone and communication products. The idea underlying these markets is that natural language spoken by the human voice will become an important means by which to communicate and control many types of computing devices and other appliances and equipment that contain microprocessors. We are designing and marketing our products and technologies to be used for these "natural language, human/machine" interfaces with:

- desktop, laptop and hand-held computers and mobile personal computing devices;
- video and audio conferencing systems; and
- automotive communication systems.

We believe that end users of these applications and interfaces will require high quality microphone and earphone products that enhance voice transmission, particularly in noisy office and mobile environments. We also believe that these applications will increasingly require microphones that are located several feet from the person speaking, or far-field microphone technology. Applications in this area include:

- continuous speech dictation to personal computers;
- multiparty video teleconferencing and software that allows participants to see and jointly communicate; and
- cellular hands free interfaces for automobiles, home and office automation.

We believe that an increasing number of these devices will be introduced into the marketplace during the next several years.

Our Strategy

Our strategy is to:

- maintain and extend our market position with our Andrea DSP Microphone and Audio Software technologies and products and our higher margin Andrea Anti-Noise products;
- develop relationships with companies that have significant distribution capabilities for our Andrea DSP Microphone and Audio Software technologies and products and Andrea Anti-Noise products;
- broaden our Andrea DSP Microphone and Audio Software product lines and Andrea Anti-Noise product lines through a more modest but still a healthy level of internal research and development;
- design our products to satisfy specific end-user requirements identified by our collaborative partners; and
- outsource manufacturing of our products in order to reduce fixed overhead and achieve economies of scale.

An important element of our strategy for expanding the channels of distribution and broadening the base of users for our products is our collaborative arrangements with manufacturers of computing and communications equipment and software publishers that are actively engaged in the various markets in which our products have application. In addition, we have been increasing our own direct marketing efforts.

The success of our strategy will depend on our ability to, among other things:

- increase net revenues of Andrea DSP Microphone and Audio Software products and our line of existing Andrea Anti-Noise products;
- continue to contain costs;
- introduce additional Andrea DSP Microphone and Audio Software products and Andrea Anti-Noise products;

- maintain the competitiveness of our technologies through focused and targeted research and development; and
- achieve widespread adoption of our products and technologies.

Our Technologies

We design our Andrea DSP Microphone and Audio Software and Andrea Anti-Noise products to transmit voice signals with the high level of quality, intelligibility and reliability required by the broad range of voice-based applications in computing and telecommunications. We achieve this through the use of several audio technologies that employ software processes that are proprietary to us. Software processes of this type are commonly referred to as algorithms.

Andrea DSP Microphone and Audio Software Technology

This set of technologies is generally based on the use of an array of microphones from which the analog signals are converted to digital form and then processed using digital electronic circuitry to eliminate unwanted noise in the speaker's environment. Our Andrea DSP Microphone and Audio Software Products provide clear acoustic and audio input performance where the desired audio signal is at a distance from the microphone. An example of this is a person driving an automobile who wants to control various systems in the car or communicate through a wireless telephone. We have also engineered our Andrea DSP Microphone and Audio Software Products to be compatible with Universal Serial Bus, or USB, computer architecture. USB is an industry standard for connecting peripherals, such as microphones, earphones, headsets, keyboards, mice, joysticks, scanners and printers, to personal computers. We believe that our Andrea DSP Microphone and Audio Software technology achieve far-field microphone performance previously unattainable through microphones based on mechanical acoustic designs and microphones based on analog signal processing.

Our Andrea DSP Microphone and Audio Software Products include the use of the following technologies, among other technologies and techniques:

Digital Super Directional Array (DSDA®). Our patented DSDA microphone technology enables high quality far-field communications by centering microphone sensitivity on a user's voice and canceling noise outside of that signal. DSDA continuously samples the ever changing acoustic properties within an environment and adaptively identifies interfering noises that are extraneous to the voice signal, resulting in increased intelligibility of communications.

PureAudio®. Our patented PureAudio is a noise canceling algorithm that enhances applications that are controlled by speech by sampling the ambient noise in an environment and attenuating the noise from sources near or around the desired speech signals, thus delivering a clear audio signal. Designed specifically to improve the signal-to-noise ratio, PureAudio is effective in canceling stationary noises such as computer and ventilation fans, tires and engines.

EchoStop®. Our patented EchoStop is an advanced acoustic echo canceller (stereo version available) developed for use with conferencing systems such as group audio and videoconferencing systems and cellular car phone kits. EchoStop allows true two-way communication (often referred to as full duplex) over a conferencing system, even when the system is used in large spatial environments that may be vulnerable to extensive reverberation. EchoStop incorporates noise reduction algorithms to reduce the background noise of both the microphone input and the loudspeaker output, thus preventing the accumulation of interfering noise over conferencing systems that facilitate communication among multiple sites.

SuperBeam™. SuperBeam is a highly accurate digital algorithm that forms an acoustic beam that extends from the microphone to the speech source in an environment. We believe SuperBeam provides a fixed noise reduction microphone solution for the typical acoustic environment found in room environments in which speech is used, such as in offices and homes. The microphone beam is generated by processing multiple microphone samples through pre-established digital filters and adding the outputs. The result is an optimum speech enhancement and noise reduction solution to a predefined setting. Because the beam is able to adapt to changes in the acoustic environment, this technology is called adaptive beamforming.

Direction Finding and Tracking Array (DFTA®). Our patented DFTA technology utilizes an array of microphones, unique software algorithms and digital signal processing to detect the presence of a user's voice. DFTA determines the direction of the voice which then tracks the speaker when he or she moves.

Andrea Anti-Noise Technologies

Noise Cancellation (“NC”) Microphone Technology. This technology is based on the use of pressure gradient microphones to reduce the transmission of noise from the speaker’s location. Instead of using electronic circuitry to reduce noise, pressure gradient microphones rely on their mechanical and acoustic design to do so. Our NC microphones are well-suited for applications in which there is less background noise in the speaker’s environment.

Active Noise Cancellation (“ANC”) Microphone Technology. This technology is based on analog signal processing circuits that electronically cancel the transmission of noise from the speaker’s location. ANC is particularly well-suited for those environments in which the speaker is surrounded by high levels of ambient background noise.

Our ANC and NC microphones are most effectively used in “near-field” applications where the microphone is next to the speaker’s mouth such as a headset environment.

Active Noise Reduction (“ANR”) Earphone Technology. This technology is based on analog signal processing circuits that electronically reduce the amount of noise in the environment that the listener would otherwise hear in the earphone. Our ANR earphones improve the quality of speech and audio heard by a listener in extremely noisy environments, particularly those characterized by low frequency sounds, such as those in aircraft, machine rooms, factories, automobiles, trucks and other ground transportation equipment.

Our Products and their Markets and Applications

Our Andrea DSP Microphone and Audio Software Products and Andrea Anti-Noise Products have been designed for applications that are controlled by or depend on speech across a broad range of hardware and software platforms. These products incorporate our DSP, NC, ANC and ANR microphone technologies, and are designed to cancel background noise in a range of noisy environments, such as homes, offices, factories and automobiles. We also manufacture a line of accessories for these products. For the consumer and commercial markets, we have designed our Andrea DSP Microphone and Audio Software Products and Andrea Anti-Noise Products for the following applications:

– Speech recognition for word processing, database, and similar applications;

– Distance Learning (education through the use of Internet-base lessons and training information);

– Audio/videoconferencing;

– Internet telephony and Voice Chat;

– Professional audio systems;

– Voice-activated interactive games;

– Cellular and other wireless telecommunications; and

– Telematics, or in-vehicle computing (the use of computer-controlled systems in automobiles and trucks)

We market and sell our products directly to end users through our website, computer product distributors, through value-added resellers, to original equipment manufacturers and to software publishers. For more information about these collaborative arrangements, please refer to the information under the caption “Our Collaborative Arrangements”.

Andrea DSP Microphone and Audio Software Products

We develop our Andrea DSP Microphone and Audio Software Products primarily through customer-specific integration efforts, and we either license our related algorithms, sell a product incorporating our related algorithms, or both. For example, we have developed technologies that can be, or are, embedded into a PC, PC monitors, high-end videoconferencing units, IP telephony applications, automotive interiors and hand-held devices, among others. In addition, we have developed stand-alone products for specific customers who then sell such products to end users. As a result, such products are not available from us directly. However, as part of our strategy to increase sales to prospective customers desiring high-quality microphone performance for certain customer-specific environments, we have developed the following products that may be purchased directly from Andrea:

Andrea Superbeam Array Microphone. The Superbeam Array Microphone is a two-microphone device that attaches to the top of any laptop or PC equipped with Analog Devices’ SoundMax® Digital Audio System. The SoundMax Cadenza software is integrated with Andrea Electronics’ PureAudio and DSDA noise-cancellation software, thereby removing the high costs associated with required memory and processing power from previous, DSP-based microphone devices (now powered by Intel’s host processor).

Andrea USB Stereo Full Duplex Adapter (“USBD2A”). The USBD2A was designed for users who desire to utilize Andrea Electronics’ award winning Superbeam Array Microphone, and who operate PCs which do not have integrated stereo microphone input capability. In addition to providing users with high quality voice input to enable, headset-free, speech-based PC applications such as VoIP, voice command and control, and online-gaming, the USBD2A also provides high fidelity, amplified stereo output for multimedia audio playback.

Andrea AudioCommander™. Offering an audio interface for controlling PC multimedia applications, AudioCommander includes controls to operate noise cancellation features, thereby enhancing microphone performance. The software also includes an audio wizard that sets microphone levels to optimize PC audio for speech-enabled applications including speech recognition, Internet telephony and command and speech control functions.

Andrea AutoArray™ Microphone ("AutoArray"). The AutoArray is a digital, high performance microphone system designed for computing applications in vehicles such as automobiles and trucks. It is the first super-directional audio input device designed specifically for in-vehicle computing. The AutoArray incorporates our DSDA and PureAudio technologies, among others.

Andrea VoiceCenter™ ("VoiceCenter"). The VoiceCenter is a multi-functional, digital voice recorder software application that enables recorded speech files to be applied for productivity as well as expressing personality. The digital WAV recorded files are automatically labeled and can be compressed with WMA for attachment to e-mail, used as voice memos, voice alarms (with a calendar reminder function) and even add your voice annotation to documents. The VoiceCenter also includes Andrea PureAudio noise reduction/speech enhancement technology for increasing the recording sound quality of any microphone.

Andrea Anti-Noise Products

Our Andrea Anti-Noise Products include a line of headsets, handsets and related accessories that incorporate our NC, ANC and ANR technologies. Our headsets are mostly differentiated by the various designs of their headband, microphone boom and earphone components and are available in both single earphone monaural and dual earphone stereo models.

NC Products. Our NC products are sold through our internal contact center, as well as to original equipment manufacturers for incorporation into, or for use with their products. With some of our headsets, customers have the unique ability to mix and match microphone boom and headband components to meet their specific application and user comfort preferences. The speaker-housing unit in these models can be used for digital, CD-quality sound. By removing the speaker-housing unit, we can offer this headset for simple speech applications at a lower price.

ANC Products. All of our ANC products are sold through our internal contact center. Two of our higher end ANC headset products incorporate a dual microphone housing design that optimizes the acoustic performance of the sound output with tenor and base attributes that are set, or pre-equalized, at the time of manufacture.

We have developed and manufactured a line of accessories for our Andrea Anti-Noise Products:

Andrea Personal Computer Telephone Interface (“PCTI”). The PCTI is a comprehensive desktop device that integrates computer applications controlled by speech and traditional telephony applications by connecting headset users to the telephone, to the computer, or to both simultaneously. Users can alternately or simultaneously conduct telephone conversations and use speech recognition to enter data or dictate into the PC, without having to pause or toggle between connectivity devices.

Andrea MC-100 Multimedia Audio Controller. The Andrea MC-100 Multimedia Audio Controller connects a PC headset or handset with a PC multimedia speaker system thereby allowing a user to conveniently switch between the headset/handset and the speaker system.

Our Collaborative Arrangements

An important element of our strategy is to promote widespread adoption of our products and technologies by collaborating with large enterprises and market and technology leaders in telecommunications, computer manufacturing, and software publishing. For example, we have arrangements and/or relationships with Analog Devices, Ericsson Inc. and Creative Labs. We are currently discussing additional arrangements with other companies, but we cannot assure that any of these discussions will result in any definitive agreements.

Patents, Trademarks, and Other Intellectual Property Rights

We rely on a combination of patents, patent applications, trade secrets, copyrights, trademarks, nondisclosure agreements, and contractual restrictions to protect our intellectual property and proprietary rights. We cannot assure, however, that these measures will protect our intellectual property or prevent misappropriation or circumvention of our intellectual property.

Andrea maintains a number of patents in the United States covering claims to certain of its products and technology, which expire at various dates ranging from 2012 to 2024. We also have other patent applications currently pending; however, we cannot assure that patents will be issued with respect to these currently pending or future applications which we may file, nor can we assure that the strength or scope of our existing patents, or any new patents, will be of sufficient scope or strength or provide meaningful protection or commercial advantage to us.

Research and Development

We consider our technology to be of substantial importance to our competitiveness. To maintain this competitiveness, we have organized our research and development efforts using a “market and applications” approach for meeting the requirements of new and existing customers. Consistent with this approach, our engineering staff interacts closely with our sales and marketing personnel and directly with customers. The engineering staff is responsible for the research and development of new products and the improvement and support of existing products. For the years ended December 31, 2007 and 2006, total research and development expenses were $676,977 and $571,288, respectively. During 2008, we expect research and development expenses to remain at the same level when compared to 2007. We expect this will occur as a result of our overall plan to improve cash flows by containing our expenses. Additionally, most of Andrea’s core technology is already developed, therefore, heightened emphasis will be placed on application engineering, sales and marketing activity and less emphasis on research and development. No assurance can be given that our research and development efforts will succeed. See “Part II – Item 6 – Management’s Discussion and Analysis or Plan of Operation.”

Sales and Marketing

We employ a sales staff as well as outside sales representative organizations to market our Andrea DSP Microphone and Audio Software Products and our Andrea Anti-Noise Products. Andrea DSP Microphone and Audio Software Products and Andrea Anti-Noise Products are marketed to computer OEMs, distributors of personal computers and telecommunications equipment, software publishers, and end-users in both business and household environments. These products are sold to end-users through distributors and value-added resellers, software publishers, Internet Service Providers and Internet Content Developers. Under our existing collaborative agreements, our collaborators have various marketing and sales rights to our Andrea DSP Microphone and Audio Software and Andrea Anti-Noise Products. We are seeking to enter into additional collaborative arrangements for marketing and selling our Andrea DSP Microphone and Audio Software Products and Andrea Anti-Noise Products, but we cannot assure that we will be successful in these efforts. Market acceptance of the Andrea DSP Microphone and Audio Software Products and Andrea Anti-Noise Products is critical to our success.

Production Operations

In 2007 and 2006, all of our assembly operations were done with subcontractors in Asia or in the United States. Most of the components for the Andrea DSP Microphone and Audio Software Products and Andrea Anti-Noise Products are available from several sources and are not characteristically in short supply. However, certain specialized components, such as microphones and DSP boards, are available from a limited number of suppliers and subject to long lead times. To date we have been able to obtain sufficient supplies of these more specialized components, but we cannot assure that we will continue to be able to do so. Shortages of, or interruptions in, the supply of these more specialized components could have a material adverse effect on our sales of Andrea DSP Microphone and Audio Software Products and Andrea Anti-Noise Products.

Competition

The markets for our Andrea DSP Microphone and Audio Software Products and Andrea Anti-Noise Products are highly competitive. Competition in these markets is based on varying combinations of product features, quality and reliability of performance, price, sales, marketing and technical support, ease of use, compatibility with evolving industry standards and other systems and equipment, name recognition, and development of new products and enhancements. Most of our current and potential competitors in these markets have significantly greater financial, marketing, technical, and other resources than us. Consequently, these competitors may be able to respond more quickly to new or emerging technologies and changes in customer requirements, or to devote greater resources to the development, marketing, and sale of their products than we can. We cannot assure that one or more of these competitors will not independently develop technologies that are substantially equivalent or superior to our technology.

We believe that our ability to compete successfully will depend upon our ability to develop and maintain advanced technology, develop proprietary products, attract and retain qualified personnel, obtain patent or other proprietary protection for our products and technologies and manufacture, assemble and market products, either alone or through third parties, in a profitable manner.

Employees

At December 31, 2007, we had 16 employees, of whom 3 were engaged in production and related operations, 4 were engaged in research and development, and 9 were engaged in management, administration, sales and customer support duties. None of our employees are unionized or covered by a collective bargaining agreement. We believe that we generally enjoy good relations with our employees. In addition to our regular employees, we utilize 6 independent consultants (3 are sales representatives and 3 engaged in research and development activities).

ITEM 2. DESCRIPTION OF PROPERTY

In March 2005 Andrea entered into a lease for its corporate headquarters, which is located in Bohemia, New York. The lease is for approximately 11,000 square feet of leased space, which houses our production operations, research and development activities, sales, administration and executive offices. We believe that we maintain our machinery, equipment and tooling in good operating condition and that these assets are adequate for our current business and are adequately insured. See Notes 5 and 12 to the accompanying Consolidated Financial Statements for further information concerning our property and equipment and leased facilities.

ITEM 3. LEGAL PROCEEDINGS

Andrea is involved in routine litigation incidental through the normal course of business. While it is not feasible to predict or determine the final outcome of the claims, Andrea believes the resolution of these matters will not have a material adverse effect on Andrea’s financial position, results of operations or liquidity.

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

None.

PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS AND SMALL BUSINESS ISSUER PURCHASES OF EQUITY SECURITIES

The table below sets forth the high and low sales prices for Andrea's Common Stock as reported by the Over the Counter Bulletin Board for the eight fiscal quarters ended December 31, 2007. On March 24, 2008, there were approximately 452 holders of record of Andrea's Common Stock.

Quarter Ended	High		Low	
March 31, 2006	$	0.09	$	0.03
June 30, 2006	$	0.17	$	0.06
September 30, 2006	$	0.13	$	0.06
December 31, 2006	$	0.16	$	0.09
March 31, 2007	$	0.16	$	0.06
June 30, 2007	$	0.22	$	0.12
September 30, 2007	$	0.14	$	0.07
December 31, 2007	$	0.10	$	0.05

No cash dividends were paid on Andrea's Common Stock in 2007 or 2006.

During the three months ended December 31, 2007, the Company did not repurchase any of its common stock.

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

Overview

Our mission is to provide the emerging "voice interface" markets with state-of-the-art communications products that facilitate natural language, human/machine interfaces.

Examples of the applications and interfaces for which Andrea DSP Microphone and Audio Software Products and Andrea Anti-Noise Products provide benefits include: Internet and other computer-based speech; telephony communications; multi-point conferencing; speech recognition; multimedia; multi-player Internet and CD ROM interactive games; and other applications and interfaces that incorporate natural language processing. We believe that end users of these applications and interfaces will require high quality microphone and earphone products that enhance voice transmission, particularly in noisy environments, for use with personal computers, mobile personal computing devices, cellular and other wireless communication devices and automotive communication systems. Our Andrea DSP Microphone and Audio Software Products use "far-field" digital signal processing technology to provide high quality transmission of voice where the user is at a distance from the microphone. High quality audio communication technologies will be required for emerging far-field voice applications, ranging from continuous speech dictation, to Internet telephony and multiparty video teleconferencing and collaboration, to natural language-driven interfaces for automobiles, home and office automation and other machines and devices into which voice-controlled microprocessors are expected to be introduced during the next several years.

We outsource to Asia high volume assembly for most of our products from purchased components. We assemble some low volume Andrea DSP Microphone and Audio Software Products from purchased components. As sales of any particular Andrea DSP Microphone and Audio Software Product increases, assembly operations are transferred to a subcontractor in Asia.

Our Critical Accounting Policies

Our consolidated financial statements and the notes to our consolidated financial statements contain information that is pertinent to management's discussion and analysis. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities and determination of revenues and expenses in the reporting period. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. On a continual basis, management reviews its estimates utilizing currently available information, changes in facts and circumstances, historical experience and reasonable assumptions. After such reviews, and if deemed appropriate, those estimates are adjusted accordingly. Actual results may vary from these estimates and assumptions under different and/or future circumstances. Management considers an accounting estimate to be critical if: 1) it requires assumptions to be made that were uncertain at the time the estimate was made; and 2) changes in the estimate, or the use of different estimating methods that could have been selected, could have a material impact on the Company’s consolidated results of operations or financial condition.

The following critical accounting policies that affect the more significant judgments and estimates used in the preparation of the consolidated financial statements have been identified. In addition to the recording and presentation of our convertible preferred stock, we believe that the following are some of the more critical judgment areas in the application of our accounting policies that affect our financial condition and results of operations. We have discussed the application of these critical accounting policies with our Audit Committee. The following critical accounting policies are not intended to be a comprehensive list of all the Company's accounting policies or estimates.

Revenue Recognition – Non software-related revenue, which is generally comprised of microphones and microphone connectivity product revenues, is recognized when title and risk of loss pass to the customer, which is generally upon shipment. With respect to licensing revenues, Andrea recognizes revenue in accordance with Statement of Position ("SOP") 97-2, "Software Revenue Recognition," as amended, and Staff Accounting Bulletin Topic 13 "Revenue Recognition." License revenue is recognized based on the terms and conditions of individual contracts (for example, see Note 9 of our consolidated financial statements). In addition, fee based services, which are short-term in nature, are generally performed on a time-and-material basis under separate service arrangements and the corresponding revenue is generally recognized as the services are performed.

Accounts Receivable – We are required to estimate the collectibility of our trade receivables. Judgment is required in assessing the realization of these receivables, including the current creditworthiness of each customer and related aging of the past due balances. We evaluate specific accounts when we become aware of a situation where a customer may not be able to meet its financial obligations due to a deterioration of its financial viability, credit ratings or bankruptcy. The reserve requirements are based on the best facts available to us and are reevaluated and adjusted as additional information is received. Our reserves are also determined by using percentages applied to certain aged receivable categories. At December 31, 2007 and 2006, our allowance for doubtful accounts were $21,705 and $16,704 respectively.

Inventory – We are required to state our inventories at the lower of cost or market. In assessing the ultimate realization of inventories, we are required to make considerable judgments as to future demand requirements and compare that with our current inventory levels. Our reserve requirements generally increase as our projected demand requirements decrease due to market conditions, technological and product life cycle changes as well as longer than previously expected usage periods. We have evaluated the current levels of inventories, considering historical net revenues and other factors and, based on this evaluation, recorded adjustments to cost of revenues to adjust inventories to net realizable value. Inventories of $714,864 and $1,088,778 at December 31, 2007 and 2006 are net of reserves of $566,941 and $591,980, respectively. It is possible that additional charges to inventory may occur in the future if there are further declines in market conditions, or if additional restructuring actions are taken.

Long Lived Assets – Statement of Financial Accounting Standards ("SFAS"), No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets" ("FAS 144") requires management judgments regarding the future operating and disposition plans for marginally performing assets, and estimates of expected realizable values for assets to be sold. Andrea accounts for its long-lived assets in accordance with FAS 144 for purposes of determining and measuring impairment of its other intangible assets. Andrea's policy is to periodically review the value assigned to its long lived assets to determine if they have been permanently impaired by adverse conditions which may affect Andrea. If required, an impairment charge would be recorded based on an estimate of future discounted cash flows. In order to test for recoverability, Andrea compared the sum of an undiscounted cash flow projections (gross margin dollars from product sales) of the Andrea DSP Microphone and Audio Software core technology to the carrying value of that technology. Considerable management judgment is necessary to estimate undiscounted future operating cash flows and fair values and, accordingly, actual results could vary significantly from such estimates. No impairment charges were recognized during the years ended December 31, 2007 and 2006, respectively.

Deferred Tax Assets – We currently have significant deferred tax assets. SFAS No. 109, "Accounting for Income Taxes"("FAS 109"), requires a valuation allowance be established when it is more likely than not that all or a portion of deferred tax assets will not be realized. Furthermore, FAS 109 provides that it is difficult to conclude that a valuation allowance is not needed when there is negative evidence such as cumulative losses in recent years. Therefore, cumulative losses weigh heavily in the overall assessment. Accordingly, and after considering changes in previously existing positive evidence, we recorded a full valuation allowance. In addition, we expect to provide a full valuation allowance on future tax benefits until we can sustain a level of profitability that demonstrates our ability to utilize the assets, or other significant positive evidence arises that suggests our ability to utilize such assets. The future realization of a portion of our reserved deferred tax assets related to tax benefits associated with the exercise of stock options, if and when realized, will not result in a tax benefit in the consolidated statement of operations, but rather will result in an increase in additional paid in capital. We will continue to re-assess our reserves on deferred income tax assets in future periods on a quarterly basis.

Contingencies - We are subject to proceedings, lawsuits and other claims, including proceedings under laws and government regulations related to securities, environmental, labor, product and other matters. We are required to assess the likelihood of any adverse judgments or outcomes to these matters, as well as potential ranges of probable losses. A determination of the amount of reserves required, if any, for these contingencies is based on an analysis of each individual issue with the assistance of legal counsel. The amount of any reserves may change in the future due to new developments in each matter.

The impact of changes in the estimates and judgments pertaining to revenue recognition, receivables and inventories is directly reflected in our segments’ loss from operations. Although any charges related to our deferred tax provision are not reflected in our segment results, the long-term forecasts supporting the realization of those assets and changes in them are significantly affected by the actual and expected results of each segment.

Cautionary Statement Regarding Forward-Looking Statements

Certain information contained in this Management's Discussion and Analysis or Plan of Operation for the year ended December 31, 2007 and other items set forth in this Report on Form 10-KSB are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The words "anticipates," "believes," "estimates," "expects," "intends," "plans," "seeks," variations o words, and similar expressions are intended to identify forward-looking statements. We have based these forward-looking statements on our current expectations, estimates and projections about our business and industry, our beliefs and certain assumptions made by our management. Investors are cautioned that matters subject to forward-looking statements involve risks and uncertainties including economic, competitive, governmental, technological and other factors that may affect our business and prospects. These statements are not guarantees of future performance and are subject to certain risks, uncertainties and assumptions that are difficult to predict. In order to obtain the benefits of these "safe harbor" provisions for any such forward-looking statements, we wish to caution investors and prospective investors about the following significant factors, which, among others, have in some cases affected our actual results and are in the future likely to affect our actual results and could cause them to differ materially from those expressed in any such forward-looking statements. These factors include:

Risk Factors

Our operating results are subject to significant fluctuation; period-to-period comparisons of our operating results may not necessarily be meaningful and you should not rely on them as indications of our future performance.

Our results of operations have historically been and are subject to continued substantial annual and quarterly fluctuations. The causes of these fluctuations include, among other things:

– the volume of sales of our products under our collaborative marketing arrangements;

– the cost of development of our products;

– the mix of products we sell;

– the mix of distribution channels we use;

– the timing of our new product releases and those of our competitors;

– fluctuations in the computer and communications hardware and software marketplace;

– general economic conditions.

We cannot assure that the level of revenues and gross profit, if any, that we achieve in any particular fiscal period will not be significantly lower than in other fiscal periods. Our net revenues for the year ended December 31, 2007 were approximately $5 million versus $5.7 million in the year ended December 31, 2006. Net loss for the year ended December 31, 2007 was approximately $390,000, or $0.01 per share on a basic and diluted basis, versus net income of approximately $19,000, or $0.00 per share on a basic and diluted basis for the year ended December 31, 2006. We continue to explore opportunities to grow sales in other business areas; we are also examining additional opportunities for cost reduction, production efficiencies and further diversification of our business. Although we have improved cash flows by reducing overall expenses, if our revenues continue to decline we may not continue to generate positive cash flows and our net income or loss may be affected.

If we fail to maintain access to funds sufficient to meet our operating needs, we may be required to significantly reduce, sell, or refocus our operations and our business, results of operations and financial condition could be materially and adversely effected.

In order to be a viable entity we need to maintain and increase profitable operations. To continue to achieve profitable operations we need to maintain/increase current net revenues and continue to look for ways to control expenses. We might also need to sell additional assets or raise capital as a means of funding continued operations. In recent years, we have sustained significant operating losses. Since 1997, we have been unable to generate sufficient cash flow from operations to meet our operating needs and, correspondingly, from time to time during the past several years, we have raised additional capital from external sources. We may have to continue to raise additional capital from external sources. These sources may include private or public financings through the issuance of debt, convertible debt or equity, or collaborative arrangements. Such additional capital and funding may not be available on favorable terms, if at all. Additionally, we may only be able to obtain additional capital or funds through arrangements that require us to relinquish rights to our products, technologies or potential markets, in whole or in part, or result in our sale. As a result of past few years of performance, we believe that we have sufficient liquidity to continue our operations at least through December 2008, provided our net revenues do not decline and our operating expenses do not increase. Although we have revised our business strategies to reduce our expenses and capital expenditures, we cannot assure you that we will be successful in generating positive cash flows or obtaining access to additional sources of funding in amounts necessary to continue our operations. Failure to maintain sufficient access to funding may also result in our inability to continue operations.

Shares Eligible For Future Sale May Have An Adverse Effect On Market Price; Andrea Stockholders May Experience Substantial Dilution.

Sales of a substantial number of shares of our common stock in the public market could have the effect of depressing the prevailing market price of our common stock. Of the 200,000,000 shares of common stock presently authorized, 59,861,193 were outstanding as of March 24, 2008. The number of shares outstanding does not include an aggregate of 29,357,677 shares of common stock that are issuable. This number of issuable common shares is equal to approximately 49% of the 59, 861,193 outstanding shares. These issuable common shares are comprised of: a) 9,626,820 shares of our common stock reserved for issuance upon exercise of outstanding awards granted under our 1991 Performance Equity Plan, 1998 Stock Plan and 2006 Stock Plan; b) 14,984 shares reserved for future grants under our 1998 Stock Plan; c) 5,636,361 shares reserved for future grants under our 2006 Stock Plan; d) 4,149,736 shares of common stock that are issuable upon conversion of the Series C Preferred Stock; e) 4,771,432 shares of common stock issuable upon conversion of the Series D Preferred Stock; and f) 5,158,344 of common stock issuable upon exercise of warrants relating to the Series D Preferred stock.

Conversions of our Series C Preferred Stock, Series D Preferred Stock and related warrants may result in substantial dilution to other holders of our common stock.

As of March 24, 2008, we had 90.701477 shares of Series C Preferred Stock, 1,192,858 shares of Series D Preferred Stock and 5,158,344 Common Stock warrants outstanding. The issuance of shares of common stock upon conversion of the Series C Preferred Stock is limited to that amount which, after given effect to the conversion, would cause the holder not to beneficially own in excess of 4.99% or, together with other shares beneficially owned during the 60 day period prior to such conversion, not to beneficially own in excess of 9.99% of the outstanding shares of common stock. The issuance of common stock upon conversion of the Series D Preferred Stock and the related warrants also is limited to that amount which, after given effect to the conversion, would cause the holder not to beneficially own an excess of 4.99% of then outstanding shares of our common stock, except that each holder has a right to terminate such limitation upon 61 days notice to us. Beneficial ownership for purposes of calculation of such percentage limitations does not include shares whose acquisition is subject to similar limitations. If all shares of the Series C and Series D Preferred Stock and warrants, which are outstanding to be issued, are assumed to be converted into or exercised for shares of common stock, the number of new shares of common stock required to be issued as a result would aggregate 14,079,512 shares, which would represent 24% of the then outstanding shares of common stock.

Short sales of our common stock may be attracted by or accompany conversions of Series C Preferred Stock and Series D Preferred Stock, which sales may cause downward pressure upon the price of our common stock.

Short sales of our common stock may be attracted by or accompany the sale of converted common stock, which in the aggregate could cause downward pressure upon the price of the common stock, regardless of our operating results, thereby attracting additional short sales of the common stock.

If we fail to commercialize and fully market our Andrea DSP Microphone and Audio Software products, or continue to develop, and not fully market, Andrea Anti-Noise Headset products, our net revenues may not increase at a high enough rate to improve our results of operations or may not increase at all.

Our business, results of operations and financial condition depend on the successful commercialization of our Andrea DSP Microphone and Audio Software products and technologies. We introduced our first Andrea DSP Microphone products in 1998 and we continued to introduce complementary products and technologies over the last several years. We are primarily targeting these products at the desktop computer market, the audio and video conferencing markets and the market for in-vehicle computing, among others. The success of these products is subject to the risks frequently encountered by companies in an early stage of product commercialization, particularly companies in the computing and communications industries.

If we are unable to obtain market acceptance of Andrea DSP Microphone and Audio Software products and technologies or if market acceptance of these products and technologies occurs at a slow rate, then our business, results of operations and financial condition will be materially and adversely affected.

We, and our competitors, are focused on developing and commercializing products and technologies that enhance the use of voice, particularly in noisy environments, for a broad range of computer and communications applications. These products and technologies have been rapidly evolving and the number of our competitors has grown, but the markets for these products and technologies are subject to a high level of uncertainty and have been developing slowly. We, alone or together with our industry, may be unsuccessful in obtaining market acceptance of these products and technologies.

If we fail to develop and successfully introduce new products and technologies in response to competition and evolving technology, we may not be able to attract new customers or retain current customers.

The markets in which we sell our Andrea DSP Microphone and Audio Software and Andrea Anti-Noise Headset products are highly competitive. We may not compete successfully with any of our competitors. Most of our current and potential competitors have significantly greater financial, technology development, marketing, technical support and other resources than we do. Consequently, these competitors may be able to respond more quickly to new or emerging technologies and changes in customer requirements, or devote greater resources to the development, marketing, and sale of their products than we can. One or more of these competitors may independently develop technologies that are substantially equivalent or superior to our technology. The introduction of products incorporating new technologies could render our products obsolete and unmarketable and could exert price pressures on existing products.

We are currently engaged in the development of digital signal processing products and technologies for the voice, speech and natural language interface markets. We may not succeed in developing these new digital signal processing products and technologies, and any of these new digital signal processing products or technologies may not gain market acceptance.

Further, the markets for our products and technologies are characterized by evolving industry and government standards and specifications that may require us to devote substantial time and expense to adapt our products and technologies. For example, certain of our Andrea DSP Microphone and Audio Software and Andrea Anti-Noise Headset products are subject to the Federal Communications Commission requirements. We may not successfully anticipate and adapt our products and technologies in a cost effective and timely manner to changes in technology and industry standards or to introductions of new products and technologies by others that render our then existing products and technologies obsolete.

If our marketing collaborators do not effectively market their products that include or incorporate our products, our sales growth will be adversely affected.

We have entered into collaborative and distribution arrangements with software publishers and computer hardware manufacturers relating to the marketing and sale of Andrea DSP Microphone and Audio Software products through inclusion or incorporation with the products of our collaborators. Our success is dependent to a substantial degree on the efforts of these collaborators to market their products that include or incorporate our products. Our collaborators may not successfully market these products. In addition, our collaborators generally are not contractually obligated to any minimum level of sales of our products or technologies, and we have no control over their marketing efforts. Furthermore, our collaborators may develop their own microphone, earphone or headset products that may replace our products or technologies or to which they may give higher priority.

Shortages of, or interruptions in, the supply of more specialized components for our products could have a material adverse effect on our sales of these products.

The majority of our assembly operations are fulfilled by subcontractors (primarily in the Far East) using purchased components. Some specialized components for the Andrea DSP Microphone and Audio Software products and Andrea Anti-Noise products, such as microphones and digital signal processing boards, are available from a limited number of suppliers (and in some cases foreign) and subject to long lead times. We may not be able to continue to obtain sufficient supplies of these more specialized components, particularly if the sales of our products increase substantially or market demand for these components otherwise increases. If our subcontractors fail to meet our production and shipment schedules, our business, results of operations and financial condition would be materially and adversely affected.

Our ability to compete may be limited by our failure to adequately protect our intellectual property or by patents granted to third parties.

We rely on a combination of patents, patent applications, trade secrets, copyrights, trademarks, and nondisclosure agreements with our employees, independent contractors, licensees and potential licensees, limited access to and dissemination of our proprietary information, and other measures to protect our intellectual property and proprietary rights. However, the steps that we have taken to protect our intellectual property may not prevent its misappropriation or circumvention. In addition, numerous patents have been granted to other parties in the fields of noise cancellation, noise reduction, computer voice recognition, digital signal processing and related subject matter. We expect that products in these fields will increasingly be subject to claims under these patents as the numbers of products and competitors in these fields grow and the functionality of products overlap. Claims of this type could have an adverse effect on our ability to manufacture and market our products or to develop new products and technologies, because the parties holding these patents may refuse to grant licenses or only grant licenses with onerous royalty requirements. Moreover, the laws of other countries do not protect our proprietary rights to our technologies to the same extent as the laws of the United States.

An unfavorable ruling in any current litigation proceeding or future proceeding may adversely affect our business, results of operations and financial condition.

From time to time we are subject to litigation incidental to our business. For example, we are subject to the risk of adverse claims, interference proceedings before the U.S. Patent and Trademark Office, oppositions to patent applications outside the United States, and litigation alleging infringement of the proprietary rights of others. Litigation to establish the validity of patents, to assert infringement claims against others, and to defend against patent infringement claims can be expensive and time-consuming, even if the outcome is in our favor.

Changes in economic and political conditions outside the United States could adversely affect our business, results of operations and financial condition.

We generate revenues to regions outside the United States, particularly in Asia. For the years ended December 31, 2007 and 2006, net revenues to customers outside the United States accounted for approximately 28% and 49%, respectively, of our net sales. International sales and operations are subject to a number of risks, including:

- trade restrictions in the form of license requirements;
- restrictions on exports and imports and other government controls;
- changes in tariffs and taxes;
- difficulties in staffing and managing international operations;
- problems in establishing and managing distributor relationships;
- general economic conditions; and
- political and economic instability or conflict.

To date, we have invoiced our international revenues in U.S. dollars, and have not engaged in any foreign exchange or hedging transactions. We may not be able to continue to invoice all of our revenues in U.S. dollars in order to avoid engaging in foreign exchange or hedging transactions. If we are required to invoice any material amount of international revenues in non-U.S. currencies, fluctuations in the value of non-U.S. currencies relative to the U.S. dollar may adversely affect our business, results of operations and financial condition or require us to incur hedging costs to counter such fluctuations.

If we are unable to attract and retain the necessary managerial, technical and other personnel necessary for our business, then our business, results of operations and financial condition will be harmed.

Our performance is substantially dependent on the performance of our executive officers and key employees. The loss of the services of any of these executive officers or key employees could have a material adverse effect on our business, results of operations and financial condition. Our future success depends on our continuing ability to attract and retain highly qualified managers and technical personnel. Competition for qualified personnel is intense and we may not be able to attract, assimilate or retain qualified personnel in the future.

Compliance with the Sarbanes-Oxley Act of 2002 will require substantial financial and management resources and may result in additional expenses, which as a smaller public company may be disproportionately high.

Section 404 of the Sarbanes-Oxley Act of 2002 requires that we evaluate and report on our system of internal controls as of December 31, 2007 and requires that we have such system of internal controls audited beginning with our Annual Report on 10-KSB for the year ending December 31, 2008, though the Securities and Exchange Commission (the “SEC”) has proposed to delay the audit requirement one additional year. If we fail to maintain the adequacy of our internal controls, we could be subject to regulatory scrutiny, civil or criminal penalties and/or stockholder litigation. Any inability to provide reliable financial reports could harm our business. Section 404 of the Sarbanes-Oxley Act of 2002 also requires that our independent registered public accounting firm report on management’s evaluation of our system of internal controls. The documentation and further development of our internal controls to achieve compliance with the Sarbanes-Oxley Act has been a notable expense in this year and will continue to be an expense in the future. Additionally, we devoted a significant amount of our time to ensure that we are compliant with Sarbanes-Oxley Act of 2002. .. Furthermore, any failure to implement required new or improved controls, or difficulties encountered in the implementation of adequate controls over our new or revised financial processes and reporting in the future, could harm our operating results or cause us to fail to meet our reporting obligations which will require us to continue to devote a large amount of our general and administrative employees’ time to the continued compliance.. Inferior internal controls could also cause investors to lose confidence in our reported financial information, which could have a negative effect on the trading price of our stock.

Results Of Operations

Year Ended December 31, 2007 Compared to Year Ended December 31, 2006

Net Revenues

	For the Year Ended December 31 2007	2006	% Change	
Andrea Anti-Noise Products net Product revenues				
Sales of products to an OEM customer for use with speech recognition software	$376,580	$595,109	(37)	
All other Andrea Anti-Noise net product revenues	2,242,284	1,995,946	12	
Total Andrea Anti-Noise Products net Product revenues	2,618,864	2,591,055	1	(a)
Andrea DSP Microphone and Audio Software Products revenues				
Sales of array microphone products to an OEM customer	928,367	1,442,112	(36)	(b)
All other Andrea DSP Microphone and Audio product revenues	803,759	921,739	(13)	(c)
License revenues	695,223	780,384	(11)	(d)
Total Andrea DSP Microphone and Audio Software Products revenues	2,427,349	3,144,235	(23)	
Total Revenues	$5,046,213	$5,735,290	(12)	

(a) The slight increase in Andrea Anti Noise Product revenues of 1% is primarily due to the 12% increase in sales to our Valued Added Resellers in the education learning space as well as to our customers utilizing our products for distance learning. This increase was offset by the 37% decrease in sales of Andrea Anti-Noise Products to an OEM customer for use with speech recognition software which decreased due to the OEM's decreased demand for our products during 2007 as compared to 2006. We believe that this decreased demand is related to the OEM's increased demand in 2006 due to their product revision whereas the OEM needed additional product in 2006. We hope to improve these revenues in 2008 and to that end we were recently selected to participate in the OEM's 2008/2009 product line quote process.

(b) The significant 36% decrease in sales of microphone array products to an OEM customer relates to the decreased demand from the OEM customer. We believe that this decrease was due to the introduction of the OEM's product in 2006 and the OEM customer's need to supply all of its customers for the initial launch as opposed to regular fulfillment of a regularly stocked product. Therefore the introduction in 2006 caused the first year of sales to be significantly higher than the second. We believe that our 2008 volume will be consistent with our 2007 volume.

(c) The 13% decrease in all other Andrea DSP Microphone and Audio product revenues is due to decreases from two customers. Approximately $50,000 of this decrease relates to OEM's current production. As of March 24, 2008, shipments to this OEM are consistent with the shipments in quarter ended March 31, 2007. Approximately $45,000 of this decrease relates to the timing of a state funded project that incorporates our Andrea AutoArray

Microphone in state police cars.

(d) The 11% decrease in licensing revenues for the year ended December 31, 2007 is a result of one of OEM licensing partner not including one of our licensed products in their new Vista bundles. This decrease was partially offset in part by increases other licensing revenues. We expect that our 2008 licensing revenues will be in line with our 2007 licensing revenues.

Cost of Revenues

Cost of revenues as a percentage of net revenues for the year ended December 31, 2007 decreased to 51% from 54% for the year ended December 31, 2006. The cost of revenues as a percentage of net revenues for the year ended December 31, 2007 for Andrea Anti-Noise Products was consistent with the percentage for the year ended December 31, 2006 at 60%. The cost of revenues as a percentage of net revenues for the year ended December 31, 2007 for Andrea DSP Microphone and Audio Software Products is 42% compared to 49% for the year ended December 31, 2006. The decrease is primarily the result of the decreases in high volume low margin sales of Andrea Anti-Noise Products to an OEM for use with speech recognition software and sales of array microphone products to an OEM customer. as described under "Net Revenues" above.

Research and Development

Research and development expenses for the year ended December 31, 2007 increased 19% to $676,977 from $571,288 for the year ended December 31, 2006. This increase primarily relates to the increase in stock based compensation expense as well as employee compensation and related benefit costs related to an employee dedicated to product development For the year ended December 31, 2007, the increase in research and development expenses reflects a 7% increase in our Andrea DSP Microphone and Audio Software Technology efforts to $480,552, or 71% of total research and development expenses and a 59% increase in our Andrea Anti-Noise Headset Product efforts to $196,425, or 29% of total research and development expenses. With respect to DSP Microphone and Audio Software technologies, research efforts are primarily focused on the pursuit of commercializing a natural language-driven human/machine interface by developing optimal far-field microphone solutions for various voice-driven interfaces, incorporating Andrea's digital super directional array microphone technology, and certain other related technologies such as noise suppression and stereo acoustic echo cancellation. We believe that continued research and development spending should provide Andrea with a competitive advantage.

General, Administrative and Selling Expenses

General, administrative and selling expenses increased approximately 9% to $2,143,159 for the year ended December 31, 2007 from $1,963,977 for the year ended December 31, 2006. This increase is principally related to the increase in stock based compensation expense as well as the employment agreement entered into with the Company's President and Chief Executive Officer in November 2006. For the year ended December 31, 2007, the increase reflects a 3% increase in our Andrea DSP Microphone and Audio Software Technology efforts to $1,255,588, or 59% of total general, administrative and selling expenses and a 19% increase in our Andrea Anti-Noise Headset Product efforts to $887,571, or 41% of total general, administrative and selling expenses.

Interest Income (Expense), net

Other income, net for the year ended December 31, 2007 was $8,623 compared to an interest expense of $2,899 for the year ended December 31, 2006. The year to date increase in other income is the result of interest earned on higher cash balances in 2007.

Provision for Income Taxes

The provision for income taxes is a result of certain licensing revenues that are subject to withholding of income tax as mandated by the foreign jurisdiction in which the revenues are earned. Amounts are based on net revenues and are therefore subject to change. Effective January 1, 2007, the Company adopted the provisions of Financial Accounting Standards Board ("FASB") Interpretation No. 48, "Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 establishes for all entities a minimum threshold for financial statement recognition of the benefit of tax positions, and requires certain expanded disclosures. FIN 48 is effective for fiscal years beginning after December 15, 2006, and is to be applied to all open tax years as of the date of effectiveness. The adoption of FASB Interpretation No. 48 did not have a material effect on the Company's condensed consolidated financial position or results of operations or cash flows (See Note 9 of the accompanying financial statements).

Net (loss) Income

Net loss for the year ended December 31, 2007 was $390,124 compared to a net income of $18,666 for the year ended December 31, 2006. The net income for the year ended December 31, 2007 principally reflects the factors described above.

Off-Balance Sheet Arrangements

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

Liquidity And Capital Resources

Our principal sources of funds are and expected to continue to be gross cash flows from operations. At December 31, 2007, we had cash and cash equivalents of $811,403 compared with $303,678 at December 31, 2006. The balance of cash and cash equivalents at December 31, 2007 is primarily a result of our cash provided from operations during the year ended December 31, 2007.

Working capital balance at December 31, 2007 was $1,837,521 compared to a working capital of $1,562,083 at December 31, 2006. The increase in working capital reflects a decrease in total current assets of $14,758 and a decrease in total current liabilities of $290,196. The decrease in total current assets reflects an increase in cash and cash equivalents of $507,725, an increase in accounts receivable of $154,847, a decrease in inventory of $373,914, and a decrease in prepaid expenses of $303,416. The decrease in total current liabilities reflects a decrease in trade accounts payable of $144,813, a decrease in the current portion of capital lease of $5,068, and a decrease of $140,315 in other current liabilities.

The increase in cash and cash equivalents of 507,725 reflects $559,438 of net cash provided by operating activities, $46,645 of net cash used by investing activities and $5,068 of net cash used by financing activities.

The cash provided by operating activities of $559,438, excluding non-cash charges, is primarily attributable to the $390,124 net loss for the year ended December 31, 2007, a $159,848 increase in accounts receivable, a $398,953 decrease in inventory, a $303,416 decrease in prepaid expenses and other current assets, a $144,813 decrease in accounts payable, and a decrease of $123,603 in other current liabilities. The changes in inventory, accounts payable and other current and long term liabilities primarily reflect differences in the timing related to both the payments for and the acquisition of inventory as well as for other services in connection with ongoing efforts related to Andrea's various product lines. Additionally, we secured better pricing on certain inventory items by purchasing in larger volumes.

The cash used by investing activities of $46,645 reflects an increase in property and equipment of $33,870 and an increase in patents and trademarks of $12,775. The increase in property and equipment reflects capital expenditure associated with molds for our Andrea Anti Noise Headset business line and computer related. The increase in patents and trademarks reflects capital expenditures associated with our intellectual property.

The net cash used by financing activities of $5,068 reflects payments of our capital leases associated with communication related equipment.

We plan to continue to improve our cash flows in 2008 by aggressively pursuing additional licensing opportunities related to our Andrea DSP Audio Software and increasing the sales of our Andrea Anti-Noise Headset Products through the introduction of refreshed product line scheduled to be introduced in the early part of 2008 as well as the increased efforts we are putting into our sales and marketing efforts. However, there can be no assurance that we will be able to successfully execute the aforementioned plans. As of March 24, 2008, Andrea has approximately $750,000 of cash and cash equivalents. We believe that we have sufficient liquidity available to continue in operation through at least December 2008. To the extent that we do not generate sufficient cash flows from our operations in the next twelve months, additional financing might be required. Although we have improved cash flows by reducing overall expenses, if our revenues decline, these reductions may impede our ability to be cash flow positive and our net income or loss may be disproportionately affected. We have no commitment for additional financing and may experience difficulty in obtaining additional financing on favorable terms, if at all. Any financing we obtain may contain covenants that restrict our freedom to operate our business or may have rights, preferences or privileges senior to our common stock and may dilute our current shareholders' ownership interest in Andrea. We cannot assure that demand will continue for any of our products, including future products related to our Andrea DSP Microphone and Audio Software technologies, or, that if such demand does exist, that we will be able to obtain the necessary working capital to increase production and provide marketing resources to meet such demand on favorable terms, or at all.

Recently Issued Accounting Pronouncements

For a discussion of the impact of recent accounting pronouncements, see Note 2 of the accompanying financial statements.

Market Risk

Our principal source of financing activities is the issuance of convertible preferred stock with financial institutions. We are affected by market risk exposure primarily through any amounts payable in stock, or cash by us under convertible securities. We do not utilize derivative financial instruments to hedge against changes in interest rates or for any other purpose. In addition, substantially all transactions entered into by us are denominated in U.S. dollars. As such, we have shifted foreign currency exposure onto our foreign customers. As a result, if exchange rates move against foreign customers, we could experience difficulty collecting unsecured accounts receivable, the cancellation of existing orders or the loss of future orders. The foregoing could materially adversely affect our business, financial condition and results of operations.

ITEM 7. FINANCIAL STATEMENTS

The financial statements are included in this Report beginning on page F-1.

ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 8A(T). CONTROLS AND PROCEDURES

(a) Disclosure Controls and Procedures

The Company's management, including the Company's principal executive officer and principal financial officer, have evaluated the effectiveness of the Company's "disclosure controls and procedures," as such term is defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended, (the "Exchange Act"). Based upon their evaluation, the principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective for the purpose of ensuring that the information required to be disclosed in the reports that the Company files or submits under the Exchange Act with the SEC(1) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (2) is accumulated and communicated to the Company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

(b) Internal Controls Over Financial Reporting

Management’s annual report on internal control over financial reporting is included herein by reference to the section titled “Management’s Annual Report on Internal Control Over Financial Reporting” immediately preceding the Company’s audited Consolidated Financial Statements in this Report..

(c) Changes to Internal Control Over Financial Reporting

There were no changes in the Company’s internal control over financial reporting during the three months ended December 31, 2007 that have materially affected, or are reasonable likely to materially affect, the Company’s internal control over financial reporting.

ITEM 8B. OTHER INFORMATION

None.

PART III

ITEM 9. DIRECTORS, EXECUTIVE OFFICERS PROMOTERS, CONTROL PERSONS AND CORPORATE GOVERNACE; COMPLIANCE WITH SECTION 16(a) OF THE EXCHANGE ACT

Information on the Directors of the Company follows (all Directors serve a one-year terms; ages are as of December 31, 2007):

Douglas J. Andrea, age 45, has been Chairman of the Board of Directors since November 2001, a Director of the Company since 1991, Corporate Secretary since 2003 and Chief Executive Officer since January 2005. He was Co-Chairman and Co-Chief Executive Officer of the Company from November 1998 until August 2001. He served as Co-President of the Company from November 1992 to November 1998, as Vice President - Engineering of the Company from December 1991 to November 1992, and as Secretary of the Company from 1989 to January 1993.

Gary A. Jones, age 62, has been a Director of the Company since April 1996. He has served as President of Digital Technologies, Inc. since 1994 and was Chief Engineer at Allied Signal Ocean Systems from 1987 to 1994. From March 1998 to December 2000, Mr. Jones was the Managing Director of Andrea Digital Technologies, Inc, a wholly-owned subsidiary of Andrea Electronics Corporation.

Louis Libin, age 49, has been a Director of the Company since February 2002. He is President of Broad Comm, Inc., a consulting group specializing in advanced television broadcast, interactive TV, Internet Protocol and wireless communications. Prior to his tenure at Broad Comm, Mr. Libin was Chief Technology Officer for NBC, and was responsible for all business and technical matters for satellite, wireless and communication issues for General Electric and NBC. Since 1989, Mr. Libin has represented the United States on satellite and transmission issues at the International Telecommunications Union (the ITU) in Geneva, Switzerland. Mr. Libin is a Senior Member of the Institute of Electrical and Electronic Engineers (IEEE), and is a member of the National Society of Professional Engineers.

Joseph J. Migliozzi, age 58, has been a Director of the Company since September 2003. He operates his own management consulting firm since 2001. From 1997 to 2001 Mr. Migliozzi was the Chief Operating and Financial Officer of Voyetra Turtle Beach. Prior to that, he served in various executive management positions in the electronics manufacturing industries, with both financial and operational responsibilities. Mr. Migliozzi is a Certified Public

Accountant.

Jonathan D. Spaet, age 51, has been a Director of the Company since 2003. He is Vice-President of Advertising Sales for Time Warner Cable National Advertising Sales since September 2004, overseeing advertising sales for Time Warner Cable markets around the country. Previously, he was Vice-President of Sales for Westwood One Radio Networks, managing ad sales for one of the largest radio groups in the country. From 2002 to 2003, he was the Chief Operating Officer of MEP Media, a company that was starting a digital cable channel devoted to the music enthusiast. Prior to MEP, he was President of Ad Sales for USA Networks, supervising ad sales, marketing, research and operations for both USA and Sci-fi, two top-tier cable channels. Previously, he was President of Ad Sales for About.com. This followed 15 years at NBC, where Mr. Spaet's career included a six-year position in NBC Cable and nine years in the NBC Television Stations Group.

Information about Executive Officers Who Are Not Directors

The following information is provided for the Company's executive officer who is not also a director:

Corisa L. Guiffre, age 35, has been the Company's Vice President and Chief Financial Officer since June 2003 and Assistant Corporate Secretary since October 2003. Ms. Guiffre joined the Company in November 1999 and served as Vice President and Controller until June 2003. Prior to joining the Company she was a member of the Audit, Tax and Business Advisory divisions at Arthur Andersen LLP. She is a Certified Public Accountant, a member of the American Institute of Certified Public Accountants and a member of the New York State Society of Certified Public Accountants.

Ms. Guiffre is elected annually and holds office until her successor has been elected and qualified or until she is removed or replaced.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires the Company's directors and officers and persons who beneficially own more than ten percent of the Company's common stock to file with the Securities and Exchange Commission ("SEC") initial reports of ownership and reports of changes in ownership of common stock in the Company. Officers, directors and greater-than-ten percent shareholders are also required to furnish the Company with copies of all Section 16(a) reports they file. Based solely upon a review of Forms 3 and 4 and amendments thereto furnished to the Company under Section 16(a) of the Securities Exchange Act of 1934, as amended, during the year ended December 31, 2007 and Forms 5 and amendments thereto furnished to the Company with respect to the year ended December 31, 2007, and written representations provided to the Company from the individuals required to filed reports, the Company believes that each of the individuals required to file reports complied with applicable reporting requirements for transactions in the Company's common stock during the year ended December 31, 2007, except Mr. Libin filed late one Form 4 for one transaction and Mr. Migliozzi filed late one Form 4 for two transactions.

Code of Business Ethics and Conduct

Andrea Electronics has adopted a Code of Business Ethics and Conduct. See Exhibits to this Annual Report on Form 10-KSB.

Audit Committee and Audit Committee Financial Expert. –

The Company has a separately designated standing Audit Committee which currently consists of Messrs. Jones, Libin, Migliozzi and Spaet. The Board of Directors has designated Mr. Migliozzi as an audit committee financial expert under the rules of the Securities and Exchange Commission.

ITEM 10. EXECUTIVE COMPENSATION

Summary Compensation Table

The following table sets forth information for the last two fiscal years relating to compensation earned by each person who served as chief executive officer and the other most highly compensated executive officers whose total compensation was over $100,000 during the year ended December 31, 2007 and 2006.

Name and Principal Position	Year	Salary	Bonus	Stock Options (1)	Total
Douglas J. Andrea, Chairman of the Board, Chief Executive Officer,	2007	$ 300,000	$ -	$ 100,264	$ 400,264
and Corporate Secretary	2006	255,000	35,516	61,082	351,598
Corisa L. Guiffre, Vice President, Chief Financial Officer and	2007	$ 119,712	$ -	$ 5,612	$ 125,324
Assistant Corporate Secretary	2006	96,923	-	4,886	101,809

(1) Reflects the dollar amount recognized for financial statement reporting purposes in accordance with FAS 123(R) for 1,000,000 and 350,000 options in 2007 for Mr. Andrea and Ms. Guiffre, respectively, based upon a fair value of each option of $0.09 using the Black-Scholes option pricing model. The weighted average assumptions used in the valuation of the options were as follows: dividend yield, 0%; expected volatility, 101%; risk-free rate, 4.17%; and expected life in years of 6 years and 2,000,000 and 400,000 options in 2006 for Mr. Andrea and Ms. Guiffre, respectively, based upon a fair value of each option of $0.12 using the Black-Scholes option pricing model. The weighted average assumptions used in the valuation of the options were as follows: dividend yield, 0%; expected volatility, 102%; risk-free rate, 5.07%; and expected life in years of 7 years.

Outstanding Equity Awards at Fiscal Year-End

The following table provides information concerning unexercised options for each named executive officer outstanding as of December 31, 2007. None of the named executive officers had stock awards that have not vested or unearned equity incentive plan awards at December 31, 2007.

	Option Awards			
Name	Number of securities underlying unexercised options (#) exercisable	Number of securities underlying unexercised options (#) unexercisable	Option exercise price ($/share)	Option expiration date
Douglas J. Andrea	50,000	-	$ 14.625	3-03-2008
	100,000	-	$ 14.125	6-08-2008
	100,000	-	$ 6.250	3-23-2009
	50,000	-	$ 5.375	8-17-2009
	75,000	-	$ 6.875	4-14-2010
	50,000	-	$ 6.000	8-01-2010
	250,000	-	$ 0.690	1-31-2012
	400,000	-	$ 0.130	6-14-2014
	250,000	-	$ 0.100	8-04-2014
	250,000	-	$ 0.040	8-04-2015
	600,000	-	$ 0.050	8-10-2015
	333,000	667,000(1)	$ 0.120	11-02-2016
	333,000	667,000(1)	$ 0.120	11-16-2016
	-	1,000,000(3)	$ 0.110	9-12-2017
Corisa L. Guiffre	25,000	-	$ 7.125	11-22-2009
	10,000	-	$ 6.875	4-14-2010
	10,000	-	$ 6.000	8-01-2010
	10,000	-	$ 1.780	3-19-2011
	25,000	-	$ 0.690	1-31-2012
	250,000	-	$ 0.050	8-10-2015
	133,200	266,800(2)	$ 0.120	11-16-2016
	-	400,000(3)	$ 0.110	9-12-2017

(1) The stock options vest 33.3% from and after August 1, 2007, 33.3% from and after August 1, 2008 and 33.4% from and after August 1, 2009

(2) The stock options vest 33.3% from and after the first anniversary of the Date of Grant, 33.3% from and after the second anniversary of the Date of Grant and 33.4% from and after the third anniversary of the Date of Grant, which was November 16, 2006.

(3) The stock options vest 33.3% from and after the first anniversary of the Date of Grant, 33.3% from and after the second anniversary of the Date of Grant and 33.4% from and after the third anniversary of the Date of Grant, which was September 12, 2007.

Employment Agreements

In November 2006, the Company entered into a new employment agreement with the Chairman of the Board, Douglas J. Andrea. The employment agreement expires July 31, 2008 and is subject to renewal as approved by the Compensation Committee of the Board of Directors. Pursuant to his employment agreement, Mr. Andrea will receive an annual base salary of $300,000 per annum. In addition, upon execution of the employment agreement, Mr. Andrea was entitled to a salary adjustment from August 1, 2006 through the date of the employment agreement. The employment agreement provides for quarterly bonuses equal to 25% of the Company's pre-bonus net after tax quarterly earnings in excess of $25,000 for a total quarterly bonus amount not to exceed $12,500; and annual bonuses equal to 10% of the Company's annual pre-bonus net after tax earnings in excess of $300,000. All bonuses shall be payable as soon as the Company's cash flow permits. All bonus determinations or any additional bonus in excess of the above will be made in the sole discretion of the Compensation Committee. On November 2, 2006, in accordance with his employment agreement, Mr. Andrea was granted 1,000,000 stock options. This grant provides for a three year vesting period, an exercise price of $0.12 per share, which was fair market value at the date of grant, and a term of 10 years. These stock options have a fair value of $100,000 and are being expensed over the vesting period of three years. The stock based compensation expenses included in general, administrative and selling expenses. On November 16, 2006, in accordance with his employment agreement, Mr. Andrea was granted an additional 1,000,000 stock options. This grant provides for a three year vesting period, an exercise price of $0.12 per share, which was fair market value at the date of grant, and a term of 10 years. These stock options have a fair value of $100,000 and are being expensed over the vesting period of three years. The stock based compensation expenses included in general, administrative and selling expenses. Mr. Andrea is also entitled to a change in control payment equal to two times his salary with continuation of health and medical benefits for two years in the event of a change in control. At December 31, 2007, the future minimum cash commitments under this agreement aggregate $175,000.

Director Compensation

The following table provides the compensation received by individuals who served as non-employee directors of the Company during the 2007 fiscal year.

Director	Fees Earned of Paid in Cash	Stock Awards (1)	Stock Option Awards (2)	Total
Gary A Jones	$ 1,750	$ 5,625	$ 1,960	$ 9,335
Louis Libin	1,750	5,625	241	7,616
Joseph J. Migliozzi	1,750	5,625	4,539	11,914
Jonathan D. Spaet	1,500	5,625	1,960	9,085

(1) Reflects the dollar amount recognized for financial statement reporting purposes in accordance with FAS 123(R) for 181,820 shares of Common Stock with a fair market value of $0.11, 166,668 shares of Common Stock with a fair market value of $0.12 and 400,000 shares of Common Stock with a fair market value of $0.05 of stock granted during the years ended December 31, 2007, 2006 and 2005 of, respectively..

(2) Reflects the dollar amount recognized for financial statement reporting purposes in accordance with FAS 123(R) for 16,667, 16,667 and 41,667 options in 2006 for Messrs. Jones, Migliozzi and Spaet, respectively, based upon a fair value of each option of $0.10 using the Black-Scholes option pricing model and 33,182, 15,000, 33,182 and 60,455 options in 2007 for Messrs. Jones, Libin, Migliozzi and Spaet, respectively, based upon a fair value of each option of $0.09 using the Black-Scholes option pricing model. The assumptions used in the valuation of the 2006 options were as follows: dividend yield, 0%; expected volatility, 102%; risk-free rate, 5.07%; and expected life in years of 7 years. The assumptions used in the valuation of the 2007 options were as follows: dividend yield, 0%; expected volatility, 101%; risk-free rate, 4.17%; and expected life in years of 6 years. At December 31, 2007, Messrs. Jones, Libin, Migliozzi and Spaet held 194,849, 165,000, 277,122 and 159,849 options to purchase shares of common stock.

Annual Retainer and Meeting Fees for Non-Employee Directors.

The following tables set forth the applicable retainers and fees that will be paid to non-employee directors for their service on the Board of Directors of the Company during 2007 and 2008. Employee directors do not receive any retainers or fees for their services on the Boards of Directors.

Annual Retainer	$ 5,000	(paid in the form of common stock) (1)
Fee per Board Meeting (Regular or Special)	$ 500	
Fee per Committee Meeting	$ 250	
Additional Annual Retainer for the Chairperson of the Compensation and Nomination and Governance Committee	$ 2,500	(paid in the form of stock options) (2)
Additional Annual Retainer for the Chairperson of the Audit Committee	$ 5,000	(paid in the form of stock options) (2)

(1) This stock grant will be granted upon the nomination of each director at the Annual Meeting of Stockholders.
(2) Stock option grants will be granted based on the directors past year of service, and will have an exercise price equal to the fair market value of the Company's common stock on the date of grant, an eighteen-month vesting period and a term of 10 years.

ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Stock Ownership

The following table sets forth certain information as of March 24, 2008, with respect to the common stock ownership of (i) each director of the Company, (ii) each executive officer named in the Summary Compensation Table and (iii) all directors and executive officers of the Company as a group.

Name of Beneficial Owner	Number of Shares Owned (excluding options)	Number of Shares That May be Acquired Within 60 days by Exercising Options	Percent of Common Stock Outstanding(1)
Douglas J. Andrea	261,014(2)	2,791,000	4.9%
Corisa L. Guiffre	2,750	463,200	*
Gary A. Jones	244,159	157,722	*
Louis Libin	141,667	150,000	*
Joseph J. Migliozzi	226,534	231,804	*
Jonathan D. Spaet	226,534	132,722	*
Current directors and executive officers as a group (6 persons)	1,102,658	3,926,448	7.9%

*Less than 1%

(1) Percentages with respect to each person or group of persons have been calculated on the basis of 59,861,193 shares of Company common stock, plus the number of shares of Company common stock which such person or group of persons has the right to acquire within 60 days from March 24, 2008, by the exercise of options. The information concerning the shareholders is based upon information furnished to the Company by such shareholders. Except as otherwise indicated none of the shares listed are pledged as security and all of the shares next to each identified person or group are owned of record and beneficially by such person or each person within such group and such persons have sole voting and investment power with respect thereto.

(2) Includes 12,438 and 3,876 shares owned by Mr. Andrea's spouse and Mr. Andrea's daughter, respectively.

The following table sets forth certain information as of March 24, 2008, with respect to the stock ownership of beneficial owners of more than 5% of the Company's outstanding common stock:

Name and Address	Shares of Common Stock Owned	Common Stock Equivalents (1)	Percent of Common Stock and Common Stock Equivalents Outstanding (2)
Alpha Capital Anstalt Pradafant 7, Furstentums 9490	-	5,722,159 (3)	9.6%

Vaduz, Liechtenstein			
Nickolas W. Edwards 937 Pine Ave, Long Beach, CA 90813	5,390,000 (4)	-	9.0%

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(1) The issuance of shares of common stock upon conversion of the Series C Preferred Stock is limited to that amount which, after given effect to the conversion, would cause the holder not to beneficially own in excess of 4.99% or, together with other shares beneficially owned during the 60 day period prior to such conversion, not to beneficially own in excess of 9.99% of the outstanding shares of common stock. The issuance of common stock upon conversion of the Series D Preferred Stock and the related warrants also are limited to that amount which, after given effect to the conversion, would cause the holder not to beneficially own an excess of 4.99% of then outstanding shares of our common stock, except that each holder has a right to terminate such limitation upon 61 days notice to us.

(2) Percentages with respect to each person or group of persons have been calculated on the basis of 59,861,193 shares of Company common stock, plus the number of shares of Company common stock which such person or groups of persons has the right to acquire within 60 days of the conversion of Series C Preferred Stock and Series D Preferred Stock.

(3) Based on information filed with the Securities and Exchange Commission in a Schedule 13G (Amendment No. 1) on February 15, 2007. Common stock ownership of Alpha Capital Anstalt (“Alpha Capital’) is not known as of March 24, 2008. Based on Company records as of March 24, 2008, Alpha Capital has 4,854,638 common stock equivalents from Series C Preferred Stock, Series D Preferred Stock and related warrants. See footnote (1) above, for limitations on the conversion of such commons stock equivalents.

(4) Based on information filed with the Securities and Exchange Commission in a Schedule 13G (Amendment No. 1) on October 20, 2006 by Nickolas W. Edwards.

The following table sets forth certain information as of March 24, 2008, for all compensation plans, including individual compensation arrangements under which equity securities of the Company are authorized for issuance.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options. warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
•Equity compensation plans approved by security holders	9,626,820	$ 0.68	5,651,345
•Equity compensation plans not approved by security holders	-	-	-
Total	9,626,820	$ 0.68	5,651,345

ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Each member of the Company's Board of Directors is independent under the listing standards of the Nasdaq Stock Market, except for Mr. Andrea, Chairman of the Board, President and Chief Executive Officer of the Company.

ITEM 13. EXHIBITS

INDEX TO EXHIBITS

Exhibit Number	Description
3.1	Amended and Restated Certificate of Incorporation of Registrant (incorporated by reference to Exhibit 3.1 of the Registrant's Form 10-K for the year ended December 31, 1992)
3.2	Certificate of Amendment of the Restated Certificate of Incorporation of Registrant (incorporated by reference to Exhibit 3.2 of the Registrant's Form 10-K for the year ended December 31, 1997)
3.3	Certificate of Amendment of the Restated Certificate of Incorporation of Registrant (incorporated by reference to Exhibit 3.1 of the Registrant's Current Report on Form 8-K filed November 30, 1998)
3.4	Certificate of Amendment to the Certificate of Incorporation of the Registrant (incorporated by reference to Exhibit 3.1 of the Registrant's Current Report on Form 8-K filed June 22, 1999)
3.5	Certificate of Amendment to the Certificate of Incorporation of the Registrant (incorporated by reference to Exhibit 3.1 of the Registrant's Current Report on Form 8-K filed October 12, 2000)
3.6	Certificate of Amendment to the Certificate of Incorporation of the Registrant dated August 22, 2001 (incorporated by reference to Exhibit 3.6 of the Registrant's Annual Report on Form 10-K filed April 1, 2002)
3.7	Certificate of Amendment to the Certificate of Incorporation of the Registrant dated February 5, 2003 (incorporated by reference to Exhibit 3.1 of the Registrant's Registration Statement on Form 8-A/A filed February 6, 2003)

3.8	Certificate of Amendment to the Certificate of Incorporation of the Registrant dated February 23, 2004 (incorporated by reference to Exhibit 3.1 of the Registrant's Registration Statement on Form 8-K filed February 26, 2004)
3.9	Amended By-Laws of Registrant (incorporated by reference to Exhibit 3.2 of the Registrant's Current Report on Form 8-K filed November 30, 1998)
4.1	Rights Agreement dated as of April 23, 1999 between Andrea and Continental Stock Transfer and Trust Company, as Rights Agent, including the form of Certificate of Amendment to Certificate of Incorporation as Exhibit A, the form of Rights Certificate as Exhibit B and the Summary of Rights to Purchase Shares of Series A Preferred Stock (incorporated by reference to Exhibit 4.1 of the Registrant's Current Report on Form 8-K filed May 7, 1999)

10.1 *1991 Performance Equity Plan, as amended (incorporated by reference to Exhibit 4 of the Registrant's Registration Statement on Form S-8, No. 333-45421, filed February 2, 1998)

10.2 *1998 Stock Plan of the Registrant, as amended (incorporated by reference to Exhibit 4.1 of the Registrant's Registration Statement on Form S-8, No. 333-82375, filed July 7, 1999)

10.3 *Change in Control Agreement, dated as of November 22, 1999, by and between Corisa L. Guiffre and the Registrant (incorporated by reference to Exhibit 10.3 of the Registrant's Form 10-KSB for the year ended December 31, 2006)

10.4 Exchange and Termination Agreement, dated as of February 11, 2004, by and among the Company and HFTP Investment L.L.C (incorporated by reference to Exhibit 10.1 of the Registrant's Registration Statement on Form 8-K filed February 17, 2004)

10.5 Acknowledgement and Waiver Agreement, dated as of February 11, 2004, by the Company and the investors listed in such agreement (incorporated by reference to Exhibit 10.2 of the Registrant's Registration Statement on Form 8-K filed February 17, 2004)

10.6 Securities Purchase Agreement, dated February 20, 2004, by and among the Company and the investors listed in such agreement (incorporated by reference to Exhibit 4.1 of the Registrant's Registration Statement on Form 8-K filed February 26, 2004)

10.7 Registration Rights Agreement, dated February 23, 2004, by and among the Company and the investors listed in such agreement (incorporated by reference to Exhibit 4.2 of the Registrant's Registration Statement on Form 8-K filed February 26, 2004)

10.8 Form of Common Stock Warrant (incorporated by reference to Exhibit 4.3 of the Registrant's Registration Statement on Form 8-K filed February 26, 2004)

10.9 *Employment Agreement, dated as of June 14, 2004, by and between Douglas J. Andrea and the Registrant (incorporated by reference to Exhibit 10.0 of the Registrant's Form 10QSB filed on August 13, 2004)

10.10 *Amendment 1 dated March 29, 2006 to Employment Agreement, dated as of June 14, 2004, by and between Douglas J. Andrea and the Registrant (incorporated by reference to Exhibit 10.9 of the Registrant's Form 10KSB filed on March 31, 2006)

10.11 *2006 Equity Compensation Plan of the Registrant (incorporated by reference to Appendix A of the Registrant's Schedule 14A filed on October 17, 2006.

10.12 *Employment Agreement, dated as of November 11, 2006, by and between Andrea Electronics Corporation and Douglas J. Andrea (incorporated by reference to Exhibit 10.1 of the Registrant's Form 8-K filed on November 8, 2006)

14.0 Code of Business Ethics and Conduct (incorporated by reference to Exhibit 14.0 of the Registrant's Form 10KSB filed April 15, 2005)

21.0 Subsidiaries of Registrant

23.1 Consent of Independent Public Accountants

31.0 Rule 13a-14(a)/15d – 14(a) Certifications

32.0 Section 1350 Certifications

* Management contract or compensatory plan or arrangement

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ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Audit Fees

The following table sets forth the fees billed to the Company for the fiscal years ended December 31, 2007 and 2006 by Marcum & Kliegman LLP:

Marcum & Kliegman LLP	2007	2006
Audit Fees	$ 131,000	$ 125,500
Audit-related fees	-	-
Tax fees	-	-
All other fees	-	-

Pre-Approval of Services by the Independent Auditor

The Audit Committee has adopted a policy for pre-approval of audit and permitted non-audit services by the Company's independent auditor. The Audit Committee will consider annually and, if appropriate, approve the provision of audit services by its external auditor and consider and, if appropriate, pre-approve the provision of certain defined audit and non-audit services. The Audit Committee also will consider on a case-by-case basis and, if appropriate, approve specific engagements that are not otherwise pre-approved.

Any proposed engagement that does not fit within the definition of a pre-approved service may be presented to the Audit Committee for consideration at its next regular meeting or, if earlier consideration is required, to the Audit Committee or one or more of its members. The member or members to whom such authority is delegated shall report any specific approval of services at its next regular meeting. The Audit Committee will regularly review summary reports detailing all services being provided to the Company by its external auditor.

During the year ended December 31, 2007, all services were approved, in advance, by the Audit Committee in compliance with these procedures.

Management’s Report on Internal Control Over Financial Reporting

The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. The internal control process has been designed under our supervision to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company’s financial statements for external reporting purposes in accordance with accounting principles generally accepted in the United States of America.

Management conducted an assessment of the effectiveness of the Company’s internal control over financial reporting as of December 31, 2007, utilizing the framework established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management has determined that the Company’s internal control over financial reporting as of December 31, 2007 is effective.

Our internal control over financial reporting includes policies and procedures that pertain to the maintenance of records that accurately and fairly reflect, in reasonable detail, transactions and dispositions of assets; and provide reasonable assurances that: (1) transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States; (2) receipts and expenditures are being made only in accordance with authorizations of management and the directors of the Company; and (3) unauthorized acquisition, use, or disposition of the Company’s assets that could have a material effect on the Company’s financial statements are prevented or timely detected.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

This annual report does not include an attestation report of the Company’s registered public accounting firm regarding internal control over financial reporting. Management’s report was not subject to attestation by the Company’s registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the Company to provide only management’s report in this annual report.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To The Audit Committee of the Board of Directors and Shareholders of
Andrea Electronics Corporation:

We have audited the accompanying consolidated balance sheets of Andrea Electronics Corporation (a New York corporation) and subsidiaries (the “Company”) as of December 31, 2007 and 2006, and the related consolidated statements of operations, changes in shareholders’ 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 financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of Andrea Electronics Corporation and subsidiaries as of December 31, 2007 and 2006, and the consolidated results its operations and its cash flows for the years then ended in conformity with United States generally accepted accounting principles.

/s/ Marcum & Kliegman LLP

Marcum & Kliegman LLP
Melville, New York
March 28, 2008

ANDREA ELECTRONICS CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	December 31, 2007	December 31, 2006
ASSETS		
Current assets:,		
Cash and cash equivalents	$ 811,403	$ 303,678
Accounts receivable, net of allowance for doubtful accounts of $21,705 and $16,704, respectively	994,446	839,599
Inventories, net	714,864	1,088,778
Prepaid expenses and other current assets	64,005	367,421
Total current assets	2,584,718	2,599,476
Property and equipment, net	57,751	39,243
Intangible assets, net	2,977,673	3,437,432
Other assets, net	12,864	12,864
Total assets	$ 5,633,006	$ 6,089,015
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Trade accounts payable	$ 474,346	$ 619,159
Short-term portion of capital lease	-	5,068
Other current liabilities	272,851	413,166
Total current liabilities	747,197	1,037,393
Series B Redeemable Convertible Preferred Stock, $.01 par value; authorized: 1,000 shares; issued and outstanding: 0 shares	-	-
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, $.01 par value; authorized: 2,497,500 shares; none issued and outstanding	-	-
Series C Convertible Preferred Stock, net, $.01 par value; authorized: 1,500 shares; issued and outstanding: 90.7 and 100.7 shares, respectively; liquidation value: $907,015 and $1,007,015, respectively	1	1
Series D Convertible Preferred Stock, net, $.01 par value; authorized: 2,500,000 shares; issued and outstanding: 1,192,858 and 1,242,858 shares, respectively; liquidation value: $1,192,858 and $1,242,858, respectively	11,929	12,429
Common stock, $.01 par value; authorized: 200,000,000 shares; issued and outstanding: 59,861,193 and 59,021,857 shares, respectively	598,612	590,219
Additional paid-in capital	76,568,825	76,352,407
Accumulated deficit	(72,293,558)	(71,903,434)
Total shareholders' equity	4,885,809	5,051,622
Total liabilities and shareholders' equity	$ 5,633,006	$ 6,089,015

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

ANDREA ELECTRONICS CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	For the Years Ended December 31, 2007	2006
Revenues		
Net product revenues	$ 4,350,990	$ 4,954,906
License revenues	695,223	780,384
Revenues	5,046,213	5,735,290
Cost of revenues	2,595,414	3,115,273
Gross margin	2,450,799	2,620,017
Research and development expenses	676,977	571,288
General, administrative and selling expenses	2,143,159	1,963,977
(Loss) income from operations	(369,337)	84,752
Other income (expense), net		
Interest income	10,858	497
Interest expense	(2,235)	(3,396)
Other income (expense), net	8,623	(2,899)
(Loss) income before provision for income taxes	(360,714)	81,853
Provision for income taxes	29,410	63,187
Net (loss) income	$ (390,124)	$ 18,666
Basic weighted average shares	59,559,623	58,470,811
Diluted weighted average shares	59,559,623	68,325,677
Basic and diluted net (loss) income per share	$ (0.01)	$ 0.00

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

ANDREA ELECTRONICS CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2007 AND 2006

	Series C Convertible Preferred Stock Outstanding	Series C Convertible Preferred Stock	Series D Convertible Preferred Stock Outstanding	Series D Convertible Preferred Stock	Common Stock Shares Outstanding	Common Stock	Additional Paid-In Capital	Accumulated Deficit	Total Shareholders' Equity
Balance, January 1, 2006	105.701477	$ 1	1,328,572	$ 13,286	58,283,575	$ 582,836	$ 76,246,870	$ (71,922,100)	$ 4,920,893
Conversions of Series C Convertible Preferred Stock	(5.00000)	-	-	-	228,758	2,287	6,069	-	8,356
Conversions of Series D Convertible Preferred Stock	-	-	(85,714)	(857)	342,856	3,429	(2,572)	-	-
Stock Grant to Outside Directors and related expense	-	-	-	-	166,668	1,667	18,333	-	20,000
Expense of Stock Option Grants	-	-	-	-	-	-	83,707	-	83,707
Net income	-	-	-	-	-	-	-	18,666	18,666
Balance, December 31, 2006	100.701477	$ 1	1,242,858	12,429	59,021,857	590,219	76,352,407	(71,903,434)	5,051,622
Conversions of Series C Convertible Preferred Stock	(10.00000)	-	-	-	457,516	4,575	12,137	-	16,712
Conversions of Series D Convertible Preferred Stock	-	-	(50,000)	(500)	200,000	2,000	(1,500)	-	-

Stock Grant to Outside Directors and related expense	-	-	-	-	181,820	1,818	20,682	-	22,500
Expense of Stock Option Grants	-	-	-	-	-	-	185,099	-	185,099
Net loss	-	-	-	-	-	-	-	(390,124)	(390,124)
Balance, December 31, 2007	90.701477	$ 1	1,192,858	$ 11,929	59,861,193	$ 598,612	$ 76,568,825	$ (72,293,558)	$ 4,885,809

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

ANDREA ELECTRONICS CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Years Ended December 31,	
Cash flows from operating activities:	2007	2006
Net (loss) income	$ (390,124)	$ 18,666
Adjustments to reconcile net (loss) income to net cash used in operating activities:		
Depreciation and amortization	487,896	488,422
Stock based compensation expense	207,599	103,707
Provision for bad debt	5,001	(2,152)
Inventory reserve	(25,039)	(81,837)
Change in:		
Accounts receivable	(159,848)	(231,484)
Inventories	398,953	(327,939)
Prepaid expenses and other current assets	303,416	(148,800)
Trade accounts payable	(144,813)	159,015
Other current and long term liabilities	(123,603)	(35,690)
Net cash provided by (used in) operating operations	559,438	(58,092)
Cash flows from investing activities:		
Purchases of property and equipment	(33,870)	(21,598)
Purchases of patents and trademarks	(12,775)	(22,768)
Net cash used in investing activities	(46,645)	(44,366)
Cash flows from financing activities:		
Payments under capital lease	(5,068)	(12,461)
Net cash used in financing activities	(5,068)	(12,461)
Net increase (decrease) in cash and cash equivalents	507,725	(114,919)
Cash and cash equivalents, beginning of period	303,678	418,597
Cash and cash equivalents, end of period	$ 811,403	$ 303,678
Supplemental disclosures of cash flow information:		
Non-cash investing and financing activities:		
Conversion of Series C Convertible Preferred Stock and related dividends into common stock	$ 16,712	$ 8,356
Cash paid for:		
Interest	$ 2,235	$ 2,899
Income Taxes	$ 76,420	$ 29,421

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

ANDREA ELECTRONICS CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED STATEMENTS OF CASH FLOWS
DECEMBER 31, 2007

1. ORGANIZATION AND BUSINESS

Andrea Electronics Corporation, incorporated in the State of New York in 1934, (together with its subsidiaries, "Andrea" or the "Company") has been engaged in the electronic communications industry since its inception. Since the early 1990s, Andrea has been primarily focused on developing and manufacturing state-of-the-art microphone technologies and products for enhancing speech-based applications software and communications, primarily in the computer and business enterprise markets that require high quality, clear voice signals. Andrea's technologies eliminate unwanted background noise to enable the optimum performance of various speech-based and audio applications. Andrea DSP Microphone and Audio Software Products and Andrea Anti-Noise Products have been designed for applications that are controlled by or depend on speech across a broad range of hardware and software platforms. These products incorporate Digital Signal Processing, Noise Cancellation, Active Noise Cancellation and Active Noise Reduction microphone technologies, and are designed to cancel background noise in a wide range of noisy environments, such as homes, offices, factories and automobiles. Andrea also manufactures a line of accessories for these products for the consumer and commercial markets in the United States as well as in Europe and Asia.

Management's Liquidity Plans

As of December 31, 2007, Andrea had a working capital of $1,837,521 and cash and cash equivalents of $811,403. Andrea's loss from operations was $369,337 for the year ended December 31, 2007. Andrea plans to continue to improve its cash flows during 2008 by aggressively pursuing additional licensing opportunities related to Andrea DSP Audio Software and increasing its Andrea Anti-Noise Headset Products sales through the introduction of refreshed product line scheduled to be introduced in the early part of 2008 as well as the increased efforts the Company is dedicating to its sales and marketing efforts. However, there can be no assurance that Andrea will be able to successfully execute the aforementioned plans.

As of March 24, 2008, Andrea has approximately $750,000 (unaudited) of cash. Management projects that Andrea has sufficient liquidity available to operate through at least December 2008.While Andrea explores opportunities to increase revenues in new business areas, the Company also continues to examine additional opportunities for cost reduction and further diversification of its business. Andrea was cash flow positive in 2007 and 2006. Although these steps are encouraging, if Andrea fails to develop additional revenues from sales of its products and licensing of its technology or to generate adequate funding from operations, or if Andrea fails to obtain additional financing through a capital transaction or other type of financing, Andrea will be required to continue to significantly reduce its operating expenses and/or operations or Andrea may have to relinquish its products, technologies or markets which could have a materially adverse effect on revenue and operations. Andrea has no commitment for additional financing and may experience difficulty in obtaining additional financing on favorable terms, if at all.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The financial statements include the accounts of Andrea and its wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

Loss (earnings) Per Share

Basic (loss) earnings per share is computed by dividing the net (loss) income by the weighted average number of common shares outstanding during the period. Diluted (loss) earnings adjusts basic (loss) earnings per share for the effects of convertible securities, stock options and other potentially dilutive financial instruments, only in the periods in which such effect is dilutive. Securities that could potentially dilute basic earnings per share ("EPS") in the future that were not included in the computation of the diluted EPS because to do so would have been anti-dilutive for the periods presented, consist of the following:

Total potentially dilutive common shares as of:	December 31, 2007	December 31, 2006
Options to purchase common stock (Note 13)	9,686,820	1,925,000
Series C Convertible Preferred Stock and related accrued dividends (Note 7)	4,149,736	-
Series D Convertible Preferred Stock and related warrants (Note 8)	9,929,776	5,158,344
Total potentially dilutive common shares	23,766,332	7,083,344

ANDREA ELECTRONICS CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED STATEMENTS OF CASH FLOWS
DECEMBER 31, 2007

The following table sets forth the components used in the computation of basic and diluted earnings per share for the year ended December 31, 2006

	December 31, 2006
Numerator:	
Net (loss) income	$ 18,666
Denominator:	
Weighted average shares	58,470,811
Effect of dilutive securities:	
Series C Convertible Preferred Stock	4,607,252
Series D Convertible Preferred Stock	4,971,432
Employee stock options	276,182
Denominator for diluted earnings per share-adjusted weighted average shares after assumed conversions	68,325,677

The above computation was not necessary for the year ended December 31, 2007 as the period had a net loss.

Cash and Cash Equivalents

Cash and cash equivalents include cash and highly liquid investments with original maturities of three months or less. The Company has cash deposits in excess of the maximum amounts insured by the Federal Deposit Insurance Corporation at December 31, 2007 and 2006. The Company mitigates its risk by investing in or through major financial institutions.

Concentration of Credit Risk

Andrea is a manufacturer of audio communications equipment for several industries. Revenues of Superbeam array microphone products were significant to one customer and its affiliates, accounting for approximately 18% and 25% of the total net revenues for the year ended December 31, 2007 and 2006, respectively, and accounted for 20% and 24% of total accounts receivable at December 31, 2007 and 2006, respectively. Revenues of noise canceling and active noise canceling products were significant to one customer and its affiliates, accounting for approximately 7% and 10% of the total net revenues for the year ended December 31 2007 and 2006, respectively, and accounted for 23% and 3% of total accounts receivable at December 31, 2007 and 2006, respectively. Licensing revenues and other revenues of noise canceling and active noise canceling products were significant to one customer and its affiliates, accounting for approximately 8% and 11% of the total net revenues for the year ended December 31, 2007 and 2006, respectively, and accounted for 5% and 41% of total accounts receivable at December 31, 2007 and 2006, respectively. Licensing revenues and other service related revenues to one customer were approximately 11% and 8% of the total net revenues for the year ended December 31, 2007 and 2006 respectively, and account for 5% and 8% of total accounts receivable at December 31, 2007 and 2006 respectively.

During the years ended December 31, 2007 and 2006, Andrea purchased a substantial portion of its finished goods from two suppliers. Purchases from these two suppliers amounted to 55% and 34% in 2007 and 79% and 3% in 2006, of total purchases. At December 31, 2007, the amounts due to these suppliers in accounts payable were $191,411 and $104,760 respectively. At December 31, 2006, the amounts due to these suppliers in accounts payable were $377,019 and $0 respectively.

Allowance for Doubtful Accounts

The Company performs on-going credit evaluations of its customers and adjusts credit limits based upon payment history and the customer's current credit worthiness, as determined by the review of their current credit information. Collections and payments from customers are continuously monitored. The Company maintains an allowance for doubtful accounts, which is based upon historical experience as well as specific customer collection issues that have been identified. While such bad debt expenses have historically been within expectations and allowances established, the Company cannot guarantee that it will continue to experience the same credit loss rates that it has in the past. If the financial condition of customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

Inventories

Inventories are stated at the lower of cost (on a first-in, first-out) or market basis. The cost elements of inventories include materials, labor and overhead. Andrea reviews its inventory reserve for obsolescence on a quarterly basis and establishes reserves on inventories when the cost of the inventory is not expected to be recovered. Andrea's policy is to reserve for inventory that shows slow movement over the

ANDREA ELECTRONICS CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED STATEMENTS OF CASH FLOWS
DECEMBER 31, 2007

preceding six consecutive quarters. Andrea records charges in inventory reserves as part of cost of revenues.

Property and Equipment

Property and equipment is stated at cost less accumulated depreciation and amortization. Depreciation is provided on a straight-line basis over the estimated useful lives of the assets ranging from 3 to 7 years. Leasehold improvements are amortized on a straight-line basis over the shorter of the lives of the respective leases or the expected useful lives of those improvements.

Expenditures for maintenance and repairs that do not materially prolong the normal useful life of an asset are charged to operations as incurred. Improvements that substantially extend the useful lives of the assets are capitalized. Upon sale or other disposition of assets, the cost and related accumulated depreciation and amortization are removed from the accounts and the resulting gain or loss, if any, is reflected in the statement of operations.

Other Intangible Assets

Andrea amortizes its core technology and patents and trademarks on a straight-line basis over their estimated useful lives that range from 15 to 17 years.

Long-Lived Assets

Andrea accounts for its long-lived assets in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets,” for purposes of determining and measuring impairment of its long-lived assets (primarily intangible assets) other than goodwill. Andrea’s policy is to review the value assigned to its long lived assets to determine if they have been permanently impaired by adverse conditions which may affect Andrea whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If Andrea identifies a permanent impairment such that the carrying amount of Andrea’s long lived assets is not recoverable using the sum of an undiscounted cash flow projection (gross margin dollars from product sales), the impaired asset is adjusted to its estimated fair value, based on an estimate of future discounted cash flows which becomes the new cost basis for the impaired asset. Considerable management judgment is necessary to estimate undiscounted future operating cash flows and fair values and, accordingly, actual results could vary significantly from such estimates. No impairment charges were recognized during the years ended December 31, 2007 and 2006.

Revenue Recognition

Non software-related revenue, which is generally comprised of microphones and microphone connectivity product revenues, is recognized when title and risk of loss pass to the customer, which is generally upon shipment. With respect to licensing revenues, Andrea recognizes revenue in accordance with Statement of Position (“SOP”) 97-2, “Software Revenue Recognition,” as amended, and Staff Accounting Bulletin Topic 13 “Revenue Recognition in Financial Statement.” License revenue is recognized based on the terms and conditions of individual contracts. In addition, fee based services, which are short-term in nature, are generally performed on a time-and-material basis under separate service arrangements and the corresponding revenue is generally recognized as the services are performed.

Income Taxes

The provision for income taxes is a result of certain licensing revenues that are subject to withholding of income tax as mandated by the foreign jurisdiction in which the revenues are earned. For all other income taxes, Andrea accounts for income taxes in accordance with SFAS No. 109, “Accounting for Income Taxes.” SFAS No. 109 requires an asset and liability approach for financial accounting and reporting for income taxes. The provision for income taxes is based upon income or loss after adjustment for those permanent items that are not considered in the determination of taxable income. Deferred income taxes represent the tax effects of differences between the financial reporting and tax bases of the Company’s assets and liabilities at the enacted tax rates in effect for the years in which the differences are expected to reverse. The Company evaluates the recoverability of deferred tax assets and establishes a valuation allowance when it is more likely than not that some portion or all of the deferred tax assets will not be realized. If it becomes more likely than not that a tax asset will be used, the related valuation allowance on such assets would be reversed. Management makes judgments as to the interpretation of the tax laws that might be challenged upon an audit and cause changes to previous estimates of tax liability. In management’s opinion, adequate provisions for income taxes have been made for all years. If actual taxable income by tax jurisdiction varies from estimates, additional allowances or reversals of reserves may be necessary. Income tax expense consists of the tax payable for the period and the change during the period in deferred tax assets and liabilities.

ANDREA ELECTRONICS CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED STATEMENTS OF CASH FLOWS
DECEMBER 31, 2007

Effective January 1, 2007, the Company adopted the provisions of Financial Accounting Standards Board ("FASB) issued Interpretation No. 48 "Accounting for Uncertainty in Income Taxes"—an Interpretation of FASB Statement No. 109 ("FIN 48"). FIN 48 establishes for all entities a minimum threshold for financial statement recognition of the benefit of tax positions, and requires certain expanded disclosures. The adoption of FIN. 48 did not have a material effect on the Company's condensed consolidated financial position or results of operations or cash flows (Note 11).

Stock-Based Compensation

At December 31, 2007, Andrea had three stock-based employee compensation plans, which are described more fully in Note 13. Effective, January 1, 2006, the Company adopted the provisions of SFAS No. 123R, "Share-Based Payment." SFAS No. 123R establishes accounting for stock-based awards exchanged for employee services. Under the provisions of SFAS No. 123R, share-based compensation cost is measured at the grant date, based on the fair value of the award, and is recognized as expense over the employee's requisite service period (generally the vesting period of the equity grant). The fair value of the Company's common stock options are estimated using the Black Scholes option-pricing model with the following assumptions: expected volatility, dividend rate, risk free interest rate and the expected life. The Company expenses stock-based compensation by using the straight-line method. The Company elected to adopt the modified prospective transition method as provided by SFAS No. 123R. In accordance with the requirements of the modified prospective transition method, consolidated financial statements for prior year periods have not been restated to reflect the fair value method of expensing share-based compensation. Additionally, effective with the adoption of SFAS No. 123R excess tax benefits realized from the exercise of stock-based awards are classified in cash flows from financing activities. The future realization of the reserved deferred tax assets related to these tax benefits associated with the exercise of stock option will result in a credit to additional paid in capital if the related tax deduction reduces taxes payable.

Research and Development

Andrea expenses all research and development costs as incurred.

Shipping and Handling Costs

Andrea incurs shipping and handling costs in its operations. These costs are included in "Cost of revenues" in the consolidated statements of operations. $79,243 and $85,809 were billed to customers and are included in net revenues for the years ended December 31, 2007 and 2006, respectively.

Advertising Expenses

In accordance with SOP 93-7, "Reporting on Advertising Costs," all media costs of newspaper and magazine advertisements as well as trade show costs are expensed as incurred. Total advertising and marketing expenses for the years ended December 31, 2007 and 2006 were $20,677 and $16,087, respectively and are included in general, administrative and selling expenses.

Fair Value of Financial Instruments

Andrea calculates the fair value of financial instruments and includes this additional information in the notes to financial statements when the fair value is different than the book value of those financial instruments. When the book value approximates fair value, no additional disclosure is made. Andrea uses quoted market prices whenever available to calculate these fair values. When quoted market prices are not available, Andrea uses standard pricing models for various types of financial instruments which take into account the present value of estimated future cash flows. As of December 31, 2007 and 2006, the carrying value of all financial instruments approximated fair value.

Recently Issued Accounting Pronouncements

In December 2007, the FASB issued SFAS No. 141R, “Business Combinations” (“SFAS 141R”), which replaces SFAS No. 141, “Business Combinations.” SFAS 141R establishes principles and requirements for determining how an enterprise recognizes and measures the fair value of certain assets and liabilities acquired in a business combination, including noncontrolling interests, contingent consideration, and certain acquired contingencies. SFAS 141R also requires acquisition-related transaction expenses and restructuring costs be expensed as incurred rather than capitalized as a component of the business combination. SFAS 141R will be applicable prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. SFAS 141R would have an impact on accounting for any businesses acquired after the effective date of this pronouncement.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" (“SFAS 157”). SFAS 157 clarifies the principle that fair value should be based on the

ANDREA ELECTRONICS CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED STATEMENTS OF CASH FLOWS
DECEMBER 31, 2007

assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. SFAS 157 requires fair value measurements to be separately disclosed by level within the fair value hierarchy. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company does not believe the provisions of this standard will have a significant effect on its consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159 "The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment of FASB Statement No. 115" ("SFAS No. 159"), which permits entities to choose to measure many financial instruments and certain other items at fair value. The fair value option established by this Statement permits all entities to choose to measure eligible items at fair value at specified election dates. A business entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. Adoption is required for fiscal years beginning after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the entity also elects to apply the provisions of SFAS No. 159. The adoption of this pronouncement is not expected to have any material effects on the Company's consolidated financial position, results of operations or cash flows.

In December 2007, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 110 ("SAB 110"). SAB 110 amends and replaces Question 6 of Section D.2 of Topic 14, Share-Based Payment of the Staff Accounting Bulletin series. Question 6 of Section D.2 of Topic 14 expresses the views of the staff regarding the use of the "simplified" method in developing an estimate of the expected term of "plain vanilla" share options and allows usage of that method for option grants prior to December 31, 2007. SAB 110 allows public companies which do not have sufficient historical experience to provide a reasonable estimate to continue the use of this method for estimating the expected term of "plain vanilla" share option grants after December 31, 2007. The adoption of this pronouncement by the Company in fiscal 2008 is not expected to have a significant effect on its financial statements.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements – An Amendment of ARB No. 51" ("SFAS 160"). SFAS 160 establishes accounting and reporting standards for the noncontrolling interest in a subsidiary (previously referred to as minority interests). SFAS 160 also requires that a retained noncontrolling interest upon the deconsolidation of a subsidiary be initially measured at its fair value. Upon adoption of SFAS 160, the Company would be required to report any noncontrolling interests as a separate component of stockholders' equity. The Company would also be required to present any net income allocable to noncontrolling interests and net income attributable to the stockholders of the Company separately in its consolidated statements of operations. SFAS 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. SFAS 160 requires retroactive adoption of the presentation and disclosure requirements for existing minority interests. All other requirements of SFAS 160 shall be applied prospectively. SFAS 160 would have an impact on the presentation and disclosure of the noncontrolling interests of any non wholly-owned businesses acquired in the future.

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year presentation.

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, liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period.

Management bases its estimates on historical experience and on various assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. The most significant estimates, among other things, are used in accounting for allowances for bad debts, inventory valuation and obsolescence, product warranty, depreciation, deferred income taxes, expected realizable values for assets (primarily intangible assets), contingencies, revenue recognition as well as the recording and presentation of the Company’s convertible preferred stock. Estimates and assumptions are periodically reviewed and the effects of any material revisions are reflected in the consolidated financial statements in the period that they are determined to be necessary. Actual results could differ from those estimates and assumptions.

ANDREA ELECTRONICS CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED STATEMENTS OF CASH FLOWS
DECEMBER 31, 2007

3. INTANGIBLE ASSETS

Intangible assets, net, consists of the following:

	December 31, 2007	December 31, 2006
Core Technology	$ 8,567,448	$ 8,567,448
Trademarks and Patents	529,271	516,496
	9,096,719	9,083,944
Less: accumulated amortization	(6,119,046)	(5,646,512)
	$ 2,977,673	$ 3,437,432

The changes in the carrying amount of intangible assets during the years ended December 31, 2007 and 2006 were as follows:

	Core Technology	Trademarks and Patents	Totals
Balance as of January 1, 2006	$ 3,531,369	$ 355,124	$ 3,886,493
Additions during the period	-	22,768	22,768
Amortization	(441,421)	(30,408)	(471,829)
Balance as of December 31, 2006	3,089,948	347,484	3,437,432
Additions during the period	-	12,775	12,775
Amortization	(441,421)	(31,113)	(472,534)
Balance as of December 31, 2007	$ 2,648,527	$ 329,146	$ 2,977,673

Andrea accounts for its long-lived assets in accordance with SFAS No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets” for purposes of determining and measuring impairment of its long-lived assets (primarily intangible assets) other than goodwill. Andrea’s policy is to periodically review the value assigned to its long-lived assets to determine if they have been permanently impaired by adverse conditions which may affect Andrea. If Andrea identifies a permanent impairment such that the carrying amount of Andrea’s long lived assets are not recoverable using the sum of an undiscounted cash flow projection (gross margin dollars from product revenues), a new cost basis for the impaired asset will be established. If required, an impairment charge is recorded based on an estimate of future discounted cash flows. This new cost basis will be net of any recorded impairment.

In 2007 and 2006, because the revenues from the Andrea DSP Microphone and Audio Software Products business segment were lower than expected and this business segment was still operating at a loss, management compared the sum of Andrea’s undiscounted cash flow projections (gross margin dollars from product sales) of the Andrea DSP Microphone and Audio Software core technology to the carrying value of that technology. The results of this test indicated that there was not an impairment. This process utilized probability weighted undiscounted cash flow projections which include a significant amount of management’s judgment and estimates as to future revenue. If these probability weighted projections do not come to fruition, the Company could be required to record an impairment charge in the near term and such impairment could be material.

Amortization expense was $472,534 and $471,829 for the years ended December 31, 2007 and 2006, respectively. Amortization of core technology is expected to be approximately $441,421 per year for the next six years. Trademarks and patents are amortized on a straight-line basis over 17 years. Assuming no changes in the Company's intangible assets, estimated amortization expense for each of the five succeeding fiscal years ending December 31 is expected to be approximately $472,322 per year.

4. INVENTORIES, net

Inventories, net, consist of the following:

	December 31, 2007	December 31, 2006
Raw materials	$ 62,834	$ 40,237
Finished goods	1,218,971	1,640,521
	1,281,805	1,680,758
Less: reserve for obsolescence	(566,941)	(591,980)
	$ 714,864	$ 1,088,778

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ANDREA ELECTRONICS CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED STATEMENTS OF CASH FLOWS
DECEMBER 31, 2007

5. PROPERTY AND EQUIPMENT, net

Property and equipment, net, consists of the following:

	December 31, 2007	December 31, 2006
Machinery and equipment	$ 492,989	$ 459,119
Less: accumulated depreciation and amortization	(435,238)	(419,876)
	$ 57,751	$ 39,243

Depreciation and amortization of property and equipment was $15,362 and $16,593 for the years ended December 31, 2007 and 2006, respectively.

6. OTHER CURRENT LIABILITIES

Other current liabilities consist of the following:

	December 31, 2007	December 31, 2006
Accrued payroll and related expenses	$ 55,634	$ 45,766
Accrued bonus for Chief Executive Officer (Note 12)	-	121,349
Accrued professional and other service fees	65,451	77,450
Accrued interest and dividend expense	151,583	168,296
Accrued other	183	305
	$ 272,851	$ 413,166

7. SERIES C CONVERTIBLE PREFERRED STOCK

On October 10, 2000, Andrea issued and sold in a private placement $7,500,000 of Series C Redeemable Convertible Preferred Stock (the "Series C Preferred Stock"). Each of these shares of Series C Preferred Stock had a stated value of $10,000 plus $671.23 increase in the stated value, which sum is convertible into Common Stock at a conversion price of $0.2551. On February 17, 2004, Andrea announced that it had entered into an Exchange and Termination Agreement and an Acknowledgment and Waiver Agreement, which eliminated the dividend of 5% per annum on the stated value. The additional amount of $671.23 represents the 5% per annum from October 10, 2000 through February 17, 2004.

On May 24, 2006, 5 shares of Series C Preferred Stock, together with $8,356 of previously accrued dividends, were converted into 228,758 shares of Common Stock at the conversion price of $0.2551.

On April 11, 2007, 10 shares of Series C Preferred Stock, together with related accrued dividends of $16,712, were converted into 457,516 shares of Common Stock at a conversion price of $0.2551.

As of December 31, 2007, there were 90.701477 shares of Series C Preferred Stock outstanding, which were convertible into 4,149,736 shares of Common Stock and remaining accrued dividends of $151,583.

8. SERIES D CONVERTIBLE PREFERRED STOCK

On February 17, 2004, Andrea entered into a Securities Purchase Agreement (including a Registration Rights Agreement) with certain holders of the Series C Preferred Stock and other investors (collectively, the "Buyers") pursuant to which the Buyers agreed to invest a total of $2,500,000. In connection with this agreement, on February 23, 2004, the Buyers purchased, for a purchase price of $1,250,000, an aggregate of 1,250,000 shares of a new class of preferred stock, the Series D Preferred Stock, convertible into 5,000,000 shares of Common Stock (an effective conversion price of $0.25 per share) and Common Stock warrants exercisable for an aggregate of 2,500,000 shares of Common Stock. The warrants are exercisable at any time after August 17, 2004 and before February 23, 2009 at an exercise price of $0.38 per share.

In addition, on June 4, 2004, the Buyers purchased for an additional $1,250,000, an additional 1,250,000 shares of Series D Preferred Stock convertible into 5,000,000 shares of Common Stock (an effective conversion price of $0.25 per share) and Common Stock warrants exercisable for an aggregate of 2,500,000 shares of Common Stock. The warrants are exercisable at any time after December 4, 2004 and before June 4, 2009 at an exercise price of $0.17 per share.

ANDREA ELECTRONICS CORPORATION AND SUBSIDIARIES

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Knightsbridge Capital served as a financial advisor to Andrea in connection with the aforementioned transactions and the initial issuance of the Series D Preferred Stock and related warrants. In connection with these transactions, Andrea agreed to pay Knightsbridge Capital $300,000 in cash and to issue warrants exercisable for an aggregate of 377,094 shares of Common Stock. The warrants are exercisable at any time after August 17, 2004 and before February 23, 2009 at an exercise price of $0.38 per share.

The Company is required to maintain an effective registration statement from the time of issuance through June 4, 2010. In the event that the holder of the Series D Preferred Stock and related warrants is unable to convert these securities into Andrea Common stock the Company shall pay to each such holder of such registrable securities a Registration Delay Payment. This payment is to be paid in cash and is equal to the product of (i) the stated value of such Preferred Shares multiplied by (ii) the product of (1) .0005 multiplied by (2) the number of days that sales cannot be made pursuant to the Registration Statement (excluding any days during that may be considered grace periods as defined by the Registration Rights Agreement).

Prior to 2006, there were 281,250 exercises of Series D Preferred Stock Warrants. There were no Series D Preferred Stock Warrant exercises during the year ended December 31, 2007 and 2006.

On December 1, 2006, 85,714 shares of Series D Preferred Stock were converted into 342,856 shares of Common Stock at a conversion price of $0.25. On March 16, 2007, 25,000 shares of Series D Preferred Stock were converted into 100,000 shares of Common Stock at a conversion price of $0.25. On April 11, 2007, 25,000 shares of Series D Preferred Stock were converted into 100,000 shares of Common Stock at a conversion price of $0.25.

As of December 31, 2007, there are 1,192,858 shares of Series D Preferred Stock and 5,158,344 related warrants outstanding, which are convertible and exercisable into 9,929,776 shares of Common Stock.

9. LICENSING AGREEMENTS

The Company has entered into various licensing, production and distribution agreements with manufacturers of PC and related components. These agreements provide for revenues based on the terms of each individual agreement. The Company's three largest licensing customers accounted for $244,558, $233,033 and $159,525 of revenues in 2007 and $134,017, $582,569 and $0 of revenues in 2006.

10. RETIREMENT PLAN

Andrea has a defined contribution profit sharing plan that is qualified under Section 401(k) of the Internal Revenue Code and is available to substantially all of its employees. Andrea did not make any contributions to this plan for the years ended December 31, 2007 and 2006.

11. INCOME TAXES

The Company has adopted the provisions of FIN 48, on January 1, 2007. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement 109, "Accounting for Income Taxes," and prescribes a recognition threshold and measurement process for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim period, disclosure and transition. There were no unrecognized tax benefits as of January 1, 2007.

Upon the adoption of FIN 48, the Company was required to evaluate all of its tax positions including any limitations from the result of a change in control under Section 382. During 2007, the Company performed a preliminary evaluation as to whether a change in control had taken place. Management has determined that a change in control may have taken place. As a result of its preliminary evaluation management has determined that $30 million of its $50 million of total NOL may be subject to limitation and accordingly reduced its net deferred tax asset and related evaluation allowance by $11.7 million.

The Company has identified its federal tax return and its state tax return in New York as "major" tax jurisdictions, as defined in FIN 48. Based on the Company's evaluation, it has been concluded that there are no significant uncertain tax positions requiring recognition in the Company's financial statements. The Company's evaluation was performed for tax years ended 2003 through 2007. The Company believes that its income tax positions and deductions will be sustained on audit and does not anticipate any adjustments that will result in a material change to its financial position. In addition, the Company did not record a cumulative effect adjustment related to the adoption of FIN 48.

The Company's policy for recording interest and penalties associated with audits is to record such items as a component of income tax expense. There were no amounts accrued for penalties or interest as of or during the year ended December 31, 2007. The Company does not expect its unrecognized tax benefit position to change during the next twelve months. Management is currently unaware of any issues under review that could result in significant payments, accruals or material deviations from its position.

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The components of earnings before income taxes are as follows:

	For the Years Ended December 31, 2007	2006
Domestic	$ (630,420)	$ (530,560)
Foreign	269,705	612,413
(Loss) income before income taxes	$ (360,715)	$ 81,853

The provision for income tax consists of the following:

	For the Years Ended December 31, 2007	2006
Current:		
Federal	$ -	$ -
Foreign	29,409	63,187
State and Local:	-	-
Deferred		
Federal	(11,762,000)	(165,000)
Foreign	-	-
State and Local:	-	-
Adjustment to valuation allowance related to net deferred tax assets	11,762,000	165,000
	$ 29,409	$ 63,187

A reconciliation between the effective rate for income taxes and the amount computed by applying the statutory Federal income tax rate to loss from continuing operations before provision (benefit) for income taxes is as follows:

	For the Years Ended December 31, 2007	2006
Tax provision at statutory rate	(34)%	34%
State and local taxes	(4)%	32%
Core technology amortization	42%	-%
Stock Option Expense Related to Incentive Stock Options	18%	184%
Foreign income and withholding taxes	8%	77%
Change in valuation allowance for net deferred tax assets	(22)%	(250)%
	8%	77%

The effective tax rate for the year ended December 31, 2006 and subsequent decrease in effective tax rate for the year ended December 31, 2007 is a result of certain licensing revenues that are subject to withholding of income tax as mandated by the respective foreign jurisdiction in which the revenues are earned.

The components of temporary differences that give rise to significant portions of the deferred tax asset, net, are as follows:

	For the Years Ended December 31, 2007	2006
Deferred tax assets:		
Reserve for accrued expenses	$ 50,000	$ 91,000
Allowance for doubtful accounts	8,000	7,000
Reserve for obsolescence	221,000	231,000
Foreign tax credit	93,000	63,000
NOL carryforward	7,837,000	19,580,000
	8,209,000	19,972,000
Less: valuation allowance	(8,209,000)	(19,972,000)
Deferred tax asset, net	$ -	$ -

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The change in the valuation allowance for deferred tax assets are summarized as follows:

	For the Years Ended December 31, 2007	2006
Beginning Balance	$ 19,972,000	$ 20,137,000
Change in Allowance	(11,763,000)	(165,000)
Ending Balance	$ 8,209,000	$ 19,972,000

SFAS No. 109 requires that a valuation allowance be established when it is "more likely than not" that all or a portion of deferred tax assets will not be realized. A review of all available positive and negative evidence needs to be considered, including a company's performance, the market environment in which the company operates, the length of carryback and carryforward periods, and expectations of future profits, etc.

SFAS No. 109 further states that forming a conclusion that a valuation allowance is not needed is difficult when there is negative evidence such as cumulative losses in recent years. Therefore, cumulative losses weigh heavily in the overall assessment. Andrea will provide a full valuation allowance on future tax benefits until it can sustain a level of profitability that demonstrates its ability to utilize the assets, or other significant positive evidence arises that suggests Andrea's ability to utilize such assets.

As of December 31, 2007, Andrea had net operating loss and credit carryforwards of approximately $20.1 million (net amount after potential Section 382 limitations) expiring in varying amounts beginning in 2008 through 2027. Andrea has foreign tax credits of approximately $30,000 and $63,000 which will expire in 2017 and 2016, respectively. Some of this fully reserved deferred tax asset of approximately $8.2 million, may have tax benefits associated with the exercise of stock options, which will not result in a tax benefit in the consolidated statements of operations in future periods but, rather, will result in further increases to additional paid-in capital, if and when realized. The Company has elected the "with and without approach" regarding ordering of windfall tax benefits to determine whether the windfall tax benefit did reduce taxes payable in the current year. Under this approach the windfall tax benefit would be recognized in additional paid-in-capital only if an incremental tax benefit is realized after considering all other benefits presently available.

12. COMMITMENTS AND CONTINGENCIES

Leases

In March 2005, Andrea entered into a new lease for its corporate headquarters located in Bohemia, New York, where Andrea leases space for warehousing, sales and executive offices from an unrelated party. The lease is for approximately 11,000 square feet and expires in April 2010. Rent expense under this operating lease was approximately $81,279 and $78,911 for the year ended December 31, 2007 and 2006, respectively.

As of December 31, 2007, the minimum annual future lease payments, under this lease and all other noncancellable operating leases, are as follows:

2008	$ 102,326
2009	93,541

2010	29,171
Total	$ 225,038

Employment Agreements

In November 2006, the Company entered into a new employment agreement with the Chairman of the Board, Douglas J Andrea. The employment agreement expires July 31, 2008 and is subject to renewal as approved by the Compensation Committee of the Board of Directors. Pursuant to his employment agreement, Mr. Andrea will receive an annual base salary of $300,000 per annum. In addition, upon execution of the employment agreement, Mr. Andrea was entitled to a salary adjustment from August 1, 2006 through the date of the employment agreement. The employment agreement provides for quarterly bonuses equal to 25% of the Company's pre-bonus net after tax quarterly earnings in excess of $25,000 for a total quarterly bonus amount not to exceed $12,500; and annual bonuses equal to 10% of the Company's annual pre-bonus net after tax earnings in excess of $300,000. All bonuses shall be payable as soon as the Company's cash flow permits. All bonus determinations or any additional bonus in excess of the above will be made in the sole discretion of the Compensation Committee. On November 2, 2006, in accordance with his employment agreement, Mr. Andrea was granted 1,000,000 stock options with a fair value of $100,000. This grant provides for a three year vesting period, an exercise price of $0.12 per share, which was fair market value at the date of grant, and a term of 10 years. On November 16, 2006, in accordance

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with his employment agreement, Mr. Andrea was granted an additional 1,000,000 stock options with a fair value of $100,000. This grant provides for a three year vesting period, an exercise price of $0.12 per share, which was fair market value at the date of grant, and a term of 10 years. Mr. Andrea is also entitled to a change in control payment equal to two times his salary with continuation of health and medical benefits for two years in the event of a change in control. At December 31, 2007, the future minimum cash commitments under this agreement aggregate $175,000.

In November 1999, the Company entered into a change in control agreement with the Chief Financial Officer, Corisa L. Guiffre. This agreement provides for a change in control payment equal to three times her average annual compensation for the five preceding taxable years, with continuation of health and medical benefits for three years in the event of a change in control of the Company, as defined in the agreement, and subsequent termination of employment other than for cause.

Legal Proceedings

Andrea is involved in routine litigation incidental to the normal course of business. While it is not feasible to predict or determine the final outcome of the claims, Andrea believes the resolution of these matters will not have a material adverse effect on Andrea's financial position, results of operations or liquidity.

13. STOCK PLANS AND STOCK-BASED COMPENSATION

In 1991, the Board of Directors of Andrea (the "Board") adopted the 1991 Performance Equity Plan ("1991 Plan"), which was approved by the shareholders. The 1991 Plan, as amended, authorizes the granting of awards, the exercise of which would allow up to an aggregate of 4,000,000 shares of Andrea's Common Stock to be acquired by the holders of those awards. Stock options granted to employees and directors under the 1991 Plan were granted for terms of up to 10 years at an exercise price equal to the market value at the date of grant. No further awards will be granted under the 1991 Plan.

In 1998, the Board adopted the 1998 Stock Option Plan ("1998 Plan"), which was subsequently approved by the shareholders. The 1998 Plan, as amended, authorizes the granting of awards, the exercise of which would allow up to an aggregate of 6,375,000 shares of Andrea's Common Stock to be acquired by the holders of those awards. The awards can take the form of stock options, stock appreciation rights, restricted stock, deferred stock, stock reload options or other stock-based awards. Awards may be granted to key employees, officers, directors and consultants. At December 31, 2007, there were 14,984 shares available for further issuance under the 1998 Plan.

In October 2006, the Board adopted the Andrea Electronics Corporation 2006 Equity Compensation Plan ("2006 Plan"), which was subsequently approved by the shareholders. The 2006 Plan authorizes the granting of awards, the exercise of which would allow up to an aggregate of 10,000,000 shares of Andrea's Common Stock to be acquired by the holders of those awards. The awards can take the form of stock options, stock appreciation rights, restricted stock or other stock-based awards. Awards may be granted to key employees, officers, directors and consultants. At December 31, 2007, there were 5,636,361 shares available for further issuance under the 2006 Plan.

During 2006, the Board granted 400,000 stock options to the Vice President and Chief Financial Officer and 755,000 stock options to employees of the Company. Each option grant provides for vesting periods of up to three years, a weighted average exercise price of $0.12 per share, which was the fair market value of the Company's common stock at the date of grant, and a term of 10 years. The compensation expense related to these awards was $58,339 and $16,793 for the year ended December 31, 2007 and 2006, respectively.

On November 16, 2006, the Board granted 16,667 stock options to each chairperson on the Nominating and Compensation Committees and 41,667 stock options to the chairperson on the Audit Committee. The grants provide for an eighteen-month vesting period, an exercise price of \$0.12 per share, which was the fair market value of the Company's common stock at the date of grant, and a term of 10 years. The compensation expense related to these awards was \$5,112 and \$1,832 for the year ended December 31, 2007 and 2006, respectively.

On September 12, 2007, the Board granted 1,000,000 stock options to the President and Chief Executive Officer, 350,000 stock options to the Vice President and Chief Financial Officer, 60,000 stock options to the Board of Directors and 760,000 stock options to employees and consultants of the Company. Each option grant provides for vesting periods of up to three years, an exercise price of \$0.11 per share, which was the fair market value of the Company's common stock at the date of grant, and a term of 10 years. Compensation expense related to these awards was \$34,793 for the year ended December 31, 2007. There was no compensation expense related to these awards for the year ended December 31, 2006.

On September 12, 2007, the Board granted 18,182 stock options to each chairperson on the Nominating and Compensation Committees and 45,455 stock options to the chairperson on the Audit

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Committee. The grants provide for an eighteen-month vesting period, an exercise price of $0.11 per share, which was the fair market value of the Company's common stock at the date of grant, and a term of 10 years. Compensation expense related to these awards was $2,625 for the year ended December 31, 2007. There was no compensation expense related to these awards for the year ended December 31, 2006.

Total compensation expense recognized related to all stock option awards was $185,099 and $83,707 for the year ended December 31, 2007 and 2006, respectively. In the accompanying consolidated statement of operations $145,607 of the 2007 expense is included in general, administrative and selling expenses, $37,608 is included in research and development expenses and $1,884 is included in cost of revenues. In the accompanying consolidated statement of operations $74,348 of the 2006 expense is included in general, administrative and selling expenses, $8,668 is included in research and development expenses and $691 is included in cost of revenues.

The fair values of the stock options granted were estimated on the date of grant using the Black-Scholes option-pricing model that uses the following weighted-average assumptions for the year ended December 31, 2007 and 2006:

	December 31, 2007	December 31, 2006
Expected life in years (based on simplified method)	5.98	7
Risk-free interest rates	4.17%	5.05%
Volatility (based on historical volatility)	101%	102%
Dividend yield	0%	0%

The weighted average fair value of options at the date of grant using the Black-Scholes fair value based method for the year ended December 31, 2007 is estimated at $0.09. The weighted average fair value of options at the date of grant using the Black-Scholes fair value based method for the year ended December 31, 2006 is estimated at $0.04.

Option activity during 2007 and 2006 is summarized as follows:

	Options Outstanding			Options Exercisable		
	Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Options Exercisable	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life
At January 1, 2006	4,512,500	$ 1.71	7.74 years	4,182,500	$ 1.84	7.59 years
Granted	3,230,001	0.12				
Cancelled	(152,500)	0.98				
At December 31, 2006	7,590,001	1.05	8.01 years	4,397,500	$ 1.72	6.26 years
Granted	2,251,819	0.11				
Cancelled	(155,000)	5.20				
	9,686,820	0.76	7.79 years	5,355,590	$ 1.29	6.57 years

At December 31,
2007

During 2007, 1,113,090 options vested with a weighted average exercise price of $0.12 and a weighted average fair value of $0.10 per option. During 2006, 367,500 options vested with a weighted average exercise price and fair value of $0.04 per share.

Based on the December 31, 2007, fair market value of the company's common stock of $0.06, the aggregate intrinsic value of the 9,686,820 options outstanding and 5,355,590 shares exercisable is $26,500.

As of December 31, 2007, there was $258,208 of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the 1998 and 2006 Plans. This unrecognized compensation cost is expected to be recognized over the next 3 years ($174,479 in 2008, $68,319 in 2009 and $15,410 in 2010).

During the years ended December 31, 2007, 2006 and 2005, pursuant to Andrea's compensation policy for outside directors, Andrea granted 181,820 shares of Common Stock with a fair market value of $0.11, 166,668 shares of Common Stock with a fair market value of $0.12 and 400,000 shares of Common Stock with a fair market value of $0.05, respectively. Compensation expense related to these awards was $22,500 and $20,000 for the years ended December 31, 2007 and 2006, respectively.

14. SEGMENT INFORMATION

Andrea follows the provisions of SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." Reportable operating segments are determined based on Andrea's management approach.

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The management approach, as defined by SFAS No. 131, is based on the way that the chief operating decision-maker organizes the segments within an enterprise for making operating decisions and assessing performance. While Andrea's results of operations are primarily reviewed on a consolidated basis, the chief operating decision-maker also manages the enterprise in two segments: (i) Andrea DSP Microphone and Audio Software Products and (ii) Andrea Anti-Noise Products. Andrea DSP Microphone and Audio Software Products primarily include products based on the use of some, or all, of the following technologies: Andrea Digital Super Directional Array microphone technology (DSDA), Andrea Direction Finding and Tracking Array microphone technology (DFTA), Andrea PureAudio noise filtering technology, and Andrea EchoStop, an advanced acoustic echo cancellation technology. Our Andrea Anti-Noise Products include noise cancellation and active noise cancellation computer headset products and related computer peripheral products. The following represents selected consolidated financial information for Andrea's segments for the years ended December 31, 2007 and 2006:

2007 Segment Data	Andrea DSP Microphone and Audio Software Products	Andrea Anti-Noise Products	Total 2007
Net revenues from external customers	$ 1,732,126	$ 2,618,864	$ 4,350,990
License revenues	695,223	-	695,223
Loss from operations	329,097	40,240	369,337
Depreciation and Amortization	468,706	19,190	487,896
Capital expenditures	-	33,870	33,870
Purchases of patents and trademarks	3,700	9,075	12,775
Assets	4,021,688	1,611,318	5,633,006
Total long lived assets	2,852,281	183,143	3,035,424

2006 Segment Data	Andrea DSP Microphone and Audio Software Products	Andrea Anti-Noise Products	Total 2006
Net revenues from external customers	$ 2,363,851	$ 2,591,055	$ 4,954,906
License revenues	780,384	-	780,384
Income (loss) from operations	(69,591)	154,343	84,752
Depreciation and Amortization	466,976	21,446	488,422
Capital expenditures	19,009	2,589	21,598
Purchases of patents and trademarks	5,403	17,365	22,768
Assets	4,329,036	1,759,979	6,089,015
Total long lived assets	3,297,304	179,371	3,476,675

Management of Andrea assesses assets and non-operating income statement data on a consolidated basis only. International revenues are based on the country in which the end-user is located. For the years ended December 31, 2007 and 2006, and as of each respective year-end, net revenues and accounts receivable by geographic area are as follows:

Geographic Data	2007	2006
Net Revenues:		
United States	$ 3,609,523	$ 2,923,120
Foreign(1)	1,436,690	2,812,170
	$ 5,046,213	$ 5,735,290
Accounts receivable:		
United States	$ 736,122	$ 231,416
Foreign	258,324	608,183
	$ 994,446	$ 839,599

(1) Net revenue to the People's Republic of China and Singapore represented 19% and 4%, respectively of total net revenues for year ended December 31, 2007. Net revenue to the People's Republic of China and Singapore represented 21% and 11%, respectively of total net revenues for year ended December 31, 2006. .

$50,498 of our property and equipment, net represents product tools and molds. These tools and molds are located in Asia at the manufacturing facility, which produces the respective product. All of our remaining property and equipment, net is located at our facility in Bohemia, New York.

SIGNATURES

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

ANDREA ELECTRONICS CORPORATION

By: /s/ DOUGLAS J. ANDREA
Name: Douglas J. Andrea
Title: Chairman of the Board, President,
Chief Executive Officer and Corporate Secretary

Date: March 31, 2007

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

/s/ DOUGLAS J. ANDREA Douglas J. Andrea	Chairman of the Board, President, Chief Executive Officer and Corporate Secretary	March 31, 2008
/s/ CORISA L. GUIFFRE Corisa L. Guiffre	Vice President, Chief Financial Officer and Assistant Corporate Secretary	March 31, 2008
/s/ GARY A. JONES Gary A. Jones	Director	March 31, 2008
/s/ LOUIS LIBIN Louis Libin	Director	March 31, 2008
/s/ JOSEPH J. MIGLIOZZI Joseph J. Migliozzi	Director	March 31, 2008
/s/ JONATHAN D. SPAET Jonathan D. Spaet	Director	March 31, 2008